Altruism or Eurocentrism? The Energy Charter Treaty, direct foreign investment in energy resources and infrastructure and the Treaty's implications for Australia

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ABSTRACT

The Energy Charter Treaty (ECT) was initially promulgated as a European Union (EU) initiative designed to encourage economic development in Former Soviet Union (FSU) states through Foreign Direct Investment (FDI) in the energy sector by providing the legal framework within which contracts for energy projects may be formed. This framework provides stringent protection for FDI in all aspects of economic activity in the energy sector, inter alia: competition policy; national/most favoured nation treatment for investors by host states; freedom of movement for capital and investments, including the repatriation of profits; transit of energy supplies and products; environmental issues and dispute resolution.

It is argued that, in reality, the ECT is not the result of altruism but the means by which the EU states are attempting to secure their energy supplies for the twenty first century. In the EU the demand for energy products, particularly electricity, oil and natural gas, is constantly increasing. Consequently, the genesis of the ECT is to be found in the EU's increasing need for secure sources of all energy products and materials as well as the oil crises of the 1970's, 80's and 90's. The Treaty is therefore very much the creature of the EU energy policies formulated during the last decades of the twentieth century.

Further, it is argued that in order to achieve EU energy objectives, the provisions of the ECT have a number of practical legal effects which, whilst providing full protection for investments in the energy sector, have significant adverse legal implications for a host state Contracting Party.

Firstly, the ECT attempts to short-cut the negotiation process for contracts in the energy sector by rendering implicit terms and conditions which are usually subject to negotiation and agreement between the parties. Secondly, the Treaty not only abrogates the doctrine of privity of contract by conferring a right of action against the host state upon project investors who were not parties to the subject agreement,

but also renders the host state Contracting Party vicariously liable for the actions of state and privileged enterprises and sub-national and regional autonomous governments and authorities.

In addition, the obligations imposed by the ECT make substantial inroads into the sovereignty of Contracting Parties by imposing the strict obligation upon all Contracting Parties to allow the transit of energy products and supplies across their territories: by requiring that Contracting Parties effect substantial changes to domestic legislation in commercial, corporate, taxation and property matters in order to conform to the investment protection regime provided for in the Treaty: by requiring substantial changes to Contracting Party domestic economic, environmental and competition policies and by mandating what might be called "lock-in" provisions which effectively prevent a host state from amending or instituting any legislation which might affect the FDI project or agreement.

Full compliance by a Contracting Party with the provisions of the ECT could impinge upon the rights and independence of regional and sub-national autonomous governments. It is also argued that the ratification of or accession to the ECT by a Contracting Party government is unnecessary to activate the provisions of the Treaty

The language used in the Treaty is imprecise and obscure with few definitions of key terms to assist in the interpretation of its provisions and this occasional unintelligibility is exacerbated by inconsistencies between the legal effects of certain Articles. Consequently, deficiencies in drafting render the ECT a difficult document to interpret, thereby increasing the possibility and complexity of disputes arising from the application of its provisions.

Australia, as a signatory to the Treaty, is subject to its provisions and is used to illustrate the effects of the Treaty upon host state sovereignty, governance and administration.

The Dissertation discusses the origins of the ECT in the energy policies of the EU, the international context and negotiation and formation of the Treaty itself, as well as describing the structure and functions of the ECT administrative institutions. Further, it analyses the provisions of the ECT and related documents. The analysis is made from a practical legal viewpoint, by examining the legal implications for Contracting Parties of each of the discrete provisions. It then proceeds to present a discussion of those legal aspects of FDI, particularly contract negotiation and risk mitigation which the ECT seeks to address, as well as examining the impact of the ECT upon the sovereignty of Contracting Parties, particularly sovereignty over natural resources and the rights of sub-national governments and indigenous peoples.

Finally, to demonstrate the legal effects of the ECT upon a Contracting Party, the Dissertation discusses the implications for Australia of being a signatory and it is suggested that Australia has much to lose and very little to gain from membership of the ECT regime.

The ECT as an international instrument offers spurious benefit to all signatories except those developed states seeking to secure their future energy supplies through the application of the ECT's provisions to energy sector agreements. Ostensibly, it offers both impoverished FSU states and resource wealthy, energy exporting nations, such as Australia, the inducement of economic advantage through FDI in energy resources. In reality, however, the potential disadvantages implicit in the stringency of the Treaty's investment protection provisions and the resultant negative legal implications for host state-Contracting Parties, far outweigh

any putative benefits which may flow from membership to the Energy Charter Conference.

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INTRODUCTION

The Energy Charter Treaty (ECT) is ostensibly a European Union (EU) initiative designed to encourage economic development in Former Soviet Union (FSU) states through Foreign Direct Investment (FDI) in the energy sector by providing the legal framework within which contracts for energy projects may be formed. This framework provides stringent protection for FDI in all aspects of economic activity in the energy sector, inter alia: competition policy; national/most favoured nation (MFN) treatment for investors by host states; freedom of movement for capital and investments, including the repatriation of profits; transit of energy supplies and products; environmental issues and dispute resolution.

The Dissertation argues that in reality, the ECT is not the product of altruism but the means by which the EU states are attempting to secure their energy supplies for the twenty first century and beyond. In the EU, the demand for energy products, particularly electricity, oil and natural gas, is constantly increasing. The EU member states have limited energy resources and depend upon imports for their energy requirements. On the other hand, the FSU states have vast resources of oil and natural gas, do not experience the same degree of political and social opposition to the operation of nuclear power generating facilities and comprise essential transit routes from energy sources to the EU states. Moreover, energy product and supply agreements between EU states and resource wealthy developed nations, such as Australia and Canada, need to be placed on a firmer basis to ensure continuity and security of supply.

Consequently, the genesis of the ECT is to be found in the increasing demand for secure sources of all energy products and materials as well as the oil crises of the 1970's, 80's and 90's. The Treaty is therefore very much the creature of EU energy policies formulated during the last decades of the twentieth century.

Further, it is argued that in order to achieve EU energy objectives, the provisions of the ECT have a number of practical legal effects which, whilst providing full protection for investments in the energy sector, have significant adverse legal implications for the host state-Contracting Party. These practical effects are as follows:

It is submitted that the ECT attempts to short-cut the negotiation process for contracts in the energy sector by rendering implicit terms and conditions which are usually subject to negotiation and agreement between the parties, such as host government guarantees and indemnities for changes of law and force majeure events; national/MFN treatment for FDI and dispute resolution procedures. Therefore, on the one hand, the provisions of the ECT substantially reduce the time and thereby costs, associated with the negotiation and conclusion of contracts in the energy sector, by rendering mandatory significant investment protection measures. On the other hand, however, the ECT thereby abrogates the right of the host state to control the terms and conditions upon which FDI in the energy sector is undertaken within its boundaries.

It is also argued that in attempting to provide maximum protection for FDI, the ECT has significant adverse legal implications for Contracting Parties in that :

- it abrogates the doctrine of privity of contract by conferring a right of action against the host state upon project investors (such as shareholders) who were not parties to the subject agreement (Article 26);

- it renders the host state Contracting Party vicariously liable for the actions of state and privileged enterprises and sub-national and regional autonomous governments and authorities (Articles 22 and 23).

Moreover, the obligations imposed by the ECT make substantial inroads into the sovereignty of Contracting Parties by:

- imposing the strict obligation upon all Contracting Parties to allow the transit of energy products and supplies across their territories, failure to allow such transit renders the Contracting Party in breach of the provisions of the ECT (Article 7);

- requiring that Contracting Parties effect substantial changes to domestic legislation in commercial, corporate, taxation and property matters in order to conform to the investment protection regime provided for in the Treaty;

- requiring substantial changes to Contracting Party domestic economic, environmental and competition policies.

- mandating what might be called "lock-in" provisions which effectively prevent a host state from amending or instituting any legislation which might affect the FDI project or agreement.

Further, it is also argued that full compliance by a Contracting Party with the provisions of the ECT could impinge upon the rights and independence of regional and sub-national autonomous governments. The vicarious liability imposed by Articles 22 and 23 requires a Contracting Party to restrain or rectify breaches of the provisions of the ECT by such authorities. This requirement could have deleterious implications for those Contracting Parties with federal systems of government and/or autonomous indigenous and minority groups.

It is also arguable and argued that the ratification of or accession to the ECT by a Contracting Party's government is unnecessary to activate the provisions of the Treaty vis a vis contracts in the energy sector made between the Contracting Party and investors of or another Contracting Party formed since the Treaty came into

effect on 16 April 1998. It is submitted that the act of signing the Treaty renders a Contracting Party bound by its terms.

Finally, the language used in the Treaty is imprecise and obscure with few definitions of key terms to assist in the interpretation of its provisions. Furthermore, this occasional unintelligibility is exacerbated by inconsistencies between the legal effects of certain Articles. Consequently, the deficiencies in drafting render the ECT a difficult document to interpret, thereby increasing the possibility and complexity of disputes arising from the application of its provisions.

Although it is arguable that the preservation of contractual integrity is vital to the commercial success of FDI projects, the ECT goes beyond the protection of contractual relations and imposes unduly harsh and unnecessary obligations upon host state Contracting Parties. It is therefore contended that subscription to the ECT is a hazardous undertaking for all non-EU Contracting Parties, but particularly those states like Australia, which are exporters of energy products and supplies, and those FSU states whose territories fall within the direct route between sources of energy supplies and the EU states. The ECT is not the benign, altruistic instrument as represented by the Energy Charter Secretariat and the EU. On the contrary, subscription to the ECT regimen poses significant threats to the political and legislative sovereignty of all Contracting Parties.

In presenting and supporting the above arguments, Part I of the Dissertation will discuss the origins of the ECT in the energy policies of the EU, the international context and negotiation and formation of the Treaty itself, as well as describing the structure and functions of the ECT administrative institutions.

Part II will describe and analyse the provisions of the ECT and related documents. The analysis will be made from a practical legal viewpoint, by examining the legal implications for Contracting Parties of each of the discrete provisions.

Part III will discuss the practical legal effects of the Treaty. In order to achieve a full understanding of the impact of the Treaty, however, it will be necessary first to present a discussion of those legal aspects of FDI, particularly contract negotiation and risk mitigation which the ECT seeks to address. The section will then go on to discuss the effects of the provisions of the ECT upon energy sector contract negotiation and risk mitigation. Finally, Part III will examine the impact of the ECT upon the sovereignty of Contracting Parties, particularly sovereignty over natural resources and the rights of sub-national governments and indigenous peoples.

To demonstrate the legal effects of the ECT upon a Contracting Party, Part IV will analyse and discuss the implications for Australia of being a signatory. Australia was chosen as a case study for a number of reasons. Firstly, whilst Australia signed the Treaty on 17 December 1994, as at April 2004, the Treaty had not been ratified by the Australian Commonwealth government.

Secondly, Australia is rich in energy resources which it exports both to EU states and Japan (which is also a signatory). Profits from the exploitation of energy resources are a significant contributor to Australia's GDP and energy sector contracts are thereby vital to Australia's economic stability. There is therefore ample scope for the application of the ECT to energy sector agreements concluded between the Australian Commonwealth government and/or Australian corporations and other Contracting Parties and/or their legal entities.

Thirdly, Australia possesses both a federal system of government and a significant indigenous population with rights (albeit increasingly attenuated) to traditional lands upon which energy resources are found.

Finally, Australia has extensive areas of sensitive natural environments which both contain energy resources and across which extracted resources need to be shipped

(Kakadu and the Great Barrier Reef). Australia, therefore, constitutes an excellent vehicle through which to demonstrate the possible (and probable) invidious legal effects of the ECT.

It is therefore suggested that Australia has much to lose and very little to gain from membership of the ECT regime.

In conclusion, the ECT as an international instrument offers spurious benefit to all signatories except those developed states seeking to secure their future energy supplies through the application of the ECT's provisions to energy sector agreements. Ostensibly, it offers both impoverished FSU states and resource wealthy, energy exporting nations, such as Australia, the inducement of economic advantage through FDI in energy resources. In reality, however, it is argued that the potential disadvantages implicit in the stringency of the Treaty's investment protection provisions and the resultant negative legal implications for host state-Contracting Parties, far outweigh any putative benefits which may flow from membership to the Energy Charter Conference.

PART I

THE ENERGY CHARTER TREATY

CHAPTER I

ENERGY CHARTER TREATY - BACKGROUND

Introduction

When the European Energy Charter Treaty was signed by Conference participants in Lisbon in December 1994, it marked not only the culmination of three years of negotiations and discussions, but also carried with it the indelible stigmata of almost fifty years of European and indeed, world history. As a Treaty which seeks to offer assistance to developing FSU states whilst enabling the EU to achieve its energy objectives for the twenty-first century, the ECT attempts to secure the EU's economic future which has become so dependent upon the availability of energy supplies.

Moreover, the ECT is also a product of Western and Eastern European history: of post-World War II reconstruction; of the economic boom of the 1950's and 1960's in both Europe and the USA; of the difficult progression of European nations towards economic and political union; of the oil crises of the 1970's; of the environmental pressures of the 1980's; of the collapse of the Soviet Union in the early 1990's and finally, of the EU's attempts to synthesise the competing pressures of economic and industrial growth and environmental protection in its energy policies. As such, the roots and significance of the ECT go beyond the provisions contained in the Final Act of the Conference on the European Energy Charter and the policies of the EU.

Therefore, in order to place the ECT in its historical context, this chapter will address the history of the EU and the energy policies evolved from 1945 to the nineteen nineties of which the ECT is, in part, the result.

History of the European Union

In order to understand the genesis and objectives of the ECT, it is first necessary to have some grasp of the history of the European Union as an international or as some would say "supranational"[1] entity. The ECT was not developed in isolation from the political, economic and social objectives of the EU, but evolved both in response to and out of the context of European concerns in the second half of the twentieth century by providing a means of effecting EU energy policies. Moreover, the pan-European preoccupation with energy was not merely a phenomenon of the 1980's and 1990's but to a very great extent has been integral to the direction taken by European political, social and economic development since the inception of the concept of a united Europe shortly after the end of World War II. Whilst it is impossible within the context of this Chapter to discuss the plethora of Treaties which played a major role in the development of the EU, the most significant European political milestones will be addressed, albeit briefly, in order to provide some grasp of the complexity and profundity of EU history and the instruments whereby it was created.

It has been proposed[2] that the conception of the EU occurred during a speech given by Winston Churchill at Zurich University on 19 September 1946.[3] However, given the context of the speech and the personal propensities of the speaker, it is arguable that the concept of a United Europe was, despite his call for rapprochement between France and Germany, enunciated for rhetorical effect rather than as a considered proposal for European union. Certainly, Churchill did not follow his call for a United States of Europe by any overt action which would initiate procedures for

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[1] See P.S.R.F. Mathijsen, *A guide to European Community law.* 7th edn. London, Sweet & Maxwell, 1999, at 7-9 for a discussion of the concept of supranationalism as it applies to the EU.

[2] Ibid., 12.

[3] In the speech Churchill proposed that in post-war Europe, it was necessary to find a sovereign remedy to recreate the European family, or as much of it as we can, and provide it with a structure under which it can dwell in peace, in safety and in freedom. We must build a kind of United States of Europe," ibid.

realising the ideal of continental unification. Indeed, it was not until 1950 that any further mention was made of achieving a United Europe. This time the proposal came from Robert Schuman, the French Foreign Minister. On 9 May 1950 Schuman declared that a united Europe was essential for world peace and called unilaterally for a gathering of European states to eliminate the traditional animosity between France and Germany and lay the foundations for the European Federation. The first step in this process was to be the pooling of French and German coal and steel production under the control of a central High Authority. The proposal was accepted in principle by Belgium, the Netherlands, Luxembourg (the Benelux States), West Germany and Italy. However, whilst the scheme is generally described as "the Schuman Plan," it was Jean Monnet, Head of the French Commissariat du Plan (the Economic Planning Commission) who was in fact the progenitor of what was to become the European Coal and Steel Community (ECSC).[4]

Monnet's vision was not simply to create a "huge continental market on the European scale"[5] but also to "build a genuine community which could adopt common economic policies and national planning procedures."[6] The unification of European coal and steel production was just the beginning: the first essential step on the road to a European union. Despite Monnet's apparent utopian conception, however, his plan for a new Europe was based firmly in reality and pragmatism. Coal and steel were central to Western European post-war industrial reconstruction. Coal, the major energy source, was in short supply due to the exigencies of post-war production demands and the destruction of many of the major coal producing facilities, especially in Germany. Steel production, however, exceeded demand. Regulation of supply and demand on a European scale was therefore essential for balanced economic redevelopment and growth. Moreover, the supranational regulatory framework of the ECSC would impose a degree of transparency upon the

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[4] Stephen George, *Politics and policy in the European Union.* OUP, Oxford, 1997,2.
[5] Ibid.
[6] Ibid.

development of the German and French coal and steel industries, thereby preventing either country from pursuing clandestine rearmament.[7] Accordingly, on 18 April 1951, six nations: the Benelux States, the Federal Republic of Germany, France and Italy, signed the Treaty of Paris, establishing the ECSC. Ratification of the Treaty of Paris by the national parliaments of the signatories soon followed, and the ECSC commenced operation on 25 July 1952. Despite the auspicious beginning, however, the ECSC began to flounder as the Benelux States and West Germany chafed under the centralised control of the ECSC High Authority. In the mid-1950's, therefore, proposals were mooted for a common market based upon free-market principles as distinct from centralised planning and control. France was less than enthusiastic about this proposal, fearing that under free market conditions French industry would become swamped by West German exports. The proposal, however, was pursued by the other member states, and on 25 March 1957 the Treaty establishing the European Atomic Energy Community (Euratom) was signed in Rome, followed on 1 January 1958 by the signing of the European Economic Community Treaty (Treaty of Rome).[8] It is indicative of the importance of energy policy to European economic development that Euratom was established by Treaty nine months prior to the signing of the Treaty of Rome. Certainly, in the 1950's nuclear power was regarded as providing a relatively cheap and efficient solution to European industry's increasing energy demands[9] and the proliferation of nuclear power stations across Europe in the 1950's and 1960's is testament to the determination with which the Holy Grail of cheap, reliable and efficient nuclear energy production was pursued.

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[7] This gloss upon the alternative (if not ulterior) objective underlying the establishment of the ECSC was kindly suggested by Prof. Friedl Weiss in May 2003.

[8] Ibid., 3-5.

[9] Ibid., 15. Despite the increasing disrepute of nuclear power as an efficient energy source since Chernobyl in 1986, Eastern European FSU states, particularly Russia and Ukraine, still regard nuclear power as a viable source for their increasing energy demands. See James O. Jackson, "Dirty Rotten Reactors," *TIME*, 18 September 2000, 44-45.

From 1958 to 1965, the three Communities, the ECSC, Euratom and the EEC, continued to operate more or less independently, although the EEC, with its emphasis upon the promotion of economic integration through the development of a common market, a common agricultural policy and mutual trading concessions between member states, tended to acquire pre-eminence, at least in the popular perception, if not in fact.[10] The EEC had adopted the institutional structure of the ECSC,[11] with the Commission (the governing executive) adopting a similar role to the ECSC's High Authority. However, as George states: "The Commission, unlike the High Authority, had no independent area of action marked out for it. Its role in the new Community was to make proposals as to the Council of Ministers which would have to be accepted by the Council before they would become Community law.[12]

From 1965, the member states of the three Communities agreed to merge the institutions and activities of the ECSC, Euratom and the EEC into the one supranational organisation to be known as the European Community ("the EC").[13] The decision was implemented in 1967.

After many negotiations, politically fraught public announcements and machinations,[14] the founding members of the EEC: France, the Federal Republic of Germany, Italy and the Benelux States, were joined in the EC by other European nations. In 1973, the United Kingdom, Ireland and Denmark became members,[15] in 1981 Greece joined, followed in 1986 by Spain and Portugal.
On 1 July 1987 the Single European Act (SEA) came into force with the objective of realising the so-called "internal market" defined as "an area without internal

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[10] George, op.cit., 6.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] For an interesting analysis of the political manoeuvres which bedevilled what was eventually become the European Union, see George, ibid., 5-19.
[15] Greenland also became a member in 1973, but seceded in February 1985 pursuant to a referendum on the question of the relevance of its membership.

frontiers in which the free movement of goods, persons, services and capital is assured."[16]

Finally, on 7 February 1992 EC members signed the Treaty of the European Union. (Maastricht Treaty) in Maastricht in the Netherlands. When the Maastricht Treaty was ratified by all members and on 1 November 1993[17] the EU formally came into existence. In addition to the establishment of the European Council, whose role is to define general political, economic and social policy, the Maastricht Treaty enunciated certain objectives of the EU, including the establishment of an economic and monetary union with common polices and mutual support amongst all members states.

At the heart of what can only be described as the "New Age" EU practices of co-operation and interdependence is the Union's energy policy. Just as the first practical steps towards a new Europe were based on the need to increase energy supplies through the ECSC, the future of the EU economic and social development depends upon the development and implementation of sustainable, realistic and equitable energy policies. Moreover, since the inception of the ECT is to be found in the evolution of EU approaches to the exploitation and supply of energy resources, an understanding of these policies will assist in placing the ECT firmly within the context of EU and international energy resource supply and demand. Therefore, the nature and content of these policies will be discussed in the following section.

EU Energy Policies

Background

As discussed above, energy policies have always been central to European nations' economic planning. Indeed, at the beginning of the twenty first century, reliable, secure, efficient and environmentally safe energy sources are even more crucial than

[16] SEA, Article 14(2).
[17] Austria, Finland and Sweden joined the EU in 1995.

in the post-World War II period, which saw the inception of the ECSC. "Without modern energy systems, society as we know it today would cease to exist. Providing adequate energy supplies at reasonable prices has been an integral part of modernization and national building throughout the Western World."[18]

From the very beginning of the movement towards European unification movement, therefore, energy policies have formed the lynch-pin of economic planning. The ECSC, Euratom and the joint policies issued by the various incarnations of European unity prior to the emergence of the EU *per se* and the general historical context have all played a role in shaping energy polices of the late twentieth and early twenty first century EU. However, difficult as economic and political conditions may have been prior to 1990, the EU faces far more critical challenges as it attempts to open up and expand the energy industry in order to meet its economic and social objectives. The problems of security and adequacy of raw materials and energy supplies; the extension of infrastructure; the environmental concerns raised by CO_2 emissions and global warming and the omnipresent Banquo's ghost of nuclear power, must all be addressed if the EU is to achieve any of its goals.

As noted above, in post-war Europe, energy supplies, particularly coal, became a major priority to facilitate European industrial reconstruction. In the 1950's and 1960's, however, the major issue for all European countries was providing sufficient energy to fuel the rapid economic growth which had been sparked by the eminently successful post-war reconstruction. Major investments were required to develop infrastructure and generating capacity to satisfy the increased demand for electricity. Furthermore, all European countries were becoming increasingly dependent upon oil supplies, as oil replaced coal as a vital energy source both for production industries and transportation.

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[18] Torlief Haughland et. al., *Energy structures and environmental futures* . OUP, Oxford, 1998, 1.

Furthermore, the use of nuclear power for electricity generation was becoming both a blessing and a curse to energy hungry European nations. Even prior to the establishment of Euratom in 1957 many European nations had built and were operating nuclear installations. Between 1952 and 1957, France had commissioned five nuclear reactors, Sweden one, West Germany one and Britain two.[19] The prospect, albeit illusory, of "clean," efficient and reliable nuclear power generation was regarded as an extremely attractive proposition, especially in comparison to the older-style coal-fired power plants. However, the term "nuclear" is forever linked in public perception with atomic weapons. Furthermore, in the late 1950's and early 1960's rumours were rife concerning radiation leakage from nuclear facilities in Britain at Windscale and Dounreay.[20] Such adverse publicity, coupled with the negative connotations invoked by the term "atomic" prompted a fierce opposition movement in the late 1960's to an increase in the use of nuclear power.

Moreover, the safe operational period for a nuclear power plant is, at the most, 40 years, after which time, despite extensive maintenance and upgrades, they became unsafe.[21] Thus, those facilities throughout Europe which were commissioned in the heyday of nuclear power in the late 1950's and 1960's have left a potentially lethal legacy to the EU of the early twenty first century. Indeed, in 2000 there were more than 110 nuclear installations in the EU in varying stages of decommissioning and a further 150 installations will have been decommissioned by 2020.[22]

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[19] The European Commission, Decommissioning Status of Shutdown Nuclear Installations in the EU(online). http://europa.eu.int/comm/energy/en/nuclearsafety/decomm5.htm.

[20] Release of documents relating to these two nuclear facilities in the 1990's proved the rumours to have been correct (See Lorna Arnold, *Windscale 1957*, Macmillan, London,1992, for a description and analysis of the accident).

[21] The European Commission, Decommissioning in Short (online) http://www.ec-decom.be/about/inshort/whatis.html.

[22] Patrick Vankerckhoven, European Regulatory Policy Strategy Aspects on Nuclear Decommissioning, European Commission DGX1/C3.

In the 1970's the geopolitical aspects of energy supplies came to the forefront, particularly in relation to oil. In 1973, the Middle eastern oil producing countries tripled the price of crude oil per barrel, prompting an oil crisis which affected not merely the European states, but all nations dependent upon imports of crude oil from the OPEC nations. Further, in 1978-79 a second oil crisis was prompted by developments in Iran, where a revolution against the Shah resulted in strikes in the oil fields. Panic buying led to shortages in oil supplies and the greatest price increases since 1973. As Haughland states, the oil crises of the 1970's "reinforced and established in an entire generation of policy makers a world-view centred on energy security."[23]

In the 1980's European environmental concerns began to rank with the security and stability of energy supplies as major issues in the energy policies of the European nations. The nuclear accidents at Three Mile Island, in Pennsylvania, USA in 1979 and later, the Chernobyl tragedy in Ukraine in April 1986, highlighted the dangers inherent in nuclear reactors and the problems of reliance upon nuclear generated electricity. Further, the depredations of acid rain on the European environment, water quality and environmental degradation caused by industrial wastes prompted environmental activists and lobby groups to pressure European governments into instituting environmental protection policies and to take environmental factors and protection into account in all economic development objectives.

In early 1990's, concurrent with and, to a large extent, as a result of the apparently rapid disintegration of the Soviet Union, Western European nations were becoming increasingly aware of the parlous state of Eastern European economies. The exigencies of a command economy and the lassitude and atrophy this engendered in the industrial sectors had left a legacy of obsolescence and inefficiency within the economies of all but the most vibrant Baltic states.[24] In effect, the wealthy Western

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[23] Haughland, op. cit., 3.

[24] A legacy which continues to retard the economic development of Ukraine, Moldava, Belarus, Romania and Bulgaria (*The Economist*, 23 September 2000, 26).

European states were faced with the daunting prospect of finding what were, and still continue to be, virtually "Third World" economies planted squarely and firmly upon their doorsteps. It was forecast that the social, technological, economic and industrial inequalities which had always existed between the Western and Eastern European nations would give rise to even greater problems than the threat of the spread of Communism once the lifting of the "Iron Curtain" was completed.

First amongst these was the fear that the more prosperous states would find themselves channeling billions of US dollars from both international aid agencies, such as the European Bank of Reconstruction and Development (EBRD) and their own coffers in financial and technological aid to assist the moribund economies of their impoverished neighbours. Whilst it is possible to distribute largesse to impecunious and desperate nations on the other side of the globe on a discretionary and ad hoc basis, assistance to bankrupt neighbours was both obligatory and imperative. Further, history has demonstrated that devitalised and struggling economies have a tendency to foment political instability and ideological extremism. An unstable Eastern Europe has the potential to present as great a threat to pan-European peace as communist chauvinism. Moreover, once the "Iron Curtain" was lowered, there existed the spectre of tens, possibly hundreds of thousands of "economic" refugees fleeing across the open borders to the wealthier states of the EU behind the "Brussels Curtain." Such an influx of legal and illegal migrants would place severe pressures upon the social services, housing and employment sectors and economies of the host nations.[25]

Furthermore, in 1990, the US, EU and other developed nations were becoming increasingly concerned about the future of crude oil supplies from the OPEC countries in the Middle East. Iraq, under the leadership of Saddam Hussein, was

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[25] This prediction of mass migration from FSU states to wealthier nations has been realised. For example, in 2000, it was estimated that out of a population of 4.3 million in Moldava, there were approximately 600,000 Moldavan illegal immigrants in EU countries (ibid., 26).

exhibiting increasing belligerence both towards non-Islamic nations and its Middle Eastern nations. Interruption to or cessation of OPEC oil supplies to the developed nations and/or any increase in the price per barrel of crude oil, could have a potentially disastrous impact upon their economies. Thus, it was generally perceived that for the sake of the long-term economic viability of oil dependent developed states, alternative sources of crude oil, as well as the development and proliferation of alternative energy sources, should be a priority.[26]

It was against this historical background, spanning almost fifty years, and in the face of an uncertain future that the EU, in the 1990's attempted to develop energy policies consonant with its objectives and principles.

Policy Areas

Article 2 of the Maastricht Treaty (1992) states (inter alia) that one objective of the Union is :

> "to promote economic and social progress which is balanced and sustainable in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union... ."

However, the Treaty itself does not provide any legal basis for community actions in the energy sector. Therefore, specific energy policies have been developed piecemeal and in reaction to certain events or situations, rather than as a coherent body of programmes. Under the structure of the EU, imposed by EU Treaty, the

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[26] In retrospect, this concern for the long term viability of oil supplies in terms of OPEC production and pricing has been justified to some extent by events in 2000 and 2001. The increase in the price per barrel of crude oil coupled with the decrease by OPEC nations in production in September 2000, prompted fears of a 1973 - type oil crisis. Further, the terrorist attack upon the United States on 11 September 2001 and the continuing Israel/Palestine conflict has once more highlighted the political instability of the Middle East and predominately Islamic countries such as Pakistan, Afghanistan, Malaysia and Indonesia.

office of Directorate - General for Energy and Transport (D-G XVII) was created to develop and implement EU energy policies. However, as noted above, the issue of energy is central to all economic and social development. Therefore, in the EU bureaucratic structure, energy is not simply the province of D-G XVII and it is arguable that the policies and proposals issuing from the Directorate-General for the Environment, Nuclear Safety and Civil Protection (D-G XI), the Directorate-General for Science, Research and Development as well as the Directorates-General for External Relations (D-G I), Regional Policies (D-G XVI), Agriculture (D-G VI), Industry (D-G III), Competition (D-G IV) and Transport (D-G VII) have as much, if not more impact upon EU energy policies than D-G XVII.

Moreover, since the Maastricht Treaty, the influence of the European Parliament has grown significantly and the development of EU polices in all areas is no longer a matter of executive proposal and initiative, but becomes an integral part of the EU consultative and legislative process. Policy is both debatable and debated. Therefore, it cannot be said that there is, within the EU, a single source of energy policy and the isolation of particular objectives in regards to specific areas of the energy system often becomes a matter of such detective work, cross-referencing and deduction, as would become Sherlock Holmes. However, this section will attempt to outline the major EU energy policy areas as they relate to the ECT.

The White Paper

In December 1995 D-G XVII released a White Paper entitled "An Energy Policy for the EU." This was adopted by the Council on 8 July 1996.[27] As the title suggests, the paper was a review of energy policies inaugurated by other Ds-G, as well as providing a programme for policy achievement. The main foci of the paper for energy policy implementation were : integration of the market, managing external dependency, sustainable development, and energy technology and research. However whilst the paper itself is a useful guide to the allocation of energy areas

[27] OJC, 224 1.8.96

between the various Ds-G, it provides little insight into energy policies beyond their relation to the four main EU objectives. Thus, the paper is "a more general discursive document with a mixture of fact, forecast, suggestion, requirement and demand."[28]

In the midst of the welter of discourse, however, it does present an interesting analysis of future EU energy trends, synthesised from a statistical report "European Energy to 2020: A Scenario Approach," published by the Commission as an Annexure to the White Paper. These trends indicate that by the year 2020:

- Europe will significantly increase its dependence upon imported energy;
- gas will compete with oil as a leading component of the energy fuel mix;
- European consumers will become increasingly dependent upon "grid" supplied energy.[29]

Apart from the UK, the Netherlands, and Sweden, no EU countries have substantial commercial oil and natural gas deposits. Further, the decommissioning of some 260 to 300 nuclear power stations by the year 2020 will severely deplete the EU nations access to "grid" energy. In consideration of the above trends, therefore it is not surprising that the EU should seek alternative secure energy supplies from beyond the borders of the EU from the FSU states and that it should attempt to safeguard these through the provisions of the ECT. Indeed, the White Paper stressed that "energy developments in the Community are increasingly influenced by external developments and efforts must therefore be made to ensure that the Community develops a coherent and consistent approach to energy matters within their countries."[30] The White Paper concluded that EU energy policy was developing in the context of disparate national, regional and local situations and that the least developed member countries, such as Portugal, Spain and Greece, were handicapped

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[28] Paul K. Lyons, *EU energy policies of the mid 1990's* . EC Inform, UK, 1996, 85.
[29] Ibid.
[30] OJC, 224, op, cit., 1.

by inadequate access to energy supplies and inefficient technology. The goal of EU energy policies should therefore be to address the major energy issues raised by unification whilst attempting to ensure that energy usage and supply were consonant with the projected trends.[31] The findings and recommendations of the White Paper were enshrined in a Communication from the Commission of 23 April 1997 (COM(97) 167 final) as an overall view of energy policy and actions. In essence the Communication is a review of energy policies of the various Ds-G extant at the time, merely restating (inter alia) polices on liberalisation and competition in the electricity and gas markets, funding parameters for research and development in the energy sectors and assistance to the FSU states. Whilst it does not present any novel policies or innovative approaches, however, it does provide a useful resume of EU energy priorities in the late 1990's.

Specific Energy Policies

As noted above, the White Paper was not so much a policy document as a discursive and descriptive review of existing EU energy policies. Further, it served to underline the diffuse bureaucratic sources from which these policies devolved. However, despite the lack of a coherent, comprehensive and co-ordinated statement of EU energy objectives, it is possible to distil particular goals in specific energy areas from the diverse and disparate sources and relate these to general EU objectives as expressed in the EU Treaty.

Electricity

As a means of achieving the objective of a single European market, the various Commissions of the EU have devised rules and regulations designed to liberalise certain sectors of the economy and increase competition within markets.

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[31] Lyons, op. cit., 69.

Liberalisation (privatisation)[32] was regarded by the Commission as the most efficient means of achieving market integration throughout the EU. Moreover, in the energy sector, particularly electricity generation, it was hoped that by dismantling the "closed shops" of energy utilities, not only would foreign investors[33] be encouraged to participate in the energy sector within the EU, but also, electricity companies within the EU would be free to purchase electricity from non-EU states, particularly FSU countries.

In December 1996 the European Parliament and Council issued a directive concerning the common rules for the internal market in electricity.[34] The objective of the Directive was:

"To ensure the free movement of electricity while improving security of supply and the competitiveness of the European economy." (Article 1)

It went on to establish rules for the production, transmission and distribution of electricity (Article 3(1)). In effect, the Directive transposed the competitive policies of the EU into the particular situation of the electricity market. Thus, it provides for transparency in the tendering procedures, pricing and accounting, as well as rules for access to the electricity system by a legal entity as single purchaser. The Directive also provided that Member States may require the distribution system operator to give priority to the use of renewable energy sources (Article 3(5)), thus maintaining

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[32] Confusion often arises between the denotation and connotations of the terms "liberalisation," "privatisation" and "de-regulation." In the above discussion, liberalisation and privatisation have been used to denote the transfer (usually by sale) of energy utilities from government or State Owned Enterprise ("SOE") ownership and control to non-government, private ownership. "De-regulation," on the other hand, is taken to denote the relaxation or removal of government regulation of an industry. Thus, whilst a State's energy sector may be liberalised or privatised, the newly created private entity may impose regulations in regard to tariffs, grid coverage, ancillary activities and accountability, as occurs in New South Wales in regard to the energy utilities Energy Australia (electricity) and AGL (gas).

[33] "Foreign" in the wider sense of nationals from non-EU member countries but also in the more insular sense of nationals from other EU states.

[34] 96/92/EC.

compliance by the electricity sector with EU environmental policies. Pursuant to the Directive, therefore a Member State could stipulate that a system operator use alternative energy sources to nuclear or coal based electricity generation.

However, despite attempts to achieve economic integration and liberalisation in sectors such as energy, which are dominated by nationally organized monopolies, the EU has faced and will continue to face, major policy issues. The Directorate-General for Competition (D-G IV), supported by the Directorate-General for Industry (D-G III) has tended to approach the issue of market integration from the perspective of removal of barriers to entry within the individual member states, rather than in terms of co-ordination of the whole market.[35] On April 1998 and 4 May 1999 the Commission presented two follow-up reports on the implementation of the Directive in Member States. Despite the relatively optimistic tone of these reports, liberalisation (privatisation) of the EU electricity markets is at different stages in different member countries. Germany, Sweden and Britain have liberalised the whole of their electricity systems, whilst France and Italy have achieved a mere 30% of their market.[36] Such discrepancies between stages of liberalisation have created inconsistencies in the extent and nature of barriers to entry, pricing/tariff policies and industry structure amongst the electricity sectors in the various EU nations.[37]

Moreover, there has been substantial opposition from some member states, particularly from France,[38] in regard to market liberalisation. For historical and geographic reasons the European electricity industry has been more sensitive to competition policy than the other energy sectors. Electricity generation, because of its national importance and the huge sunk costs required to establish generating

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[35] Colin Scott, Changing Patterns of European Community Utilities Law and Policy : An Institutional Hypothesis. In J Shaw and G. Moore (eds.) *New legal dynamics of the European Union.* Clarendon, Oxford, 1995, 201-203.
[36] COM (98) 212 Final, COM(99) 198 Final.
[37] *The Economist*, Too Cosy for Comfort, 4 November 2000, 22.
[38] Ibid.

facilities has tended to be controlled by either government, regional or quasi-governmental generating authorities. As a result, throughout Europe, the electricity industry has been organised as a series of intra-national monopolies. Therefore, the liberalisation of the electricity sector pursuant to EU competition policy is proving an extremely complex task. From the early 1990's the Commission has attempted to press the objective of liberalisation through the Court of Justice. In 1991 the EU Commissioner commenced proceedings against nine member states for alleged breaches of competition policy in regard to restraints in the import and export of electricity. However, the proceedings languished until 1994 when the decision in the *Almelo* case was handed down by the European Court of Justice on 27 April 1994.[39] Accordingly, the Commissioner pressed the proceedings against five of the nine member states originally indicted, claming that France, Italy, Spain, Ireland and the Netherlands had maintained legislation which restricted the import and export of electricity in breach of Articles 30, 34 and 37, pursuant to Article 139 of the Maastricht Treaty. The Commission's success in these cases, however, has done little to speed the process of sector liberalisation in these states.

In recognition that sector liberalisation alone is sufficient to effect an integrated market, the EU has also developed a policy for the creation of Trans-European-Networks (TENs) pursuant to Article 154 of the Maastricht Treaty. The philosophy behind TENs is that European economic and social cohesion would best be achieved through programmes which required parties to development projects to join forces across national borders or to link up with firms from

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[39] *Almelo v Ijsselmij* [1994] ECRI-1477 had been referred to the Court of Justice by the Dutch Court and concerned restrictive practices by power generators. The Court found that although there had been restrictive practices and a disruption of trade, a company operating within a sector which implies public service obligations, legal restraints should be taken into consideration in assessing the extent of the obligations. It made no finding as to whether public service obligations vitiated monopolistic behaviour.

less-developed EU regions. In the electricity sector, the priorities for electricity networks are:

- the connection of isolated electricity networks to the interconnected European networks;
- the development of interconnections between member States and of internal connections so far as necessary in order to enhance these interconnections;
- the development of interconnections with the developing countries outside the EU in order to contribute to the reliability and security of the EU's electricity networks and to add to electricity supplies to the EU.[40]

In pursuit of these objectives the Commission put forward in January 1994 two draft Decisions concerning energy TENs[41] which proposed the initiation of "projects of common interest," set out the criteria upon which these should be assessed, and designating 23 projects in both EU and non-EU states for consideration.

To further assist in the integration process by encouraging the cross-border transmission of electricity therefore, on 13 March 2001, the Commission put forward a Proposal for a Regulation of the European Parliament on conditions for access to the network for cross-border exchanges in electricity.[42] The Proposal puts forward detailed regulations for such aspects (inter alia) as tarification, compensation for transit flows, harmonisation of network changes, allocation of interconnection capacity and maintaining network viability. Should the Regulations be adopted by the European Parliament, they will provide detailed conditions not only for cross-border electricity transmission between Member States, but also between Member and non-member states. Such access to outside sources of electricity will become increasingly important to EU states as the electricity grid is extended to less developed regions and EU states accelerate their nuclear reactor

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[40] Lyons, op. cit., 73.
[41] COM/93/685 19 January 1994.
[42] COM (2001) 125.

decommissioning programs. In order to meet the shortfall between supply and demand, the EU will need to import electricity from non-EU countries. Regulation of the cross-border transmission of electricity purchased pursuant to the ECT will facilitate this process.

Oil

The oil industry, perhaps more than any other energy sector, is global in character. The geographical concentration of oil reserves and the vital role played by oil in modern society has resulted in oil becoming not merely an international commodity, but also a strategic resource. For the historical reasons outline above, having few domestic reserves but high oil usage, the EU nations during the 1990's were and still are anxious to ensure security of oil supplies was as much a strategic as an economic imperative. With the collapse of the Soviet Union, EU leaders were not slow to grasp the significance to Europe of the potential offered by the energy, especially oil, resources of the FSU. Indeed, the potential contribution of FSU nations to EU energy requirements is acknowledged in the European Commission publication "The First European Energy Charter Treaty: Early Perspectives for Investors,"[43] which states that : "The European Union faces increasing dependence on imported energy which could pose particular problems for the electricity sector."[44] Whereas "the former Soviet Union is, after the Middle East, the region which has the most resources. It is therefore of great interest to the oil industry."[45] Thus, the ECT became the EU's key to the wealth of energy resources on its doorstep.

Further, in 1994 the Commission introduced a policy through Directive 94/22 to encourage countries' hydrocarbon exploration and production. However, since only Britain, the Scandinavian countries and the Netherlands have commercially viable hydrocarbon[46] deposits, the policy is of limited value to other EU nations, other than

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[43] European Commission, *The first European Energy Charter Treaty: Early perspectives for investors* . ECSC-EC-EAEC, Brussels, 1995.
[44] Ibid., 11.
[45] Ibid., 30.
[46] i.e. natural gas, coal and oil.

offering the hope that prospecting and exploration within the EU might yield sufficient oil reserves to augment imports.

Therefore, because oil is, essentially an imported product there have been few policy initiatives directed towards oil production. Those policies which exist are directed towards regulation of excise duties on oil imports, competition policies and environmental provisions.

Natural Gas

Natural gas is a relatively new energy source in Europe. In the 1960's it accounted for merely 2% of total energy use. However, since the 1970's its use has increased significantly, partly because it is an economically and environmentally viable energy alternative to other fossil fuels.[47] Further, there are deposits of natural gas in EU states, such as Britain's North Sea fields, as well as in the Netherlands and Norway. Smaller onshore deposits are also to be found in Northern Italy, Southern France and Germany.

Despite domestic reserves of natural gas, however, all of the EU states, apart from Britain, are dependent upon imports from Russia and Algeria.[48] Russia, particularly, has huge reserves of gas which have been developed to supply the energy needs of both Russia and the former FSU states. However, Russian natural gas supplies reach the EU through pipelines constructed across FSU states, and during the 1990's particularly the most worrying question was the transit of natural gas through Ukraine, whose fragile economy carried the risk of disruption to EU supplies.[49] Similarly, political instability in Algeria also threatened the security of the EU's natural gas/supplies.

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[47] Haughland, op. cit., 96.
[48] Ibid., 99.
[49] Ibid., 109.

Accordingly, as with oil, natural gas is of strategic as well as economic value to the EU and is encompassed by EU international agreements such as the ECT. Furthermore, as with electricity, natural gas supply is also subject to competitive policies, "Projects of Common Interest" and TEN's. In 1994 the Commission put forward its objectives for natural gas projects of common interest, which are:

- the introduction of natural gas into new regions;
- the connection of isolated gas networks to the interconnected European network;
- increasing gas delivery pipelines, reception and storage capacities needed to satisfy demand;
- diversification of supply sources and routes;
- upgrading of existing networks.

In addition to the increase in demand for natural gas resulting from the extension of the European gas networks, the role of natural gas as an efficient, economical and environmentally cleaner fuel than coal or oil has also put pressure on gas supplies.[50] Due to the escalation in demand it is estimated that by 2020 the EU will need to import 67% of its natural gas supply.[51] Procurement of new sources and security of future supplies is therefore a priority in EU gas policy and it should be noted that Russia-Ukraine-EU and the Russia-Belarus-Poland-EU gas pipelines are amongst the Projects of Common Interest.

Moreover, on 22 June 1998 the European Parliament and Council issued a Directive concerning common rules for the internal market in natural gas,[52] the objectives of

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[50] During the 1990's the demand for natural gas increased on average 4.5% per year over all sectors. The most spectacular increases were in three major markets: the power sector +104%; the tertiary domestic sector +32% and industry +16% (European Commission, Directorate-General for Energy and Transport, *2000 - Annual Energy Review*, January 2001, 5.

[51] *Shared analysis of the economic foundations for European energy policy*, December 1999, quoted by Dr Ria Kemper in an Address to the Centre for European Policy Studies, 17 May 2000, 3. www.encharter.org.

[52] 98/30/EC.

which are "to ensure the free movement of gas and improve security of supply and industrial competitiveness." The Directive applies to all products in the natural gas sector, including liquefied natural gas (LNG) and, in addition to establishing rules for the storage and transmission of natural gas, augments EU competition policies by providing for transparency in accounting, access to supplies and price harmonisation. As with electricity, liberalisation of the natural gas sector will facilitate the cross-border acquisition of gas from non-member states. Indeed, on 13 March 2001, the Commission presented a proposal to the European Parliament amending Directives 96/92/EC and 98/30/EC to establish common rules for the internal electricity and gas market,[53] with the objective of accelerating the completion of the integrated internal market. Naturally, once both the gas and electricity markets are internally integrated, access to supplies from non-EU states will be facilitated and encouraged.

Coal

Unlike natural gas and oil, most EU states have extensive reserves of both hard-coal and lignite. Hard-coal is generally extracted from mines and therefore, due to the high levels of sunk costs needed for production, tends to require state support so that producers may compete effectively with imported coal and other fuels. Lignite, on the other hand, is more cheaply extracted, usually through open-cut mining, and if used close to source, is more economically viable. However, lignite is not only inferior to hard-coal in heat content, but poses greater environmental hazards in use, waste disposal and method of extraction. Not all of the EU's demands for coal are satisfied by domestic production and vast quantities of hard-coal are imported from Australia, South Africa and Canada.

In the late 1970's and 1980's, environmental concerns began to overshadow the use of coal as an energy source. Coal combustion produces both sulphur dioxide (SO_2) and nitric oxide (NO_x), both of which cause acidification (acid rain). Further,

[53] COM (2001) 125.

although the thermal efficiency and combustion technologies for coal were improved during the 1980's and 1990's, toxic emissions during coal combustion cannot be eliminated entirely. Thus, although all energy sources are caught, to some extent, by environmental controls, coal production and usage has been most affected by EC and EU environmental policies.

Whilst EC Directives setting ambient air quality levels of SO_2 and NO_x were instituted in the late 1980's, and a Large Combustion Plant Directive (1988) set emission reduction targets, EU environmental policy directives of the 1990's have increased in both number and severity. Even despite stringent emission control regulations, however, a working document presented to the Commission on acidification in 1995 showed that even using best available technology (BAT), by 2010 the maximum reduction for SO_2 would be 90% and for NO_x only 70%.[54] At these levels, acidification would still reach critical load over most of Europe and that the sources of emissions came from within the EU.[55] As a result, the Commission concluded that a large number of measures would need to be taken to restrict emissions even further.

In response to this, EU states' environment ministers agreed to accept the Commission's measures to affect a coherent strategy against acidification. Because coal as an energy source is a pollutant and EU policies on environmental issues in the 1990's, through the aegis of the Environment Agency, centre on the monitoring of air quality, there has been a greater push by EU nations to support industry conversion to natural gas and renewable energy sources. Moreover, in view of the declining value of coal as an energy source, in 1994 the Commission proposed that the Technical Coal Research Programme, funded by the ECSC should be phased out.[56] Thus, whilst the proposal emphasised the need to maintain coal as a strategic

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[54] COM/95/372 26 July 1995.
[55] European Commission. *Working document on acidification.* 27 November 1995 SEC/95/2057.
[56] OJ/94/C67 4 March 1994.

resource, it also stressed the need to devote more research and development funding to investigate the potential of cleaner technologies.

Furthermore, since the EU coal industry is gradually closing down as mines and open cut extraction are phased out, it is highly unlikely that coal particularly hard-coal will continue to be a major source of energy in the near future It is also considered highly likely that EU nations will become increasingly dependent upon coal imports from Australia, Canada and South Africa.[57] Thus, it is vital that the EU develop a framework within which imported coal supplies are secured. The ECT provides this framework.

Nuclear

The issues relating to nuclear power and nuclear materials are perhaps the most contentious of any raised in the EU, but surprisingly, the EU does not have a coherent nuclear energy policy.[58] Instead, there are a number of discrete policies which either touch upon briefly or concern nuclear matters and which emanate from different Directorates-General[59] and EU bodies, particularly Euratom and the Commission itself. This apparent neglect of so important an area of policy would seem to demonstrate either a glaring lack of co-ordination and co-operation within the Commission, Euratom and the Directorates-General, a case of bureaucracy gone mad, or a singular lack of courage on the part of the Commission to address comprehensively and cohesively what could both literally and figuratively be an extremely explosive issue. However, within the multifarious regulations and Ds-G directives, it is possible to isolate three major nuclear policy issues:

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[57] Haughland, op. cit., 43.

[58] Lyons, op. Cit., 96-98.

[59] In addition to Directives issued by the Directorate-General for Environment, Nuclear Safety and Civil Protection, (D-G XI), nuclear issues are also covered by D-G III, and the Directorate-General for External Relations (D-G I) through the Programme for Technical Assistance for Central and Eastern Europe [Phare] and Technical Assistance to the Commonwealth of Independent States [Tacis], the Directorate-General for Science, Research and Development (D-G XII), and the Directorate-General for Energy (D-GX VII).

- nuclear power generation and decommissioning of reactors;
- nuclear safety and waste disposal;
- nuclear trade.

Prior to briefly addressing these areas, however, it is necessary to look briefly at the EU body which logic would suggest, should have governance over all nuclear matters, Euratom.

Euratom : Euratom was established in 1957 pursuant to the European Atomic Energy Community Treaty. Its objective, in these heady days of nuclear fervour, was to encourage co-operation between the European countries in order to develop the nuclear energy sector. By sharing the resources and research data available in all member countries, it was hoped to commonly develop the technology which would promote the rapid growth of the European nuclear power industry. However, whilst in the context of post-war Europe the plan might have appeared to be laudable in theory, its implementation was extremely problematic for a number of reasons. Firstly, the US held technological dominance in the nuclear industry and European nuclear power programmes.[60] Such US assistance as was forthcoming in nuclear technology was given to its former allies, Britain, France and Belgium. Furthermore, the various European governments held widely divergent views on nuclear power. Some states such as Denmark and Ireland (Eire) regarded nuclear technology with distinct suspicion after the demonstration of nuclear energy's destructive capabilities at Hiroshima and Nagasaki. Others, like the UK, France and Belgium embraced nuclear technology from the early 1950's. Against the background of diametrically opposed national nuclear policies Euratom was unable

[60] This dominance was due in no small measure to the US advances in nuclear technology during World War II through the Manhattan Project. By the end of the War economically and socially devastated European nations were too intent upon the reconstruction of their basic industries to have either the funds or scientific knowledge available to devote to research into nuclear power. The US, therefore, by default, gained a head start in nuclear technology.

to formulate a coherent policy applicable to all European nations. After having lost the policy initiative in its early years, Euratom has participated, albeit in a desultory manner, in various European Community programmes, taking control to some extent of the regulation of trade in nuclear materials.

Some coherence of policy, however, was achieved in the early 1990's. As a reaction to the Chernobyl disaster all member states, apart from France, had adopted moratoria on the construction of new reactors and commenced programmes to decommission existing nuclear power facilities. Once again, however, Euratom did not take the initiative and the decommissioning programmes were placed under the control of D-G XI.

Thus, Euratom's role today is mostly confined to the control of nuclear trade, the provision of funding for nuclear research and providing financial support through the European Investment Bank (EIB) for the construction and upgrading of nuclear power plants in Eastern Europe.

To some extent, therefore, Euratom is an anachronism in the EU of the twenty-first century. The provisions of its Treaty provide for the promotion of nuclear power in a time when all EU nations except France are instituting programmes to decommission their nuclear power plants. It purports to guide nuclear policy when in fact those policies which do exist have emanated from the various Ds-G of the Commission. In view of the phasing out of nuclear energy and Euratom's limited activity, it is arguable that, as a regulator of nuclear energy, Euratom has outlived its usefulness and should either be substantially revised or abolished altogether.

Nuclear power generation:: In 1998 for the first time since nuclear power was exploited for electricity generation, both installed capacity and generation in the EU fell by 0.7% and 1.4% respectively.[61] France is now the only EU state in which

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[61] *2000-Annual energy review*, 5.

there is any possibility of an expansion in the nuclear energy sector, although no specific projects have been proposed. Indeed, in early 2000, Germany decided to institute a progressive phase-out of the nuclear contribution to its electricity grid. With the moratoria on establishment of new nuclear facilities, therefore, most EU policies have centered upon the decommissioning of existing reactors and attendant safety issues.

At the end of 1992 there were 424 nuclear power generation plants in operation around the world, approximately 300 of these being in the EU and Eastern Europe,[62] and by 1995 Europe was deriving 40% of its electricity from nuclear energy.[63] However, as noted above, in the 1990's a large percentage of the nuclear reactors in use were rapidly reaching the stage at which they should be shutdown or undergo extensive and expensive upgrading. In view of nearly all EU member states' attitudes to nuclear power, this latter alternative was not an option. Accordingly, in the early 1990's the Commission and D-G XI instigated various research projects and studies on decommissioning of nuclear power plants. Since it is estimated by D-G XI that by the year 2020 some 260 installations will have been dismantled, this was a prudent measure. During the 1990's, therefore, the European Commission and D-G XI issued a number of directives and resolutions pursuant to Article 37 of the Euratom Treaty in the area of decommissioning. These included a Council Resolution of 15 June 1992 concerning the "Community Action Plan within the EU in the field of Radioactive waste," Council Directive 97/11/CE of 3 March 1997 concerning the assessment of the effects of certain public and private projects on the environment and the European Commission Report D-G XI/C3 EU17.622(1997), "A review of the situation of decommissioning of nuclear installations in Europe."

Whilst the EU nations are busily decommissioning their obsolete nuclear reactors and maintaining moratoria on the construction of new facilities, however, the FSU

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[62] D-G XII, What is decommissioning? 1998-99, 2.
[63] *2000-Annual energy review*, ibid.

states, Russia in particular, are not only upgrading existing facilities, but planning the construction of new nuclear power plants.

The Russian government proposes that by 2030 it will have increased its number of operating reactors from 29 to 59 at a cost of US$25 billion, whilst at the same time upgrading old reactors, many of which are RBMK units similar to the one involved in the Chernobyl tragedy.[64] Ukraine has plans for a similar expansion of its nuclear power generating capacity including the upgrading of RBMK units even older than the fatal Chernobyl facility. A large proportion of the funding required by FSU states to expand their nuclear power generating capacity will come from the EIB through Euratom.[65]

It is possible to argue that Russia and other FSU states are taking advantage of the EU's increasing need for electricity by developing their nuclear generating capacity at FSU expense, to enable them to resell excess supply into the liberalised, integrated EU electricity market. However, it is equally possible to argue, on the basis of the D-G XI commitment to the decommissioning of all nuclear power stations (except for those in France), that the EU, through Euratom and the EIB are shifting the nuclear problem offshore, by encouraging the FSU states to undertake the very risky business of nuclear power generation.

It is almost a truism to state that nuclear power generation poses environmental and human hazards. Even in the most efficient nations such as France, the US, the UK and Japan, accidents happen. Between 1945 and 1999 there were more than 60 critical accidents (i.e. major accidents involving fatalities and/or environmental contamination) reported in these countries.[66] In Russia, (excluding other USSR states and Chernobyl) for the same period, there were 384 reactor accidents causing

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[64] James O. Jackson, op cit. 44.

[65] It has proven impossible to establish exactly how much EIB and Euratom will be contributing since the cost of such projects are hidden in estimates for Phare and Tacis programmes.

[66] *New Scientist*, 30 October 1999, 20.

environmental contamination, 58 deaths and 214 cases of acute radiation poisoning.[67] Nuclear accidents are caused not merely by reactor failure but also human error.[68] Russia and the FSU states do not have a very encouraging record in either. It is not suggested here that the EU states are encouraging the construction and development of nuclear power generating facilities in the FSU states whilst at the same time, decommissioning such reactors within member country territories to obviate the risk of environmental damage and human tragedy in the event of an accident. Chernobyl demonstrated that all of Europe and Central Asia would suffer the affects of such a disaster in an FSU country. However, by "relocating" nuclear power generating from the EU, where nuclear issues are extremely politically sensitive and cause strong and often violent reactions from environmental movements, to the more "nuclear friendly" FSU states, the EU accomplishes two purposes. Firstly, it obviates internal protest from opponents of nuclear energy. Secondly, it is able to bridge the shortfall between demand and supply of electricity caused by the decommissioning of nuclear power stations in the EU by entering into electricity purchasing agreements with FSU states. Such Power Purchase Agreements may be concluded under the aegis of the ECT.

Nuclear Safety : Nuclear safety issues within the EU are under the aegis of D-G XI and cover four major areas :

1. radiation protection;
2. civil protection;
3. the safety of nuclear installations;
4. radiation waste management.

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[67] Jackson, op cit, 45. These figures exclude the *Kursk* tragedy of 12 August 2000.
[68] On 30 September 1997 at a uranium processing plant at Tokaimura in Japan, an accident was caused not by mechanical failure but by human error. Indeed, the Chernobyl tragedy of April 1986 was caused, not so much by the age of the reactor, but, once again, human error.

Public concerns over the safety of nuclear power generators, the disposal of nuclear waste and the non-proliferation of nuclear weapons generally overshadow other nuclear issues. It is often forgotten, therefore, that ionising radiation[69] also has extensive medical[70] and industrial[71] uses. Indeed, medical exposure to ionizing radiation accounts for the second highest effective radiation dose in the global population.[72]

Therefore, this section concentrates solely upon the issues raised by the use of nuclear materials in the energy sector : the safety of nuclear installations and radioactive waste management.[73] It does not cover the most common and thereby, the most important areas of radiation safety: the medical and industrial uses of nuclear materials.

Perhaps the most comprehensive EU policy on nuclear safety was contained in the Commissions Proposal on Basic Safety Standards (COM/94/298) which suggested new definitions, more restrictive maximum dose limits, the prohibition of

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[69] Ionizing radiation is the term used to describe the emissions from radioactive materials and may be classed as particulate radiation which is composed of tiny particles moving through space and electro-magnetic (E/M) radiation, which occurs when electric and magnetic fields travelling at the speed of light interact. In both particulate and E/M radiation, the rays generated by the source are capable of knocking electrons from atoms in their path, thus leaving behind electrically charged particles (or ions). Non-ionizing radiation, on the other hand, is unable to cause ionization. Common forms of non-ionizing radiation are visible light, radiowaves, microwaves and infrared and ultraviolet light. Both forms of radiation are potentially harmful to humans.

[70] Ionising radiation is now vital to modern medicine both in diagnostics (x-rays, radioactive tracers, radiography) and therapeutics (radiotherapy).

[71] The industrial uses of ionising radiation are almost as extensive as medical applications. Industrial radiography is an indispensable tool for non destructive testing, particularly in the steel industry, as are gas and mass spechtometry. Radioactive materials are also used in industrial and domestic fire-detectors.

[72] UNSCEAR, *Sources and effects of ionizing radiation*, Report to the UN General Assembly. UN, New York, 2000, 7.

[73] It must also be remembered that disposal of radioactive waste from industrial and medical uses are also a significant issue.

unjustified uses of radioactivity[74] and a new close constraint concept, including natural radiation in exposure calculations.

The disposal of radioactive waste has always been, and probably always will be, a contentious environmental, social and political issue. Even if all nuclear power plants in the EU and the FSU were closed, there would remain the problem of the safe disposal of the radioactive materials they contained, in addition to the disposal of waste from other uses of radiation. In March 1994, the Commission attempted to address this issue and released a Resolution on Nuclear Waste Management[75] which outlined the parameters of its strategy. The substance of the Resolution provided that:

- the option of recycling low level waste should be explored further;
- efforts should be increased to reduce the volume and radio toxicity of radioactive waste;
- optimum use should be made of national facilities bearing in mind political issues;
- management of radioactive waste should take into account the risks of long term toxicity;
- appropriate controls are needed on shipments of radioactive waste;
- there is a need to objectively inform the public regarding waste management.

As with most EU policies on nuclear matters, the Resolution's list of general objectives were admirable but did not present any clear strategies as to how they could be implemented. Indeed, the mere fact that the Commission had enunciated the goals for nuclear waste management, did little to allay the growing discontent and unease of some member states in regard to the problem. In May 1995 the German government had urged the Commission to impose a total ban on the

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[74] For example, solaria.
[75] Lyons, op. Cit., 104.

cross-border transportation of radioactive waste,[76] whilst other Member States refused to introduce legislation to facilitate such shipments. On a more ad hoc basis than the issuance of policies, the Commission also provides Opinions on radioactive waste disposal procedures pursuant to Article 37 of the Euratom Treaty. These are published in the Official Journal. On 10 July 1995 the Commission published a Report on the application of Article 37 and Opinions on 13 Plans from six Member States which had been examined (COM/95/328). In all of the Opinions the Commission concluded that "routine discharges of radioactive effluents were not liable to result in radioactive contamination, significant from the point of view of health, of another Member State."[77]

The safety of nuclear installations within the EU was a further nuclear issue which confronted the Commission in the 1990's. On 15 December 1993 the Commission released a Communication (COM/93/649) which set the framework for member states to progress towards a satisfactory degree of protection of the health of its citizens and of the environment at the highest practical safety levels. The process of achieving equivalent safety standards for installations is co-ordinated by the Commission and implemented by the Reactor Safety Working Group and the Nuclear Regulations Working Group.

Perhaps the most urgent problems confronting the EU in regard to nuclear safety issues, however, are those raised by the ex-Soviet built nuclear reactors in Eastern Europe, particularly those at Chernobyl in Ukraine and Kozlodu and Mochovce in

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[76] The German people continue to oppose strenuously the shipment of radioactive waste across their territory. In November 2001 violent demonstrations erupted in Germany against the transportation of radioactive waste from France into Germany for disposal. Whilst such opposition may be contrary to the spirit of the EU, it is easy to understand the German point of view, particularly in consideration of the fact that the German government has consistently pursued policies which attempt to limit the nonmedical and non-industrial uses of radioactive materials within its borders.

[77] Lyons, op. cit., 105.

Russia. The EU has active aid programmes for nuclear safety implemented through Phare and Tacis initiatives co-ordinated by D-G1.

In addition to Tacis and Phare funds, both the European Bank for Reconstruction and Development (EBRD) and the EIB, through Euratom, provided and continue to provide funds for the development of nuclear safety programmes and upgrading nuclear facilities in the FSU states.

On 14 December 1998 the Council adopted a multiannual programme (SURE) to promote nuclear safety in Tacis countries (OJ L7, 13/01/99), with the aim of improving the safe transport of radioactive materials in the EU and the Safety of nuclear installations in countries participating in the Tacis programme by means of increased co-operation in the field of safeguards and industrial co-operation. In order to implement the scheme, the programme was granted EUR 3.6 million for projects in 1998-99 and a further EUR 5.4 million for 2000/2002. It remains to be seen as to how successful the programme has been.

On 6 September 2000 the Commission issued a Communication which evaluated the Commission's support of nuclear safety in the FSU and Eastern European Sates (COM(2000) 493 final). Whilst acknowledging that much had been achieved by the Commission in assisting the development of safer nuclear installations and nuclear safety generally in Europe,[78] the Commission acknowledge that "much remains to be done." Certainly, the EU's commitment to the promotion of nuclear safety in the FSU states cannot be doubted, especially in view of its enormous financial contributions through Euratom, the EBRD and EIB[79] and technical assistance in

[78] Particularly the Commissions contribution to the successful closure of Chernobyl on 15 December 2000.

[79] Between 1991 - 1992, the EU committed EUR 913 million in the FSU for nuclear safety, between 1994-1999 an additional EUR 190.4 million was contributed to Ukraine alone and between 2000-2006 estimates that Slovakia will receive EUR 150 million, Lithuania 165 million, in addition to its substantial financial contributions to the closure of the Kozloduy reactors in Bulgaria (*About Synergy,* hhtp://www.cordis.lu/synergy/srs/about.htm).

nuclear sectors to various states. However, from a pragmatic point of view, the EU's investment in nuclear safety in the FSU is not wholly philanthropic. The proximity of the EU states, particularly Scandinavia and Germany, to the FSU countries would make them vulnerable in the event of a major nuclear accident, as was proven by the widespread radioactive fallout from Chernobyl.[80] Furthermore, the upgrading of nuclear technology in FSU would enhance the security of supplies to the EU of nuclear generated electricity from these states. Thus, funds and technical assistance committed by the EU represent not merely charitable actions but less altruistic measures to protect EU investments, environment and energy supplies.

Nuclear Trade : As noted above, radioactive materials are used not only in nuclear power generation, but also extensively for medical and industrial purposes. Thus, even though the EU states decommission all of their nuclear power facilities by the year 2020, nuclear reactors will still be necessary to produce isotopes for medical and industrial uses, and the demand for nuclear materials will continue to increase.[81] Almost all commercial reactors use uranium. Uranium is a relatively abundant mineral in the earth's crust and its decay gives rise to essentially all radioactive elements in nature. Whilst uranium is a fairly common mineral, whether it is mined depends upon environmental, economic and political as well as commercial factors. Although in the EU, France, Spain and Portugal have commercial uranium mines, in 1995 90%[82] of the natural uranium used by EU nuclear facilities was imported from countries outside the EU. The major suppliers of uranium to the EU are Australia, China, Canada, Kazakhstan, Russia, South Africa, Ukraine, USA and Uzbekistan. Most of the uranium imported is in the form of uranium ore,[83] which is then processed in the EU to produce uranium hecafluoride. However, the EU also

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[80] The radioactive emissions from Chernobyl spread northward across Scandinavia, westwards to Eastern Europe and Western Europe to Britain, and Southwest to the Mediterranean (John Greenwald, Deadly Meltdown. *TIME* 12 May 1986, 5-13 at 8.
[81] There are two major purposes for nuclear reactors : for power generation or the creation of isotopes for medical and industrial uses.
[82] European Union *Energy* web site @ europa.eu.int/comm/energy/en/faq2.htm, 3.
[83] Uranite (UO2) or pitchblende.

imports processed uranium from the US, Canada and Russia. If the EU is to ensure a supply of nuclear materials, it is therefore essential that amicable trade relations with uranium exporting nations are maintained.

Nuclear trade in the EU comes under the aegis of the Euratom Supply Agency (ESA). Created pursuant to Chapter VI of the Euratom Treaty, the objective of the ESA is to ensure a regular and equitable supply of nuclear materials to EU nuclear facilities. In order to achieve this, the ESA has been granted the following powers :

- the right of option on all uranium ores and fissile materials[84] produced within the EU;
- the exclusive right to conclude contracts for such materials from all sources.[85]

Furthermore, all contracts negotiated between a supplier and purchaser in regard to the sale of nuclear materials must be submitted to ESA for approval and validation. Prior to approving a contract, the ESA ensures that such contracts are compatible with the objectives and provisions of the Euratom Treaty and the EU's supply policy.

Of particular concern to the ESA in the 1990's was trade with the FSU states. In 1994 33% of EU nuclear materials were imported from FSU states.[86] In its 1994 report the ESA noted that whilst the lower prices offered by FSU exporters of nuclear materials were appreciated by EU utilities, concerns had been voiced by users as to the security of supply.[87] Accordingly, the ESA during 1995 and 1996 attempted to negotiate trade agreements with the major FSU exporting countries of Russia, Ukraine, Uzbekistan, Tadjikistan, Kyrgyzstan and Kazakhstan. However,

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[84] Enriched uranium, plutonium and other uranium products.
[85] European Union *Energy* web site, op. cit..
[86] Lyons, op. cit., 100.
[87] Ibid.

various members of the EU objected to the terms of the proposed agreements and insisted that imports of natural and enriched uranium should be restricted.

Similar difficulties were encountered by the ESA in its attempt to negotiate a nuclear fuel trade agreement with the USA in the early 1990's. Failure to reach consensus over the terms of the agreement, the opposition of the EU Council, and debate over long-term consent rights,[88] as well as concessions and restrictions served to stretch the negotiations from 1991 to 1996.[89] Given the importance of nuclear material imports to the EU, such stalled trade negotiations had the potential to adversely affect the security of supply, and, as such, seriously disrupt not merely the domestic and industrial energy sector, but also EU economies.

Conclusion : From the above albeit brief review, it is arguable that EU nuclear energy policies in the 1990's were and continue to be, to say the least, contradictory. On the one hand, there is distinct policy of decommissioning all nuclear power plants in all EU states except France. On the other hand, throughout the 1990's and to the present, the EU has provided technical and financial support to FSU states to upgrade and develop their nuclear power generating capacities. Further, whilst over the last ten years the EU states have consistently affirmed their opposition to any increase in nuclear power, they have neglected to point out that because of the increasing medical and industrial uses of nuclear materials, nuclear reactors will remain integral to these sectors and all EU states will remain dependent upon imports of either uranium ore or enriched uranium. The issue of nuclear energy is an extremely sensitive political area, with the problems posed by nuclear energy and radioactive waste disposal in particular, inciting strong and often violent opposition form all sectors of society. It is not surprising, therefore, that the governments of EU states have chosen to adopt a covert pro-nuclear stance. By using imported electricity generated by nuclear power plants in the FSU, EU states are able to

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[88] Such as how radioactive contamination should be dealt with, perpetuity and termination of rights.

[89] The Agreement was signed on 20 May 1996 (OJL 120 20.05.1996).

access relatively cheap energy. By decommissioning nuclear power plants, EU states are able to obfuscate the fact that radioactive materials are still essential to their health systems and industrial sectors. As Lyons states, "Nuclear affairs, like adulterous love affairs, are largely conducted in secret, or at least behind closed doors... ."[90] This has certainly been the case in regard to the EU nuclear policies.

Transit

As has been noted at various points above, the EU states are dependent upon imports from external sources for the greater percentage of their energy supplies and are therefore vulnerable to disruption in the transit of supplies, particularly via pipelines and grids.

With the collapse of the FSU and increasing trade in energy supplies between the FSU states and the EU, transit of these supplies became a major issue for a number of reasons. Firstly, the pipelines which convey oil and gas, and the electricity grid infrastructure within the FSU states were in extremely poor states of repair, and, therefore, unsuitable for international transportation of energy.[91] Certainly, Phare and Tacis funds were devoted to providing technical and financial assistance to FSU states to upgrade and extend their pipelines and grids. However the EU, through the EBRD and EIB could not continue to pour funds into FSU states for energy infrastructure projects.

Secondly, international and internal political disputes could disrupt energy supplies. There is very little that can be done to protect pipelines and electricity grid systems from damage caused by war or civil unrest. Under such circumstances it is a matter of risk mitigation and allocation. Further transit of energy supplies from an FSU state to the EU could be endangered by a third party, over whose territory the supplies must pass, refusing permission for transport of the supplies across its

[90] Lyons, op. cit., 109.
[91] Ibid.

territory. This was a particularly difficult and pressing problem in regard to transit of oil and gas from Eastern Russia and Central Asia, to the EU. Even a cursory glance at a map of this region will demonstrate the number of other countries though which the pipelines must pass to reach the EU states.

To a great extent the ECT and the ECT Transit Protocol (2000) attempt to address these issues.[92]

Synergy

In an early effort to resolve the issue of secure energy supplies, the EU became involved in energy related projects following the oil crises of the 1970's through the European Community International Energy Co-operation Programme (ECIECP). The objective of the ECIECP was to inaugurate ad-hoc programmes aimed at promoting co-operation with non-EU member countries in the formulation and implementation of energy policies. Despite receiving EU funding, what came to be called the Synergy Programme operated on an unofficial basis, providing liaison with and technical assistance to less developed energy producing states. In mid-1995 the Commission put forward a proposal to formalise the Synergy Programme with a projected budget of EUR 50 million for 1996-2000. Regulation (EC) No 701/97[93] came into force on 12 May 1997 establishing Synergy under the aegis of D-G XVII. It was proposed that Synergy would help to achieve the EU objectives set out in the White Paper by contributing to the financing of activities concerning:

- advice and training;
- energy analyses and forecasting;
- the organisation of conferences and seminars;

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[92] See 103-108 below.
[93] OJL 104 22.04.1997.

- support for regional cross-border projects.[94]

No funding, however, is granted for investment, research, development and demonstration projects.[95]

Certainly, Synergy was pro-active in EU energy policies even prior to its incarnation as an official programme of D-G XVII. Since 1989 almost half of Synergy's budget has been targeted towards projects in Central and Eastern Europe. Further, during the early negotiations between EU member and non-member states of the FSU, Synergy performed an invaluable role in assisting Russia to understand the legal and technical aspects of the draft Treaty texts. Considering the growing significance to the EU of Russia's vast energy resources, and its importance, therefore, to the implementation of the EU's energy policies, Synergy's function as interpreter of complex concepts and terminology to a crucial potential signatory of the ECT arguably justified its establishment as an official entity.

In addition, since its official inauguration Synergy has undertaken a number of significant energy projects in the FSU states. These include the Black Sea Regional Energy Project and the Balkan Energy Interconnection Taskforce. Both programmes aim at reinforcing the dialogue between Balkan and Black Sea countries and the EU by providing assistance in modernising their energy sectors, especially in the areas of transit and infrastructure, through the organisation of conferences and seminars and the provision of technical assistance and funding. Naturally, efficient FSU energy sectors will provide the EU with the secure and effective access to the Eastern European and Central Asian energy resources it needs.

However, Synergy's focus has not merely been Central and Eastern Europe. Synergy has promoted and funded various projects in Latin America, especially in Brazil, Venezuela, Chile, Argentina, Uruguay and Peru. In June 1996 Synergy

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[94] *About Synergy* web site, op.cit..
[95] Ibid.

organised a conference entitled "Energy: the link between the countries of Latin America and the European Union in a changing world," aimed at strengthening the energy links and enhancing co-operation between the EU and Latin America countries.

The Asian countries have also received funding and assistance from Synergy, especially China and India. Synergy has operated training courses in China in energy management and efficiency since the early 1980's and in India since 1989. Further, the mid-1990's saw a greater involvement of Synergy in ASEAN countries, especially Indonesia, Brunei and Malaysia.

Thus, to a certain extent, the activities of Synergy mirror the energy policies of the EU in that the major thrust of its programmes are aimed predominantly at those countries with extensive natural energy resources such as the FSU states, and Uruguay, Venezuela, Malaysia, China and Indonesia. The assistance in energy matters given to non-EU nations through Synergy programmes cannot but assist the EU in forming strong trade links in energy resources with recipient countries, and thus enabling the EU to achieve its energy goals.

Conclusion

From the above discussion, it is possible to identify four major stages in the development of EU energy policies since the end of World War II.

1. From 1946 to 1957, energy was a major problem facing European nations grappling with the problems of post war reconstruction and fuel shortages.

2. From 1957 to 1972, energy was not an issue of concern to most European nations. Post-war reconstruction had resulted in industrial resurgence and strong economic growth. Oil supplies were cheap and plentiful, whilst nuclear power

offered what was generally believed to be a cheap and virtually inexhaustible supply of electricity.

3. From 1972 to 1985, however, energy supplies once again became an issue. Oil price increases in the early 1970's together with the growing dissatisfaction with nuclear power as an energy source and increasing concerns about the impact of CO_2, SO_2 and NO_x emissions on the environment, placed the problems of energy uses and supplies once again at the forefront of concerns of most European nations.

4. Finally, the period from 1986 to the end of the 1990's, represents an attempt by the EU to develop and secure energy supplies through the development of common EU energy policies.

However, throughout the 1990's, energy policy development was piecemeal and fragmented. This fragmentation was not only the result of the diverse and often conflicting internal energy policies of individual EU member countries, but also a product of the structure and operations of the EU policy making institutions. Energy issues come within the portfolios of various Commission Directorates-General, leading to lack of co-ordination, over-lap and replication in the formulation and implementation of policies.

Despite the apparent ad-hoc approach, however, it is possible to identify three major trends in EU energy policies; trends which are aimed at increasing and securing EU energy supplies for the twenty-first century and beyond. These are as follows:

1. the liberalisation and integration of internal EU energy markets;

2. the development of common policies for the gas, oil and nuclear energy industries;

3. the establishment of open international energy market regimes and secure energy trade relations with the FSU states and those non-EU countries which have extensive energy resources.

The ECT has become essential to the achievement of these energy objectives by providing both the legal framework and impetus for the stimulation and expansion of non-EU state energy markets. Originally conceived within the shifting political and volatile economic milieu of post-Communist Europe as a Euro-centred multilateral instrument, the scope of the ECT has widened to encompass non-EU and non-FSU nations. Moreover, as the 1990's progressed, the declared focal point of the ECT objectives shifted. From the provision of economic assistance to FSU nations through the encouragement of trade and investment in energy resources, with the provision of secure energy supplies to the EU as a concomitant, if not ancillary outcome, the focus of the ECT changed, becoming centred in the late 1990's solely upon the acquisition and security of EU energy supplies. As a result, the international application of the Treaty widened beyond the boundaries of Europe and Central Asia, to embrace all states on whatever continent with an interest in energy resources, either as consumers or producers. Thus, within the context of EU energy policies as a whole, the philanthropic intent of the ECT's initial phase appears to have dissipated, leaving merely a multilateral instrument whose sole purpose is to secure the EU's present and future energy supplies upon terms most favourable to EU investors/purchasers.

The following chapters will therefore, discuss in detail the international context and origins of the ECT, its administration and the evolution of its objectives.

CHAPTER II

GENESIS OF THE ENERGY CHARTER TREATY

Introduction

This Chapter will examine the genesis of the ECT from the first proposals of Ruud Lubbers in June 1990 to its entry into force in April 1998, the administrative structures underlying its implementation and the evolution which has occurred in the aims and objectives of the Treaty from its inception in 1990 to the early years of the twenty first century. However, it must also be remembered that the ECT, whatever its origins, is no longer a Euro-centred instrument: non-European nations are also signatories, whilst the major international and economic organisations have Observer status. Therefore, to develop an understanding of the significance of the objectives and provisions of the ECT to countries beyond Europe it is important to have some conception of the broader implications of exploitation of and trade in energy resources and the international context within which the ECT has evolved. Accordingly, the first section of this Chapter will attempt to place the ECT within a wider economic and political framework, constructed from bi- and multilateral international agreements and driven by a growing demand in the EU for energy resources and products.

International Context of the ECT

As noted above, during the mid- to late 1990's the focus of the ECT changed from a Euro-centred multilateral Treaty with application solely within EU and FSU states to an international instrument governing trade in energy resources. To a large extent, since the mid- 1990's, the ECT Conference process has targeted those nations, other than the FSU states, which have the most to offer the EU by way of energy resources, whilst at the same time have an economic need for the advantages offered by Foreign Direct Investment (FDI) in their energy sectors. Thus, intensive lobbying by the ECT Secretariat has resulted in an increase in the number of Conference

Observers (participants in the Conference who are not signatories of the Treaty) and links being established with resource rich Asian-Pacific and Latin America countries.

Moreover, attempts have been made by the Secretariat to establish relationships with those nations which are sufficiently wealthy not to require FDI, but which can contribute to EU energy needs, such as the OPEC nations and the US, both within the Conference process and through EU political and diplomatic initiatives. Whilst the ECT is no longer Euro-centric, it is still central to the implementation of EU energy policies and ensuring the security of the EU's energy supplies. Despite its broader international scope, therefore, the ECT must be viewed within the context of EU energy requirements and policies and the political and diplomatic maneuvers used to secure these.

The EU is the World's largest net energy importer with a steady growth of 2.5% p.a. in energy imports from 1985 to 1998.[1] As such, the security of the EU's energy supplies is dependent upon its ability to establish and maintain amicable and secure energy trade relations with major energy exporting nations. The maintenance of external relations, however, requires sustained and committed policy application. For relations with individual states, EU policies vary from the provision of technical assistance and funding to the organisation and implementation of conferences and training courses. Prior to the break-up of the FSU, the EU as a trading bloc had traditionally maintained relations with many areas of the world, but especially those nations which had been former colonies of the various EU countries.

In the late 1980's and early 1990's, however, the focus of EU external polices shifted to the former Soviet bloc. Funds and assistance were channelled to FSU states through Phare, Tacis and Synergy programmes. In addition, the EU sought to develop wider collaboration through the use of Europe Agreements. These cover

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[1] European Commission, *2000 - Annual energy review*, op cit, 3

political co-operation, preferential trade relations and concern almost all aspects of economic activity, including energy procurement and supply. The first of what was to become a series of Europe Agreements with FSU states were concluded with Poland and Hungary in February 1994, followed by Bulgaria, Romania, Slovakia, the Czech Republic and the Baltic States in February 1995.[2] Each of these Agreements contained specific and detailed sections on co-operation in all energy sectors between the EU and the other party, with particular emphasis upon the opening up of energy markets to facilitate the transit of gas and electricity to the EU, the improvement of distribution and diversification of supply and the development of energy resources.

In view of the comprehensive nature of the Europe Agreements, each of which were concluded after the ECT Conference and the similarity between the declared energy objectives of the Agreements and the ECT, it would be possible to argue that the Europe Agreements were and continue to be, otiose. Each of the non-EU parties to the Agreements are also signatories of and have ratified the ECT and its Protocols. Therefore, since each party is bound by the provisions of the Treaty, why was it necessary to conclude separate agreements with individual FSU states rather than relying upon the provisions of the ECT? Perhaps the distinction between the ECT and the Europe Agreements may be seen more clearly from the specific objectives as revealed by their actual content and provisions, rather than the broad statements of aims set out in the preambles.

As will be discussed in greater depth in Chapter XI, the ECT governs the formation and content of contracts in relation to energy resource development and supply and the inter- and intra national legal framework within which energy agreements are concluded. Europe Agreements, on the other hand, have far wider application and extend beyond jurisdictional, legislative and legal concerns to encompass political and economic factors which impinge upon relations between the EU and specific

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[2] Lyons, op. cit., 127.

FSU states. Thus, whilst the ECT deals in a generic way, with specific legal aspects of energy agreements, Europe Agreements encompass more comprehensive diplomatic, economic and political issues peculiar to the EU's relationship with the other party.

To a certain extent, therefore, Europe Agreements may be regarded as ancillary and supplementary to the ECT and the means by which the EU secures amicable political and economic relations with its closest geographic neighbours.

Moreover, as the EU's energy requirements increase, non-renewable energy resources become increasingly depleted and political instability threatens energy, particularly oil, supplies from the Middle East countries, it has been necessary for the EU to search further afield for potential energy supplies. Since the late 1990's, the EU has intensified its attentions upon Latin American, African and South East Asian countries. As noted at 44-46 above, Synergy Programmes played an important role in developing amicable relations with resource rich, but economically and technically impoverished countries of these regions.

In addition to the strengthening relations with developing FSU and what are generally referred to as "third world" countries, in the late 1990's the EU executed initiatives designed to secure trade relations with "developed" nations. However, dealing with governments who were not in need of EU technical and financial assistance proved to be more problematic. The OPEC states, the US, Canada and Australia were, and still are, important suppliers of energy resources to the EU. Whilst the Co-operation Agreement between the EU and the Gulf Co-operation Council (GCC) of 1990 and the New Transatlantic Agenda between the EU and the US signed in December 1995 assisted, to some extent, in furthering EU relations between the OPEC countries and the US, relations between the EU and major energy resource suppliers remained uncertain.

Unable to rely upon FDI as an incentive to potential energy suppliers and faced with an increasingly competitive energy market, the EU at the close of the twentieth century, was forced to rely upon diplomatic and political measures to secure energy trade agreements with developed nations. Reliance upon diplomacy, however, was not always an effective means of securing amicable trade relations. Throughout the 1990's, the EU states become identified increasingly as a trading 'bloc' by outside governments. Whilst this group identification offered certain advantages to member states in terms of negotiating and political weight, it could also produce unwelcome and politically deleterious effects. Any delinquent activity of a single member state, even if carried out in defiance of a Commission Directive, could be imputed to the EU as a whole. A vivid example of this is presented by the French underground nuclear tests in French Polynesia in 1995/96: an incident which not only severely damaged the reputation of the EU in regard to environmental protection, but which also threatened the political unity of the EU itself. The French Government's insistence upon re-commencing[3] nuclear testing provoked vociferous opposition from all non-EU nations especially those bordering on or situated in the Pacific. These protests came not merely as demonstrations by anti-nuclear organisations,[4] such as Greenpeace, but also as substantive condemnations by governments such as Australia, New Zealand, Japan, the Oceanic nations, Canada and the US.

Reacting to pressure from these governments, on 5 September 1995, the date of the first test, Commission President Jacques Santer, informed the European Parliament's Foreign Affairs Committee that the Commission intended to implement Article 34 of the Euratom Treaty.[5] With the agreement of French

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[3] The French government had previously carried out underground nuclear tests on the Muroroa Atoll in the mid-1970s.

[4] Anti-nuclear organisations have been described (even accused) of "orchestrating" the anti-French, anti-nuclear protests. See Lyons, op.cit., 96.

[5] **"Article 34:**

Any Member State in whose territories particularly dangerous experiments are to take place shall take additional health and safety measures, on which it shall first obtain the opinion of the Commission. The assent of the Commission shall be required where the effects of such experiments are liable to affect the territories of

President Jacques Chirac, the Commission sent a Mission to the Muroroa Atoll to investigate the effects of the tests upon the inhabitants and the environment. After assessing the Mission's Report, the Commission concluded that the nuclear testing programme did not contravene the Euratom Treaty in that the tests did "not give rise to a significant threat to the health of workers or people in the region."[6] The Commission concluded, therefore, that neither the European Parliament nor the Commission itself had any authority to prohibit the French nuclear tests.

The majority of members of the European Parliament were infuriated both by this response and the apparent inability of the Commission to restrain a member state from engaging in an activity which was, to all intents and purposes, alienating important EU trading partners.[7] The opposition by member states to the French tests was made apparent in the United Nations in November 1995. When the UN General Assembly passed a Resolution criticising the French government for its actions, ten EU member states voted in support of the Resolution: Germany, Greece and Spain abstained and only the UK voted with France.[8]

The French nuclear test debacle occurred at a difficult juncture in EU trade and political relations with other world powers, especially with the US. In the late 1980's and early 1990's intractable disagreements erupted between the US and the EU during the General Agreement on Tariffs and Trade (GATT) negotiations over

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other Members States.

[6] Lyons, ibid..

[7] It is not the intention to suggest that the European Parliament's opposition to French nuclear testing was instigated solely by the potential damage caused to trade relations with Australia, New Zealand, Japan, the US and Canada by continued French recalcitrance. The EP has both collectively and through individual members, demonstrated its commitment to environmental protection. However, it is highly likely that the fear of "being tarred by the same brunch," in appearing to countenance the French tests was a motive for vocal protests in both the media and the forum of the United Nations by individual member states.

[8] France finally ceased its nuclear tests in 1996, after a successful application by New Zealand to the International Court of Justice for injunctive relief. Moreover, in April 1998, the UK, France and the US were the first members to ratify the UN Comprehensive Test Ban Treaty.

trade in services and agriculture. Many of the difficulties arose from the US reluctance to engage in the type of multilateral negotiations required by the GATT initiatives. In a multilateral context, the considerable bargaining power enjoyed by the US as a result of its de facto (if not de jure) position as the world's largest economy, was significantly diminished.[9] Thus, in order to conserve the weight of its position, the US has tended to prefer bilateral encounters.[10] Perhaps to some extent it may be argued that this preference for bilateral negotiations explains the difficulties experienced by the US in dealing with the EU. Whilst as a trading bloc the EU constitutes a unified entity, in reality the EU remains a collective of independent nations, including the most economically powerful states in Europe. When dealing with the EU, therefore, the US is faced with a creature analogous to the Hydra, rather than the mouse it appears to prefer.

Notwithstanding the difficult relations between the US and the EU caused by the GATT talks and, after September 1995, by US opposition to the French nuclear tests, the EU and the US reached agreement on a number of issues, including energy resource and production, during this period. In 1994 the EU signed an agreement providing for more liberal procurement regimes for EU members and state agencies from the US, including the purchase of power generating equipment. In May 1995 a new Euratom - US accord was signed. Despite difficulties in negotiations, provisions were agreed upon allowing for (inter alia) nuclear trade and industrial relations, nuclear research and development and nuclear safety.[11] Furthermore, at the height of the French nuclear testing controversy, in December 1995 the EU and US concluded the New Transatlantic Agenda. Pursuant to this, and in the face of apparent irony, the parties agreed to promote worldwide peace and stability,

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[9] George, op. cit., 88.

[10] This tendency towards bilateralism was particularly noticeable during the Clinton administration and became evident in the US Federal Aviation Authority's (FAA) attempts to conclude bilateral agreements with individual EU member states on landing rights for US airlines. The FAA persisted with the negotiations despite strongly worded objections from the European Commission on the grounds that transport was within the purview of the Commission (George, op. cit., 89).

[11] Lyons, op. cit., 99.

democracy and development, and to contribute to the expansion of worldwide trade and economic relations. In view of the problems experienced by the EU in its dealings with the US, the subsequent position of the US during ECT negotiations[12] is not surprising.

Throughout the 1990's and concurrent with the development of the ECT, the EU worked consistently towards the establishment of trade and amicable diplomatic relations with non-EU countries, particularly those which were able to provide energy resources and supplies. The direction was consistent with EU energy policies as developed during the late 1980's and 1990's, when the emphasis was placed upon achieving security of supply. FDI, diplomacy, hard-line negotiation, and indeed, any techniques to hand, were used by the EU to achieve its goals. Within the context of EU international relations and policy, therefore, the ECT emerges not so much as the altruistic instrument devised solely to assist FSU economic development, as declared at its inception,[13] but as the legal framework within which and by means of which, the EU could achieve its energy objectives. This international context and the energy policies of the EU, therefore, must be considered when examining the origins and development of the ECT discussed in the following section.

Inception of the ECT

The ECT was conceived against the background of an imploding Soviet Union and impending oil shortages in Europe generated by the political volatility of the Middle East. As discussed at 16 above, in 1990 the collapse of the Soviet Union presented the spectre of economically and technically impoverished FSU nations struggling to survive on the doorstep of the EU. Concurrently, Europe's oil supplies from OPEC were threatened by the continuing unrest in the Middle East and particularly by the

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[12] Discussed at 65 ff below.

[13] As will be discussed below, the objectives of ECT have undergone a number of changes since the first Conference was convened in July 1991.

increasing belligerence of Iraq. However, as luck would have it, although the FSU states were indigent, they were either rich in energy resources, such as the vast oil and natural gas fields in Central Asia[14] and the hard coal reserves of Eastern Europe or presented potential overland routes for pipelines carrying natural gas and oil, or, like Russia and Ukraine, demonstrated a willingness to develop and maintain nuclear energy generating plants within their territories. It is arguable, therefore, that it was not mere coincidence that in order to forestall the pessimistic, but nonetheless plausible scenario of an energy starved and uniformly impoverished Europe, the EU countries in 1990 turned their attention to the valuable but highly under-exploited energy resources of the FSU states and began to cast about for a viable strategy.

It was in response to this stimulus at a meeting of the European Council in June 1990 that Ruud Lubbers, the then Prime Minister of the Netherlands, suggested that the economic recovery of FSU states could be encouraged through assisted development in their energy sectors. Certainly, it could be said that if the government of a state is analogous to its brain, then the energy sector could be likened to its blood supply. As Thomas W. Waelde writes : "Energy is one of the world's major industries, perhaps the key industry in modern economies. Generally taken for granted, it has one essential quality. Without adequate supply of energy, nothing runs."[15] Therefore, EU assistance in FSU states' energy sectors could, it was proposed, provide a logical and relatively cost-efficient means of revivifying their flagging economies and provide the EU with the opportunity to reap some

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[14] In 2001, Kazakhstan produced 250 million barrels of oil and a newly prospected field in the Caspian Sea raised the estimates of total Kazakhstan oil reserves to 17.6 billion barrels. Further, in addition to huge oil reserves, Turkmenistan has the fifth largest deposits of natural gas in the world (Mike Edwards, Central Asia Unveiled. *National Geographic,* February 2002, 108-125).

[15] Thomas W. Waelde, Sustainable Development and the 1994 Energy Charter Treaty: Between Pseudo-Action and the Management of Environmental Investment Risk. In Friedl Weiss et al (eds), *International economic law with a human face.* Kluwer Law, the Hague, 1998, 223-270, at 224.

benefits in return. Thus, it is hardly surprising that Prime Minister Lubbers' proposal was received with no small degree of enthusiasm by the other members of the European Council. Accordingly, the Commission of the European Communities was invited to investigate the most appropriate and effective means of implementing a scheme of mutual benefit to the EU and the FSU. In February 1991 the Commission put forward the proposal for a European Energy Charter (EEC). It was envisaged that the EEC would both establish the legal rights and obligations in regard to a range of FDI, trade and legislative issues, including transit of goods, the environment and access to capital markets within the energy sector and also serve as a political foundation for East-West co-operation by promoting Eastern economic development whilst, at the same time, securing energy supplies to the EU.

The First Conference to discuss the terms of the proposed Charter was held in Brussels on 16-17 July 1991. The participants in the Conference included not merely delegates from the countries listed in Figure 1 below, but also representatives of various interest groups and organisations such as the OECD.

Figure 1

List of Participant Countries to the First Conference on 16-17 July 1991:

Albania	Kyrgystan
Armenia	Latvia
Australia	Liechtenstein
Austria	Lithuania
Azerbayan	Luxembourg
Belgium	Malta
Belarus	Moldava
Bulgaria	Netherlands
Canada	Norway
Croatia	Poland

Cyprus	Portugal
Czech Republic	Romania
Denmark	Russia
Estonia	Slovak Republic
Finland	Slovenia
France	Spain
Georgia	Sweden
Germany	Switzerland
Greece	Tajikstan
Hungary	Turkey
Iceland	Turkmenistan
Ireland	Ukraine
Italy	UK
Japan	USA
Kazakhstan	Uzbekistan

It is interesting to note that amongst the predictable country delegates of continental Euro-Central Asia, Australia, Canada, Japan and the US are also listed as participants. Whilst it is obvious why the non-EU Euro-Central Asian nations of the FSU would both qualify for and perceive the benefits of subscription to the EEC, it is more difficult to appreciate the participation of Australia, Canada, Japan and the US. Certainly, membership of OECD offered the right of participation to representative nations in the Conference discussions, but their role in what was in effect an agreement with limited geographical application is open to speculation. Perhaps the answer is to be found in the energy requirements and natural resources of the four "ring-in" countries. Both Japan and the United States have extensive energy requirements. Whilst the United States has substantial oil fields, it does not produce sufficient to supply domestic needs, and must, perforce, import oil from OPEC.[16]

[16] This is despite approx. 570 million bbl of oil stockpiled in salt caves along the Gulf Coast of Texas and Louisiana (See Eric Pooley, Who's Right About Oil?

Japan, on the other hand, has few natural energy resources and an enormous demand for both electricity and petroleum render it dependent upon imports from ASEAN and OPEC nations. It is hardly surprising therefore, that given their inadequate resources and high domestic demand for energy, both the US and Japan should welcome the opportunity to acquire energy resources from developing Euro-Central Asian nations under more favourable conditions than from OPEC.

In contrast to the US and Japan, Australia and Canada, both possess rich sources of oil, natural gas and uranium. Why two resource wealthy nations should become signatories to a Treaty which is geographically removed from their sphere of influence and which places them at a distinct disadvantage vis a vis negotiating the sale of their natural resources is less comprehensible. Whilst Canada's participation in the EEC may be explained to some extent by its geographic and diplomatic proximity to both Europe and the US, the reason for Australia's involvement are more obscure. In view of the potential impact of the ECT upon Australian sovereignty and governance (discussed in detail in Chapter XIII below) it is perhaps sufficient here to suggest that its subscription to the ECT regime was either at least ill-considered, or at worst, reckless.

However, despite the disparate political and economic positions of the First Conference participants, the completed Charter was adopted by signature at the Hague at the Second Conference on 16-17 December 1991.[17] All signatories agreed to :

- pursue the objectives and principles of the Charter; and
- implement the initiatives through negotiation and co-operation as soon as possible.

TIME, 2 October 2000, 32-35.)

[17] Considering the relative promptness with which the EEC was developed and adopted, it can only be supposed that the Gulf War of 16 January - 24 February 1991 added no small degree of impetus to the preliminary negotiations.

The EEC is, in effect a statement of intent; a declaration which enunciates both the objectives of the scheme it proposes and the guidelines for subsequent negotiation of a further Basic Agreement[18] and an accompanying set of Protocols. As a Charter, therefore, the EEC did not constitute a legally binding international agreement, nor was it eligible for registration pursuant to Article 102 of the UN Charter. However, despite its non-binding nature, the EEC held more significance than a mere declaration of goodwill. In effect, it set the parameters for issues to be negotiated for the European Energy Charter Treaty (EECT), provided the foundation of the principles for implementation of the EECT policies, i.e.:

- state sovereignty and sovereignty over natural resources
- non-discrimination
- market-oriented pricing
- minimisation of environmental pollution,[19]

and served as a template for its objectives i.e.:

- to improve security of energy supplies
- to maximise efficiency of production, conversion, transport, distribution and energy use
- to improve safety
- to minimise environmental problems.[20]

Following the adoption of the EEC, the Conference then began to develop the instrument through which the objectives of the Charter could be achieved. This was to become the Energy Charter Treaty - a comprehensive agreement legally binding upon all signatories.

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[18] Which was to become the ECT

[19] European Commission, *2000-Annual energy review*, 8-9.

[20] Ibid.

Treaty Negotiations

Although negotiations for the EECT had commenced prior to the signing of the Charter, and despite the sense of urgency with which the EEC had been initiated and completed, the negations for the Treaty and its Protocols did not progress smoothly. Disputes arose not only between Eastern and Western European participants in regard to predictable issues such as nuclear safety, market liberalisation and competition policy, but also between individual OECD and EU members. Faced with the growing impatience of the European Commission, which had provided financial and administrative support for the Conference and those Conference participants anxious to commence reaping the benefits of the Treaty, the temporary Secretariat was forced in mid-1994, to impose a deadline of six months for completion of negotiations.

Despite the sense of urgency, however, three years was not an inordinately lengthy period in which to negotiate a binding multilateral document containing comprehensive provisions of such novel and, one might arguably suggest, invasive effect upon the political and economic sovereignty of the parties. Indeed, in view of the nature and extent of the contentious issues, the most significant of which are discussed below, which arose during the negotiations, it is surprising that the terms of the Treaty were concluded in so short a time.

As might have been expected, disputes arose between the EU and FSU states, particularly Russia, in a number of significant areas. These differences originated not only from the practical application of certain articles in areas such as nuclear trade, but also in regard to their legal import and effects. A major example of this is provided in regard to the imposition of National Treatment standards or non-discriminatory conditions for projects in the pre-investment stage. Russia's unwillingness to accede to those provisions was based partly upon the fact that, unlike the EU and other OECD nations, it had no legislation dealing with national

treatment in sensitive areas, and, consequently, no experience in applying a national treatment standard. On the other hand, Russia was unwilling to allow the OECD countries to "grandfather" their own national treatment provisions, until Russia's legislature had been given the opportunity to formulate and implement its own legislation in this area, thus allowing it to claim exemptions pursuant to the Treaty. Eventually, this issue was "shelved" on the basis that a Supplementary Treaty would be negotiated, mandated by the ECT, which would address issues of privatisation, de-monopolization and non-discriminatory practices.[21] Article 10(4) of the ECT required the signatories to commence negotiations in regard to the Supplementary Treaty no later than 1 January 1995, with a view to concluding it by 1 January 1998.

Further difficulties arose between the EU states and Russia in regard to the provisions relating to nuclear trade. Prior to the ECT negotiations, the EU and Russia had entered into a series of agreements relating to trade in nuclear materials which contained national treatment provisions applicable to imports of nuclear materials and import quotas from Russia. However, the national treatment provisions of the ECT were in direct conflict with those prior EU-Russian agreements and would, therefore, render them nugatory. Naturally, Russia was anxious to preserve its position in regard to the favourable treatment offered by the earlier agreements. The EU, on the other hand, was anxious to secure an "across the board" application of the legal regimen provided by the ECT. This issue became so fraught with conflict that negotiations between the parties continued up to 16 December 1994, when it became necessary to adjourn the ceremonial signing of the ECT in Lisbon to allow for last-minute over-night discussions.

The issues between the EU and Russia were finally resolved by a Joint Memorandum which in effect exempted the nuclear trade agreements from the

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[21] As at February 2002 the Supplementary Treaty remained in limbo. However, the energy Charter Secretariat has the completion of the Supplementary Treaty as a major priority in its 2002 Work Programme.

operation of the ECT.[22] It should be noted that throughout the negotiations, between 1991 and the eventual signing of the Treaty on 17 December 1994, representatives of the Synergy Programme (see 44 above) provided assistance to the Russian and other FSU delegates, by explaining the technical and legal aspects of the Treaty texts as they evolved.[23] Undoubtedly, this was an invaluable service, given that the legal concepts relating to commercial transactions, real and intellectual property and open market trade were unfamiliar to those FSU states whose legal systems were still endeavouring to evolve from the context of centralised, controlled, command economies. However, as a creature developed by and from the EU energy policies it is difficult to envisage how the Synergy Programme could provide independent advisers. At the very least, Synergy representatives would have experienced a perceived conflict of interest generated by the position of Synergy within the EU energy paradigm. Briefed, on the one hand, to assist in the achievement of the EU's energy policy objectives of which the ECT was a pivotal instrument and, on the other hand, charged with providing assistance to FSU delegates in understanding the terms and concepts of the Treaty, the Synergy representatives must perforce have trod the fine line between help and influence.

The Russian delegation, however, were not the only participants to create problems during the negotiation process; the US contingent also proved problematic. A late-comer to the EEC negotiations, the US was, nevertheless, a signatory of the Charter. During the ECT negotiations, however, the US proved to be a contentious and, seemingly, unwillingly partner. The major objections of the US to the ECT provisions were based upon three primary issues;

1. comparison between the ECT protection of investment in comparison to those contained in US bilateral agreements;

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[22] The Memorandum noted that nuclear trade would be governed by Article 29(2)(a) and Annex G of the ECT, which provides for exemptions of "certain other agreements" in regard to nuclear trade.

[23] Lyons, op. cit., 132.

2. the potential conflict between the ECT's national treatment provisions and the Jackson-Vanik Amendment to the *US Trade Act* 1970;

3. implementation of the Treaty at a US sub-federal level.

Despite indications early in the negotiations that the US had concerns about certain provisions of the ECT, it was not until October 1994 that Stuart Eizenstat, the US Ambassador to the EU, expressed the reasons for the US refusal to sign the Treaty. Apart from the US fear that the Treaty was too weak on investment protection and repatriation of proceeds, he added that:

> "[t]he US is also particularly troubled by provisions in the treaty which unnecessarily restrict the prerogatives of our states under the US constitution to enact tax and other measures which affect both foreign and domestic companies. No negotiating party has ever expressed concern that our states might abuse these limited powers, and there is no need for greater discipline on the states in the Energy Charter Treaty than were agreed in the North American Free Trade Agreement. This is a sensitive issue that is sure to receive scrutiny during the Congressional ratification process."[24]

Certainly, one wonders what further measures could have been included in the Treaty to strengthen the investment protection and repatriation of proceeds provisions. Indeed, the US Ambassador's call for stronger measures in these areas is at odds with his criticism, quoted above, that the Treaty, in effect derogates from the sovereignty of the US states.

Whilst the US objections to specific provisions and ultimate legal effects of the ECT are comprehensible, it is arguable that they were at least partly based upon the US propensity, discussed above, to avoid multilateral agreements. However, whatever the ultimate foundation of the US exceptions, the upshot was that the US refused to

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[24] Lyons, op. cit., 132.

sign the ECT despite holding a position as Conference Observer and has to date, maintained this stance.[25]

Ratification

Despite the lengthy and difficult negotiation process discussed above, most delegations signed the Treaty in Lisbon on 17 December 1994. The Treaty was open for signing until June 1995 by those delegates who had not been prepared in December 1994. By this time 50 of the 52 delegates had subscribed. Canada had, however, expressed its intention to sign, and only the US persisted in its refusal. Ratification of the ECT by signatory governments has, however, taken much longer. As at December 2002 the governments of 46 of the original 51 signatories had ratified or acceded to the Treaty. Of the six remaining countries, Belarus and the Russian Federation have acceded to and apply the Treaty provisionally. Unlike all other FSU states, except Belarus, Russia remains wary of the much lauded benefits of the ECT.

In January 2001 parliamentary hearings were held in Moscow by the Duma to examine the issue of the ECT ratification. However, there was considerable debate amongst parliamentarians and energy industry representatives as to the benefits offered to Russia by the ECT. In particular, *Gazprom* (the Russian gas monopoly) representatives argued that ratification would damage the country's economic interests, undercutting its position in European markets by forcing Russia to open its gas network: by requiring Russia to transport cheaper gas from Central Asia and by limiting the level of transit tariffs imposed on energy resources from third countries to those charged for internal transportation. Accordingly, the Duma recommended

[25] In November 2001, Dr Ria Kemper visited the US for discussions with the US government in an attempt to persuade the Bush administration to become a signatory.

that further analysis of the Treaty be carried out by the Security Council before further consideration of the ratification issue.[26]

The reluctance to ratify the Treaty of the remaining six signatories (including Australia) was, to a great extent, immaterial to the application of its provisions prior to entry into force, by virtue of Article 45. Article 45 (discussed at greater length at 166 ff below) provides for the provisional application of the Treaty by all signatories pending its official entry into force. In effect, therefore, the Treaty became binding upon signatories with limited exceptions, from the closing date for signatures on 16 June 1995.

Notwithstanding the fact that by 8 April 1998 only 34 of the 51 signatories had ratified, the Treaty came into effect on 16 April 1998 pursuant to Article 44(1) which provides for entry into force" on the ninetieth day after the date of deposit [with the Depository] of the thirtieth instrument of ratification, acceptance or approval thereof, or of accession by a State or Regional Economic Integration organisation which is a signatory of the ECT as of 16 June 1995. Moreover, because of the breadth of membership, it had become an international rather than intra-European instrument, the descriptor "European" was dropped from the tittle to reflect the global application and membership of the Energy Charter Conference. Due to the provisional application of the Treaty noted above, it was necessary for the administrative and organisational structures of the Treaty to become operational as soon as practicable after the 16 June 1995. Although signatories were only required

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[26] Russia is regarded by the EU as its most significant energy partner. The Energy Charter Secretariat (ECS) has estimated that by 2020 Russia could be supplying 40% of the EU's gas needs (Ria Kemper, Powering up EU-Russia energy Links. *The Economist*, 17 May 2001). However, despite the EU-Russia energy partnership launched on 30th October 2000 Paris and intensive lobbying on the part of the ECS, especially the Secretary General Dr Ria Kemper, as at January 2002, Russia had not ratified the ECT. However, on 23 January 2002 Gennady Ustyuzhanin, Russia's Deputy Minister of Energy and former Gazprom executive, was appointed Vice-Chairman of the energy Charter Conference. That Russia has not ratified the ECT in 2002, is not because of lack of effort in the part of the Secretariat.

to apply the Treaty on a provisional basis, it was, to all intents and purposes effective and, as such, required the support of an efficient bureaucracy. The development and operation of this administration discussed in Chapter III.

CHAPTER III

ORGANISATION AND ADMINISTRATION

Introduction

Although the ECT did not become officially effective until 16 April 1998, some four and a half years after it was opened for signing by Charter Conference participants, the provisional application pursuant to Article 45 rendered it imperative that decisions should be made and steps taken to ensure that matters arising from the operation of the Treaty could be dealt with effectively and efficiently. Therefore, the period between 16 June 1995 and 16 April 1998, marked a time of furious activity as the administrative arrangements were established for the organisation of the Conference and Secretariat. The establishment of the organisational and administrative structures and the operation of the ECT bureaucracy will be discussed in detail below.

Establishment of the Administration

Despite the provisional application of the ECT from 16 June 1995, little was done by the Conference prior to this date to provide either a permanent headquarters or fully staffed bureaucracy to implement the Treaty's provisions. Indeed, it was not until after the closing date for subscription had passed that effective steps were taken to establish a permanent home for the ECT institutions.

Accordingly, a greater part of 1995 was devoted to protracted negotiations over the actual location of the administrative headquarters. Although most of the negotiations of the conference for the Treaty had taken place in Brussels and the temporary Secretariat had been located in the offices of D-GXVII, arguments were propounded that the administrative headquarters should be located in Paris. Apart from the fact that a move to Paris would emphasise the independence of the Charter Conference and Secretariat from the executive and political influence of the EU, the

International Energy Agency has its headquarters in Paris, and it was hoped that such proximity would strengthen the relationship between the two organisations.

However, in view of the genesis of the ECT as an EU initiative, the financial and practical support supplied by the EU institutions to the Charter Conference and the ECT's Eurocentric objectives, EU member states had a strong vested interest in retaining the administration of the Treaty in geographical as well as ideological propinquity. Accordingly, in September 1995, after lengthy and heated debate, the Conference resolved that the administrative bureaucracy of the Treaty should remain in Brussels, and in late 1996 the Secretariat moved out of D-G XII into its own premises.

Although the administrative structure for the implementation of the ECT is set out in Part VII of the Treaty, creating the Conference and the Secretariat (discussed at 69 ff below) concurrent with the debate as to the location of the Executive throughout 1995, the Conference was faced with the resolution of numerous procedural and financial issues. Decisions were made as to the salary and ranking of the Secretariat's senior officials, the recruitment of permanent Secretariat staff, the working languages which were to be used for Conference proceedings (French, English, German, Italian, Spanish and Russian were finally chosen) and the arrangements for those countries, such as the US, and the international organisations, such as OPEC, which had been granted observer status. After these issues had been resolved and Peter Schutterle had been appointed the first Secretary General and Leif Ervik, its Director of Negotiations in November 1995, the implementation apparatus of the ECT, as described in the following sections, could commence operation.

Institutions

Energy Charter Conference

The Energy Charter Conference ("the Conference") was instituted pursuant to Article 34 Part VII of the ECT. Ostensibly, the Conference is an independent, intergovernmental organisation which constitutes the decision making body of the ECT process. All states who are signatories or who have acceded to the Treaty, referred to as "Contracting Parties" in the ECT, are members of the Conference, and as such are entitled to participate in discussions, negotiations and voting[1] in regard to new ECT Protocols or Declarations (Article 33 (2)) as well as being involved in the functions of the Conference as set out in Article 34 (3), viz to:

"(a) carry out the duties assigned to it by this Treaty and any Protocols;

(b) keep under review and facilitate the implementation of the principles of the Charter and of the provisions of this Treaty and the Protocols;

(c) facilitate in accordance with this Treaty and the Protocols the coordination of appropriate general measures to carry out the principles of the Charter;

(d) consider and adopt programmes of work to be carried out by the Secretariat;

(e) consider and approve the annual accounts and budget of the Secretariat;

(f) consider and approve or adopt the terms of any headquarters [sic] or other agreement, including privileges and immunities considered necessary for the Charter Conference and the Secretariat;

(g) encourage cooperative efforts aimed at facilitating and promoting market-oriented reforms and modernization of energy sectors in those countries of central and eastern Europe and the former union of Soviet Socialist Republics undergoing economic transition;

(h) authorize and approve the terms of reference for the negotiation of Protocols, and consider and adopt the texts thereof and of amendments thereto;

(i) authorize the negotiation of declarations, and approve their issuance;

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[1] Provided the Contracting Party has discharged its financial obligations to the Conference. Any Party in persistent arrears may have its voting rights suspended (Article 36 (8)).

(j) decide on accessions to this Treaty;

(k) authorize the negotiation of and consider and approve or adopt association agreements;

(l) consider and adopt texts of amendments to this Treaty;

(m) consider and approve modifications of and technical changes to the Annexes to this Treaty;

(n) appoint the Secretary-general and take all decisions necessary for the establishment and functioning of the Secretariat including the structure, staff levels and standard terms of employment of officials and employees."

In addition, the Conference is empowered to establish subsidiary bodies (Article 34(5)) to assist in the implementation of the Treaty, consider and adopt rules relating to procedure and finance (Article 34 (6)), as well as conducting a review of the functions of the ECT at intervals of not more than five years (Article 34(7)).[2]

Voting in the Conference is governed by Article 36, which requires that in relation to decisions by the Conference to:

"(a) adopt amendments to this Treaty other than amendments to Articles 34 and 35 and Annex T;

(b) approve accessions to this Treaty pursuant to Article 41 by States or Regional Economic Integration Organisations which were not signatories to the Charter as of 16 June 1995;

(c) authorize the negotiation of and approve or adopt the text of association agreements;

(d) approve modifications to Annexes EM, NI, G and B;

(e) approve technical changes to the Annexes to this Treaty; and

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[2] Commenced in 1999.

(f) approve the Secretary-General's nominations of panelists pursuant to Annex D, paragraph 7,"

there should be unanimity of all contracting parties present (Article 36(1)). On all other matters, the members should "make every effort to reach agreement by consensus." Where consensus cannot be reached, there must be a majority of three-quarters of the Conference in relation to most other matters, including budgetary issues and decisions in regard to Treaty review. However, despite the fairly meticulous specifications in regard to majority voting and unanimity set out in paragraphs 1 to 5 of Article 36, paragraph 6 provides:

"Except as provided by paragraph 2 [budgetary matters], no decision referred to in this Article shall be valid unless it has the support of a simple majority of the Contracting Parties."

It would appear, therefore, that where an impasse in voting has been reached in regard to all matters except budgetary issues, paragraph 6 may be invoked to allow for a "simple majority" to constitute a valid decision. Considering the diversity of interests held by the Contracting Parties and the potential for decision making within the Conference to be obstructed by bi - or multilateral politically and economically based disputes between members, paragraph 6 obviously presents a useful "fail-safe" device which may be invoked when a three-quarters majority cannot be achieved.

However, useful as this provision may be, it may also present a tool by which potentially unpopular and contentious decisions may be forced through the Conference in the face of opposition from a large proportion of the members. Further, since there is no definition within Part VII or anywhere else in the Treaty, of exactly what should constitute a "simple majority," it must be assumed that a majority of one would be sufficient to validate such a decision. Whilst the previous scenario may appear unlikely, it is by no means impossible. The political, economic

and geographic affiliations which exist between states facilitate the establishment of powerful lobby groups and voting blocs within international organisations. These may be used to great affect both in defeating or promoting contentious decisions.[3] Thus, whilst the detailed voting requirements set out in Article 36 appear to provide a rigid framework within which consensual decisions may be made, they offer little hindrance to possible discriminatory or oppressive action by the Conference against a particular member or bloc of members.

In addition to Contracting Parties, the Conference includes a number of Observers. These may be either individual states or international organisations with an interest in energy and energy resource development. As the title suggests, a Conference Observer may observe and even take part in discussions, but has no voting rights. As at December 2001, Conference Observers were as follows:

Observers to the Conference and Charter Signatories

Canada

United States of America

Observers

States

Algeria	Qatar
Bahrain	Saudi Arabia
China (as from 17 December 2001)	Tunisia
Kuwait	United Arab Emirates
Morocco	Venezuela
Oman	

International Organisations

EBRD	CIS Electric Power Council
IEA	Black Sea Economic Cooperation (BSEC)

[3] The history of negotiations and deliberations within the UN hold testament to this.

OECD

Baltic Sea Regional Electricity Co-operation (BASREC)

UN-ECE

World Bank

WTO

Whilst Observers have minimal input in regard to the decision making process of the Conference, even the most cursory glance at the list of the states and organisations with Observer status reveals an indication of the potential "behind the scenes" influence they are able to exert over Conference members, both within and outside Conference sessions.

Pursuant to Article 34 (1), Contracting Parties "shall meet periodically in the Energy Charter Conference," and the frequency of these meetings "shall be ... at intervals determined by the Charter Conference." Since April 1998 the Conference has met twice a year. However, the Conference's subsidiary groups on Transit, Investments, Energy Efficiency and Trade, established under Article 34(5) generally meet more frequently during the months between Conference sessions. Furthermore, Article 34(2) provides for the convening of extraordinary Conference meetings at such times as determined by the Conference or at the written request of a Contracting Party.

Funding for the Conference and the Secretariat is governed by Article 37, which provides that:

- each party shall bear its own costs of representation;
- the costs of the Conference and Secretariat are to be borne by the Contracting Parties according to their ability to pay and;
- the Conference may accept voluntary contributions from either individual Contracting Parties or from any other sources.

Individual Conference member contributions are assessed annually by the Secretariat, which bases its assessment upon the latest UN Regular Budget Scale of Assessment (Annex B of the ECT).

The costs of the Secretariat arising from the implementation of or related to a Protocol are met by the parties to the Protocol on a pro rata basis and calculated in the usual manner.

Whilst the provisions for the funding of the Conference and Secretariat may appear surprisingly egalitarian if not unremarkable, it is still interesting to note the inclusion of paragraph 5, regarding acceptance of voluntary contributions from one or more Contracting Parties or other sources. Furthermore, there are no restrictions within the ECT as to what those "other sources" may be, neither are there any requirements as to declaration of interest, accounting or disclosure of funding sources placed upon either the Secretariat or the Conference, beyond the general provisions of Part VII. The lack of transparency requirements, whilst not derogating from the effectiveness of the Treaty and its implementation by the Conference and Secretariat, must argue against perceived impartiality of Treaty institutions, especially in those instances in which contributions are made by organisations or states with a vested interest in the outcome of Conference deliberations and Secretariat actions.

Secretariat

The Secretariat is the administrative and support arm of the ECT institutional structure and its functions are set out in Article 35. These are:

- to monitor implementation of the Energy Charter Treaty and Protocol obligations
- to represent the Energy Charter Conference in the development of its relations with non-member states and other relevant international organisations and institutions
- to support negotiations on new instruments mandated by the Conference
- to provide analytical support and advice to the Conference and its subsidiary bodies on all aspects of the Energy Charter process
- to organise and administer meetings of the Conference and its subsidiary bodies
- to conduct or facilitate dispute resolution/conciliation procedures.

Considering the broad scope of the ECT, the Secretariat is comprised of a relatively small permanent staff under the direction of the Secretary General. For its 2002 Work Programme the Secretariat estimated that it would employ 29 staff, plus 18 months of "secondees" time.[4] However, it must be remembered that in the original Charter negotiations, the intention was expressed that neither the Charter Conference nor the Secretariat should duplicate the work either of other international organisations such as the IEA, the UN-ECE or of other EU programmes, such as Tacis, Synergy and Phare. As such, therefore, the Secretariat is focused solely upon providing services to the Conference, organisation and implementation of the provisions of the ECT, as well as considerable public relations activities in dissemination of information about the Treaty, liaison with governments and the active recruiting of more signatories. Certainly, as Secretary General, Dr Ria Kemper has been actively promoting the benefits of subscription to the ECT through her participation in international energy seminars and conferences, the delivery of addresses to organisations and the lobbying of governments and energy ministries. Her gruelling international schedule during 2001 was indicative of those countries and geographic areas which the Charter Conference and Secretariat are anxious to attract within the ECT organisation.[5] Of particular note

[4] Energy Charter Secretariat Work Programme 2002, www.encharter.org at 11.

[5] Dr Kemper was appointed in January 2000. The following list of her

have been the Secretariat's liaison with the Chinese government over the last two years. In mid-2000 a Chinese Translation of the ECT was issued by the Secretariat,[6] followed by the joint Chinese government - ECT Secretariat Symposium on Energy, held in Beijing 9-10 July 2001. On 17 December 2001, China became an Observer to the Conference.

The value of the Secretariat and its organisational and administrative support divisions to the functioning of the Conference and implementation of the ECT cannot be underestimated. Even a most cursory glance at the Secretariat Work Programme for 2002 will reveal that, whilst the concepts and principles behind the ECT are discussed within the Conference and its attendant work groups, it is the Secretariat which provides the impetus and structure through which the ECT objectives are disseminated and achieved. It is also interesting to note that as the Secretariat has become increasingly established as the mechanism for implementation of the Treaty, the objectives it seeks to achieve have changed subtly

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engagements during 2001 and early 2002 is by no means exhaustive, but nonetheless serves to highlight the major target areas of the EC Secretariat:

18-19 May 2001 - Address to the 21st Meeting of the Asia-Pacific Economic Co-operation (APEC) Energy Working Group, Kuala Lumpur.

13 June 2001 - Address to the Energy Charter Secretariat Seminar, Strasbourg.

18 June 2001 - Speech to BASREC Conference, Djurhamn, Sweden.

9-10 July 2001 - Address to Symposium organised by the Chinese State Development and Planning Commission and the EC Secretariat for Chinese government officials, Beijing.

17-21 September 2001 - Visit to Moscow for negotiations and meetings with the Russian government and energy industry representatives regarding the ECT

October 2001 - Attendance at the EU-Russia Summit, Brussels.

1 November 2001 - Speech to the Atlantic Council of the United States, Washington D.C.

19 February 2002 - Address to the Institute of Petroleum during its "IP Week 2002", London.

[6] Prior to this, the ECT was available in English and Russian, the two official languages of the EC organisations. However, the 2002 Secretariat Work Programme lists the translation of the ECT into Arabic as a priority.

since the inception of the then European Energy Charter to meet the needs not of the newly liberated FSU states but of an energy-hungry EU. The subtle but nevertheless significant change in focus of these objectives is discussed in the following section.

Objectives

In a speech to the Atlantic Council of the United States ("ACUS") on 1 November 2001, Dr Kemper described the genesis of the ECT thus:

> Ours is an intergovernmental organisation, which was set up in the early 1990's following the end of the Cold War. The collapse of communism in eastern Europe presented an unprecedented opportunity to overcome the divisions of the past, by offering the newly independent states of Eastern Europe and the CIS participation in a system of equal and transparent cooperation. And nowhere were the prospects for this cooperation more clear than in the energy sector. Russia and many of its CIS neighbours were rich in energy resources but needed major investments to ensure their development; whilst the states of western Europe had a strategic interest in diversifying their sources of energy supplies, thus reducing their potential dependence on any single area, such as the Middle East. There was therefore a clear need to ensure that a commonly accepted foundation was established for developing energy cooperation between the states of the new post-Cold War community.[7]

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[7] http://www.encharter.org/topic=31,1. Dr Kemper's speeches to various international organisations provide a valuable insight into the policy directions of the Conference and Secretariat. Even allowing for obvious rhetoric and repetition it is possible to trace through them, the major preoccupations and emphases of the ECT organisational bodies. Because of their use as directional indicators, therefore, Dr Kemper's speeches will be quoted at some length in this section. Her speeches are available on the Energy Charter Web site @ www.encharter.org.

Thus, the underlying objective of the ECT, as stated in the Preamble to the Treaty, was the implementation of the basic concept of the European Energy Charter initiative which was "to catalyse economic growth in the FSU by means of measures to liberalize investment and trade in energy."[8] Certainly, the concept of mutual benefits, the prospect of achievable and rapid economic development for the FSU states and the provision of much needed energy resources to the EU, presented as an extremely attractive proposition for the FSU states. Any suspicions as to the EU motives that might have been harboured by FSU state representatives were lulled by the declared benefits which would flow to the EU in the form of vital energy supplies. Only Russia, exhibiting the distrust of and skepticism towards Western Europe that has been a characteristic of Russian governments since the fifteenth century, remained unconvinced. For the other FSU states,[9] however, the apparent transparency of the ECT offered the advantages of assisted economic reconstruction and concurrent legislative development aimed at achieving viable free market economies, in return for the provision of energy resources and rights of transit.

Furthermore, the ECT was to provide the legal framework within which the objectives of the EEC may be achieved through the promotion of "long-term co-operation in the energy field, based on complementaries and mutual benefits."[10]

In addition to the underlying principles embodied in the EEC, all signatories to the ECT (termed "Contracting Parties" in the Treaty) acknowledged certain statements and propositions as set out in the recitals contained in the Preamble.

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[8] ECT, Preamble.

[9] Except for Belarus, which has little to offer the EU in the way of energy resources and which is, perhaps, the poorest of all the FSU states and consequently, the most in need of economic assistance.

[10] Article 2.

These include :

(i) the recognition of the importance of "the effective implementation of full international treatment and most favoured nation treatment," and the implementation of such through the execution of ancillary treaties;

(ii) subscription to the objectives of trade liberalisation and non-discrimination in international trade;

(iii) the removal of all barriers to free trade in energy materials, products and equipment;

(iv) recognition of the terms of the General Agreement on Tariffs and Trade (GATT) and the obligations it imposes upon participants;

(v) compliance with rules relating to "mergers, monopolies, anti-competitive practices and abuse of dominant position."

(vi) compliance with the terms of the Treaty on the Non-proliferation of Nuclear Weapons and other such international obligations;

(vii) endorsement of the concept that the "exploration, production, conversion, storage, transport, distribution and use of energy" should be carried out as efficiently as possible;

(viii) recognition of the need to protect the environment.

In effect, the propositions and principles to which the Contracting Parties subscribed in the Preamble, were an attempt to overcome what were generally regarded as both the major obstacles to foreign investment[11] and the glaring weaknesses in the industrial and energy sectors of the FSU states.

Firstly, points (i), (ii) and (iii) above are aimed specifically at the early tendency[12] of FSU states to favour protectionist and anti-competitive policies. They signify an attempt to obtain agreement (in principle if not practice) to legal reforms within those states to facilitate the achievement of the objectives of the Treaty.

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[11] Waelde, op. cit., 227-229.

[12] The result of the legacy of Soviet xenophobia and insularity.

Moreover, legal reform tending towards open-markets and settled economic policies would assist in promoting consistency and continuity in the legislation of FSU states dealing specifically with foreign investment and foreign/domestic joint ventures. Unpredictability in the substance and application of foreign investment and domestic laws have traditionally been a *bete noir* of foreign investors seeking to invest in developing nations. Whilst to a certain extent, the potential impact of legislative changes upon foreign investment projects maybe addressed through "change of law" and "change of government" provisions in such instruments as joint-venture, FDI and production sharing agreements, the enforcement of such provisions may be problematic, especially when the change of law and/or change of government arise from a political and/or ideological shift within the host country.

However, in a situation in which initial legislative change[13] has been :

(a) the result of encouragement and a certain amount of pressure and

(b) when there are substantial penalties for the repeal of the resultant legislation in the form of the withdrawal of necessary outside financial assistance,

it is to be presumed that the host government would be less inclined to implement any changes which might breach the terms of either the Treaty or any resultant agreements. Thus, not only is legislative stability encouraged but possible.

Furthermore, the recitals in the Preamble attempt to establish and enforce a recognition of environmental concerns. Prior to the break-up of the FSU, industry and resource exploitation and development in FSU states were marked by a history of environmental disasters and degradation. The uncontrolled dumping of toxic wastes, outdated and inefficient industrial infrastructure, toxic and greenhouse gas emissions from industry into the atmosphere, and the pollution of water sources which had characterised industrial development in the FSU were the result of a total

[13] In this instance, a change towards legislation which facilitates and preserves free international trade, protection of foreign investment and cross-border financing.

disregard by the central and satellite governments of environmental issues. Those environmental protection measures which had been developed, were applied haphazardly or not at all. Indeed, the "organisational structure of institutions responsible for environmental protection" which existed in the FSU were "plagued with the same inconsistencies as the legislative system."[14]

Thus, points (vii) and (viii) above are an attempt in the Treaty to secure some recognition in principle, if not immediately in practice, from FSU Contracting Parties, of the importance of environmental protection and the need for environmentally sensitive and sustainable resource exploitation and industrial development.

However, laudable as the philanthropic intentions vis a vis the FSU were, as the 1990's progressed there occurred an obvious shift both in the central aims of the Treaty and in the enunciation of its objectives both within the Conference and by the Secretariat. This shift involved what can only be described as a rejection and abandonment of the attempts, through the operation of the Treaty mechanism, to stimulate economic growth in the FSU states via direct investment in their energy sectors.

By 2001, the ECT was no longer regarded as a means of achieving economic development and stability in the FSU, but solely as the means by which the EU could secure its energy supplies. Thus, as the focus of Conference negotiations moved from the FSU to other nations rich in energy resources and the geographic scope of the ECT broadened, the emphasis of the ECT ancillary documents, such as the Supplementary Treaty and Protocols, and the work of the Secretariat and Conference Working Groups became centred upon the issues of investment

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[14] Mark Mininberg, Iveta Hodkova and Diane Bellantoni, Promoting economic growth and environmental protection: The Institute of Sustainable Development, *Connecticut Journal of International Law*, (**9**)1, 1993, 69-86 at 71.

protection and security of transit. This apparent *volte face* in objectives has been rationalised, if not justified, in a number of ways.

Firstly, it is explained by the Secretariat as being the result of the insuperable difficulties encountered in assisting the FSU states through the mechanism of a multilateral instrument. This aspect is enunciated by Dr Kemper in her speech to ACUS:

> Seven years on from the signing of the Energy Charter Treaty, there are those who have argued that it has failed to justify the expectations originally associated with it. Hopes that the adoption of this binding international agreement would trigger an immediate transformation in the energy sectors of Europe's transition economies, based on enormous inflows of foreign capital, have faded, as more and more companies have confronted the harsh realities of the present business environment in many ex-Soviet republics. And critics also point to the fact that Russia, which has a pivotal role to play in the future of European and global energy cooperation, has still not ratified the Treaty, seven years after signing it in 1994.[15]

The failure of the ECT to produce a "quick fix" for the economic ills of the FSU is referred to by Dr Kemper in a number of her speeches to various international organisations. The reason for the failure is attributed not to the ECT Conference and the lengthy and tortuous negotiation process, but to the inherent legal and political weaknesses within the FSU states themselves. As Dr Kemper states in an address to the Center for European Policy Studies in Brussels on 17 May 2001:

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[15] Dr Kemper, 1 November 2001, op. cit.

> Looking back, with the benefit of that great luxury called hindsight, one can say that much of this optimism concerning the pace of transformations in the countries of the former Soviet bloc was misplaced. Financial instability, institutional weaknesses, and pervasive corruption have been the harsh realities that have confronted many energy companies operating in the CIS region in particular. This sobering experience has demonstrated that creating an attractive, transparent investment climate in such countries is by no means a simple task, and will require a long period of time to be successfully accomplished.

Whilst this attitude may be, justified to some extent, it nevertheless suggests the analogy of a medical practitioner blaming the patients for the severity of their illness. Certainly, the internal political, legal and economic turmoil of most of the FSU states has tended to retard legislative reforms to facilitate free trade, investment protection and political transparency. Such reforms can only be wrought from within. Attempts to force legislative change from external forces, such as the ECT, merely result in the widening of political divisions within subject parliaments as the issues raised are debated, thereby lengthening the reform process.

There is certainly a sense of disillusionment underlying Dr Kemper's explications on the topic of the Treaty's failure to achieve the rapid economic recovery in the FSU as prognosticated at its inception. However, in view of the economic and political conditions extant in all FSU states in the early 1990's, it is arguable that the Pollyanna-type optimism expressed by the Conference in relation to FSU economic reconstruction through the development of energy resources and trade with the EU was, to say the least, naive. In view of the expertise in political and economic analysis available to the Conference in the early 1990's, it is difficult to accept that some form

of feasibility study or practical projections were not produced as a means of assessing the viability and attainability of the FSU economic redevelopment objectives as incorporated into both the EEC and the ECT itself.

What is apparent in Dr Kemper's speeches, however, is the disappointment of the EU nations at the lengthy ratification process and consequent delay in implementation of the ECT provisions. Rather than the speedy and efficient access to the rich energy resources from the FSU initially envisaged by the EU delegates to the Conference, six years after the ECT was opened for signatories, the EU is no closer to achieving security of energy supplies. Thus, in order to diversify its sources of energy resources and reducing its potential dependence upon any single area, such as the Middle East, the EU has been forced to seek out alternative energy sources in non-EU non-FSU states. This has resulted in the flurry of activity by the EU and the Conference Secretariat in lobbying governments of other energy rich areas such as the Asia-Pacific region, China and Latin America.

Alternatively, the broader international context of the ECT as a multilateral instrument governing trade and transit of energy resources is now cited as its sole *raison d'être*. In her speech to ACUS (op. cit.) Dr Kemper suggested that the economic reconstruction of the FSU was merely a consideration upon which the ECT process was born. It was, in effect, a stimulus rather than an objective of the Energy Charter, which is:

> A political declaration of intent regarding international energy cooperation. However, the Charter's Signatories agreed at the time that this declaration represented only a first step, on the basis of which they needed to build further, by developing a legally-binding foundation for their relations in the energy sector.

Thus, the declarations contained in the EEC dealing with economic assistance to the FSU states are presented as being merely ancillary to the ultimate objectives of the ECT. They represent merely the "first step" towards a more comprehensive international scheme, rather than the primary objective. To what extent and how clearly this "first step" aspect of the ECT was explained to the original FSU signatories is open to debate, as is the sincerity with which the FSU economic development issues were promulgated by EU delegates.

The question remains, therefore, as to whether the objective of economic assistance to the FSU was at the outset, merely a ruse to attract FSU states participation in the Conference, thereby gaining potential access to their rich energy resources or whether the objective has been placed in an EU "too hard basket" and, to all intents and purposes, abandoned. Certainly, since 2001, the Conference and Secretariat, as evidenced by the content of speeches and the briefs given to the Conference Working groups, appears to have eschewed all mention of assistance to the FSU. Indeed, Dr Kemper describes the ECT thus:

> The Energy Charter Treaty is a comprehensive international legal framework for cross-border economic cooperation in the energy sector. The Treaty's primary aim is to promote the necessary climate of legal stability and predictability that is required in order to attract investments and stimulate business activity in the energy sectors of our member states, in particular transition economies. To this end, the Treaty enshrines, in a legally-binding form, the key principles of openness, transparency and non-discrimination as the basis for the relations among the Charter's constituents in the energy sector.

The Treaty's provisions focus on five broad areas:

- the protection of foreign energy investments, where the Treaty's provisions have the equivalent force of a network of bilateral investment protection agreements and are based on the fundamental principle of extending national treatment, or most-favoured nation treatment, whichever is more favourable, to energy sector investors from the Signatory states. Other important provisions relate to protection in cases of expropriation, and the freedom of transfer of payments in connection with an investment;
- free trade in energy materials, products and energy-related equipment, based on the application of WTO rules to such trade among the Treaty's Signatories, even if they are not members of WTO;
- facilitation of interstate energy transit through pipelines and grids;
- dispute resolution - the Treaty includes rules for binding international arbitration in the case of disputes between governments, or between an investor and a host government;
- energy efficiency, where in addition to the Treaty's provisions on mitigation of the environmental impact of the energy cycle, a separate legal instrument has been adopted under the Energy Charter's auspices, called the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, which requires its participating states to formulate the implement clear strategies and programmes for improving energy efficiency.

> By participating in the Energy Charter's work, and subscribing to the Energy Charter Treaty, I believe that governments convey a strong political message to potential investors, underlining their commitment to observe the principles of openness, transparency and non-discrimination in the energy market. This message alone can significantly enhance the investment climate in a state's energy sector as perceived by international investors and financial institutions.[16]

As will be gathered from Dr Kemper's description, the ECT is now promoted as a multilateral treaty dealing specifically with energy of the type envisaged by John Maynard Keynes in the 1940's (the Havana Charter). Scant mention is made of what was once heralded as its seminal objective. Furthermore, what Dr Kemper fails to point out in this and other speeches, is the Euro-centric nature of the aims of the Treaty. Whilst expressed in general terms and presented to a non-European audience, the ECT takes on the guise of an effective and even desirable multilateral instrument. What is not revealed, however, is the emphasis given to the protection of the energy purchaser/investor, envisaged from the outset of the EEC negotiations as being an EU state, nor the restrictions imposed by the ECT provisions upon the other Contracting Party (discussed in Chapters X and XI below).

It is true, however, that whilst the focus of ECT objectives may have shifted from a Euro-centred to international context, the provisions of the ECT remain substantially unchanged.[17] Given that the ultimate goal of the ECT, as is argued here, has always been the security of EU energy supplies, it has

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[16] Speech by Dr Kemper at 21st Meeting of the Asia-Pacific Economic Cooperation (APEC) Energy Working Group in Kuala Lumpur (online). 18-19 May 2001, www.encharter.org topic ID:31

[17] Since December 1994 there has been only one major amendment to the provisions of the ECT (discussed in Part II below). The Amendments to the Trade-Related Provisions (concluded in July 1998) are more related to textual than substantive modifications.

therefore been unnecessary to amend the provisions of the ECT to conform to its current guise. Irrespective of rhetoric and the general terms in which the aims of the Treaty are described by Dr Kemper, any state acceding to the Treaty, whether FSU or not, will be subject to its provisions and regime, as described in the following Chapters set out in Part III.

PART II

ANALYSIS OF THE PROVISIONS OF THE ENERGY CHARTER TREATY

CHAPTER IV

ENERGY CHARTER TREATY - STRUCTURE AND PROVISIONS

Introduction

The ECT and its attendant Protocol on Energy Efficiency is a fairly concise document in view of its broad scope and intended effects. Its provisions cover inter alia the legal rights and obligations in regard to FDI in energy production and energy resource development, trade in energy supplies and energy related equipment, intellectual property and technology transfer, environmental protection and dispute resolution. This range of issues is predictable in a multilateral instrument which purports to provide the legal framework for international agreements concerning energy supply, trade and transit, and in general terms is ostensibly unremarkable. The regulation of inter partes contractual relations by domestic legislation and even international instruments is not unusual, and is, indeed, essential to ensure predictability in and the security of commercial transactions. In those jurisdictions deriving their legal principles from English Common Law, the application of such regulations and the availability of remedies for breach are limited to the parties to the contract.[1] However, the provisions of the ECT goes beyond the parameters of traditional domestic and international law in abrogating the doctrine of privity of contract by accenting third parties rights of action pursuant to agreements caught by the ECT.

Furthermore, at the state level, the regulation of the actions of governments by binding bi-and multilateral treaties constitutes the basis of international relations. The need to restrain states from activities which compromise the well-being of other nations or of particular classes or groups of persons is accepted as a necessary concomitant of an increasingly interdependent international community. Similarly, the necessity of placing certain obligations upon states to ensure international

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[1] The common law tort of interference with contractual relations is indicative of the sanctity accorded to inter partes contractual dealings.

political stability has always been regarded as a *sine qua non* of global security.[2] In this vein, the ECT contains rules applicable to the individual state Contracting Parties which regulate domestic competition policy, access to capital markets, the granting of most favoured national (MFN) status and the internal and cross-border transit of energy supplies. These provisions require those states bound by the Treaty whose domestic legislation does not conform to the ECT regulations to effect substantial domestic legislative changes in these areas covered by the Treaty. Such provisions, it will be argued below, go beyond the purview of international instruments and impinge upon the sovereignty of Contracting Parties.

However, in order to appreciate the potential impact of the ECT upon the practical and theoretical state rights of Contracting Parties and its deviation from the commonly accepted principles of commercial law it is necessary to examine the structure and content of the Treaty itself. Therefore, this Chapter will discuss the structure of the ECT and its ancillary documents before progressing in Chapters V to VIII to a detailed discussion of the individual Articles of the Treaty.

Although the ECT is a multilateral instrument consisting of fairly predictable "soft law" provisions, it is also intended to be enforceable, Therefore, interspersed between the statements of principle and exhortations to adopt best practice, there are Articles which impose definite and definitive obligations upon Contracting Parties, infringement of which renders the Party liable to proceedings pursuant to Articles 26 and 27.

Accordingly, the analysis of the provisions contained in the following Chapters has been approached as a contract review from the perspective of a lawyer acting on behalf of a client who is a party to the Treaty. The discussion will therefore concentrate upon the practical legal effects of each of the provisions and the

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[2] Whilst the promulgation of such international regulations controlling the behaviour of independent nation - states in such bodies as the UN is not an easy task, their enforcement can be even more problematic.

enforceable legal implications for all parties to an energy agreement formed pursuant to the Treaty.

This methodology, whilst theoretical in nature, most effectively emphasises the potential pitfalls which are inherent in the document for the unwary Contracting Party. In order to present the breadth and scope of the ECT regimen, the analysis of the provisions in the following Chapters, will be prefaced by a brief discussion in this Chapter of the structure of the ECT and a description of its related instruments.

ECT and Related Instruments

The Final Act of the ECT as Amended[3] consists of 50 Articles, plus Understandings, Annexures and Decisions of the Conference. The Understandings comprise 21 pronouncements of principle and explanation in regard to specific Articles of the Treaty and one general statement (Understanding 1) "with respect to the Treaty as a whole." The Article-specific Understandings are more conveniently examined below in conjunction with the Articles they qualify, Understanding 1, however, as a statement referring to the whole ECT, will be discussed below in association with the Preamble. The Annexures contain provisions and qualifications ancillary to specific Articles either by way of explication or by specifying those Contracting Parties exempted from the application of that Article. The Decisions with respect to the Treaty embody five determinations and/or commentaries on specific Articles adopted by the Conference.[4]

Amendment to the Trade-Related Provisions

The Amendment to the Trade-Related Provisions of the ECT ("the Amendment") and its annexed Decisions was negotiated at the inaugural meeting of the Conference

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[3] By the Amendment to the Trade Related Provisions, op. cit.

[4] Discussion of Annexures and Decisions will be incorporated into the examination of individual Articles infra.

on 23 and 24 April 1998, and adopted at this time. Although as at November 2002, the Amendment has not been implemented, it does allow for provisional application, i.e. individual Contracting Parties have the discretion to apply the Amendment prior to its official entry into force. On 13 July 1998 the European Council approved the Amendment[5] and its provisional application by individual EU states. However, it was not until July 2001[6] that the Council approved the deposit of the Instrument of Approval with the Portuguese Government[7].

In essence the Amendment updates the Treaty from the General Agreement on Tariffs and Trade (GATT) regime of 1947 to World Trade Organisation (WTO) provisions as set out in Articles 29, 30 and 31 of the ECT. It also extends the application of these Articles to include "energy-related equipment" in addition to "energy materials and products."

Whilst EU states and other WTO members now provisionally apply the Amendment, non-members of WTO have been reluctant to accept WTO rules before accession to the WTO itself. This is despite the fact that the Secretariat has publicised the acceptance of the Amendment as a "first step" towards WTO accession.[8] It is unlikely, therefore, that the Amendment will be implemented until the 12 non-WTO members either agree to apply the Amendment on a provisional basis or became members of the WTO.[9] Until the Amendment applies as between all Contracting Parties, therefore, the current regime set out in Article 29 of the Treaty will apply.

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[5] OJL 252, 12/09/1998, 0021-0022.

[6] OJL 209, 02/08/2001 p.32-32.

[7] Articles 39 and 49 of the ECT provide that instruments of ratification, acceptance or approval shall be deposited with the ECT Depository (Article 39), which, pursuant to Article 49 is the Portuguese Government.

[8] In May 2001 Steivan Defilla, as Chair of the Conference Trade Group outlined the Energy Charter's role as a stepping stone for membership of WTO. Since 12 of the 51 Signatories are not WTO members, this represents a significant recruitment for the WTO (www.encharter.org/topicID=47)

[9] For the Amendment to be implemented, pursuant to Article 36 it needs a unanimous Conference vote.

The Supplementary Treaty

In addition to the main body of the ECT is the proposed Supplementary Treaty. Although negotiations on the provisions of the Supplementary Treaty commenced in January 1995 and were provisionally completed in early 1998, as at 2002 it was not concluded.[10] The Supplementary Treaty will deal with legally binding national and MFN treatment standards in the pre-investment stage as well as containing provisions relating to the application of the ECT in the event of privatization and demonopolisation. It is proposed, however, that the national or MFN treatment provisions will be subject to a number of Understandings and Obligations as well as reservations in relation to the application of investor-state dispute resolution regulations. However, until the Supplementary Treaty has reached its definitive stage, it is difficult to speculate on the exact nature of its final form.

Protocols

Pursuant to Article 33(1), the provisions of the ECT may be supplemented by Protocols. These are treaties to which Contracting Parties may elect, but are not required to subscribe. In effect, Protocols complement, supplement, extend or amplify the provisions of the Treaty in a particular sector or area of activity. Currently, there is one Protocol in force: the Protocol on Energy Efficiency and Related Environmental Aspects, which was signed by all signatories of the ECT on 17 December 1994 and which was implemented, like the ECT, on 16 April 1998.[11]

In addition, in December 1999 the Conference approved the commencement of negotiations on a Transit Protocol. Although the ECT, in conformation to WTO principles, provides for freedom of transit on a non discriminatory basis, it is envisaged that the proposed Transit Protocol will provide a more comprehensive set of regulations aimed at strengthening the existent transit-related obligations set out

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[10] The Secretariat in its 2002 Work Programme has listed the concluding of the Supplementary Treaty as one of its priorities for 2002.

[11] The provisions of the Energy Efficiency Protocol will be discussed at 171 ff below.

in Article 7. Impetus for the proposal came in 1994 as a result of the realisation by Conference participants that "the collapse of the USSR has created specific problems in the area of energy transportation that hamper the development of energy projects in the CIS region involving inter-state transit. As is well known, this has led to frequent problems over energy transit flows in a number of CIS states over recent years."[12]

Accordingly, it is proposed that the new Protocol will address issues such as:

- the binding obligation for states to prevent unlawful taking of energy in transit;
- the question of ensuring that access to available transit capacity is allocated on a non-discriminatory basis;
- transparent criteria for setting transit tariffs; and
- dispute resolution procedures.

To complement the Protocol the Transit Working Group is currently developing a set of non-binding Model Transit Agreements which may be used either between public parties or a host government and prospective investor, as guidelines on the best practices to follow in relation to negotiations and agreements involving energy transit.

It is clear that the target of the proposed Transit Protocol is the FSU states. As Dr Kemper stated in an address to the Institute of Petroleum on 19 February 2002:

> ... the FSU region offers major potential as a source of gas supplies for European consumers.[13]

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[12] Energy Charter Treaty Web site at www.encharter.org, Energy Charter Transit Protocol, topic ID=17.

[13] www.encharter.org, topic ID=31.1.

Since it has been projected that by 2020, 70% of the EU supply of natural gas will be sourced form Russia,[14] the aim of the Protocol is to supplement Article 7 and obviate the energy transit problems posed in FSU states and thereby secure the EU's access not merely to the extensive natural gas resources of Russia, but also those of Central Asia. Although Dr Kemper in the speech quoted above attempts to cloak this fundamental objective of the Protocol in the aura of mutual benefit by stating that implementation of the Protocol will stimulate interest in FSU countries from major international energy companies,[15] she is unable to provide a plausible disguise. Certainly, there is sufficient impetus for the Secretariat to place the conclusion of the Transit Protocol with the Supplementary Treaty as a major priority for 2002.

Conclusion

In effect, the documents ancillary to the ECT are intended to provide added weight to various Articles in the Treaty itself by both expanding the ambit of issues covered and providing more detailed explication of the obligations imposed upon Contracting Parties.

However, whilst the Energy Efficiency Protocol together with the pending Supplementary Treaty, the Amendment to the Trade-Related Provisions and Transit Protocol strengthen and expand the ECT, the provisions, Understandings, Decisions and Annexures contained in the ECT *per se*, without the ancillary documents, constitute a draconian regulation of all aspects of trade in energy and energy related materials. Therefore, in order to fully understand the stringency of this regime, Chapters V to VII will present a detailed analysis of the relevant individual provisions of the Treaty.

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[14] Ibid.

[15] Arguably a furphy on the basis that the interest exists already.

CHAPTER V

PREAMBLE, PARTS I AND II

Introduction

The text of the ECT is divided into Background, a Preamble and eight Parts. The Background and Preamble set the scene and enunciate the principles upon which the ECT regime is founded. Part I both defines specific terms used in the Treaty (Article 1) and states the objective (Article 2).

Part II (Articles 3 - 9), delineates and dictates the administrative and legislative conditions required within a host state Contracting Party for the effective encouragement of FDI in the energy sector.

This Chapter will examine the Background, Preamble and Parts I and II.

Background and Preamble

By way of introduction, the text of the Final Act of the ECT Conference includes a brief history (Background) of the ECT development process. Prominent as a *raison d'etre* is the initial suggestion of Ruud Lubbers that: "economic recovery in Eastern Europe and the then Union of Soviet Socialist Republics could be catalysed and accelerated by co-operation in the energy sector." The implementation of this co-operation was ostensibly the purpose of the ECT. This is reflected in the fifth Recital of the Preamble, which provides that all Contracting Parties wish "to implement the basic concept of the European Energy Charter initiative which is to catalyse growth by means of measures to liberalize investment and trade in energy."

The Preamble cites in general terms a list of principles upon which the Contracting Parties subscription to the Treaty rests. These principles, in addition to the one quoted above, include the intention to progressively liberalize and introduce non-discriminatory practices into international trade and to develop measures to achieve energy efficiency and environmental protection.

Further, the Parties agree to recognize the objectives and obligations of GATT,[1] the Treaty on Non-Proliferation of Nuclear Weapons and the UN Convention on Climate Change, in addition to general rules in regard to competition, mergers, monopolies and abuse of dominant position.

The recitals also express certain undertakings or agreements by Contracting Parties, viz:

- to place the commitments of the ECT on a secure binding international legal issues;
- to establish a structural framework require to implement the ECT;
- to effectively implement full national and MFN treatment to be set out in the Supplementary Treaty;
- to remove barriers to trade in energy materials and products and energy related equipment, technologies and services;
- not to impede non-GATT (WTO) members from achieving membership.

Whilst the premises enunciated in the Preamble are not, per se, binding on Contracting Parties, they do, to a great extent, prefigure the provisions of the ECT to which Contracting Parties are committed. For example, the recital concerning the establishment of the structural framework necessary to

[1] All references to GATT are changed to "WTO" in the Amendment to the Trade-Related Provisions

implement the principles of the ECT mirror Article 6(2) which provides that each Contracting Party will ensure that its legal system is commensurate with competition policy. Moreover, the recitals serve to place the ECT firmly within the purview of existing international trade, particularly GATT/WTO, and environmental protection agreements. This recognition of other international instruments and regimes serves not only to qualify the provisions of the ECT, but also to imbue it with a degree of relevance and status as an international agreement.

Both the Background and Preamble of the ECT therefore provide an introduction to the substantive provisions of the Treaty by reciting its history and the underlying precepts and agreements - in-principle of the Contracting Parties. However, although both the Background and Preamble include "the basic concept of the European Energy Charter initiative which is to catalyse economic growth by means of measures to liberalize investment and trade in energy" (Preamble), a basic concept which, it is argued, has now been abandoned, neither make any reference to what is the principal objective, i.e. to secure the EU's future energy supplies. Had such mention been made, it would no doubt have marred the philanthropic almost idealistic aura of the whole. Certainly, this generously enlightened beginning is belied as the substantive provisions are examined.

Part I : Definitions and Purpose

As noted above, Part I of the Treaty enunciates both the purpose of the ECT and the definitions of particular terms used throughout the text. Because it purports to encapsulate the broad objective of the Treaty, Article 2 will be discussed before Article 1.

Article 2

Article 2 of the ECT sets out the purpose of the Treaty, i.e. "to establish a legal framework in order to promote long-term co-operation in the energy field, based on complementaries and mutual benefits, in accordance with the objectives and principles of the Charter." Whilst there is nothing exceptional in this statement of purpose, like the Background and Preamble the significance of Article 2 lies in what it omits rather than in its tacit statement.

The omission of what, it is argued here, was always the basic principle of the ECT, i.e. achieving security of EU energy supplies, appears more conspicuous in 2002 than in 1994. This is especially so in the light of explicit articulation of Treaty objectives in Dr Kemper's speeches some of which were cited supra, viz "the European Union .... continues to attach major importance to the Energy Charter's strategic role in promoting energy security in Europe."[2] Indeed, it could be argued that apart from the general statement regarding economic growth, quoted at length above, nowhere are the specific objectives, referred to in Article 2, explicitly stated. It is therefore necessary to infer objectives from both ancillary documents, such as Dr Kemper's speeches, EC Secretariat press releases and programmes, by implication from the provisions and effect of the Articles themselves. However, whilst the failure to explicitly recite the objectives anywhere in the Treaty leads to a degree of uncertainty, it does allow for changes in European energy policy direction without the need to undertake the arduous process of formal amendment.[3]

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[2] Dr Ria Kemper, Energy Security for Europe: The role of the Energy Charter: Address to the Centre for European Policy Studies, Brussels (online). 17 May 2000 www.encharter.org./topic=31.

[3] The difficulties surrounding the negotiation and implementation of the Amendment to the Trade-Related Provisions is indicative of just how lengthy and arduous this process can be.

Article 1

To some extent, an ostensible degree of certainty is accorded to the ECT by the Definitions contained in Article 1. The list of definitions is by no means exhaustive and a number are totally innocuous. The definitions of "Charter" and "Contracting Party" are predictable and obvious. The scope of "Energy Materials and Products" is elucidated in Annex EM, which sets out the system of nomenclature of the EU Customs Co-operation Council.

Similarly, the definition of "Economic Activities in the Energy Sector," i.e. "an economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing or sale of energy materials and products, is qualified by Understanding 2 and Annex EM. Understanding 2 states that the Treaty is confined to economic activity in the energy sector and goes on to provide examples of such activity. Annex EM, on the other hand, sets out the energy materials and products to which the definition of "economic activity" does not apply, i.e. charcoal, fuel woods and products of the distillation of high temperature coal tar. "Intellectual Property" is given its commonly used/understood application regarding copyrights, trademarks, patents and designs and also includes a mysterious reference to "geographical indications." It is unclear from the context whether this term refers to the results of geophysical studies, as produced for the purposes of mineral exploration, or some other form of geographical activity. Further, the definition is qualified by Understanding 2, which contains the principle that all representatives (i.e. at the initial EC Conference) recognize the necessity for adequate and effective protection of Intellectual Property rights.

Related to the definition of "economic activity in the energy sector" in Article 1(5) and perhaps more problematic, is the definition of "investment."

Article 1(6) defines an investment as being every kind of asset owned or controlled by an investor and includes (therefore not limited to):

- tangible and intangible, movable and immovable property or rights in property (e.g.. leases, loans etc.);
- a corporate or business enterprise, securities, equity or any form of debt;
- choses in action relating to an investment;
- intellectual property;
- returns;[4] and
- any right conferred by law or contract, licence or/permit granted pursuant to law regarding any economic activity in the Energy Sector.

Further, Article 1(6) goes on to provide that a change in the form in which the assets were invested does not affect their character as investments. It is to be noted that this list is non-exclusive.

Furthermore, the definition is qualified by Understanding 3, which provides that in determining whether an investment made in the Area (i.e. territory) of one Contracting Party by another, the control of the investment will be determined after an examination of all of the facts and circumstances surrounding the investment including the investors:

- financial interest and equity in the investment;
- the ability to exercise control over the management and operation of the investment; and

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[4] Defined by Article 1(9) as "the amounts derived from or associated with an investment irrespective of the form in which they are paid, including profits, dividends, interest, capital gains, royalty payments, management, technical assistance or other fees and payments in kind."

- the ability to exercise substantial control over the selection of the board of directors or other managing body.

Where an investor claims control over an investment, the burden of proof falls upon the investor.[5] However, it is to be noted in regard to the issue of control over an investment that Declaration records Russia's request that in the negotiations regarding the Supplementary Treaty, the question of the importance of national legislation regarding control of an investment, be reconsidered. Considering the scope of the definition, it is surprising that more Contracting Parties did not express reservations in regard to this aspect of the Treaty.

Certainly, Article 1(6) presents an extremely broad definition of investment/asset which in effect includes any investment/asset related to economic activity in the energy sector and which may, thereby, provide the basis for the application of the Treaty to operations ancillary to but not directly concerned with economic activity in the energy sector. For example, the Treaty may be invoked in regard to the maritime transportation of products in connection with but not necessarily significant to the energy industry or the production of petrochemicals, exempted from the operation of the ECT by virtue of Annex NI but which are produced within the premises of an oil refinery.

Further, the inclusion of choses in action, i.e. "claims to money and claims to performance of a contract having an economic value and associated with an investment" (Article 1(6)(c)) conceivably extends the operation of the ECT potentially to all parties to litigation involving an energy related contract.

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[5] It is interesting to note that no standard of proof is specified, although in such a case it is arguable that the balance of probabilities would be most appropriate. However, it is not impossible to envisage situations in which the more appropriate standard would be beyond reasonable doubt.

Moreover, the definition in Article 1(6)(c) does not specify the jurisdiction in which such claims may be pursued. Therefore, it is arguable that any claim in any jurisdiction (including small claims i.e. with a low jurisdictional financial limit) in connection with an energy related investment would be brought within the ambit of the definition of an investment and thereby under the provisions of the Treaty. Such a scenario is not, by any means, far fetched. It would appear from the scope of the definition that any connection with the energy sector, however tenuous, would render an issue subject to the ECT regime by virtue of a literal application of the definitions of economic activity and investment.

The term "investor" as defined in Article 1(7) as meaning either a natural person with permanent residence or a corporation established pursuant to the laws of a Contracting Party or "with respect to a 'third state,' a natural person or corporation which fulfils the conditions for an investor of a Contracting Party". "Third state" being, it is presumed, a non-Contracting Party. In relation to an "investor," it should be noted that the terms gains breadth of scope by reference to the definition of investment.

Pursuant to Article 1(8), "make investments" or "making of investments" means "establishing new investments, acquiring all or part of existing investments or moving into different fields of investment activity." This is qualified, in regard to Australia, by Understanding 4, which provides that:

> Consistent with Australia's foreign investment policy, the establishment of a new mining or raw materials processing project in Australia with total investment of $A10 million or more by a foreign interest, even where that foreign interest is already operating a similar business in Australia, is considered as the making of a new investment.[6]

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[6] From the substance of this understanding, it is not difficult to envisage Australia's role pursuant to the Treaty.

In view of the breadth of the definition accorded to "investment", Australia's attempt to circumscribe "new mining or raw materials processing project" in terms of its foreign investment policy appears somewhat lame. Moreover, given the rather obscure reference in Article 1(8) to "moving into different fields of investment activity" the exact ambit of the application of the Treaty is uncertain. It is questionable whether the "different fields of investment activity refers simply to an alternative economic activity in the energy sector or an economic activity unrelated to the energy sector. Either interpretation is possible.

Part II : Commerce

Part II of the ECT establishes the optimum conditions required in the economic, commercial and legislative sectors of a Contracting Party to enable FDI in the energy sector to proceed. Whilst some provisions, such as Article 3, may be described as "soft law" or exhortatory, others, such as Article 5, impose stringent requirements which directly intrude upon economic and legislative sovereignty of the Contracting Parties upon which the prescripts are focused. Accordingly, the following section will examine in some detail the implications of the obligations enunciated in Part II of the Treaty.

Article 3

Article 3, "International Markets," provides a general exhortation that Contracting Parties "shall work to promote access to international markets on commercial terms, and generally develop an open and competitive market for Energy materials and Products." Although appearing as a statement of principle or soft law, rather than as a prescriptive pronouncement, Article 3 has extensive implications. For most of the FSU states, promoting access to

international markets and developing an internal open and competitive market involves not only changes in government domestic and foreign policy, but also, more importantly, a complete restructuring of the legal system, requiring inter alia the promulgation of new laws, the training of judicial officers and support staff and the establishment of legal institutions capable of administering the new regime. Therefore, whilst the concept of the swift and efficient transition to a free market economy by all FSU states would seem attractive to EU nations, the practical realisation of this is far more difficult and in some instances[7] economically unfeasible.

Article 4

Article 4 provides for compatibility between the provisions of the ECT and GATT[8] in that "nothing in this Treaty shall derogate, as between particular Contracting Parties which are parties to the GATT from the provisions of the GATT and Related instruments...." In essence, Article 4 prefigures the relationship between the ECT and GATT/WTO set out in Art 29.

Article 5

Article 5 prohibits the application by a Contracting Party of trade-related investment measures inconsistent with "the Provisions of Article III or XI of the GATT." Trade-related investment measures impose local content or trade balancing requirements upon foreign investors, and include obligations placed upon an enterprise:

- to purchase products of domestic (host state) origin to a particular value or proportion of volume (Article 5(2)(a));

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[7] For such impoverished states as Moldava, Belarus and Ukraine the cost of achieving reform has been almost prohibitive. To a certain extent, Ukraine has achieved some degree of movement towards a free market through the promulgation of a new Constitution, and Corporation and Property laws. However, the implementation of these has been a lengthy and arduous process.

[8] WTO pursuant to the Amendment to the Trade-Related Provisions.

- to limit the volume or value of imported goods used or purchased (Article 5(2)(b)); or which restrict:
- the importation of products used by the enterprise Article 5(2)(c);
- access to foreign exchange (Article 5(2)(d));
- the export of products (Article 5(2)(e)).

Many governments use trade-related investment measures, such as the import/export quotas and foreign exchange controls as specified in Article 5(2) (a)-(e) as a means of monitoring and maintaining their balance of trade figures and/or providing protection to particular domestic industries.[9] Protectionist measures are therefore a matter of government policy and may be integral to macro-economic planning, especially in developing nations.

To some extent, the importance of trade-related investment measures to some states is recognised by subparagraphs (3) and (4) of Article 5.

Article 5(3) includes the application of trade-related investment measures relating to requirements to purchase and use goods of domestic origin ((3)(a)) and import restrictions ((3)(c)) if those measures are conditions of eligibility for "export promotion, foreign aid, government procurement or preferential tariff or quota programmes." Further, Article 5(4) allows the continuance of trade-related investment measures which were in effect more than 180 days prior to its signature of the Treaty. However, such conditions are subject to the notification and the "phase-out" provisions listed in Annex TRM.

Annex TRM mitigates the apparent leniency of Article 5(4) by imposing stringent notification and "phase-out" requirements upon relevant

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[9] Australia, from time to time, imposes import quotas on (inter alia) certain agricultural products such as wheat, rice and beef as well as manufactured goods such as cars.

Contracting Parties. Pursuant to this Annex a Contracting Party applying trade-related investment provisions must notify the Secretariat of each general or specific application together with a detailed description of what the measure entails within 90 days after the implementation of the Treaty[10] if the Contracting Party is a member of GATT/WTO or within 12 months if the Contracting Party is not a member (1 (a) and (b)). Where measures are applied under a discretionary authority, each specific application must be notified, although commercially sensitive information need not be disclosed (2).

All trade-related investment measures notified are to be phased-out two years from the date of entry into force of the Treaty for a GATT/WTO member or 3 years for a non-member (4). Where a state or Regional Economic Integration Organization[11] accedes to the Treaty after 16 April 1998, the notification and phase-out period, paragraph (4) prohibits the Contracting Party from modifying the terms of any measures notified pursuant to paragraph (1). However, "in order not to disadvantage established enterprises which are subject to a trade related investment measure notified under paragraph (1)" during the phase-out period a Contracting Party may apply the same measure to a new investment provided the products concerned are the same (5(a)) and the application is necessary to maintain competition parity between the old and new investment (5(b)).

Any measure imposed pursuant to paragraph (5) is subject to the notification requirements but must be terminated at the same time as the prior measure. Whilst the attempt by paragraph (5) of Annex TRM to maintain a "level playing field" between investors in the same product area is laudable, such

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[10] i.e. 16 April 1998

[11] Defined in Article 1(3) as an organisation of states which have transferred competence and decision making over matters governed by the Treaty to a centralised authority

provisions could arguably prove difficult to implement, particularly where the latter investment is made within 6 to 12 months of the expiry of the phase-out period. The Contracting Party is then faced with the dilemma of either:

(a) undertaking the expensive notification process for measures which will be extant for only a few months;

(b) postponing the proposed later investment until the expiry of the phase out period and thereby risk losing the investment; or

(c) approve the investment on terms which put it in breach of the Treaty.

Thus, whilst the removal of trade-related investment measures pursuant to Article 5 may benefit investors in energy related economic activity it places onerous conditions upon the host state which would, by necessity, have negative economic impact. Repulsive as host state protectionist policies in the energy sector may be to the foreign investor, they are often necessary to assist domestic economic growth and stability in developing and FSU states.

Article 6

Article 6 deals with the issue of Competition and sets out the Treaty requirements in regard to anti-competitive conduct in Economic Activity in the Energy Sector. Whilst Article 6 (2) makes the general statement that "Each Contracting Party shall ensure that within its jurisdiction it has and enforces such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct,"[12] (a requirement in accordance with EU competition policies) it places onerous responsibility upon FSU states whose legal systems were geared towards controlled rather than free market economies. As with Article 3, of which Article 6(2) is a restatement,

[12] "Unilateral and concerted anti-competitive conduct" are to be defined according to the laws of each Contracting Party and "may include exploitative abuses" (Understanding 7(a)).

compliance with this provision must necessarily involved a total restructuring of the legal systems of those states to which it applies.

The structure in Article 6(3), which obliges Contracting Parties with experience in applying competition rules to "give full consideration" to providing assistance if requested by nonconforming Contracting Parties, does little to ease the burden. The requirement is merely to "give full consideration to" such a request, it does not prescribe that assistance be given. Therefore, to comply, the Contracting Party receiving a request for assistance need only consider the request. It is arguable that a more equitable approach would have made assistance, once requested, mandatory.

Further, a mandatory requirement to provide resource and technical assistance would have been particularly relevant in consideration of the enforcement provisions in paragraph (5). Although Contracting Parties may co-operate in the enforcement of their competition rules by consultation and exchange of information ((4)) the provisions of paragraph (5) are weighted decidedly in favour of the investor. Pursuant to this paragraph, where a Contracting Party "considers" that another Contracting Party countenances anti-competitive conduct which is adversely affecting the interests of the former, the aggrieved Party may request that the "competition authorities" of the host state Party initiate enforcement action. It is interesting to note that the aggrieved Party need only "consider" (or believe) that it is disadvantaged by anti-competitive conduct. There is no requirement in regard to proof, either onus or standard, that such conduct does or has existed, merely the requirement to provide information.

Once the host state Party or its competition authorities has been notified of the repugnant conduct, it must give full consideration to the request for appropriate action and may consult with the aggrieved Party's corresponding

authorities. Once a decision has been made, the host Party informs the notifying Party of its decision, the grounds for the decision and any enforcement action that is to be taken. "Enforcement" and "enforces" are defined by Understanding 7(b) as being any action under the competition laws of a Contracting Party "by way of investigation, legal proceeding or administrative action as well as by way of any decision or further law granting or continuing an authorization."

Similarly, Article 6(6) provides that nothing in the Article requires a Contracting Party to provide information in breach of its laws regarding "disclosure of information, confidentiality or business secrecy." However, difficulties must arise in the implementation of the Article in regard to the definition in Understanding 7(b) and the provision in paragraph (6). Firstly, there is no indication as to which Contracting Party may claim the benefit of Understanding 7(b) and/or paragraph (6), or indeed whether both Parties may invoke the provisions. Whilst this may appear a trivial point, it becomes significant when one Party seeks to apply its own laws which are in conflict with those of the other Party in regard to enforcement or nondisclosure of information.

Although paragraph (7) provides that all disputes arising from the implementation or interpretation of the Article are to be exclusively resolved pursuant to Article 27(1), it is arguable that more precise drafting of Article 6 could have obviated the need for dispute resolution. Since any delay in FDI can prove expensive both to the investor and the host state, failure to provide precise definitions, and thereby increasing the risk of disputes arising in regard to implementation and enforcement are indicative of a regrettable lack of commercial acumen on the part of the Treaty's drafters.

Secondly, no provision is made in either Understanding 7(b) or paragraph (6) for the eventuality that one Party does not have competent or indeed, any laws in force which deal with either enforcement of competition laws or protection of sensitive commercial information. Should such a situation arise the Party lacking the appropriate legislation could well be placed at a disadvantage vis a vis the other Party seeking to impose its regime. Although dispute resolution is mandatory pursuant to Article 27, the necessity for lengthy and expensive litigation does not accord with best commercial practice, if such disputation could have been avoided by careful drafting. Furthermore, since it is more likely that it would be the FSU Party which lacked the adequate legal system, it would be the FSU Party who would be disadvantaged in the implementation of paragraphs (5) and (6).

Article 7

Article 7 addresses the difficult issue of Transit of Energy Materials and Products and, until the implementation of and accession to the Transit Protocol by all Parties, contains the transit rules of the ECT.

Secure Transit of energy supplies is of vital importance to the EU nations. As Dr Kemper stated in an address to the Centre for European Policy Studies (op. cit.), in view of the EU's growing dependence upon imported gas and oil:[13]

> further measures will be needed in order to strengthen the EU security of supply. In strategic terms, this means ensuring greater diversification of supply sources, with the aim of ensuring that Europe's vulnerability to possible disruptions I supply from any single area is reduced to a minimum. Consequently, this implies a growth in importance for Europe of new oil and gas production areas, often in land-lacked areas such as the Caspian Sea region. Ensuring

[13] By 2020, 67% of the EU's demand for gas and 90% of its demand for oil will need to be met from imports.

> the security of supply from such areas is a key strategic task for governments. And this will only be achieved if a commonly-accepted regulatory regime covering grid-bound energy transit flows is put in place.

Therefore, until the implementation of the Transit Protocol, Article 7 embodies not only the major obligations and rights in relation to the transit of energy, but also, perhaps, the most contentious provisions.

Transit, for the purpose of Article 7 is defined either as the carriage of energy materials and products originating in the territory (Area) of one state, destined for another state (either of whom may be a Contracting Party) through the territory of a Contracting Party (7(10)(a)ii)) or the carriage of energy materials and products originating in and destined for the territory of a Contracting Party, through the territory of a Second Contracting Party (7(10)(a)(ii)). Contracting Parties may opt out of this latter definition by lodging notification with the Secretariat for recording in Annex N. However, since todate only Canada and the US have chosen to do this, and since the US is not a signatory, the definition applies to all Contracting Parties except Canada.

Pursuant to Article 7(1), each Contracting Party is obliged to take "the necessary measure to facilitate the Transit of energy materials and products" consistent with the principle of freedom of transit and upon non-discriminatory principles as to origin, destination, ownership or pricing. In addition, Contacting Parties shall encourage "relevant entities: to modernize and develop Energy Transport Facilities (Art 7(2)(a) and (b), to facilitate the interconnection of Energy Transport Facilities ((2)d)) and take measures to reduce interruptions to supply ((2)(c)). Energy Transport Facilities are defined as: "high pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines," and other fixed facilities "for

handling energy materials and products" ((10) (b)). Whilst paragraph (2) may be regarded as a "soft law" provision, it does impose obligations upon Contracting Parties to effect improvements in transit within their boundaries without defining the relevant entities" they are obliged to encourage.

Paragraph (3) provides that Contracting Parties undertake to treat energy materials and products in transit across its territory no less favourably than such materials and products either originating in or destined for its own territory. In effect, this paragraph seeks to prevent such discriminatory measures as higher transit costs for non-domestic energy supplies, higher ground rents or licence fees regarding pipelines carrying Second and Third Party energy materials and products and other such policies which impose higher cost burdens upon other Contracting Parties wishing to transport energy supplies across the First Party's territory. As such, the emphasis upon non-discriminatory treatment of energy supplies in transit prefigures some of the provisions suggested for the Supplementary Treaty.

Paragraph (4) decrees that where the existing Energy Transport Facilities do not allow the Contracting Parties to transport energy materials or products "on commercial terms," "Contracting Parties shall not place obstacles in the way of new capacity being established except as may be otherwise provided in applicable legislation which is consistent with paragraph (1)." This is qualified by Understanding 8 which notes that "applicable legislation" would include "provisions on environmental protection, land use, safety or technical standards." However, since paragraph (1) imposes the obligation upon Contracting Parties to take necessary measures to facilitate Transit etc., it is difficult to envisage how legislation restricting or prohibiting the establishment of "new capacity" on any grounds would not be inconsistent with paragraph (1). The mere fact that establishment of a new capacity had been delayed or restricted by such legislation would be sufficient to constitute a breach.

Moreover, the paragraph poses other difficulties. There is no definition of "commercial terms." Accordingly, a dispute could arise as to what two Parties regard as constituting "commercial terms" for the purposes of the paragraph. Naturally, each will wish to employ a definition which implies the most favourable terms for itself. Certainly, should a Contracting Party regard the terms offered by another Party in regard to the transportation of energy supplies or use of existing facilities as being unfavourable and, therefore, uncommercial, the aggrieved Party may invoke this provision to establish alternative facilities on the territory of the other party, irrespective of this Party's views on the subject.

Similarly, there is no clarification as to what constitutes an "obstacle" placed "in the way of" the establishment of new transit capacity. Whilst legislation may undoubtedly be an "obstacle" , would the threat of avid disorder by way of anti-facility demonstrations by local environmental groups similarly constitute an obstacle. to some extent the force of paragraph (4) is mitigated by (5) which provides that where a Contracting Party can demonstrate that the construction or modification of energy transport facilities ((5)(a)), or increased capacity through existing facilities ((5)(b)) would endanger "the security or efficiency of its energy systems, including security of supply," it is not obliged to permit the changes. However, in such a situation, and subject to paragraphs (6) and (7), the Contracting Parties are obliged to secure established flows "to, from or between the Areas of other Contracting Parties." Since securing established flows may involved the necessity of modifying or expanding existing facilities, as in the case of old and inefficient pipelines, electricity power lines or even relay stations, there are instances in which this paragraph could become self contradictory,[14] thereby placing the Contracting Party attempting to invoke the protective provisions of paragraph (5) in an invidious position.

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[14] This is not a fanciful scenario. Given that it has been estimated that 30% of the gas and oil pipelines which transit Ukraine carrying oil and gas from Central Asia to western Europe were built prior to 1983 and are obsolete and dangerous, it is merely a matter of time before either the Vendor or Purchaser of the energy product will require either the replacement or modification of the facilities.

Paragraph (6) provides that where a dispute occur over any matter arising from Transit, the Contracting Party over whose territory the disputed transit passes, shall not "interrupt or reduce, permit any entity subject to its control to interrupt or reduce or require any entity subject to its jurisdiction to interrupt or reduce the existing flow" of energy supplies prior to "the conclusion of the dispute resolution procedures set out in paragraph (7) except where this is specifically provided for in a contract or other agreement governing such Transit or permitted in accordance with the conciliators decision." Certainly, no other paragraph in the Article demonstrates the EU's policy of continuity and thereby security of supply as does paragraph (6). The abrogation of a Contracting Party's right to suspend transit operations which in some way infringe either its laws or its political, environmental or geographic security, until the competence of its claim has been adjudicated may be regarded as evidence of this.

Moreover, the extension of the prohibition to include actions by any "entity" subject to either the Contracting Party's control or jurisdiction in effect renders the Party liable for acts committed by such groups as environmental protesters, guerrilla or terrorist groups, or indeed, any organisation within the Party's territory. From one view, this provision could therefore be regarded as an incentive for Contracting Parties to stifle or repress civil movements protesting against aspects of energy transit (for example, the replacement of high-power electricity lines emitting electromagnetic radiation) who may interfere with the transit as a means of protest. It is not within the ambit of this discussion to speculate upon the effects this may have upon the civil rights of citizens of a Contracting Party subject to the provision, especially in those FSU states which have employed repressive and ruthless methods to stifle dissent in the past.

Paragraph (7) addresses the issue of dispute resolution in regard to disputes arising from paragraph (6). The provisions of paragraph 7 only apply if "all relevant

contractual or other dispute resolution remedies previously agreed between the Contracting Parties to the dispute" or related entities, have been exhausted.

If this occurs, a Contracting Party may notify the Secretary-General of the dispute, who will, within 30 days of notification and in consultation with the parties the Secretary-General will then appoint a conciliator who:

- shall be experienced in the matters in dispute; and
- is neither a citizen nor permanent resident of any of the Contracting Parties involved. ((7)(b)).

The conciliator then attempts to bring the parties to an agreement regarding either a resolution or the procedure to adopt to secure a resolution. If this has not occurred within 90 days of his/her appointment, the conciliator is free to recommend either a resolution or the procedure whereby the dispute might be resolved. To preserve the status quo, the conciliator also has the power to "decide the interim tariffs and other terms and conditions to be observed for Transit from a date which he shall specify the dispute is resolved" ((7)(c)). The Contracting Parties and entities under their control or jurisdiction undertake to observe any interim orders made by a conciliator for 12 months following the decision or until resolution of the dispute ((7)(d)). However, if the dispute has previously been conciliated, the Secretary-General may elect not to appoint a conciliator ((7)(e)). The Article does not specify what alternative action the Secretary-General should take in relation to a decision made pursuant to (7)(e). However, it is presumed that the dispute resolution procedures set out in Article 27 apply.

Further, paragraph (7)(f) provides that the charter Conference "shall adopt standard provisions concerning the conduct of conciliation and the compensation of conciliators." Once again there is no specification as to which "standard provisions" apply.

Paragraph (8) underlines the relationship between the transit provisions and international law by providing that nothing in the Article "shall derogate from a Contracting Party's rights and obligations under international law, including customary international law, existing bilateral or multilateral agreements, including rules concerning submarine cables and pipelines."

Finally, paragraph (9) provides that where a Contracting Party does not have a certain type of energy transport facility, it is not obliged to take any measure under Article 7 in regard to that type of energy transport facility. It is, however, obliged to comply with paragraph (4), i.e. the Contracting Party may not put "obstacles" in the way of a new facility being established. Thus, a Contracting Party is bound to comply with a request to allow the construction of a natural gas pipeline across its territory if one is required by another Contracting Party. This, in effect, secures the construction of natural gas and oil pipelines to transport supplies from Eastern Europe and Central Asia to the EU across the intervening territories of those Contracting Parties which did not previously have such facilities.

Article 8

Article 8, "Transfer of Technology," provides for the transfer of energy technology "on a commercial and non-discriminatory basis to assist effective trade in Energy Materials and Products and Investment and to implement the objectives of the Charter." This requirement is subject to the laws and regulations of the Contracting Parties and to the protection of intellectual property ((8)(i)). To give effect to paragraph (1), paragraph (2) goes on to stipulate that the Contracting Parties shall "eliminate existing and create no new obstacles" to the transfer of technology "subject to non-proliferation and other international obligations."

Certainly, Article 8 appears to be in the spirit of the original intentions of the ECT: i.e., the encouragement of assistance to the technologically handicapped FSU states.

The promotion of new energy technologies, however, is of equal value to all signatories of the ECT. Whilst the FSU countries benefit from the possible environmental safety and energy efficiency aspects of new technology, the EU states profit by way of lower tariffs from the cost-efficiencies which tend to accompany technological innovation. It is also interesting to note that paragraph (2) contains the prescription that Parties shall not allow "obstacles" to impede the transfer of technology. Furthermore, reference to "non-proliferation obligations" suggest that the new energy technologies envisaged by the signatories include advances in nuclear power generation. Therefore, it is possible that Article 8 could be invoked to compel those FSU states with nuclear power generation facilities to accede to technological upgrades of their nuclear power generating plants.[15] Whilst this is an extremely positive provision, the Article makes no mention of which Party is to be responsible for financing the technology transfer, other than to state that such transfers shall be on a "commercial" basis. It is arguable, therefore, that pursuant to Article 8, a Party could be compelled to accept the implementation of new energy technology at its own cost.

On the other hand, and on a more positive note, a literal application of Article 8 could be used to compel an unwilling possessor of new energy technology to provide other parties with access to the innovation. However, if such an application of the Article were attempted, it would be open to the Party possessing the technology to invoke intellectual property laws as a defence to disclosure.

Article 9

Article 9, "Access to Capital," outlines the Treaty requirements in regard to the capital markets of Contracting Parties. To a great extent, this Article embodies soft

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[15] Article 8 is particularly relevant in this respect to Russia and Ukraine, both of which operate outmoded and unsafe nuclear reactors. As discussed at 34 above, improvement in the safety of nuclear reactors is of extreme importance to all of Europe, not simply the FSU.

law, being exhortatory rather than prescriptive in its statement of principles and imprecise and/or undefined terminology.

Article 9(1) opens with the recital that: "The Contracting Parties acknowledge the importance of open capital markets in encouraging the flow of capital to finance trade in Energy Materials and Products and for the making of and assisting with regard to Investments in Economic Activity in the Energy Sector in the Areas of other Contracting Parties, particularly those with economies in transition." This is to be achieved by each Contracting Party using its best endeavours to "promote conditions" to enable companies and nationals of other Contracting Parties to have access to its capital markets on the same basis as domestic corporations and nationals ((9)(1)). An exception to this provision is found in U9, which provides that domestic programmes for "public loans, grants, guarantees or insurance for facilitating trade or investment abroad" may be subject to constraints regarding participation.

A difficulty arises in relation to Article 9(1) in regard to the term "capital markets." No definition is provided and whilst it may be argued that the usual rule of interpretation should apply, i.e. the application of the normal, every day meaning of the word, this is of little use when attempting to define a generic term which may be allocated a variety of meanings. On a narrow view, the term "capital markets" may refer solely to securities markets, i.e. stocks, shares and bonds. Alternatively, a broader definition could include not only stock markets but also foreign exchange, commodities, and indeed, any sector of a Contracting Party's financial/economic system. Such a broad definition is suggested by the range of exceptions contained in Understanding 9 and therefore it is envisaged that the uncertainty of the definition of "capital markets" could lead to potential problems in implementation of the Article.

Paragraph (2) permits a Contracting Party to adopt and maintain programmes for providing access to public loans, grants, guarantees or insurance for facilitating trade

or investment abroad." Such facilities shall be made available for investments in the energy sector of other Contracting Parties or for financing trade with other Contracting Parties, provided that the facilities are "consistent with the objectives, constraints and criteria of such programmes." Once more it is argued that lack of definition of terms, especially "such programmes", could prove to be a potential minefield for unwary Parties.

Paragraph (3) provides that Contracting Parties shall take advantage of "the expertise of relevant international financial institutions" in implementing measures to improve their "economic stability and investment climates."

However, paragraph (4) contains the proviso that nothing in Article 9 shall prevent "financial institutions from applying their own lending, or underwriting practices based on market principles and prudential considerations" ((4)(a)). It would appear, therefore, that the expertise envisaged by Article 9(3) is by way of financial assistance from such institutions as the EBRD and the World Bank. Moreover, the terms upon which this "expertise" is provided depend solely upon the institution's concept of what constitutes "market principles" and "prudential considerations."

Furthermore, paragraph (4)(b) provides that nothing in the Article shall prevent a Contracting Party from taking measures to protect "investors, consumers, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial services supplier" (4(b)(i)) or "to ensure the integrity and stability of its financial system and capital markets "((4)(b)(ii)). It would appear that the provisos in (4)(b)(i) and (ii) are aimed at Contracting Parties in different roles. Whilst it is possible that (4)(b)(i) could apply to a host state Contracting Party seeking to protect its own domestic investors, consumers etc., it is far more likely that the subparagraph is intended to catch the investor Contracting Party or nationals of a Contracting Party who are investing in an energy project in another signatory state. Such an interpretation, it is argued, is most probable, given the context. However, it should be noted that there

is no restriction upon what "measures" may be taken and that the protection given by, a Party may extend not only to investors and consumers, but also to "persons to whom a fiduciary duty is owed by a financial service provider."[16] This casts a very broad net of persons who may have an interest in, but who are not parties to, an energy sector agreement and who may require a Contracting Party to invoke the provisions of the Treaty. This provision is further strengthened by Article 26, which accords a right of action against a Contracting Party to investors who are non-parties the energy sector agreement.

On the other hand, (4)(b)(ii) appears to target a host Contracting Party in that it allows the Party to take measures to protect the "integrity and stability of its financial system and capital markets." However, if the opening of its capital market to access by foreign corporations could jeopardize the "stability" of the financial system of a Party, it is possible that any measures involving restriction of access would render the Party in breach of Article 9(1). Thus, paragraphs 4(b)(ii) and (1) could, under certain circumstances, prove to be in conflict. Should such a situation arise, it is by no means certain from the provisions of the Treaty, which paragraph would prevail.

Conclusion

As may be gathered from the foregoing discussion, the Background, Preamble and Parts I and II set the stage for FDI in the energy sector and deal primarily with conditions precedent for investment in energy projects. To some extent, Part II provides a soft law regime of best efforts requirements for the establishment of open and "investor friendly" energy and capital markets. On the other hand, certain provisions, such as Articles 5, 7, 8 and 9, impose stringent liabilities upon Contracting Parties to restructure and reorganise not merely their financial and energy markets, but also their legal systems and social and economic policies to

[16] For example, shareholders and equity participants.

meet the demands imposed by FDI in the energy sector. Such restructuring can only be achieved at great cost to the Contracting Party and its subjects, both in terms of economic resources and political and legislative autonomy.

This invasive nature of the obligations imposed by the ECT is maintained throughout Parts III, IV and V, as discussed in Chapter VI below, and further serve to emphasise the Euro-centric bias of the Treaty.

CHAPTER VI

PARTS III, IV AND V

Introduction

Whilst Part II of the ECT deals with the conditions precedent necessary for FDI in the energy sector, Parts III, IV and V provide for a stringent investment protection regime.

Part III deals with post-investment and is far more stringent in its requirements, providing a number of binding obligations which may be enforced through international arbitration, including the granting of national/MFN treatment to FDI, the employment of key personnel and government host state guarantees and indemnities. Part IV addresses issues such as (inter alia) environmental protection, taxation and the vicarious liability of Contracting Parties for the activities and actions of sub-regional authorities. These matters, whilst being dubbed "Miscellaneous" are non the less vital to the ECT regime. Part V sets out the procedures for Dispute Resolution to be applied to enforce the provisions of the Treaty.

Therefore, Parts III, IV and V are central to the ECT investment protection objectives and will be discussed in detail in the following sections.

Part III: Investment Promotion and Protection

Article 10

Some of the most significant provisions in this post-investment protection regime are to be found in Article 10, "Promotion, Protection and Treatment of Investments. "Paragraph (1) of the Article sets out the requirement that each Contracting Party shall "encourage and create stable, equitable, favourable and transparent" conditions for investors of other Contracting Parties wishing to make

investments within its territory. Moreover, such investors shall be treated fairly and equitably and their investments shall "also enjoy the most constant protection and security," safe from "unreasonable or discriminatory measures" which might impair their "management, maintenance, use, enjoyment or disposal," and shall be accorded treatment no less favourable than "that required by international law, including treaty obligations."

Further, Article 10(1) provides that "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." Thus, the breach of an investment agreement becomes a breach of the ECT. However, during negotiations, Contracting Parties were given the opportunity to opt out of the obligations contained in the last line of the paragraph, thereby not allowing an investor or Contracting Party to submit a dispute to international arbitration pursuant to Articles 26(3)(c) and 27 (2). Those parties who took the opportunity to opt out are listed in annex 1A and comprise Australia, Canada, Hungary and Norway. Paragraph (2) provides that each Contracting Party "shall endeavour to accord to investors of other Contracting Parties ... the Treatment described in paragraph (3)" in regard to the making of investments.

Paragraph (3) defines "Treatment" as meaning "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." Thus paragraph (3) attempts to provide national treatment requirements in regard to foreign investors in the energy sector of a host Contracting Party. Certainly, national treatment provisions are not unusual in either bilateral or multilateral agreements.[1] Paragraph (4) states that a Supplementary Treaty will be negotiated which "will specify conditions for applying the Treatment described in

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[1] Article 5 of the Closer Economic Relations Agreement between Australia and New Zealand provides for mutual national treatment in the delivery of services, similarly in Article 1402 of the Canada-United States Free Trade Area Agreement, and Article III of GATT in relation to multilateral obligations.

Article 10(3)" (Understanding 10). Whilst paragraph (4) envisages the negotiations of the Supplementary Treaty to be concluded by 1 January 1998 as noted at 85 above discussions are continuing as at 2002 and conclusion of the Treaty is a Secretariat Priority for this year. Further, Understanding 11 notes the relationship between Articles 10(4) and 29(6), which provides for negotiations to commence on 1 January 1995 in regard to an Amendment to the Treaty stipulating the level of tariffs and changes to tariff structures.[2]

Paragraphs (5) and (6) deal with exceptions to the treatment provisions in paragraph (3). Paragraph (5) provides that Contracting Parties shall endeavour to limit "to the minimum" the number of exceptions to national/MFN treatment ((5)(a)) and progressively remove all restrictions affecting foreign investors, whilst paragraph (6) requires the declaration of a Contracting Parties intentions:

- to introduce no new exceptions to national/MFN treatment ((6)(a)); and
- voluntarily commit to accord foreign investors national/MFN treatment.

Paragraph (7) extends the generic national/MFN treatment requirements of paragraph (3) specifically to investments within a Contracting Party's territory by investors of other Contracting Parties. This standard applies not merely to the investments *per se* but also to "their related activities, including management, maintenance, use, enjoyment or disposal."

The requirement of national/MFN treatment in bilateral and multilateral agreements is by no means unusual.[3] Instruments such as the 1983 Closer-Economic Relations Agreement (CER) between Australia and New Zealand, the Canada-United States Free Trade Area Agreement (CUFT), the North Atlantic Free Trade Agreement (NAFTA) and GATT all contain provisions which allow for or require national or MFN treatment. Those provisions, however, relate specifically to trade[4] and

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[2] The Amendment was approved and adopted by the Council on 13 July 2001 (OJ L209 02/02/2001 P.0032).

[3] For example, Articles I(1) and III(1) of GATT provide for the non-discriminatory or MFN treatment of goods. .

[4] Although CER relates also to the supply of services.

therefore have a specific, well defined application within this context. It is not difficult to identify discrimination or discriminatory practices in the application of import/export quotas, the levying of excise and duties, or the application of taxation laws. Moreover, such national/MFN treatment requirements are propounded in bi- or multilateral treaties concluded between equally "developed" nations, such as the US and Canada and other members of the WTO. However, the national/MFN provisions contained in the ECT are directed toward attempts by FSU states to "level the playing field" between domestic and foreign products of the same type through protectionist imposts.

Difficulties may arise, however, in the application of national and MFN treatment to investments and "their related activities," as required by the ECT. Firstly, there arises the issue of scope of application. Whilst paragraph (7) defines "related activities" to include "management, maintenance, use, enjoyment or disposal," the term is not limited to these, it is merely inclusive. Thus, the requirement could extend to any conceivable aspect of the investment's operations, such as employment of personnel, environmental protection,[5] compliance with local domestic laws and regulations, in regard (inter alia) to land use, minimum maintenance standards, transportation and access to utilities and other infrastructure.

Secondly, there is the issue of the standard to be applied. Whilst paragraph (7) provides for treatment no less favourable than that accorded to domestic investments (national) or to the investors of another Contracting Party or a third state (MFN), "whichever is the most favourable," no guidance is given as to how the most advantageous treatment is to be identified, since both national and MFN treatment offer different advantages.[6] On the one hand, national treatment may offer

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[5] Whilst environmental protection provisions are set out in Article 19 and the Protocol (discussed at 128 and 156 infra), host state environmental protection laws may impose more stringent requirements than contained in the ECT.

[6] Although Robin Burnett suggests that national treatment "is generally regarded as better than 'most favoured nation treatment' which only guarantees treatment as that accorded to entities of third countries" (*The law of international business*

immunity from import/export quotas, domestic product purchasing requirements, and exemption from import/export levies on goods produced overseas and preference in tendering processes. However, there may also be requirements imposed upon comparable/similar domestic investments such as reporting standards on financial and environmental protection measures, the payment of domestic taxes such as land tax, payroll tax, Goods and Services or Value Added taxes and Fringe Benefits Tax.

On the other hand, MFN treatment may accord an investor exemption from payment of domestic taxes, reporting requirement and certain import/export duties. However, it may also impose onerous obligations in regard to currency/FX restrictions and employment of local personnel in the investment operations. In such instances, therefore, which treatment is to be regarded as "most favourable?" Although the decision as to which treatment should apply to the investor must essentially be based upon commercial principles and that of the host Contracting Party upon consideration of the "common weal," and therefore, a matter of negotiation, there is nothing in Article 10 which limits the application of one form of treatment to the exclusion of the other.

Thirdly, the issue of negotiations between the host Contracting Party and the investor arise in this context. For example, it is arguable that a foreign investor from a Contracting Party in negotiating a resource exploitation agreement with a host Contracting Party could invoke Article 10(7) to demand the same favourable terms in regard to environmental controls, royalties, tax exemptions and state support as were negotiated and obtained by a previous investor (either domestic or foreign) for a similar project. If, as is suggested, Article 10(7) could be invoked in this way, its provisions would severely restrict the negotiating freedom of the respective parties and in particular, the host state, by enabling the foreign investor to use the prior favourable agreement as a precedent for the terms of the current contract. In those geographical locations where energy resource exploitation takes

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transactions. Federation Press, Sydney, 1994, 262).

place in environmentally sensitive regions, such as either the Kakadu National Park in the Northern Territory or the Great Barrier Reef of Australia, the application of Article 10(7) in this way could prove environmentally disastrous.

Fourthly, a difficulty arises in the application of Article 10(7) in regard to energy investments in regions within the territory of a Contracting Party which are controlled by a local autonomous authority, such as in those areas of Australia controlled by local Aboriginal Land Councils. For example, when an investor from another Contracting Party wishes to exploit uranium resources within a Land Council area, do they negotiate with the Land Council, the Australian Government or both? Furthermore, if the Land Council either refuses to sanction the exploitation or consents upon terms which could be construed as discriminatory, it is arguable that the Australian Government could be held in breach of Article 10(7). In such a situation a government is in an invidious position: it must either enforce the ECT and thereby restrict the self-determination of an autonomous local authority or remain in breach of an international multilateral agreement which may be enforced.

As the provisions of paragraph (7) stand, therefore, they raise some difficult questions as to interpretation and application. It is to be hoped, therefore, that the "modalities of application of paragraph (7)" will be addressed in the Supplementary Treaty, as provided in paragraph (8), in such a way as to clarify the issues discussed above.

In the meantime, paragraph (8) goes on to provide that each Contracting Party shall keep the Charter Conference informed of "the modalities it applies to both its programmes under which it provides grants, financial assistance and any contracts for energy research and development into which it enters.

Paragraph (9) provides that all Contracting Parties or Regional Economic Integration Organisations shall deposit with the Secretariat a "report summarizing all laws,

regulations or other measures relevant to" national/MFN treatment ((9)(a)) or financial aid programmes ((9)(b)). Further, the Contracting Party must keep the report updated.

Paragraph (10) exempts intellectual property from the application of paragraphs (3) and (7) and, instead, provides that "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." This allows Contracting Parties to honour existing national/MFN treatment agreements with respect to intellectual property.

Paragraph (11) provides that for the purposes of Article 26 (Dispute Resolution provisions) where a Contracting Party applies any of the trade-related measures set out in Article 5(1) or (2)[7] to the investment of another Contracting Party, the host (former) Contracting Party will be considered to be in breach of an obligation pursuant to Part III of the Treaty.

Finally, paragraph (12) requires that 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." In effect, this provision requires all Contracting Parties to take steps to ensure that their domestic legislation and legal systems conform to the investment protection requirements of the Treaty in regard to the "assertion of claims" and enforcement of rights relating to investments. Whilst those Contracting Parties with a tradition of commercial litigation and concomitant corpus of commercial law are able to comply with this requirement without the necessity to effect legislative or systemic changes, the FSU states are placed at a distinct disadvantage. As discussed at 100 above, for those Contracting Parties who have recently emerged from a controlled, centralised communist system, compliance with

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[7] I.e. domestic product purchasing requirements or import/export quotas.

this provision entails a complete reconstruction of their legal systems. Whilst most FSU states are undertaking this task as part of their programmes of post-Communist restructuring, this peremptory requirement can only place added pressure on already fraught systems of reform.

The effect of Article 10 is mitigated somewhat by Understanding 4, but only in regard to Canada and the US, which affirm that they will apply the provisions of Article 10 only to the extent that they do not infringe and contradict their investment policy objectives. Since this qualification applies only to Canada and the US, it is of no benefit to other Contracting Parties who must therefore comply strictly with the provisions of Article 10.

Article 11

Article 11 deals with "Key Personnel" of the investor. Paragraph (1) requires that a Contracting Party shall "examine in good faith requests by investors of another Contracting Party, and key personnel" who are employed by them for entry and residence permits. Further, paragraph (1) states that the consideration of such requests by a Contracting Party is "subject to its laws and regulations relating to the entry, stay and work of natural persons." Paragraph (2) provides that a Contracting Party must allow a "key person" to enter and remain in their territory "regardless of nationality and citizenship," once the "key person" has acquired the necessary entry and residence permit.

Article 11 may appear somewhat anomalous in that it would seem self-evident that a person who has obtained necessary entry and residence visas for a foreign state would, consequently, be allowed to utilize them. It is unclear from the Article whether the "laws and regulations" referred to in paragraph (1) and to which the provisions of Article 11 are subject are merely those laws relating to entry and residence generally, or whether the qualification also applies to domestic restrictions on employment by foreign entities of overseas personnel. If read in conjunction

with the national/MFN treatment provisions of Article 10, it is suggested that the former interpretation is the one intended. Thus, whilst a Contracting Party may apply its generic entry and residence laws to the request of a key foreign national, it cannot impose occupational restrictions if these would contravene Article 10.

Moreover, in its prescriptive force and effect, Article 11 is couched in far broader terms than comparable provisions in other multilateral agreements on services, more particularly the GATS. Whilst the GATS Article 11 requires MFN treatment for "services and service suppliers of any other Member" (Article 11(1)), access to and movement of "Natural Persons supplying services" are tempered by the relevant GATS Annex.[8] Essentially, the Annex exempts the application of the GATS from:

1. Measures affecting citizenship, residence or employment on a permanent basis (paragraph 2);
2. The regulation of natural persons into a Member's territory, including "those measures necessary to protect the integrity of, and to ensure the orderly movement of natural persons across its borders" (paragraph 3).

Further, a footnote to paragraph 3 provides that:

> The sole fact of requiring a visa for natural persons of certain Members and not for those of others shall not be regarded as nullifying or impairing the benefits under a specific commitment.

Thus, it would appear that the GATS, whilst requiring the provision of national/MFN treatment in relation to international service transactions, does not "cover labour movements *per se*."[9] On the other hand, Article 11 of the ECT applies specifically to the movement of labour, particularly key personnel.

It would appear, however, that the restriction of residency in bi- and multilateral instruments placed upon foreign nationals engaged in FDI is to be regarded as an integral part of the national/MFN treatment accorded to foreign investors. In

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[8] Annex on Movement of Natural Persons Supplying Services under the Agreement.

[9] Pryles et al., op.cit., 855.

Bilateral treaties and multilateral instruments, G. Sacerdoti argues that "[r]esidency requirements generally affect unfairly foreigners and should be justified by some public purpose or objective need in respect of the activity which is being so limited."[10] In this same vein, in May 1998 the European Court of Justice held that an Austrian residency requirement for a manager of a company was an unjustified discriminatory measure which constituted an infringement of the movement of workers rather than contravening any principle requiring national/MFN treatment.[11]

Articles 12 and 13

Article 12 and 13 of the Treaty address the issues of expropriation and compensation for losses. Except in instances in which Article 13 applies, Article 12 (1) provides that a host Contracting Party shall indemnify/compensate the investor of another Contracting Party for any losses on a national/MFN treatment basis. Compensable losses may arise from "war or other armed conflict, state of national emergency, civil disturbance or other similar event in that Area." It is important to note that it is notoriously difficult to effect insurance against such events as armed conflict and civil unrest. Whilst insurance for other *force majeure* occurrences such as flood and earthquake are highly negotiable, but by no means impossible to secure, insurance companies are extremely reluctant to underwrite risks associated with civil disorder or war, especially in those states with either a history of armed conflict or political and/or economic instability. Moreover, the provision contains the inclusionary phrase "or other similar event in the Area," which as a generic term, would arguably cover acts of terrorism. Since 11 September 2001 insurance against acts of terrorism has become if not impossible to obtain, certainly only obtainable only on the basis of exorbitant premiums.[12]

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[10] *Recueils des Cours*, **269** (1997), 349.

[11] Decision C-350/96 of 7/5/98.

[12] See 213 ff below for a discussion of insurance of *force majeure* events.

Paragraph (2) goes on to qualify paragraph (1) in that it requires that an investor of a Contracting Party which 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... ."

Such compensation must be prompt, adequate and effective. There is no stipulation as to what constitutes "adequate and effective," nor what time frame would qualify as prompt. Moreover, should the provisions of Article 12 ever need to be invoked, it is unlikely that the host Contracting Party would be in a financial or practical position to offer either "adequate" or "prompt" compensation. Whilst it is possible to appreciate the necessity to offer protection to foreign investments from risks which are, to all intents and purposes, uninsurable, it is difficult to envisage how Article 12 could be enforced. A host Contracting Party suffering the devastation of civil war and/or ethnicity-based conflict such as that experienced throughout the 1990's by the Balkan states,[13] particularly Serbia and Bosnia-Herzogovina, would have more pressing issues to occupy its government than compensation for loss suffered by a foreign investor as a result of the conflict.

Whilst Article 12 deals with compensation for the requisition or destruction of foreign investments during times of conflict, Article 13 deals with expropriation/nationalization of energy investments during peace time. Article

[13] It is possible that Article 12 was drafted with the Balkan states in mind. The constant warfare which raged throughout this region during the 1990's was an overwhelming preoccupation for much of central and eastern Europe at this time. Moreover, all of the states involved in the conflicts were not only signatories of, but have also ratified the ECT. Therefore, the strategic position of these states between Europe and the rich energy resources of Russia and Central Asia would have rendered them desirable but extremely volatile objects for FDI in energy transport facilities such as pipelines and power transmission infrastructure.

13(1) stipulates that the investments of investors of a Contracting Party in the territory of another Contracting Party shall not "be nationalized, expropriated or subjected to a measure or measures" of equivalent effect unless 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."

The compensation must equal the "fair market value" of the investment "at the time immediately before the Expropriation or impending Expropriation became known in such a way as to effect the value of the investment (herein referred to as the "Valuation Date") ((1)). Compensation shall be paid in any Freely Convertible Currency requested by the Investor calculated at the exchange rate on the Valuation Date and must include interest calculated at a commercial rate from the date of Expropriation to the date of payment. Paragraph (2) provides that the investor has the right to a "prompt" review of its case, of the valuation of the investment and the compensation payable pursuant to the law of the Contracting Party making the Expropriation by "a judicial or other competent and independent authority of the Contracting Party. Paragraph (3) clarifies the term Expropriation by including the expropriation of shares in the foreign investment by the host Contracting Party.[14]

These anti-expropriation provisions have significant implications. Firstly, they cover expropriation pursuant to a host state's environmental legislation. For example, where an energy-related investment, such as a uranium mine, is situated in a newly designated World Heritage or environmentally sensitive protected area. Secondly, it could also be construed to cover new host state legislation dealing with ethnic minority or subgroup autonomous regions. For example, in the case of

[14] For a discussion of the law relating to the expropriation of natural resources and the concept of "prompt, effective and adequate compensation," see 327 ff.

legislation which stipulates that any investment within an autonomous region, such as the Aboriginal Land Council regions of Australia, must be owned equally by the autonomous subgroup and the outside investor. Since such joint-ownership is effected by way of share transfers, and Article 13(3) includes expropriation of shares within its ambit, any expropriation of shares in an investment made pursuant to the ECT will be subject to these provisions. This, in turn, could place the host state in an unenviable position. It must then decide where the financial burden of the compensation payment must fall: upon the host state government or the sub-autonomous group. The fact that paragraph (2) provides for review of a compensation claim pursuant to domestic law by a domestic tribunal does not assist in solving this problem. Whilst in Australia various governments have not been loath to submit such Constitutional questions to the High Court for determination[15] other signatories to the ECT with significant ethnic-sub groups, such as the Tartars of the Crimea in southern Ukraine, may prefer to avoid granting autonomy to groups within areas rich in energy resources rather than risk the eventuality of large compensation payments for expropriation of energy investments within such areas.

Article 14

Article 14 deals with funds "Transfers Related to Investments." Paragraph (1) stipulates that a host Contracting Party shall allow the transfer into and out of its territory of all funds, including:

"(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;

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[15] For example *Commonwealth v Tasmania* (1983) 46 ALR 625 (the "Tasmanian Dam Case") and *Mabo v Queensland (No.2)* (1992) 175 CLR 1: 107 ALR 1 ("Mabo").

(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 part of an investment;

(f) payments arising out of the settlement of a dispute;

(g) payments of compensation pursuant to Articles 12 and 13."

It is to be noted that paragraph (1) is non-exclusive and therefore covers any transfers at all in relation to the investment. Such transfers are to be effected without delay and, except for returns "in kind", must be in a Freely Convertible Currency ((2)) and at the market of exchange existing at the date of transfer (paragraph (3)). The provisions of paragraphs (1) and (2) are modified by Decisions 3 and 4. Decision 3 stipulates that the freedom of transfer provided pursuant to Article 14(1) does not prevent a Contracting Party (referred to as a "Limiting Party") from imposing restrictions upon the movement of capital by its own investors provided that such restrictions do not affect investors of other Contracting Parties, do not affect current transactions[16] and the host Contracting Party ensures that foreign investors are accorded national/MFN treatment. However, the exceptions permitted by Decision 3 apply only to former FSU states which have notified the Secretariat that they have elected to apply the exemption. Further, the exceptions apply only for five years after the entry into force of the treaty on 1 July 2001 (i.e. the date stipulated in Article 32(3)) at the latest. Since 1 July 2001 has passed, it is assumed that the extensions granted have either lapsed or have been extended. In effect, only Russia claimed the benefit of the exemption. Moreover, the Decision was subject to an exchange of letters between the Limiting Party and the EU in regard to preserving rights under any prior agreements. In the case of Russia, this related to the 1994 Partnership and Co-operation Agreement between Russia and

[16] "Current Transactions" are defined in Decision 3(5) as 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 are meant to circumvent respective legislation of the Limiting Party in the field."

the EU. Decision 4 exempts Romania from compliance with the Currency provisions of paragraph (2). Moreover, paragraph (5) exempts agreements made by FSU states "provided that such agreements do not treat" foreign investments in their areas less favourably than the investments of nationals.

Article 14 provides other exceptions. Paragraph (4) allows the protection of creditor's rights, compliance with securities laws and the satisfaction of judgements through "the equitable, non-discriminatory and good faith application" of the host Contracting Party's laws and regulations. Paragraph (6) acknowledges that "payments in-kind" (i.e. exports pursuant to production sharing agreements) may be restricted if such restrictions are made pursuant to GATT/WTO or "Related Instruments" which "restrict or prohibit the exportation or the sale for export of the product constituting the Return in kind."

Article 15

Article 15 sets out the conditions relating to the subrogation of rights. Paragraph (1) stipulates that when a Contracting Party or "its designated agency (hereinafter referred to as the "Indemnifying Party") makes a payment pursuant to an indemnity or guarantee given in respect of an investment of an investor (the "Party Indemnified") in the area of another Contracting Party (the "Host Party") must recognize the validity of an assignment of all rights to the Indemnifying Party and its right to enforce its claims by virtue of subrogation." Thus, the Indemnifying Party is entitled to the same treatment in respect of its rights and claims and the same payments due as the Indemnified Party ((2)).

Further, pursuant to paragraph (3), a Contracting Party cannot raise as a "defence, counterclaim, right of setoff" or on any other basis that whole or part payment by way of indemnification or damages has been received or will be received pursuant to an insurance or to an guarantee contract." Thus, a received or prospective

insurance/guarantee payment made to the Indemnified or by an Indemnifying Party cannot be used to defeat any claim as against a host Contracting Party.

However, no provision is made to prevent "double-dipping" by the Indemnified Party. For example, if the Indemnified Party receives part-payment pursuant to an insurance claim, pursuant to paragraph (3) the host Contracting Party against whom action is taken is still liable for the whole amount owing, without the usual right of setoff against the claim. It is to be supposed, therefore, that in any successful proceedings pursuant to Articles 26 or 27 by an Indemnified Party, the whole amount of any award will be payable by the liable Contracting Party irrespective of the fact that part of the claim has been satisfied pursuant to a contract of insurance or guarantee. In practice, however, it is to be assumed that any award made against a liable Contracting Party will be either apportioned between the Indemnified and Indemnifying Parties according to the amount paid to the indemnified Party pursuant to the contract, or paid to the Indemnifying Party to cover the payout made pursuant to the indemnity. There is an urgent need, therefore, for clarification of paragraph (3) since the former application, absurd as it may seem, is very arguable.

Articles 16 and 17

Article 16, "Relation to Other Agreements," elucidates the relationship between the ECT and other international agreements. Thus, where two more Contracting Parties are parties to a prior or subsequent international agreement concerning "the same subject matter" as Parts III or IV of the ECT, the agreement with terms most favourable to the investor or investment shall be applied. In effect, therefore, a host Contracting Party cannot invoke the terms of a prior or subsequent international agreement to derogate from the rights conferred on an investor by the ECT and the host Party is locked in to foreign investment protection.

The Article itself does not specify which "other agreements" are caught by its provisions. Whilst Article 4 of the ECT provides that nothing in the Treaty shall

derogate from the provisions of the GATT and related instruments, it can only be assumed that the "other agreements" referred to are such bi- and multilateral agreements not formed pursuant to the GATT/WTO regime. Examples of such agreements are the Europe Agreements formed between the EU and FSU states in the 1990's and which cover political dialogue and trade relations in all areas of economic activity, including the production and procurement of energy resources.[17]

Article 17, the "Non-Application of Part III in Certain Circumstances," allows a host Contracting Party to deny the advantages of Part III either to a legal entity if owned or controlled in the area by citizens of a third state, provided the entity has no substantial business activities of the host state or to an investment of an investor of a third state with whom the host Party does not maintain diplomatic relations or with whom it prohibits transactions or against whom it maintains sanctions. Thus, if an investor from a non-Contracting Party wishes to enjoy the benefits of the investment protection offered by the ECT for energy projects within the territory of a Contracting Party, the investor will not only need to employ an entity based in a Contracting Party but also conduct substantial business there as well.

Part IV : Miscellaneous Provisions

Part IV, as the title suggests, contains a number of provisions which, whilst relevant to the scheme of the Treaty, do not come within the ambit of the other sections. However, the fact that the various provisions, including those relating to Sovereignty over Energy Resources (Article 18) Environmental Issues (Article 19), Taxation (Article 21) and State Enterprises (Article 22), are gathered under the heading "miscellaneous," should not belie their significance.

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[17] Lyons, op. cit., 126.

Article 18

Article 18, Sovereignty over Energy Resources, is declaratory rather than prescriptive in nature. As such it recites a series of principles relating to the issue of sovereignty over natural resources which Contracting Parties agree to uphold, rather than establishing rules to ensure the observance by foreign investors of a host states right to assert control over energy resources. Thus, whilst the effect of the ECT upon sovereignty in general and sovereignty over natural resources in particular will be discussed in greater detail in Chapters X and XI below, a *résumé* of the content of Article 18 is given below.

Paragraph (1) declares that each Contracting Party recognises "state sovereignty and sovereign rights over energy resources. They reaffirm that these must be exercised in accordance with and subject to the rules of international law." As a statement of principle paragraph (1) is laudable. However, the recognition of a right by a party does not necessarily ensure that the right will not be infringed. Further, paragraph (2) qualifies the statement of principle in paragraph (1) by providing that: "Without affecting the objectives of promoting access to energy resources and exploration and development thereof on a commercial basis," the Treaty shall not prejudice in any way the rules of Contracting Parties "governing the system of property ownership of energy resources." In other words, whilst Contracting Parties recognize the validity and application of host state laws relating to property in energy resources, property rights should not be allowed to obstruct the commercial exploitation of such energy resources by investors of other Contracting Parties.

Despite this restriction in sovereignty implied by paragraph (2), paragraph (3) states that each state "continues to hold in particular the rights" (inter alia) to designate:

- the geographical areas available for energy exploration and exploitation;
- the manner in which such resources are extracted;
- the measures necessary to preserve and/or rehabilitate the environment; and
- the right to impose royalties, taxes or other imposts.

Despite this declaration of rights, however, paragraph (4) requires that each Contracting Party undertakes to provide access to energy resources on a non-discriminatory basis according to published criteria.

Article 18 makes no mention of the inviolability of sovereignty over energy resources, neither does it accord a host state the discretion to determine to whom access to energy resources within its territory may be granted. Indeed, rather than affirming sovereignty, Article 18 to some extent, abrogates control over energy resources by formulating limits to host state control and the manner in which this control may be exercised.

Article 19

Article 19 deals with Environmental Issues raised by economic activity in the energy sector, and recites a list of objectives designed to promote environmental protection whilst, at the same time, preserving the profitability of energy projects. Moreover, although Article 19 should be read in conjunction with the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (EEP), Article 19 enunciates "soft law" provisions in regard to environmental protection, and policy, whereas the EEP is primarily concerned with the promotion of energy efficiency.

Paragraph (1) provides that each Contracting Party must strive to minimise the harmful environmental effects both within and outside their territories, and strive to take measures to present environmental degradation. However, not only is this requirement placed upon a "best efforts" basis in that the parties shall merely "strive" to achieve the objective, but also such measures must be "economically efficient" and carried out in a "Cost-effective"[18] manner. Further, paragraph (1) goes on the provide that when pollution does occur, the polluter must "in principle" bear the cost of the pollution, but in doing so must not distort "investment in the

[18] "Cost-effective" is defined in Article 19(3)(d) as "to achieve a defined objective at the lowest cost or to achieve the greatest benefit at a given cost."

Energy Cycle[19] or international trade." Given the economic and financial qualification of the "best efforts" principles it must be assumed that commercial considerations are to take precedence over environmental protection. Pursuant to paragraph (1), if an environmental protection measure proved to be either un-economic, not "cost-effective" or placed some constraint upon international trade, irrespective of the necessity to protect the environment, the measure need not be taken.

Subject to such financial considerations, therefore, paragraph (1) goes on to list the principles which Contracting Parties should consider when engaging in energy sector activities. Thus, Contracting Parties shall:

"(a) take account of environmental considerations throughout the formulation and implementation of their energy policies;

(b) promote market-oriented price formation and a fuller reflection of environmental costs and benefits throughout the Energy Cycle;

(c) having regard to Article 34(4),[20] encourage cooperation in the attainment of the environmental objectives of the Charter and cooperation in the field of international environmental standards for the Energy Cycle, taking into account the difference in adverse effects and abatement costs between Contracting Parties;

(d) have particular regard to improving Energy Efficiency, to developing and using renewable energy sources, to promoting the use for cleaner fuels and to employing technologies and technological means that reduce pollution;

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[19] Defined at Article 19(3)(a) as "the entire energy chain, including activities related to prospecting for, exploration, production, conversion, storage, transfer, distribution and consumption" of energy forms and "the treatment and disposal of wastes, as well as the decommissioning, cessation or closure of these activities... ."

[20] Article 34(4) provides that the Charter Conference and Secretariat shall make as full use as possible of the services and programmes of other institutions in the performance of their duties.

(e) promote the collection and sharing among Contracting Parties of information on environmentally sound and economically efficient energy policies and Cost-effective practices and technologies;

(f) promote public awareness of the Environmental impacts of energy systems, of the scope for the prevention or abatement of their adverse Environmental Impacts, and of the costs associated with various prevention or abatement measures;

(g) promote and cooperate in the research, development and application of energy efficient and environmentally sound technologies, practices and processes which will minimize harmful Environmental Impacts of all aspects of the Energy Cycle in an economically efficient manner;

(h) encourage favourable conditions for the transfer and dissemination of such technologies consistent with the adequate and effective protection of Intellectual Property rights;

(i) promote the transparent assessment at an early stage and prior to decision, subsequent monitoring of Environmental Impacts of environmentally significant energy investment projects;[21]

(j) promote international awareness and information exchange on Contracting Parties relevant environmental programmes and standards and on the implementation of those programmes and standards;

(k) participate, upon request, and within their available resources, in the development and implementation of appropriate environmental programmes in the Contracting Parties.

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[21] This is qualified by Understanding 13, which gives Contracting Party the discretion to decide "the extent to which the assessment and monitoring of Environmental Impacts should be subject to legal requirements" and the administration and application of such laws.

As with the earlier section of paragraph (1), these requirements are purely facultative and place no enforceable obligations upon the Contracting Parties to take any measures to protect the environment.

Paragraph (2) deals with resolution of disputes arising from the interpretation or application of Article 19. Thus, where "arrangements for the consideration of such disputes do not exist in other appropriate international fora" disputes will be reviewed by the Charter Conference. Flowing as it does from the Preamble to the Treaty which recognises "the increasingly urgent need for measures to protect the environment, including the decommissioning of energy installations and waste disposal, and for internationally agreed objectives and criteria for these purposes," Article 19 reads as a purely "politically correct" gesture and concession to environmental protection lobby groups. Whilst the principles enunciated in the Article carry the requisite tone of environmental concern, not only is their application subsumed to financial and commercial considerations, but also they are merely statements of principle and contain no obligations enforceable upon a party who seeks to ignore them.

Article 20

Article 20 deals with the issue of Transparency. Paragraph (1) provides that all laws, regulations, judicial decisions and administrative rulings applied by Contracting Parties in the energy sector shall conform to the transparency requirements of the GATT/WTO and related instruments. Paragraph (2) requires the prompt publication of all such laws, regulations etc. so as to enable all Contracting Parties and investors to become acquainted with them. However, this requirement does not apply to the disclosure of "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."[22]

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[22] See also the GATS Article III for comparison.

Finally, paragraph (3) requires parties to designate one or more enquiry points to which requests for information regarding laws, regulations etc. may be addressed.

Article 21

Article 21 deals with the issue of taxation in relation to economic activities in the energy sector. One of the purposes of this Article is to prevent the benefits of bilateral tax treaties between two Contracting Parties, being shared by all other Contracting Parties pursuant to the MFN provisions in Articles 9 and 10.

Therefore, paragraph (1) provides that unless otherwise specified, the ECT creates no rights and imposes no obligations in respect to the taxation measures[23] of Contracting Parties. Moreover, when an inconsistency arises between Article 21 and any other Article in the Treaty, Article 21 "prevails to the extent of the inconsistency."

However, whilst paragraph (1) preserves the privity of bilateral taxation agreements between Contracting Parties, it could possibly have the unwelcome effect of modifying other provisions of the Treaty. For example, whilst Contracting Parties are required by the ECT to observe their obligations entered into with investors or their subsidiaries, Article 21 could be invoked to defend the imposition of a tax by a host state in violation of the investment agreement.

Paragraph (2) provides that with reference to the imposts on the transit of energy products Article 7(3) shall apply, except where the tax is imposed pursuant to an agreement relating to the avoidance of double taxation (Article 21 (7)(a)(ii)) or where the objective of the tax measure is the effective collection of taxes.

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[23] "Taxation Measure" is defined in paragraph 7(a) to include any domestic laws or international agreements relating to taxation.

Similarly, paragraph (3) provides that Article 10(2) and (7) shall apply to tax measures, i.e. national/MFN treatment provisions, except where such an application would discriminate against another investor.

Moreover, although paragraph (5) provides that Article 13 "shall apply to taxes ... to the extent it pertains to whether a tax constitutes an expropriation" or a "discriminatory taxation," it would be difficult to rebut the assertion by a host state that the offending tax was not levied in the public interest and pursuant to the due process of law (Article 13 (1)(a) and (c)) and thereby exempt from the prohibition. Moreover, the proposition that a tax could constitute an expropriation for the purposes of Article 13 raises difficult issue in relation to the compensation provisions of Article 13(1). It is not fanciful to suggest that an investor aggrieved by the imposition of a new tax upon its operation by a host state could claim compensation pursuant to Article 13, from the host state for any losses sustained as a result of the tax.

Articles 22 and 23

Article 22 relates to the operation and activities of State and Privileged Enterprises in relation to FDI projects in the energy sectors. Paragraphs (1) and (2) provide that Contracting Parties must ensure that their state owned enterprises (SOEs) conduct their activities in a manner consistent with the state's obligations under Part III of the Treaty. These provisions apply not only to SOEs and nationalised entities but also to state administrative and regulatory authorities ((3)) as well as entities to which the Contracting Party has granted exclusive or special privileges (paragraph (4)).

Since "entity" is defined as including "any enterprise, agency or other organisation or individual" ((5)), the Article is framed in sufficiently broad terms to catch the activities of not only commercial enterprises but also all government departments and authorities which have regulatory or administrative functions touching upon

economic activity in energy related fields. Article 22, therefore, effectively extends the ambit of compliance with the provisions of the Treaty and agreements made pursuant to the ECT beyond the government of the Contracting Party to include all regulatory, administrative and sub-governmental authorities.

Essentially, therefore the Contracting Party becomes vicariously liable for any contraventions of the Treaty by any entity caught by the provisions. Thus, in any litigation arising from an alleged breach by such an entity, the proper Defendant will be the Contracting Party, rather than the entity itself. Moreover, any action by an entity caught by the Article which could be construed as being in breach of the ECT could give rise to litigation. In practical terms therefore, Article 22 not only attempts to ensure that Contracting Parties maintain constant and rigorous surveillance over the activities of administrative and regulatory bodies vis a vis FDI energy projects, but also facilitates litigation in the event of a breach of the Treaty by imbuing the Contracting Party with vicarious liability in all circumstances.

Similarly, Article 23, "Observance by Sub-National Authorities," renders a Contracting Party vicariously liable for breaches of the Treaty by regional and local governments and authorities within its territory by:

- making it incumbent upon the Party to take all measures necessary to ensure compliance by sub-national authorities (paragraph (1)); and
- making the dispute resolution provisions of Parts II, IV and V available to an aggrieved party against a Contracting Party in the event of a breach by a sub-national authority.

As with Article 22, Article 23 places the host state government in a very difficult position vis a vis its sub-national authorities. In those countries which operate under a federal structure of governance, such as Australia, the powers of the national government over sub-national governments are constrained by a Constitution. In Australia, "federalism means a demarcation of powers"[24] pursuant to which the

[24] Sir Owen Dixon, speech at his swearing in as Chief Justice of the High Court of Australia, (1952) 85 CLR xiii.

Commonwealth and individual State governments are both co-ordinate and independent. Thus, in matters affecting the whole of Australia, such as foreign affairs, defence, international trade and the provision of funding for health, social welfare and education, the Commonwealth has jurisdiction pursuant to its Constitutional powers. On the other hand, in matters relating to the internal affairs of each State, such as the allocation of funds for education and health, the criminal justice system, provision of infrastructure and all issues relating to the health and safety of the citizens of the state,[25] the state government has sole control.[26] Thus, State governments have a degree of independence from the Commonwealth which allows them absolute control over certain areas of governance. Any infringement or attempted infringement of this independence is subject to litigation between the State and Commonwealth governments in the High Court, which has a tendency to guard the rights of States with a high degree of vigilance.[27] Consequently, it is highly arguable that Article 23 places upon Contracting Parties onerous obligations which they may be unable to perform.

Article 24

Article 24 sets out general exceptions to the Treaty, except in regard to Articles 12, 13 and 29. Thus, pursuant to paragraph (2) the provisions of the ECT shall not prevent a Contracting Party from adopting or enforcing any measure:

"(i) necessary to protect human, animal or plant life or health;

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[25] In matters affecting the health and safety of the citizens of a State, State laws generally have precedence over federal laws.

[26] Whilst this is an extremely simplified description of the division of powers between State and Commonwealth governments, the scope of this thesis does not permit a more detailed discussion.

[27] The jurisdiction of the Commonwealth over State internal affairs has been the subject of a number of High Court proceedings, most notably:
Amalgamated Society of Engineers v Adelaide Steamship Co. Ltd (1920) 28 CLR 129;
Victoria v Commonwealth (1975) 134 CLR 338;
Tasmanian Dam Case (supra). On a sub-regional level see:
Wik Peoples v Queensland (1996) 141 ALR 129 and *Mabo* (supra), a landmark case which determined certain rights of indigenous peoples in relation to native title.

(ii) essential to the acquisition or distribution of Energy Materials and Products in conditions of short supply arising form causes outside the control of that Contracting Party, provided that any such measure shall be consistent with the principles that

(a) all other Contracting Parties are entitled to an equitable share of the international supply of such Energy Materials and Products; and
(b) any such measure that is inconsistent with this Treaty shall be discontinued as soon as the conditions giving rise to it have ceased to exist; or
(iii) designed to benefit investors who are aboriginal people or socially or economically disadvantaged individuals or groups or their Investments and notified to the Secretariat as such, provided that such measure
(a) has no significant impact on that Contracting Party's economy; and
(b) does not discriminate between Investors of any other Contracting Party and Investors of that Contracting Party not included amongst those for whom the measure is intended ... ."

These exceptions are qualified by the proviso that the measures taken are not:

- disguised restrictions upon economic activity in the energy sector; or
- arbitrary or constitute unjustified discrimination against an investor or other interested person.

Paragraph (3) goes on to state that measures taken in the interests of national security during internal conflict or war are also exempt provided such measures are not a disguised attempt to restrict Transit.

Paragraph (4) exempts the application of bilateral and multilateral MFN agreements between Contracting Parties to other Contracting Parties not privy to the agreements.

Most of the exceptions adumbrated in Article 24 are based upon trade rules contained in the GATT/WTO and upon principles and concepts developed in international trade law. However, in reiterating rules and principles formulated pursuant to trade law within the context of regulations relating to investment, the drafters of the ECT have apparently taken little cognisance of the significant differences between trade and investment practicalities.

Moreover, the exceptions listed raise the issue of significant potential inconsistencies between Article 24 and other provisions of the ECT. For example, a measure taken pursuant to paragraph (2)(b)(i) to protect plant life, i.e. an environmental measure, may be inconsistent with the requirement in Article 19 that such measures shall be Cost-Effective and economically efficient, or may "distort investment in the Energy Cycle or international trade" (19(1)). The question should be posed, therefore, that if such a repugnance between Articles 24 and 19 arises, which Article is to be applied?

Similarly, were certain measures to be taken to restrict the operations of a single investor pursuant to paragraph (3)(c) to maintain public order and to prevent civil disturbance caused by a public protest against the investor's activities, could such action be construed as discriminatory and thereby not exempt? Certainly, it would appear that the exceptions contained in Article 24 raise far more questions and thereby, provide fertile ground for contention than was intended by the drafters of the Treaty.

Article 25

Article 25, "Economic Integration Agreements," exempts EIAs from extending the MFN benefits of such an agreement to other Contracting Parties who were not privy to the EIA ((1)). An EIA is defined in paragraph (2) as an agreement "substantially liberalising inter alia, trade and investment by providing for the absence or

elimination of" discrimination between or among parties. However, the provisions of the Article refer solely to MFN treatment and, as such is of limited application.[28]

Part V : Dispute Resolution

The dispute resolution provisions of the ECT are contained in Articles 26, 27 and 28. Articles 26 and 27 provide mechanisms for dispute resolution, whilst Article 28 limits access to the procedure laid down by Article 27.

Article 26

Article 26, "Settlement of Disputes Between an Investor and a Contracting Party," specifies the regime for the resolution of disputes which may arise between a foreign investor who is a national of one Contracting Party in whose territory the investment is situated concerning alleged breaches of Part III of the Treaty.

Article 1(7) defines an "investor" with respect to a Contracting Party as a natural person having citizenship, nationality or permanent residency in the Contracting Party ((7)(a)) or in the case of a corporation, one which is organized in accordance with the laws of the Contracting Party ((7)(b)) or, in the case of an investor from a non-Contracting state ("third state") a natural person or corporation who fulfills the conditions set out in (7)(a) or (b) ((7)(c)). Furthermore, Article 1(6) and (8) define investments and making investments respectively.

However, there is no stipulation in Article 26 or within any other provision of the ECT as to the nature of the interest which must qualify a potential disputant to claim the benefits of Article 26. When the broad range of species of investment is

[28] In the original draft of the Treaty the Article had also included EIAs extending to national treatment. However, vigorous objections to the inclusion of national treatment were mooted by the US and, as a response, references to national treatment were deleted and Decision 5 and Declaration 5 were drafted by way of clarification.

considered, therefore, it is conceivable that any natural person or corporation who has any interest either legal or equitable, in the investment could invoke the provisions. For example, in addition to the obvious forms of investment, such as equity provision and share or bond holdings, it is possible that the beneficiary of a unit trust which either provides equity for or holds shares in the investment could initiate proceedings pursuant to the right conferred by Article 26. Whilst it could be argued that the interest of the beneficiary is equitable rather than legal and therefore enforceable only in the courts of equity, it is equally arguable that since the Article neither specifies the nature of the interest which must be held by the investor nor precludes the operation of the provision in regard to certain types of interest, then investors with "a second hand" interest may take advantage of the provisions.[29] If such be the case, these implications spread the net of the Article far beyond the scope contemplated by the drafters from those investors holding an interest though shares, equity participation or loans to the beneficial interests of unit holders of unit trusts[30] and other such trust arrangements. The possibilities raised by such ambiguities of drafting, whilst offering a potential bean feast for international lawyers, can only work contrary to the intention of the Treaty by hampering the development of economic activity in the energy sector through lengthy and expensive dispute resolution.

In view of the above discussion it appears almost paradoxical that paragraph (1) provides that disputes between an investor and Contracting Party "shall, if possible, be settled amicably." Where this is not possible within three months from the date of request for an amicable settlement, paragraph (2) provides that the investor party may choose to submit the dispute for resolution to:

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[29] The lack of precise definition in the ECT as to what constitutes an "investment" reflects the general dearth of a definition in international law generally. See C. Schreuer, *The ICSID Convention: a commentary*, CUP, Cambridge, 2001, at 121 ff and Sacerdoti, op. cit., at 305-307.

[30] In such instances where the Trustee provides loans, or has equity or holds shares for the unit holder/beneficiaries.

- the tribunals or courts of the host state;[31]
- a previously agreed dispute resolution procedure; or
- in accordance with Article 26.

All Contracting Parties must give unconditional consent to the submission of a dispute according to the provisions of the Article ((3)(a)) unless:

- they are listed in Annex 1D as Parties who do not give consent where an investor has previously submitted the dispute under paragraph (2)(a) or (b);[32] or

- they are listed in Annex 1A as Parties who do not give consent where the dispute arises under the last sentence of Article 10(1) i.e. "Each Contracting Party shall observe any obligations it has entered into with an investor or an investment of an investor of any other Contracting."[33]

When an investor opts to settle the dispute pursuant to the provisions of Article 26, the investor must provide consent in writing that the dispute be submitted to the International Centre for Settlement of Investment Disputes ("ICSID"), an arbitrator or arbitration panel established under the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL") or an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce ((4)). The written unconditional consent of the Contracting Party given pursuant to paragraph (3)(a) and the written consent of the investor shall be considered sufficient to satisfy the requirements of consent of the ICSID Convention, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention") and Article 1 of the UNCITRAL ((5)(a)). Any party to a

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[31] Understanding 16 provides that paragraph (2)(a) should not be interpreted as requiring a Contracting Party to enact Part III of the ECT into its domestic law.
[32] Where a Contracting Party seeks the exemption of paragraph (3)(b)(i), it must deposit a statement of policies, practices and conditions with the Secretariat. Parties seeking this exemption include Australia, Canada, the EU states and Japan.
[33] The Parties seeking an exemption under paragraph (3)(c) and listed in Annex 1A are Australia, Canada, Hungary and Norway.

dispute to be arbitrated pursuant to Article 26 may request that the arbitration be heard in any state that is a party to the New York Convention ((5)(b)).

Further, any dispute is to be heard in accordance with the ECT and applicable rules and principles of international law ((6)). Finally, all awards of arbitration are pursuant to paragraph (7) are final and binding. Moreover, where the dispute arises from the actions of a sub-national government or authority of a Contracting Party, the Contracting Party may pay damages in lieu of any other remedy and all awards are to be carried out without delay ((7)).

In essence, the effect of Article 26 is trifold. Firstly, it abrogates the doctrine of privity of contract by extending rights of action arising from breaches of the Treaty to third, non- parties to the contract. Secondly, it eliminates procedural or jurisdictional disputes by creating a regime based upon neutral arbitration.

The common law doctrine of privity of contract holds that no one may be entitled to or bound by the terms of a contract to which he is not an original party.[34] In particular, "only parties to a contract may sue for breaches of that contract, notwithstanding that some third party may be damnified by the breach and intentionally so damnified."[35] Whilst the doctrine is founded in common law arising from English precedents of the late eighteenth to mid-nineteenth centuries, the concept that there was no *vinculum juris* (legal bond) between the contracting parties and a stranger to the contract is found in both Roman law and the French Civil Code.[36] Moreover, throughout the nineteenth and twentieth centuries, in order to adapt the law to increasingly complex commercial situations, the courts gradually

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[34] Starke, Seddon and Ellinghause. *Cheshire and Fifoot's Law of contract.* 6th edn. Butterworths, Sydney, 1992 at 579.

[35] *Rookes v Barnard* [1964] 1 All ER 367 at 386 per Lord Evershed.

[36] Article 1119 of the Code expounds the doctrine of relativity, i.e. that contracts have effect only between contracting parties. Article 11120 allows certain stipulations *pour autrui* as an exception (*Cheshire and Fifoot,* op.cit., 584).

recognised exceptions to the doctrine to include certain situations of agency, actions arising in tort and in certain areas of land law.[37]

However, despite inroads made into the doctrine, the principle "that only the parties to a contract are bound by and entitled to enforce its terms"[38] remains a central rule of contract law.

In international law, however, the situation of an aggrieved investor initiating an arbitration is becoming increasingly common. Both bilateral investment treaties, such as NAFTA, and the ICSID Convention contain provisions allowing third party investment disputes.

Thus, the significance of Article 26 lies not in its direct abrogation of the doctrine of privity, but that it has extended the ambit of investment litigation to include private complainants whose rights to commence proceedings arise not as a third party but are devolved from a third party by virtue of a beneficial/trust relationship. Until such a claim has been made and challenged, however, it is uncertain as to how far the concept of investor litigation pursuant to the ECT may extend.

Article 27

Article 27 concerns the "Settlement of Disputes Between Contracting Parties." Paragraph (1) provides that Contracting Parties shall attempt to settle disputes arising from the "application or interpretation of the Treaty through diplomatic channels." If after a reasonable time, diplomacy fails, either party may serve written notice on the other party to submit the dispute for adjudication pursuant to Article 27.

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[37] For example, in the area of head leases and subleases.

[38] Per Deane J, *Trident General Insurance Co Ltd v McNeice Bros Pty Ltd* (1988) 165 CLR 107; 80 ALR 574.

The exceptions to this prescription are disputes involving the application or interpretation of Articles 6 and 19, and prohibitions on disputes arising form the interpretation and application of Article 10(1) by those parties listed in Annex 1A ((2)). Paragraph (3) provides that the adjudicating tribunal shall be constituted by one member appointed by the aggrieved party, one member appointed by the respondent party and a third member, who will be the President of the tribunal and a national of neither party, to be appointed by agreement by both parties. Where an appointment is not made in accordance with paragraph 3(a) to (c), the Secretary-General of the Permanent Court of International Arbitration ("PCIA") shall make the appointment ((3)(d)). Subparagraphs (3)(a) to (d) also impose a timetable upon the appointment of the tribunal members, viz:

- 30 days for the appointment of the aggrieved party's member (3)(a);
- 60 days for the appointment of the respondent's member (3)(b);
- 90 days for default in appointment by the respondent (3)(b);
- 150 days for the appointment of the jointly chosen member (3)(c);
- 180 days for default of joint-appointment and referral to the Secretary-General of the PCIA.

In the arbitration the UNCITRAL rules shall apply ((3)(f)), the issue decided in accordance with the provisions of the Treaty and the applicable rules and principles of international law ((3)(g)), and the award is final and binding ((3)(h)). Paragraph (3)(i) provides that where a local or regional government or authority of a Contracting Party listed in Part I of Annex P has breached the Treaty, either party to the dispute may invoke the provisions of Part II of Annex P. Since Australia is one of the two parties listed in Part I,[39] the provisions of Part II are particularly relevant.

Part II of Annex P provides that in the circumstances where the local or regional government has been found to be in breach, the Contracting Party must take all

[39] The other being Canada.

reasonable measures to ensure that the Treaty is applied ((1)). Within 30 days of the making of the award the Party must then deposit written notice of its intentions to secure observance of the Treaty with the Secretariat. The Secretariat will then notify the Charter Conference and the Party in default ("the Responsible Party") shall be given an agreed reasonable period of time within which to comply ((2)). If the Responsible Party fails to comply within the agreed time, the other party shall be entitled to agreed and reasonable compensation ((3)). Should there be further failure to comply after 20 days, the aggrieved Party is released from its obligations pursuant to the original agreement until the dispute is resolved or the breach rectified ((4)).

It is interesting to note that both Australia and Canada are the only Contracting Parties listed in Part I of Annex P and both countries operate under the Federal system of government. Thus, effectively the provisions of Part II of the Annex allows the federal government of the Contracting Party time to negotiate with the local or regional government to secure compliance. If the delinquent regional government is a State, such negotiations could prove both problematic and lengthy.

Paragraph (3)(j) of Article 27 provides that the expenses of the arbitration shall be borne equally by the parties to the dispute, although the tribunal has the discretion to order that a higher proportion of the costs be paid by one of the parties.

Further, unless the Parties agree otherwise, the tribunal shall sit in the Hague at the premises of the PCIA ((3)(k)) and a copy of the award deposited with the Secretariat ((3)(1)).

Article 28

Article 28 provides that Article 27 shall not apply to disputes regarding the application or interpretation of Articles 5 or 29 unless the Contracting Parties to the dispute agree to its application.

In conclusion, Articles 26 and 27 of Part V of the Treaty provide a fairly rigorous but nonetheless ambiguous regime for the resolution of disputes arising from the application or non-application of the ECT provisions. However, it is arguable that the contradictory, ambiguous and imprecise drafting of many of the articles will prove fertile ground for disputes. Therefore, the adequacy of an arbitral process for dispute resolution especially in the early phases of the Treaty's application, is questionable. Where interpretations and applications are contested, judicial consideration and explication may be a preferable alternative, especially in regard to such issues as are raised by Article 26 and the requisite interests of investors for invocation of the Article. Therefore, whilst a stringent regimen for arbitration may ensure speedy resolution of disputes, it is suggested that the judicial process and the courts are able, more effectively to propound and interpret the law. Since application to a court from an arbitration pursuant to the ECT is expressly prohibited,[40] it may be some time before the inconsistencies and ambiguities of the Treaty are resolved.

Conclusion

It may be appreciated form the foregoing discussion that Parts III, IV and V of the ECT have attempted to provide both a comprehensive and rigorous regime for the protection of FDI in the energy sector. What is also apparent is that the provisions of these Parts are weighted exclusively in favour of the investor. Scant regard is paid in the Treaty to either the needs or inherent rights of the host state Contracting Party. Furthermore, ambiguous drafting and inconsistencies between Articles compound the problems which must arise from the application of the ECT. Although these aspects of the Treaty will be addressed in greater depth in Chapter IX, it is sufficient to comment here that the onerous nature of the obligations imposed upon the host state Contracting Party should require greater clarity of enunciation and, at least, greater consistency.

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[40] Both Article 26(8) and Article 27(3)(h) provide that the arbitral decision is final and binding upon all parties.

Thus, whilst a foreign investor in the energy sector may experience a degree of satisfaction from the knowledge that any investments made pursuant to the Treaty will be rigorously and comprehensively protected, the host state Contracting Party can only draw cold comfort from the putative economic benefits which may flow from investments made upon such terms.

Moreover, so central to the objectives of the ECT are the protection provisions contained in the Parts discussed above, that the Transitional Provisions of Part VI and the Structural and Institutional arrangements set out in Part VII are accorded particular significance. These will be addressed in the following Chapter.

CHAPTER VII

PARTS VI, VII AND VIII

Introduction

In view of the fact that in the early 1990's both the EU states and their investors were anxious to secure energy supplies pursuant to contracts formed within the ECT regime, the Transitional provisions were accorded particular significance. Due to the length of time generally required to put into effect the provisions of a multilateral instrument, it was important for the EU states to be able to utilise the investment protection offered by Parts III, IV and V of the Treaty as quickly as possible. Therefore, Part VI of the ECT sets out a comprehensive regime for transitional arrangements prior to the entry into force of the Treaty. Part VII deals with the establishment and functioning of the support bureaucracy and Charter Conference institutions necessary for the administration of the ECT. Part VIII, the Final Provisions, address the issue of ratification, accession, provisional application and entry into force.

This Chapter will therefore examine the final provisions of the Treaty and conclude with a brief discussion of the Energy Efficiency Protocol.

Part VI Transitional Provisions

Articles 29, 30 and 31

Article 29 addresses Interim Provisions on Trade-Related Matters. These "interim" provisions apply to those Contracting Parties who are not GATT/WTO members and are thus only 'interim' until such time as all Contracting Parties have become parties to GATT/WTO ((1)). Essentially, therefore, Article 29 applies the provisions of the GATT/WTO relating to trade in Energy Materials and Products to non-GATT parties. To a certain extent, membership to the Energy Charter

Conference has been regarded as an introduction to the GATT/WTO regime. Therefore, it is hardly surprising that the relevant provisions of GATT should be deemed applicable to Contracting Parties.

Article 30 provides that Contracting Parties undertake to adopt any amendments by the Charter Conference made to the ECT arising from the Final Act of the Uruguay Round of Multilateral Trade Negotiations.

Article 31, "Energy-Related Equipment", provides that the Charter Conference shall consider the inclusion of energy-related equipment in the provisions of the Treaty. This has, in fact, been achieved in the Trade-Related Amendments.

Article 32 and Annex T

Article 32, Transitional Arrangements, is aimed at FSU states and provides exemptions from compliance with Articles 6(2) and (5), 7(4), 9(1), 10(7), 14(1)(2), 20(3) and 22(1) and (3), "In recognition of the need for time to adapt to the requirements of a market economy" ((1)). Contracting Parties subject to the exemptions are listed in Annex T ("Annex T States"), together with the measures each state undertakes to effect and the date by which these should be put into place, with the proviso that all Annex T States have achieved full compliance by 1 July 2001. Any requests for an extension to the final deadline will be considered by the Charter Conference (3)). Paragraph (4) provides for a rigid reporting scheme whereby each of the Annex T States must notify the Conference at least "once every 12 months" of the progress of their compliance measures ((4)(a)), the expected future progress ((b)) and any technical assistance needed to effect full compliance ((c)). The progress made by Contracting Parties is to be reviewed by the Charter Conference and appropriate action recommended ((6)), whilst all other Contracting Parties are exhorted to assist Annex T States by whatever means necessary to achieve full compliance ((2)).

Annex T provides a schedule of Articles (listed above) subject to the transitional arrangements, a list of the states exempted from compliance, the measures needed to be taken for compliance with the Treaty and the date by which these measures must be affected. For example, in regard to laws prohibiting anti-competitive conduct (Article 6(2)) the Russian Federation in all energy sectors is described as having "A comprehensive framework of anti-monopoly legislation ... but other legal and organisational measures to prevent, limit or suppress monopolistic activities and unfair competition will have to be adopted and in particular in the energy sector" by 1 July 2001 (Annex T, 56).

A number of comments are prompted by the Transitional regime provided by Article 32. Firstly, in hindsight, the compliance deadlines[1] were too short given the nature of the amendments to domestic law required and the political, economic and legislative turmoil extant in many of the Annex T FSU states at the time.

Secondly, the specific requirements in regard to the legislative changes demanded by the Treaty not only place onerous obligations upon the Annex T states but also constitute a direct interference with sovereignty over the domestic legislative functioning of the subject governments.

Thirdly, although paragraph (2) of Article 32 exhorts other Contracting Parties to assist the Annex T States in whatever form the Contracting Parties consider necessary and paragraph (5)(b) provides that the Secretariat shall act as a "clearing house" for assistance by "the matching of needs for and offers of technical assistance referred to in paragraph (2) ... ," no cognisance is taken by the Article of the possible political and economic ramifications of such drastic measures as those demanded by the Article and Annex T in the target states. Whilst the non-Annex T States are able to rely upon international law relating to the succession of obligations

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[1] Compliance deadlines for specific measures vary between countries and for particular Articles, but in general range from three to six years after the ECT was open for signatures in December 1994.

pursuant to international treaties to ensure compliance with the transitional measures by the successive governments of Annex T States, no provision is made for instances in which compliance by the subject state may be or become impossible, as in cases of domestic civil strife or severe financial distress. Certainly, paragraph (3) allows an application for an extension, but this is merely to be exercised in "exceptional circumstances." The Treaty is therefore, predicated upon the presumption of eventual absolute compliance, allowing for few exceptions.

Part VII: Structure and Institutions

Part VII, Articles 33 to 37, deals with the organisational structure for the implementation of the ECT, which was discussed in detail in Chapter III above.

Part VIII : Final Provisions

Part VII is headed "Final Provisions," but the conclusive, addendum-like nature of this Part belies its significance. Articles 38 to 50 particularize the practicalities for application of the Treaty. Article 38 provides that the Treaty shall be open for signature from 17 December 1994 to 16 June 1995 and Article 39 that instruments of ratification shall be deposited with the Depository, which Article 49 designates as the Government of the Portuguese Republic. The ECT was open for accession from 16 June 1995 and the instruments of accession are deposited with the Depository (Article 41). However, other Articles in this Part contain provisions of major significance to Contracting Parties, particularly the issue of Provisional Application addressed in Article 45 and discussed below.

Articles 40 - 43

Article 40, Application to Territories, allows a Contracting Party to declare that the Treaty is binding "upon it with respect to all the territories for the international relations of which it is responsible" ((1)) and that further territories may be added to this "umbrella" provision (2). The declarations pursuant to paragraphs (1) and (2)

must be deposited with the Depository and may be withdrawn at anytime by notification ((3)).

Article 42 provides that any Contracting Party may propose amendments to the Treaty ((1)), the text of which shall be given to the Secretariat at least three months prior to the date on which it is proposed for adoption by the Conference ((2)). Once an amendment has been adopted by the Conference it is then submitted to all Contracting Parties for "ratification, acceptance or approval" ((3)), and the instruments deposited with the Depositary. All such amendments became effective as between the Parties which have accepted, ratified or approved them 90 days after the deposit of the ratification instruments ((4)). Pursuant to Article 42, therefore, amendments may be made to the ECT which are effective only vis a vis those Contracting Parties who have ratified, accepted or approved them. Article 42 thereby confers a certain degree of flexibility on the Treaty in regard to the making and application of amendments in that an amendment may be effected without it being applicable to all Contracting Parties. It also enables Parties to bring additional provisions of limited application within the Treaty regime.

Further, Article 43 allows the Charter Conference to authorise the negotiation of association agreements with other states, Regional Economic Integration Organizations or international organisations in order to pursue the objectives of the Treaty ((1)), provided that the rights and obligations pursuant to the agreement are consonant with "the particular circumstances of the agreement" ((2)).

Articles 44 and 45

Article 44 deals with the date of entry into force of the Treaty which was to be the "ninetieth day after the date of the deposit of the thirtieth instrument of ratification, acceptance or approval" with the Repository ((1)). This date crystallised on 16 April 1998.

For those Contracting Parties who ratify, accede to or accept the Treaty after this date, the Treaty becomes effective on the ninetieth day after the deposit of the instrument of ratification ((2)).

Article 45, "Provisional Application," provides that each signatory agrees to apply the Treaty provisionally "pending its entry in to force," i.e. each signatory is committed to applying the Treaty, in whole or in part, until it has been ratified, acceded to or accepted, but only to "the extent that such provisional application" is consistent with its laws and constitution. In essence therefore, paragraph (1) obliges each signatory to apply the provisions of the ECT prior to its ratification by the signatory's government.

However, a party may, when signing, declare that it is unable to accept such provisional application, in which case, the non-accepting signatory need apply only the Treaty's Part VII institutional provisions and not the substantive obligations ((2)). If a signatory seeks the protection of paragraph (2)(a), it cannot claim the benefits of provisional application. Six states elected to apply paragraph (2) on signing the Treaty, these were Australia, Ireland, Japan, Malta, Norway and Poland.

Whilst Article 25 of the Vienna Convention on the Law of Treaties 1969 ("the Vienna Convention") allows for such provisional application as provided for in Article 45(1) of the ECT, the Article raises certain issues concerning the status of those states who opt for the limited application offered by paragraph (2)(a).

Firstly, under international law, the signing of a treaty does not necessarily bind the signatory state to the obligations created therein. The Vienna Convention provides for two consequences resulting from the signing of a treaty. On the one hand, the signature of a treaty may merely authenticate the text (Article 10), thus reserving the signatory's agreement to be bound by its terms until the formal ratification procedures have been completed. On the other hand, the signing of a treaty may

also indicate the signatory's willingness to be bound by its provisions and adopt the attendant obligations both prior to and irrespective of any subsequent ratification.

In instances in which the signing of a Treaty serves both purposes, the Vienna Convention requires that either:

a) the treaty provides that signature shall have this effect;

b) it should be established during the treaty negotiation process that the States agree that signature shall have this effect; or

c) the State's intention to be bound by the treaty upon signature is apparent from the powers vested in its representative or was expressed during negotiations (Article 12).

Certainly there is no provision within the ECT which explicitly states that signature of the Treaty constitutes both authentication of the text and agreement to be bound by its terms. Further, Articles 39 and 41 provide for deposit of instruments of ratification, acceptance, approval and accession with the Depository in Lisbon, suggesting that signatories must ratify, accept, approve or accede to the Treaty before being bound to observe its resultant obligations.

However, indications within the text of the Treaty imply that signature not merely authenticates the document but also imposes upon signatory states the obligation to observe its terms. In addition to the provisional application requirement of Article 45(1), a signatory state is automatically a member of the Energy Charter Conference and subject to other requirements of Part III, irrespective of whether it has sought the benefit of Article 45(2)(a) to opt out of provisional application. Thus, active involvement in the ECT administrative procedure implies acceptance of its terms. Moreover, the Article 1 definitions, define a "Contracting Party" as a state who has "consented to be bound by this Treaty and for which the Treaty is in force." Thus, since the definition does not specify that ratification must signify consent and in view of the provisional application of the Treaty pursuant to Article 45(1) and the fact that there is no corresponding definition setting out the status, rights and

obligations of a "signatory," it is very arguable that a signatory is also a Contracting Party. Therefore, both the language and provisions of the ECT indicate the intention that signature constitutes an express agreement to be bound by the Treaty's provisions prior to and without recourse to the ratification, acceptance, accession or approval process, and that the obligations contained therein crystallise on the date of entry into force of the Treaty.

Secondly, if a state opts for non-provisional application, neither the signatory nor its investors may claim the benefits of provisional application ((2)(b)). However, the Treaty does not specify the position of a non-provisional application Contracting Party vis a vis a Contracting Party (and its investors) which provisionally applies or which has ratified, acceded to or adopted the Treaty. For example, if an investor (X) of Contracting Party A, which has ratified the Treaty, alleges a grievance against Contracting Party B, who has neither ratified nor provisionally applied the provisions of the Treaty, can the investor claim:

(a) that Party B is in breach of the Treaty; and/or

(b) invoke the dispute resolution provisions of Article 26?

In regard to (a), it is arguable that since Party B is a signatory of the Treaty, it has, in principle, accepted its provisions. Article 45(2)(b) merely states that Party B cannot invoke the benefits of the Treaty: nothing in the Article provides that Party B is free from the obligations imposed by the Treaty. Thus, it may be possible for X to assert that Party B is bound by the provisions of the Treaty, despite its non-provisional application.

Further, in regard to (b) since the dispute concerns an alleged breach of the Treaty, it would be open to X to invoke Article 26 on the grounds that:

(a) Party B merely opted out of the benefits and not the obligations of the Treaty;

(b) signature of the Treaty by Party B signified its irrevocable promise to be bound by its provisions, irrespective of whether it applies these provisions or not; and

(c) the dispute concerns an alleged breach and is therefore caught by Article 26.

If the above analysis of the hypothetical situation is correct or even possible, the benefit of opting out of the provisional application of the Treaty pursuant to Article 45 (2)(a) is highly questionable

Articles 46 - 48

Article 46 states that "No reservations may be made to this Treaty," thus prohibiting any Party from opting out of certain provisions via a notification of reservation.

Article 47(1) provides that a Contracting Party may withdraw from the Treaty at any time after five years from the date of its entry into force. The withdrawal becomes effective one year after the date of receipt of the notification of withdrawal or any later date specified in the notification ((2)). However, the provisions of the Treaty shall continue to apply to investments made:

- within the territory of the Contracting Party; and
- by its nationals in other states for a period of 20 years from the date the withdrawal takes effect ((3)).

Thus, Contracting Parties who withdraw from the Treaty regime are effectively "locked" into its provisions in regard to all agreements made pursuant to the Treaty. Moreover, the five year from entry into force moratorium on withdrawals imposed by paragraph (1) ensures that:

- Annex T States cannot avoid the obligations imposed by Article 32;
- Contracting Parties which subsequently undergo a change of heart in regard to the treaty are "locked in" for at least 6 years (i.e. five years after

the Treaty becomes effective plus one year pursuant to paragraph (2)); and

- the six years provides time for energy hungry EU Contracting Parties to effect energy investment agreements prior to the five year moratorium, secure in the knowledge that such investment agreements will be protected by the provisions of the Treaty for at least twenty years.

Finally, Article 48 provides that all Annexes and Decisions are integral parts of the treaty, whilst Article 50 attests to the authenticity of the texts (in English, French, German, Italian, Russian or Spanish) signed by the signatories.

The Protocol on Energy Efficiency and Related Environmental Aspects

As noted above, the ECT regime is set out not just in the Treaty itself, but also in supplementary documents. Article 33 (1) provides that the Charter Conference may authorize the negotiation of a number of Protocols which may supplement, extend, complement or amplify the provisions of the Treaty either sectorally or by category of activity. Thus, the Protocol on Energy Efficiency ("EEP"), whilst only binding on Contracting Parties if they have elected to adopt it, expands the energy efficiency and environmental protection objectives expounded in the Preamble and Article 19.

However, the EEP has a negligible effect upon FDI in the energy sector. Whilst the provisions of the Treaty itself contain a plethora of enforceable obligations (discussed above) in regard to investment and economic activity in the energy sector, the EEP is merely a recital of principles, energy efficiency policies, declarations, "soft law" provisions and "best efforts" exhortations. In other words, it creates no obligations upon those Contracting Parties by whom it has been adopted, neither does it contain any provisions for enforcement. As with Article 19 of the Treaty, therefore, the EEP appears more as a concession to the demands of

environmental protection groups and "politically correct" thought than a serious attempt to ensure that energy projects are efficient and environmentally safe. Both the EEP and Article 19 subsume the protection of the environment to financial interests and the acquisition of energy products and materials.

Conclusion

As may be gathered from the foregoing discussion, the Articles of the ECT and its attendant documents, are an exotic admixture of "soft law," declarations of principle and enforceable, often draconian provisions couched in language which is sometimes ambiguous, obscure and confusing. The extensive protection offered to foreign investors in the energy sector, the direct accountability for and liability of host state government for acts not only of sub-governmental and state but also private authorities and of the Treaty's unabashed prescriptive interference in the domestic legislative system of Contracting Parties belie its originally declared intention of promoting FDI in the energy sectors of FSU states. Certainly, the advantages from the Treaty appear to flow to the investor and/or Contracting Party making the investment to such an extent that a host state might be excused if it were reluctant to enter in to any agreement formed pursuant to the ECT.

Moreover, on the basis that the whole is greater than the sum of the parts, the effects of the Treaty in practical application, its implications for states engaged in attracting FDI in energy resources and production, particularly in the negotiation of contracts and sovereignty over territory and natural resources, are more keenly appreciated when the Treaty is viewed as a whole. Therefore, these issues will be addressed in Part III following.

PART III

THE LEGAL EFFECTS OF THE ECT

CHAPTER VIII

LEGAL ASPECTS OF FOREIGN DIRECT INVESTMENT IN ENERGY INFRASTRUCTURE

Introduction

As a Treaty which purports to provide a legal framework within which foreign investment in energy projects may occur, the ECT must be viewed within the wider context of foreign direct investment ("FDI") in and provision of funding for energy infrastructure projects in developing nations. In essence, it is argued in this dissertation that the Treaty, whilst originally being promoted by the EU as an instrument by which economic growth in the FSU states might be encouraged, is in effect the means by which the EU states are able to secure energy supplies and products in the most efficient manner and on the most favourable terms. At the same time, the protection regime of the ECT provides the maximum protection for both investments in energy projects and energy supply agreements. However, without an understanding of the complex nature, procedures and risks inherent in FDI in general and in energy projects in particular, it is difficult to appreciate the scope and impact of the ECT upon the practical legal aspects of the bilateral and multilateral agreements concluded pursuant to its provisions.

This Chapter will therefore present a descriptive analysis of FDI. Not only will it examine the nature of and major legal instruments pursuant to which FDI is effected, but it will also discuss the risks inherent in major infrastructure investment in developing states and the measures adopted by investors to mitigate these risks.

The Importance of FDI

Over the last twenty five years there has been a significant increase in FDI, particularly from "private"[1] sponsors, in infrastructure development projects in

[1] The term "private" is used here to designate non-government as opposed to government organisations. Whilst the connotation attached to the descriptor of a

developing countries. Billions of US dollars have been invested by international aid organisations, private investors and multilateral support agencies (MSAs), such as the World Bank and the European Bank for Reconstruction and Development, in energy, telecommunications, transport and water/waste infrastructure projects. The size of such projects have varied considerably, depending upon the source and nature of the funding, from improvements in village water supplies undertaken by international aid agencies, to vast hydroelectric schemes sponsored by private investors and funded by one or other of the MSAs. In the late 1970's and 1980's, projects were mainly undertaken in the so-called "Third World" nations of Africa, Latin America and Asia. However, since 1990 and the collapse of the former Soviet Union, sponsors and investors have regarded the FSU states as worthy targets for potential investment and, ultimately, profit. Table 1 demonstrates this movement. Whilst there is a general increase in private FDI in all regions, the growth in investment in Europe and Central Asia from US$83 million in 1990 to US$15,220 million in 1997 is significant and reflects the gradual liberalisation of the FSU states in eastern Europe.

"private organisation" tends to be that of a small, localised corporation, the private participators in FDI are generally anything but small and localised. Because of the huge investments of expertise, time and, inevitably, funding required merely to initiate an FDI project, private sponsors/investors are generally large, multinational corporations operating individually or in consortium, with interests and expertise in the target infrastructure area. For example, in 1991 a consortium led by US telecommunications corporation AT&T purchased 51% of Venezuela's state owned telecommunications carrier CANTV : GEC Alstherm won the tender to develop a 700 Megawatt coal-fired power plant in Laibini, China in 1997, whilst in Australia, the Snowy Mountains Electricity Commission (SMEC) (which despite its title is a private corporation) regularly tenders for overseas hydroelectric projects in developing countries.

Table 1 : Private Infrastructure Projects by Project Costs, by Region[2]

(US$ millions, 1990-98)

Region	'1990	'1991	'1992	'1993	'1994	'1995	'1996	'1997	'1998
Latin America & Caribbean	9406.7	9897.5	13616.0	15251.4	15919.8	17153.2	24437.4	43574.7	55090.0
East Asia & Pacific	1740.1	3267.4	8418.5	13997.7	15463.3	19555.0	28188.4	35928.9	15129.0
Europe and Central Asia	83.0	264.0	420.2	1323.2	3544.7	7778.4	10262.2	15220.3	11171.0
South Asia	267.0	639.5	51.5	1097.2	3971.0	3816.2	10884.5	13459.2	4336.0
Middle East & North Africa	268.0	104.0	10.0	2947.0	649.5	150.0	375.0	5969.3	4253.0
Sub-Saharan Africa	39.6	0.0	43.2	32.3	642.7	915.8	1926.2	3417.0	1791.0
TOTAL	11804.4	14172.4	22559.4	34648.8	40191.0	49368.6	76073.7	117569.4	91770.0

Further, it should be noted from Table 2, showing the dissection of FDI in infrastructure in the FSU, that the greater proportion of FDI has been in the telecommunication and energy sectors.

Table 2[3] *Infrastructure FDI Inflows, by Sector: Europe and Central Asia*

(US$ millions, 1990-98)

Europe & Central Asia	'1990	'1991	'1992	'1993	'1994	'1995	'1996	'1997	'1998
Energy	27.5	0.0	99.6	0.0	489.7	1630.8	1791.3	1216.7	619.6
Transport	0.0	0.0	0.0	23.7	32.8	22.5	0.1	36.3	47.1
Airports	0.0	0.0	0.0	0.3	0.0	22.5	0.1	36.3	0.0
Seaports	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Railroads	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Roads	0.0	0.0	0.0	23.4	32.8	0.0	0.0	0.0	47.1
Telecoms	5.7	100.7	66.5	329.3	642.7	1323.7	1854.2	4323.3	3330.5
Water & Waste	0.0	0.0	0.0	0.2	0.6	0.6	37.6	17.6	0.0
TOTAL	33.2	100.7	166.1	376.9	1198.6	3000.1	3683.3	5630.2	4044.3

The energy infrastructure depicted in Table 2 includes the development of pipelines; the extraction of uranium, coal, oil and natural gas; the construction of power lines and energy grid development and the construction of power stations, as well as FDI

[2] Frank Sader, *Attracting foreign direct investment into infrastructure.* IFC, Washington, 2000, 157.
[3] Ibid, 162.

in privatisations of state-owned energy projects. Further, given the enormous increase in FDI in telecommunications in the region and the ever-growing dependence upon digital/computer technology in all sectors of the economies of FSU states, it is highly likely that FDI in energy infrastructure will continue to increase. Thus, given the difficulties faced by FSU governments in managing the exigencies of under-resourced and over-heated economies, FDI is likely to continue to have an important role in the technological and economic restructuring and development of in all developing regions, not simply the FSU states.

The Nature of Foreign Direct Investment

FDI is the term generally applied to the process whereby capital is invested in an enterprise or asset by a non-resident of the host country, giving the investor a significant influence or control over the management or use of the investment. In principle, FDI may take place in any area in which resident investment occurs. Thus, FDI may involve the acquisition of an existing enterprise or the development of a new one or the purchase of real property, assets or shares. For the present purposes, however, the discussion below will focus upon FDI in infrastructure projects, particularly in the energy sector.

Investment in infrastructure accounts for the largest percentage of all FDI projects, with telecommunications and energy comprising 58% and 32% respectively of the total (see Table 3).

Table 3[4] *Infrastructure FDI Inflows, by Sector : Entire Developing World*
(US$ millions, 1990 - 98)

All Developing Countries	'1990	'1991	'1992	'1993	'1994	'1995	'1996	'1997	'1998
Energy	402.6	162.2	2892.7	3494.2	3807.7	6147.2	9202.0	15086.7	5194.
Transport	244.9	95.8	312.2	486.4	303.4	634.8	581.2	1533.8	1706.
Airports	0.0	0.0	78.5	22.4	40.5	125.9	21.5	38.4	98.
Seaports	0.0	0.0	8.8	38.5	47.5	115.6	65.6	804.2	653.
Railroads	39.4	31.6	113.7	332.2	48.1	312.0	272.0	379.9	610.
Roads	205.5	64.2	111.3	93.3	167.4	81.3	222.1	311.3	344.
Telecoms	2054.6	5048.3	2838.8	3862.0	7366.0	6944.5	10999.2	19214.3	25884.
Water & Waste	0.0	10.6	63.0	679.6	73.2	169.5	90.8	500.4	215.
TOTAL	2947.0	5412.7	6419.0	9008.6	11853.8	14530.8	21454.4	37869.0	34707.

Source: Foreign Investment Advisory Services

Whilst energy and telecommunications projects are undoubtedly the most expensive to undertake, the preponderance of FDI in these sectors far outweighs the relative cost in comparison to other infrastructure development. It can only be assumed, therefore, that the predominance of FDI in the energy and telecommunications sectors is a reflection of their importance as perceived by investors, sponsors and host governments. However, in the energy sector, projects such as pipelines for oil and natural gas, greenfield and existing power station projects, coal, natural gas, uranium and oil extraction projects, development of new and re-development of existing power line and grid systems require huge outlays of capital with little or no initial return on the investment. Furthermore, the myriad of risks inherent in any infrastructure project in stable, developed economies, are magnified in developing countries where political instability, legislative uncertainty and economic disintegration present challenges to even the most prescient investor.[5]

[4] Ibid., 159.
[5] For an analysis of the broad economic data relevant to FDI see Sacerdoti, op. Cit., 265-282.

The Benefits and Disadvantages of FDI to Host States: the Double Edged Sword

Certainly, for the host state, FDI offers certain advantages. In addition to the development of infrastructure and the consequent social and economic advantages which flow from this, FDI projects generally result in the importation of the technology and expertise lacking in the host state but which are necessary to implement complex technology dependent projects. Further, the influx of foreign funds and exchange reduces the host economy's vulnerability to downturns in world economic conditions by tying foreign repayments to ability to pay.

Balanced against the obvious technological, social and economic advantages there are the inevitable drawbacks attendant upon foreign intervention in the economy and, in most cases, the government of a sovereign state. Although the foreign sponsor of an infrastructure project supplies the host state with a development it could neither afford nor accomplish without foreign aid, this assistance creates a dependency upon the foreign funding in the host state which carries with it the threat of loss of autonomy.

Essentially, FDI in infrastructure imposes a degree of foreign control over development undertakings which may be significant in, if not essential to the economy of the host state. This is particularly so when the project is wholly funded by foreign investment, as opposed to foreign investor - host state joint ventures. When a project is funded entirely by foreign investment, decisions of importance in regard to the construction and operation of the project will, inevitably, be made abroad. Whilst it is possible for host states to retain some control over the decision-making process through the negotiated terms in the various project agreements,[6] the bargaining power exerted by the host government will be

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[6] See 200 ff below.

dependent upon numerous factors, including the importance of the project to the development of host state, the existence of extraneous restraints upon the involvement of the host government, such as the provisions of bilateral and multilateral treaties[7] and the requirements of funding providers, such as the MSAs.[8]

Furthermore, the objectives of foreign investors and funding providers are not totally altruistic. By its very nature foreign investment, as indeed investment of any kind, implies the necessity to achieve a return upon invested funds commensurate with the attendant risks and extent of the enterprise. Sponsors and investors require a certain level of profit from the venture whilst funding providers are concerned that the project will return sufficient profit to enable the borrower to service the debt. Therefore, it is not inconceivable that decisions will be made in relation to the project by foreign developers which, whilst preserving and enhancing the profitability of an enterprise, may be in conflict with the national interest of the host state. Such conflicts often arise in relation to projects which are environmentally sensitive, such as hydroelectric facilities and mineral extraction and processing industries which have the potential to cause ecological damage. Sufficient pollution and waste product control can be extremely expensive to install and operate, particularly when projects are situated in or near ecologically susceptible regions, such as catchment areas, water courses and water-dependent environments.

Certainly, detailed specifications for all aspects of a project are contained in attendant and detailed documentation. Proposals, plans and agreements set out, in varying degrees of clarity, all information necessary for the parties involved to make necessary decisions. Moreover, all contracts connected with an undertaking will

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[7] Contractual provisions used to restrict the involvement of host states in the development and operation of overseas funded infrastructure projects is discussed in greater detail at 200 ff below.

[8] MSA's, particularly the World Bank, often impose restrictions upon the activities of the host state, in areas such as governance and legislative change, either by seeking undertakings from the host government or by making available funding contingent upon certain legislative amendments prior to the commencement of the project.

contain specific provisions relating to variation.[9] It would appear, therefore, that a host government would be fully cognisant of all aspects of a project prior to execution of the necessary agreements, and, therefore, would be able to exercise substantial control over these elements of the project which are of particular importance and/or which could have substantial impact upon the well-being of the State. However, the degree to which a host state is able to exercise this control is dependent upon multifarious political, economic and practical considerations, including the perceived necessity of the venture to the host state and the stage reached in the project development. The negotiating strength of a host state is much greater in the initial phases of project development, prior to the execution of the various contracts. It is much more difficult for a host to resile from or attempt to vary certain provisions once a project is underway.[10] Furthermore, in the project documentation, sponsors and finance providers require stringent government guarantees which indemnify foreign participants against such contingencies.[11] The stringent and often draconian financial liabilities attached to such indemnities may effectively deter impecunious developing nations from attempting to impose legislative and/or political pressure upon foreign project participants.

Indeed, Rebert Pritchard, in *Economic Development, Foreign Investment on the Law* does not regard the loss of control of a host state over project development and operation as posing any great threat to national sovereignty on the grounds that the "host country retains the sovereign right to set the rules governing business activities within its borders and the sovereign right to impose taxes and other imposts."[12]

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[9] As with most contracts variation provisions usually provide that any deviation from original terms and conditions must be in writing and agreed to by all parties.
[10]Certainly, this is not always the case. Commencement of the construction of the Dhabol Power Project in Maharashtra, India, in February 1995 did not prevent the newly elected national Indian government cancelling the project in March 1995. However, this example has proven to be the exception which to all intents and purposes has changed the rules.
[11] For a detailed discussion of project risks and risk amelioration see 180ff below.
[12] Robert Pritchard (ed), *Economic development, foreign direct investment and the law* . Kluwer Law, The Hague, 1996, 4.

However, this optimistic pronouncement fails to take cognisance of the fact that most project development contracts contain provisions restraining the host government from amending legislation or changing the law relating to the project and from increasing taxes and imposts beyond those specified in the contract.[13] Therefore, as noted above, whilst such contractual restraints may not always be effective, they usually constitute fairly cogent restraints upon any capricious or indeed necessary acts of the host government which might impinge upon the efficacy or profitability of the project.

Thus, foreign direct investment proves a double edged sword for most host nations. Essentially, the host government must balance the benefits of development funded and controlled by foreign participants with the obvious disadvantages. However, it is not easy to asses the relative merits of economic development against the very real threat of impairment or even loss of sovereignty, especially when the host state has an urgent economic and social need for the proposed development. It is hard for the government of an impoverished nation to refuse the offer of a foreign-financed project which holds out the hope of future national advancement. Further, spurred by the prospect of future profits, either through direct immediate returns,[14] or longer-term returns from cost intensive developments,[15] it is easy to appreciate both the decision of project sponsors to engage in FDI and their desire to mitigate attendant risks by whatever means available. Given these considerations, therefore, from one view, FDI could be regarded as a gun, held to the head of impoverished nations, a golden gun, but a gun nevertheless.

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[13] See 208 ff below.

[14] Such profits as may arise from investment in manufacturing industries, where the development phase is fairly short.

[15] Such as infrastructure projects.

Types of FDI

Whilst it is convenient to discuss FDI projects as if they are homogeneous, it must always be borne in mind that FDI is as varied in form as domestic investments. Aside from the numerous incarnations of FDI in manufacturing, processing and securities industries, as well as infrastructure, various strategies are adopted in effecting FDI. Naturally, the size and type of transaction will determine the strategy adopted, especially infrastructure projects, which because of their size require by far the higher level of funding than other areas. Privatisation and greenfield projects account for 96% of infrastructure FDI.[16]

Up to 1998, privatisation appears to have been the largest generator of FDI, accounting for 66% of FDI inflows, whilst representing only 22% of all concluded transactions. Greenfield projects,[17] on the other hand, represents only 30% of infrastructure FDI inflows but 75% of all transactions.[18] The apparent discrepancy in the percentage of FDI inflows and the number of transactions between privatisation and greenfield projects stems primarily from the type of projects undertaken. Transactions in telecommunications and electricity tend to take the form of investment in privatisation of large, state-owned monopolies, whilst greenfields projects tend to be represented by smaller investments in water, waste and transport facilities.[19]

The larger percentage of FDI funding in privatisation projects could be said to be a reflection of the lower level of risk encountered in investment in established enterprises. However, such generalisations can be misleading especially in relation to FDI in energy projects. Privatisation in the energy industry often requires a high

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[16] Sader, 12.
[17] A greenfield transaction is the term used to describe a project which is created from the very beginning, (literally "a green field") as opposed to privatisation, which represents investment in an existing and operational enterprise.
[18] Sader, op.cit.,12.
[19] Ibid., 11.

level of investment in the upgrading and expansion of existing facilities, such as pipelines, electricity distribution infrastructure and power plants. Furthermore, many new energy projects, such as hydroelectric schemes and oil and gas exploration, extraction and distribution enterprises are greenfield projects requiring extremely high levels of investment, especially in the initial stages.

Moreover, whilst it is true that initially the level of sunk costs[20] and exposure to risk are much higher in the development of greenfield projects, it is also true that, once a greenfield project is operational, the risks faced by foreign investors are the same as those confronting investors in privatisation enterprises. Therefore, in regard to greenfield projects, foreign investors, project sponsors and finance providers tend to place great reliance upon the financing structure and risk mitigation through standard and negotiated contractual provisions. These aspects of FDI are discussed briefly in the following sections

Project Finance

Whilst established energy enterprises are able to obtain funds for new projects through financing obtained upon the basis of their credit standing, new energy projects undertaken through FDI by private sponsors cannot rely upon balance-sheet financing to raise funds. Therefore the most common financing structure used to fund major infrastructure projects in both developed and developing countries is "project finance."

This type of financing involves the incorporation of a legal entity whose sole purpose is the development of the project. This newly created corporation has no assets other than those generated by or acquired for the purposes of the specific development. Thus, unlike balance-sheet financing, pursuant to which the borrower

[20] Sunk or past costs are those costs expended upon the actual planning, development and construction of a project which are unavoidable, which cannot be recouped and which have little or no value outside the intended use (see Charles T Horngren *Cost accounting : A managerial emphasis* Prentice-Hall, New Jersey, 1967, 417-420, 425-426).

relies upon its creditworthiness and previous performance record to raise funds, developers seeking project finance rely solely upon the predicted cash flow of the project to attract investors and lenders. It is upon the cash flow that the repayment of principal and interest and the return on investment depend. If the project is unable to generate sufficient cash flow to service the debt, lenders and investors have recourse only to the project company's assets. Infrastructure projects such as dams, power transmission grids, pipelines and roads involve a high level of sunk costs, especially in the initial stages of development. As a result, the assets of the project corporation are rarely sufficient to cover liabilities in the event of default. Moreover, because the project corporation is a discrete and legal entity, lenders and investors do not have recourse to the assets of the project sponsor or parent company, if the project company is a subsidiary.[21] In certain circumstances the lenders may require debt guarantees by the parent company, the project sponsor or a third party, in the event of default by the project company. However, the extent of the guarantee is limited and is never sufficient to satisfy the full extent of the liability.[22] Because of the high level of risk and huge costs involved, together with the high degree of expertise necessary to effect and implement project financing of infrastructure developments, project sponsors usually seek funding from well established commercial institutions, such as large merchant banks or bilateral and multilateral institutions such as MSAs.

Furthermore, the high level of risk for lenders and investors in infrastructure financing renders financial/credit analysis of the project by lenders, the assessment of commercial, political/country and force-majeure[23] risks a complex, time consuming and inevitably expensive process. Further, once the risks have been evaluated, the sponsors, lenders and governments need to reach agreement on risk allocation. Efficient mitigation and allocation of risks is vital to a projects financial

[21] Because the recourse for debt repayment or default lies exclusively with the project company, project finance is often called non-recourse financing.
[22] Project Finance structures in which the debt is secured by a limited guarantee given by a third party, are known as limited recourse financing.
[23] Often significant in developing countries.

viability, however, it is no easy task. Once a project has been mooted sponsors, naturally, wish to have the project financed as quickly as possible. However, finance providers, especially commercial lenders, are traditionally risk-averse, whilst governments are loath to relinquish any degree sovereignty by agreeing to any checks upon legislative powers. Further, parties are seldom willing to offer guarantees or indemnities for risks which are beyond their control. Therefore, essential to the development of any FDI infrastructure project are the negotiations between parties and the engrossing of the numerous agreements upon which the viability of the project will depend. These pre-project implementation procedures are discussed in the following section.

Pre-Project Implementation Procedures

The pre-project implementation procedures necessary to prepare the requisite agreements and documentation are complex, time consuming and exceedingly expensive. Aside from the practical and technical planning and development stages needed to achieve the point at which a proposed project is ready to be placed before potential investors, lenders and the host government,[24] there are the lengthy and often fruitless rounds of presentations and negotiations, intended to produce workable written agreements in which the competing interests of all parties are addressed. Most FDI infrastructure projects flounder at this stage. In 1998, 35% of all privatisation transactions were concluded, whilst only 11% of proposed greenfield infrastructure projects reached closure.[25] When it is considered that project preparation accounts for between 2% and 5% of total project costs,[26] the economic loss to a sponsor of a failed infrastructure project is substantial.

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[24] For example, the financial scientific, engineering and technical expertise needed to develop an FDI project and produce the plans, specifications, projections upon which the project will be based.

[25] Sader, op cit, 17-18.

[26] Ibid, 31. With large, complex developments this may reach 10% to 20%.

In the negotiation process, a project sponsor needs to lobby or negotiate with numerous parties whose interests are affected by or who have an interest in the project. Not all of these groups will be actual parties to the agreements, but may have such influence with or upon parties that their interests must be considered.

At the level of host country government the sponsor will need to enter into agreements with national, and often regional and municipal governments to obtain for instance permits, leases, property titles and certain exemptions. Moreover, special interest groups with national and local government influence will also need to be approached. For example, where a proposed project is environmentally sensitive, local and international[27] environmental groups may be particularly active and influential. In such cases environmental impact studies may need to be made and careful consideration given to their results. At the construction and operating stages, contracts with construction companies, materials providers and transport companies will need to be concluded. However, where agreements encompass the provision of labour, the sponsor may need to approach local and national trade/labour unions. Moreover, in some FSU states, particularly Russia and Ukraine, consideration may need to be given to the influence of "mafia" groups,[28] which may control labour, transport and goods distribution within the region designated for the proposed project.

Finally the project sponsor must attract funding from investors, equity providers, commercial lenders, and in many instances MSA's. Naturally, investors and equity providers will require certain assurances regarding the protection of and returns on their investment, whilst commercial lenders, a traditionally risk averse group, will need to be assured of the viability and security of the project.

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[27] Such as Greenpeace.

[28] For a detailed and comprehensive division of organised crime in Russia see Bruno Leone (ed.), *Organised crime.* Greenhaven Press, San Diego, 1999.

Considering the diversity of competing interests, the multitude of contractual parties and the potential risks which await the unwary FDI project sponsor, the higher proportion of concluded privatisation transactions to greenfield infrastructure projects is hardly surprising. Whilst the pathway to FDI in privatisation projects is by no means smooth, many of the problems in the planning, development and construction stages which beset the project sponsor of greenfield developments, are obviated. With privatisation projects, much of the infrastructure needed to initiate the project may already exist.[29] Of course, there are areas of infrastructure privatisation where substantial development funding may be required, such as the redevelopment of gas and oil pipelines, but in general, the initial problems facing FDI sponsors in privatisations are political. A host government must have a political commitment to commercializing what was once, or would normally have been, a state controlled enterprise. However, whilst the process of negotiation with a host government and subsequent legislative and political adjustment may take years, once this has been achieved, the chances that the project will be aborted or cancelled is relatively small.

With greeenfield projects, on the other hand, each stage of the preparation process is fraught with particular difficulties and risks.[30] Even eventual financial closure and commencement of the project offer no certainty that the project will be completed.[31] Even though thorough preparation and negotiation cannot always ensure the eventual success of a project, it is essential that each step in the procedure is carefully carried out.

The most common structure used for an FDI greenfield project has been what is known as the Build-operate-transfer (BOT) model. In a BOT type arrangement, the project company develops the project : arranging funding, co-ordinating

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[29] For example, investment in the privatisation of a host nations energy sector.
[30] These will be discussed at 189 below.
[31] Perhaps the most infamous example of a greenfield infrastructure project which was halted in the construction phase is the Dhabol Power Project discussed at length at 197 below.

construction, conducting necessary negotiations, and on completion operates the facility for a fixed period. On the expiry of the term, the facility is then transferred to the host government. During the operating period, the project company recoups the investment and operating costs as well as a return on the initial investment from the revenue generated by the project. This type of model for an FDI has become so common that the acronym BOT has come to be used as a generic term for a variety of infrastructure development arrangements which involve privately developed and operated projects financed on a non-recourse basis pursuant to a concession type agreement with the host government.[32] Energy projects, particularly, lend themselves to BOT-type arrangements due to their high level of sunk costs and fairly predictable revenue streams during the operating period. However, the BOT-type arrangement is particularly complex and contractual negotiations with all parties involved may take years to conclude, with numerous opportunities along the way for the whole project to fail.

As noted above, however, lengthy and often ruinous delays are a common feature of all FDI arrangements, whether BOT-type, privatisation transactions or the comparatively straight forward turnkey contract.[33] Stalled negotiations, implementation delays, contract cancellations, costly and drawn out legal disputes and host government volatility can all lead to delay in, if not failure of the project. Indeed, FDI projects of all types are so fraught with risk for all parties, that the

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[32] Other common arrangements similar to BOT include the following :

Build-own-operate (BOO) - pursuant to which the project company does not transfer the facility to the host government.

Build-transfer-operate (BTO) - the new facility is built by the project company and ownership is transferred to the host government on completion. The private contractor then operates the facility pursuant to a separate agreement.

Build-lease-transfer (BLT) - after completion of the project, the facility is leased to the host government for a specific period. Upon expiry of the term, ownership is transferred to the host government.

[33] Pursuant to a turnkey contract the host government contracts with a private company to build a specific facility for which the private company will be paid upon completion of the project.

identification, mitigation and allocation of risks is vital to the project's financial feasibility and frequently, a stumbling block in contract negotiation

FDI Risks

The implementation of FDI infrastructure projects are beset by numerous specific risks. Such risks are not mere inconveniences but impact directly upon the costs for sponsors and investors, the bankability of the project for lenders, and the ultimate viability of and returns on the particular facility. Risks therefore affect not merely the performance of contracts, but the attractiveness of the project to investors and lenders.

Investors, naturally, will be concerned about both the safety of and returns upon their investment. In the case of energy infrastructure projects, especially for energy generation facilities, the fact that a projected cash-flow from the completed installation comes solely from the power generated which is usually assured through the Power Purchase Agreement,[34] increases the desirability of risk mitigation. Moreover, delays experienced in project development and construction substantially increase costs, necessitating the revision of projected returns and an increase in funding. Whilst the control exercised by investors will vary according to the way in which their investment in the project is structured, most will require assurances prior to investment that all possible risks have been identified and addressed.

Further, funding for FDI infrastructure projects is generally obtained from commercial lending institutions such as large merchant banks and MSAs. These institutions tend to be extremely risk-averse. Having no direct management control

[34] The Power Purchase Agreement is generally a complex document which creates the power sales obligations between the private producer and the power purchaser, by committing the producer to specific production conditions and the purchaser to accepting specified output at fixed tariff rates.

over the project, they need to be assured that the projects cash flow will be sufficient to service debt repayments.

The interests of host governments are also affected by the latent and foreseeable risks involved in a development project. Aside from the obvious loss to the economy and national well being occasioned by the failure of an important infrastructure facility, governments are usually required to provide certain indemnities and/or guarantees[35] which represent sizeable contingent liabilities.

Risks are generally categorised as being commercial, political or country and force majeure or non-political risks and may eventuate at any time during project preparation, development or completion and operation. However, as will become clear from the discussion below, these categories are not mutually exclusive. An adverse event may be the result of the crystallization of two or more types of risk. For example, a "completion risk", such as the failure to meet a completion deadline may eventuate as a result of the coalescence of a political risk, such as the failure of the host government to renew licenses or permits. Similarly, a force majeure event, such as a coup d'etat may result from unstable political factors within the host government. Whilst it is convenient, therefore, to discuss the multifarious risks in terms of categories, it must always be remembered that these are not mutually exclusive.

Commercial risks are generally those which relate to the cost and eventual profitability of the project.

In the construction phase, variations (usually increases) in development costs such as raw materials, fuel, equipment acquisition, maintenance and operation, host government charges and tariffs[36] and labour can have a significant impact upon the total costs of the project. Where such costs increases are significant, there is always

[35] Discussed in more detail at 206 ff below.
[36] Also regarded as a political risk.

the danger of a cost over run. When a project sponsor has negotiated a fixed borrowing from funding providers and the original amount provided is exhausted, it is necessary to source and negotiate a further loan or in the worst case, terminate the project. Failure to meet schedules and timetables (completion risks) can also substantially inflate the cost of construction. Disputes with construction contractors, problems in obtaining supplies equipment and raw materials, natural disasters,[37] delays in obtaining government permits and licenses or changes in relevant law[38] can all significantly prolong a project beyond the estimated time. Such delays not only increase labour and other costs, but failure to meet schedules may attract penalties. Moreover, completion delays may also necessitate postponement of the date by which the project was due to become operational, thereby postponing the time at which the project was expected to generate cash flow. Completion delays, and indeed delays at all stages of project development, can also present risks in regard to the technology it is proposed to use in the completed project. In instances when the planning and implementation of an infrastructure development is drawn out over a number of years, there is always a risk that the technology proposed originally will have become obsolete by the date of completion. This is especially true in those projects, such as power generation, which are dependant upon computers.

Moreover, it is anomalous that whilst familiar and well-tried technology may be reliable, it may also become obsolete more quickly than newer, state-of-the-art equipment. The project sponsor is then faced with the unenviable and expensive choice between upgrading or replacing existing equipment, or risking reduction in cash flow due to obsolescence and reduced production capacity. Whilst those commercial risks relevant to the planning and construction of a project tend to increase project costs, operation risks, i.e. those risks which manifest after completion and the facility is operational, tend to reduce cash flow and profitability. Whilst many operational risks are consonant with those encountered in the development and construction stage, such as increases in the cost of labour,

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[37] Also force majeure.
[38] Political risks.

materials, fuel and equipment, others are peculiar to the operation of the project, such as changes in market demand. This, however, is not generally a risk faced in energy infrastructure. Not only has the demand for energy, in all forms tended to increase, especially for electricity, but also, where the project is a power generating facility, sale of electricity produced is assured though execution of a Power Purchase Agreement.

Further risks that may threaten the commercial viability of an infrastructure project at any stage of development are those posed by environmental factors. These risks are particularly pertinent to energy infrastructure projects. Natural gas and oil pipelines, the extraction of natural gas, oil and coal, and power generation facilities, especially nuclear power plants, all harbour the potential to create environmental disasters.[39]

In the construction phases, monitoring, preventative measures and the rectification of any environmental damage can cause substantial delays and inflate costs. In the operational stage, an environmental disaster may not only reduce cash flow by increasing operational costs and causing production delays, but could also prove ruinous if the facility operator were found to be liable either through payment of statutory fines and penalties or as a result of a damages award handed down by a local or international tribunal. Whilst it is possible to argue that environmental protection measures should be accounted for in construction and operation costs, even the most conscientious and environmentally aware infrastructure or mining operator is subject to the vagaries of fate and accidents do happen. It is therefore necessary to consider potential environmental damage, from whatever cause, as a decided risk in any project which impacts upon the environment.

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[39] Whilst the accidents at the nuclear power plants at Three Mile Island, in Pennsylvania, USA in 1979 and Chernobyl in Ukraine in April 1986 are perhaps the most obvious examples of environmental catastrophes, oil spills from inadequately maintained terrestrial and marine pipelines, contamination of ground-water and catchments from mining operations, especially in uranium extraction, have the potential to wreak considerable havoc on the environment.

Political Risks are a particularly pressing problem in those countries which are most in need of the economic assistance and benefits of FDI, but are generally perceived to be beyond the control of project developers. Furthermore, all FDI projects, whether privatisation transactions or greenfield developments in all sectors are vulnerable to government intervention and can only be successful with host government co-operation. Whilst a detailed examination of the socio-economic and political factors underlying political instability is beyond the scope of this work, it is necessary to make certain observations, albeit general, in this regard.

As noted above, those states subject to the highest levels of political risk tend to be in greatest need of FDI. In developing nations, weak economies, widespread poverty, poor agricultural practices, lack of basic resources such as clean water, energy and transport infrastructure, lack of technological sophistication and extreme vulnerability to meteorological disasters such as droughts and floods, are all contributing factors to the political instability which engender those political risks most feared by sponsors, investors and lenders. Further, many developing post-colonial states, particularly the FSU republics, are struggling to establish governmental and legislative structures consonant with their relatively new free-market economies. In the FSU, particularly, this has involved the structuring of completely new administrative and legislative systems which are to all intents and purposes, diametrically ideologically opposed to those in operation under the Communist regimes. However, despite the apparent commitment of FSU states to free and open markets based upon the capitalist model, there still lingers a residual suspicion of large western multinational corporations and their capitalist ethos, particularly amongst the "old guard."[40] It is not surprising, therefore, that the

[40] Vladimir Putin, the Russian President and an ex-KGB officer under the old regime, has shown a decided bias in his cabinet towards the "old believers." Moreover, Ukraine's government, under Leonid Kuchma, is directing its foreign policy away from an eventual membership with the E.U. towards greater economic and political ties with Russia (see Adrian Karatnycky, Meltdown in Ukraine, *Foreign Affairs*, **80** (3), May/June 2001, 73-86).

apparent uncertainty of attitude on the part of FSU governments towards potential Western sponsors and lenders (particularly MSAs) engenders a degree of nervousness on the part of those involved in FDI, and renders analysis of political risk in these countries particularly important.

As may be appreciated from the brief discussion above, political risks arise from a variety of interrelated sources and causes. However, for convenience of examination, they are discussed below as arising from legislative/regulatory, administrative and ideological factors.

The lack of cohesive legislative/regulatory structure in a host country poses a number of threats to the viability of an FDI infrastructure project. As Flint et al state:

> If the host country risks include significant elements of legal risk, the foreign investor will be faced with a classical dilemma : either to forego the opportunity or proceed with the investment under legal conditions which are less than adequate. Only the bravest foreign investor will invest in a country with a legal system which offers no constitutional or legislative safeguards for investment.[41]

Perhaps the most significant risk is posed in those FSU states in which the law relating to property rights is incomplete. Whilst most FSU states have promulgated laws relating to real and personal property, such legislation is relatively new and subject to the inadequacies and challenges which beset all new legislation. Further, in FSU states, these initial problems are exacerbated by the fact that property rights did not exist prior to the break up of the FSU[42] and therefore there were no precedents or even customary laws upon which the rights embodied in the

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[41] David Flint, Robert Pritchard and Thomas Chiu, Constitutional and Legislative Safeguards for FDI : A Comparative Review Utilizing Australia and China. In *Economic development, foreign investment and the law*, op cit., 103.

[42] Even prior to the Communist Revolution in Russia in 1917, property rights under the Tzars were limited.

legislation could be based. Accordingly, uncertainty in land tenure, and the power to grant leases lead to difficulties in acquiring or transferring title to land for proposed developments. These difficulties become acute in relation to greenfield projects. Any FDI sponsor who invests the huge amount of funds necessary to undertake a greenfield infrastructure project in circumstances in which the legislative framework renders title to the land uncertain, must face the possibility that at some future time that title may be challenged. Further legislative inadequacies may be found in commercial law, such as contract, restrictive trade practices and labour law: areas of law which are essential to the development of a project.

Moreover, when there is a newly established or developing legal system, court processes tend to be slow and unpredictable, making dispute resolution a time consuming, frustrating and inevitably expensive process. As Douglas Webb notes :

> For litigation between private business parties, where the emphasis should be upon achieving a speedy resolution, court delays devalue financial claims and provide incentives for non-performance of contracts.[43]

Government administrative procedures and practices may also pose a threat to the viability of an FDI project. Differences of opinion at a ministerial level within the host government about the desirability of or approach to be taken to a proposed FDI undertaking can lead to long delays in the negotiation stages. Similarly, the lack of co-ordination or antagonism between the host central government and state, provincial or municipal governments can cause substantial delays in both the negotiation and construction phases of a project.[44] Sub-sovereign authorities are

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[43] Douglas Webb, Legal System Reform and Private Sector Development in Developing Countries. In *Economic development, foreign investment and the law*, op.cit, 50.

[44] For example, in 1992 the Philippine government established the Subic Bay Metropolitan Authority (SBMA) as an autonomous body charged with the re-development of the former US naval base. In mid-1996, Hutchinson-Whampoa, based in Hong Kong, won the re-development contract. President Ramos ordered that the tenders be re-evaluated. Hutchinson was again the successful tenderer. In

often jealous of their autonomy and may be hesitant to conform to policy prescriptions or interventions by central governments. On the other hand, central governments, in order to effectuate matters of policy, may need to impose certain conditions upon sub-sovereign administrations. Such tensions between central and sub-sovereign governments can lead to substantial delays in the issuing and re-issuing of permits, licences, easements, rights-of-way and other approvals necessary to the project.

Ideological factors can also render a host government unreliable in the eyes of potential investors. Changes in government policy, and indeed, changes in government can lead to numerous difficulties. Changes in government policy may result in changes in the laws upon which the development depends[45] or result in an increase in government taxes, tariffs or other imposts. Whilst such changes in policy cause significant delays and cost increases, by far the most threatening eventuality for all parties to an FID project is the spectre of expropriation, nationalization or confiscation of the facility. A distinction is usually made between expropriation, nationalization and confiscation. An expropriation occurs when the host state "takes," for want of a better word, the property of a foreign investor in pursuance of economic reforms. The expropriation of foreign property in Russia after the 1917 Revolution and in Mexico in 1917 and 1938 are perhaps the best known examples. Such expropriations, provided equitable compensation is paid to the prior foreign owner, are not generally held to be in violation of international law. In *De Sabla v The Republic of Panama* (1934) 28 AJIL 602, which concerned the expropriation of land pursuant to land reforms, it was held that in order "to bring order out of a chaotic system of land administration" the loss of the private property

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January 1997 and again in the September 1997 President Ramos once more ordered that SBMA re-open the bidding. In December 1997 the tendering process was halted by Supreme Court injunction resulting from a lawsuit, not surprisingly, brought by Hutchinsons' against both the Philippine Government and SBMA.

[45] For example, legislative changes requiring compliance with more stringent environmental protection provisions.

of aliens is "perhaps inevitable," and provided compensation was paid, such expropriation was not unlawful.

The nationalisation of foreign property is normally effected in the course of a programme which "seeks to end alien control of the economy."[46] As with expropriations in general terms, nationalisations are not contrary to international law provided they are in pursuance of economic and/or public policies and the dispossessed foreign owner is adequately compensated.

Confiscation, on the other hand, is generally defined as "the taking of property by the ruler or the ruling coterie of the state for personal gain."[47] Thus, lacking legal and political justification, confiscations are violations of international law. In the twenty first century, however, when internationally observed sanctions may be imposed upon states pursuing arbitrary confiscations and when foreign investors are often multinational corporation wielding greater economic and political power than the host state, it is predicted that confiscations will be rare occurrences. Further, in a political and economic climate in which privatisations are occurring in all countries, not merely the developing or FSU states, nationalization may be regarded as an unlikely prospect. However, given the political uncertainties subsisting in many states, it is necessary to regard both nationalization and expropriation as possible if not probable risks.

Finally, a change of government after the negotiation and execution of contracts may potentially prove disastrous for an FDI project. Perhaps the most famous (if not infamous) example of the deleterious affects of a change of government is to be found in the Dhabol Power Station project. In December 1993, the US company Enron (now defunct) contracted with the state government of Maharashtra to build a 2,015 Megawatt power station at a cost of US$2.84 billion on a BOO basis. The

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[46] M. Sornarajah, *The international law on foreign investment* . CUP, Cambridge, 1994, 280.
[47] Ibid, 278.

project was instigated as a result of the October 1991 policy reforms of the Government of India which allowed for 100% foreign private ownership of power generating facilities. The newly formed Dabhol Power Corporation (DPC) commenced construction of the project in February 1995. In March 1995 state elections returned a new state government to office, which cancelled the project. After lengthy re-negotiation of contracts, including a reduction of 22% in tariffs, the project was recommenced in December 1996. Enron estimated the costs of the delay at US$175 million. In addition to the more obvious political risks discussed above, it is also necessary to take into account events such as war and sabotage. Furthermore, it must always be borne in mind that it is not merely countries which are subject to political or religious divisions which suffer from civil unrest and/or terrorist attacks. Sabotage, prompted by local opposition to a project or acts of terrorism can occur in any country,[48] however politically and/or economically stable. Thus, war, sabotage and terrorism, whist not necessarily foreseeable or even likely, must, nevertheless, be regarded as potential risks.

Force Majeure risks are caused by natural disasters or accidents such as fires, floods, storms or earthquakes and, as such are beyond the control of humanity. Despite, this, however, such risks may be foreseeable depending upon the geographic and climatic features of the host state.

Risk Allocation and Mitigation

Successful risk mitigation necessitates that each party is allocated and takes full or proportionate responsibility for particular events which come within its ambit or sphere of influence. Thus, the loss arising from the occurrence of an adverse event is borne by the party or parties responsible, either directly or through insurance claims. Because mitigation of commercial, political and force majeure risks is vital to the viability and profitability of a project, great care is taken in the engrossing of

[48] As evidenced by the tragic and horrifying events in the US on 11 September 2001.

contracts and agreements to maximise risk mitigation through identification and allocation of all potential risks. To assist this process it is usual to prepare a Risk Matrix. The Risk Matrix identifies all foreseeable risks as well as addressing the cause, possible remedies and consequences of such risks. Whilst, inevitably, a risk matrix is not, nor can it be, exhaustive, it does provide a summary of potential threats to the project's viability and ways in which these may be addressed.

Further, each FDI project is unique, and whilst it is possible to both broadly categorise and identify the risks to which all FDI projects are prone and to develop general strategies for risk allocation and mitigation, the eventual viability and success of the project will always depend upon the contract/agreement negotiations, the terms agreed upon and their ultimate effects.

The four most common means by which FDI project risks may be allocated between the various parties and/or mitigated are as follows :

1. through the provisions of the numerous contracts and agreements necessary to secure the interests and define the rights and obligations of all parties;
2. through host country guarantees which indemnify the foreign participants against loss occasioned by events within government control or pursuant to which the host government undertakes to effect reforms in its legal system, either of its own motion or pursuant to contractual or international instrument provisions, in order to reduce actual and investor-perceived risks posed by inadequate commercial legislative structure and/or changes of government;
3. through the invocation and application of both international instruments, such as bilateral and multilateral treaties and the formal requirements of funding bodies such as MSAs;
4. through the use of insurance to cover political and force majeure risks.

Whilst each of the methods of risk allocation and mitigation will be discussed separately below, it must be noted that they are not mutually exclusive. Indeed, in

many FDI projects, all four forms are used to a greater or lesser degree. For example, a provision in the contract between the project developer and host government may purport to bind the successors of the government to contractual obligations relating to tax exemptions. Such terms will need to be negotiated in regard to the quantum of exemptions, but the issues raised by succession are also addressed in international instruments dealing with succession.

Contractual Provisions

The complex network of contracts and agreements between the principal and subordinate parties to an FDI venture is, necessarily, the basis upon which the project is built. Naturally, during negotiations each party will seek to obtain terms advantageous to itself, whilst placing as much liability and responsibility as possible on the shoulders of other parties. However, as noted above, in the initial stages of project development, the project sponsor is often in an advantageous position vis a vis the host government, in that it is offering an undertaking which will aid the economic development of the state and will be anxious to achieve security of its investment. The host government, on the other hand, whilst anxious to attract FDI, will inevitably be wary of ceding any degree of sovereignty to a foreign investor.

Stabilisation Clauses

FDI project sponsors and investors constantly face the risk that the host government will, *ex post facto*, use its legislative powers to modify, to its advantage, certain terms of an executed agreement.

In order to minimize this risk, a stabilization clause is generally inserted into the agreement between the project developer and host government. Stabilisation clauses attempt to restrict the power of the host government to amend or abrogate the agreement by legislation passed after the agreement has been executed.

Such clauses generally provide :

1. that the terms of the agreement take precedence over any subsequent legislation or regulations enacted by the host government;
2. that the terms of the agreement may only be varied by mutual written consent,[49]
3. the law applicable to the agreement is the law extant in the host state at the time of execution of the contract.

The value and enforceability of stabilization clauses, however, is questionable. A host government may only restrict its legislative sovereignty if empowered to do so pursuant to its constitution. Furthermore, when the development agreement is entered into with a state-owned entity or regional government, the issue arises as to whether the host state party has the power to bind the national government. Pursuant to the principles of privity of contract, the result of such an inquiry must be in the negative - on the basis that an entity which is not a party to the contract cannot be bound by it.

This difficulty is usually overcome by the contracting host state entity indemnifying the foreign party against any loss caused by a change in laws, such loss to be assessed by an independent third party, usually an international arbitrator.

Naturally, such indemnities are difficult to negotiate in that the contracting state entity will wish to limit its exposure to liability as much as possible, whilst the foreign investor will seek to protect its investment. Further, agreement must be reached between the parties as to the appropriate mechanism in the event that the clause is activated by a change in host state laws. Whilst the International Centre for the Settlement of Investment Disputes (ICSID),[50] the International Chamber of

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[49] This particular contractual term is to be found in most commercial agreements and is generally referred to as the "variation clause."

[50] ICSID was established in 1966 pursuant to the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of other states.

Commerce International Court of Arbitration[51] or the London Court of International Arbitration (LCIA), are all able to arbitrate international FDI disputes, agreement must be reached as to which international body should be appointed. A resolution much dependent upon the perceptions of the parties as to the political bases, real or imagined, of the various fori available.

De-nationalization Clauses

A foreign project developer may also seek to quarantine an FDI project from changes in host state laws by invoking international law[52] as the law governing the project and the attendant agreements. Such clauses were common in mineral exploration and production agreements, particularly for oil, in the 1970's.[53] However, if the clause is activated difficulties generally arise as to

- the identification of which rules apply
- the conflict between international and host state rules vis a vis constitutionality and *lex situ.*

It is very difficult for a plaintiff foreign investor to argue that *lex situ* should not apply to its investment in a host state, when *lex situ* would undoubtedly be applied to the investors investments in its home country. Moreover, the submission of such agreements to international arbitration pursuant to the usual "arbitration clause"[54]

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[51] The first international arbitration conducted by the ICC Court took place on 22 June 1923.

[52] Often expressed as "the principles of common law" or "the principles of international law."

[53] Both UK and USA multinational petroleum corporations favoured this type of clause in their oil exploration agreements with the Libyan Government in the very early 1970s, which prompted a series of disputes between these corporations and the Libyan Government in 1974, pursuant to nationalisations by the government in 1973 of foreign oil companies.

[54] Discussed at 214 below.

has, to some extent, achieved the objective of the de-nationalization clause and obviated the need or its inclusion in contemporary FDI agreements

Governing Law clauses

Closely related to the concept of de-nationalisation clauses is the issue of the governing law of the FDI agreements. Whilst de-nationalisation clauses attempted to isolate the project and the foreign investment primarily from changes in host state law, governing law clauses address the much broader issues raised by the legal system per se of the host country.

As previously noted, most developing countries, especially FSU states, do not have legal systems of sufficient sophistication to cope with issues such as securitisation, property rights and indemnification, raised by extensive and complex FDI projects.

Most foreign investors would, naturally, prefer the governing law to be that of a jurisdiction with which they are familiar, such as the United Kingdom or the United States. The host government, on the other hand, may prefer the application of domestic laws, even in situations where commercial laws are relatively new or, in some instances, non-existent. Certainly, the parties will not be able to avoid the domestic laws of the host state completely. Property rights, contracts and sub-contracts with local service providers, lease, easements, rights-of-way and the myriad of other legal relationships which arise from the physical location of the project within the host state, are governed by the *lex situ*. However, those agreements regulating cross-border legal relationships such as the project finance agreements, pose a more difficult problem in regard to choice of law. Lenders may be reluctant to enter into agreements governed by laws which may not adequately recognise or be able to enforce guarantees or security rights.

Whilst it is generally recognised that cross-border agreements are subject to international law and provide for arbitration by the ICSID, the ICA or the LCIA in

the event of disputes, the exact terms of the clauses are still negotiable and, necessarily, subject to negotiation.

Re-negotiation clauses

Re-negotiation clauses generally provide that, in the event of supervening circumstances such as, inter alia, a change in host state laws or host government policy, the parties undertake to re-negotiate the agreement in good faith. Further, the host state or entity undertakes to waive any right to unilaterally alter the terms of the agreement.

As a means of protecting the foreign developer from the vagaries of host government legislative changes, the re-negotiation clause may appear futile in comparison to the effect of the stabilization clause. However, in situations where re-negotiations flounder, the matter is generally referred to international arbitration pursuant to the "dispute resolution clause." The international arbitrator then attempts to restore contractual equilibrium by determining the new contractual terms and/or the level of indemnification due to the foreign developer.

Exchange Control clauses

Exchange control clauses attempt to insulate the foreign investor :

1. from any measures taken by the host government to restrict payments in convertible currency;
2. any rapid devaluation of the currency of the host state;
3. compulsory repatriation by the host government of convertible currency.

Almost all FDI projects are undertaken in developing countries in which economic malaise and political uncertainty render the currency of the host state extremely volatile. Lack of sufficient convertible currency and rapid devaluation of the host state currency often lead governments to effect foreign exchange controls, such as

the compulsory repatriation of revenues generated abroad from local products[55] or the imposition of restrictions upon the receipt or making of payments in a form other than the local currency.

It is usual for the costing estimates, funding and revenue projections of FDI projects to be expressed in US dollars in most of the documentation. Apart from the relative stability and convertibility of the US dollar, it also provides a convenient currency for cross-border transactions and offers an almost universal standard by which costs and revenues may be evaluated. Furthermore, because these factors, it is a currency which became during the twentieth century the *moneta franca* of foreign trade.

Exchange control clauses therefore enable the foreign enterprise to maintain overseas bank accounts and protect the value of the investment and revenues from the vagaries of the local economy.

Whilst the foreign participants in an FDI project may regard the project as financially unattractive if tied to a local currency, a host government may be loath to surrender its control over foreign exchange and the application of monetary policy. The rights of a national state to direct its economy and legislate to regulate foreign exchange are rights intrinsic to the concept of sovereignty. It is not surprising, therefore, that such clauses often prove to be difficult to negotiate.

An alternative to the exchange control clause is a government guarantee against movements in the exchange rate and on the convertibility and transferability of domestic currency earning. However, whilst such guarantees may be practicable for relatively small-scale FDI enterprises such as manufacturing projects, when used to indemnify potential exchange rate losses on energy projects, they represent huge contingent liabilities for the host state.[56] Thus, it is not surprising that most host

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[55] This is a particularly contentious issue when the revenues are generated by extracted minerals or energy products such as oil and natural gas.

[56] When it is considered that the cost of energy FDI projects, especially greenfield

governments would baulk at accepting a liability which could be almost equivalent to the host state's GNP.

Government Guarantees

Government guarantee provisions are used to assure the foreign project developer and funding providers that perceived risks within the host government's control, such as legislative changes and political risk, will not eventuate, or, if they do, will indemnify the FDI participants for any losses which may arise as a result. The requirements for and extent of government guarantees vary according to the nature of the project and the willingness of the host government to indemnify foreign participants is regarded as both a function and measure of the host government's commitment.[57] Many funding providers, particularly the MSA's, will not consider financing a large scale energy project such as a greenfield power plant or new pipeline without extensive sovereign guarantees.[58]

Accordingly, a wide variety of government guarantees have been developed to enable project developers, investors and funding bodies to mitigate host government-controlled risks. The most common forms are as follows :

Debt or equity guarantees : pursuant to a host government debt or equity guarantee, the government provides direct guarantees either for the annual debt servicing of the project funding facility, or a minimum return on equity. The guarantees may be linked to a specific risk category, such as political risk, or general, covering a

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power projects can exceed US$ 1 billion, a 1% fall in the domestic currency exchange rate represents a huge liability if the host government is called upon to honour the guarantee.

[57] Peter A. Cordukes (ed.), *Submissions and evaluation of proposals for private power generation projects.* World Bank, Washington, 1994, 26.

[58] Ibid, 27.

number of adverse situations. Pursuant to a debt or equity guarantee, if the risk covered eventuates the government becomes responsible for the projects' debt service or exercises a buy-out option at a pre-determined price.

Whilst foreign project participants are, understandably, attracted to such blanket indemnities, serving as they do to minimise the risks which would endanger the viability and profitability of the enterprise, host governments are extremely reluctant to adopt what is always a high-risk contingent liability. It is therefore extremely difficult to persuade a host government to accept a guarantee in such terms and consequently, debt and equity guarantees are rarely used.

Exchange rate guarantees : exchange rate guarantees are used in addition to or in place of exchange control clauses. Such guarantees may range from full indemnification against movements in the exchange rate to guarantees on convertibility and transferability of domestic currency earnings. Whilst the latter are fairly common provisions, used to ensure investor and lender confidence in the viability of the project at relatively low risk exposure to the host government, full exchange rate volatility guarantees are rare, representing, as they do, a potentially enormous contingent liability.

Cash-flow guarantees : these provide for government support in the event that minimum revenue or consumption targets are not reached. Such guarantees are generally used in the Power Purchase Agreements executed in relation to BOO and BOT power plant projects. Essentially, pursuant to a cash-flow guarantee the host government explicitly guarantees the power purchaser's obligations to purchase a set megawattage of power at a particular tariff. If the purchaser's requirements fall below the agreed level and/or there is an intervening event which forces a reduction in the tariff, thus negatively impacting upon the project's cash flow, the host government underwrites the resulting shortfall, thus maintaining the enterprise's level of cash-flow.

Government counter-guarantees : these are generally used when the host state contracting party is not the host government but a local authority or public sector entity and are used for BOT-type projects. Pursuant to a counter-guarantee the host government indemnifies investors and lenders against any default by the host state contracting party.

Change-of-law guarantees : these are used to indemnify foreign investors and funding providers against loss caused by the adverse effects of changes in legislation, regulations or administrative procedures affecting the project by the host government. Such guarantees may either exempt the project from the operation of future changes or indemnifies the foreign participants against any loss caused by such changes.

Adaptation/promulgation of laws guarantees : pursuant to such guarantees, the host government or public authority agree to either adapt existing laws or introduce new legislation. Such laws or regulations may relate specifically to facilitating the construction and/or operation of the project, such as local authority regulations relating to land use or impost exemptions. However, in host countries with underdeveloped or developing legal systems, the guarantee may relate to laws which have much wider import within the states' legal system. For example, the government may undertake to enact laws relating to foreign ownership of domestic property, foreign investment or real property ownership. Whilst the foreign project participants may regard such undertakings as desirable not merely for project viability, but also in regard the general legal well-being of the host state, such guarantees may be regarded as an infringement of the host states' legislative sovereignty. Moreover, even if the host government willingly agrees to enact legislative changes, it faces the possibility that in fulfilling its obligations pursuant to the guarantee, it will encounter such political and public opposition to the changes

as will render it impossible to effect the required changes within the time-frame provided by the contract.

Certainly, the perception of foreign investors and funding providers appears to be that in order to encourage and actively promote foreign investment in the domestic private sector of developing nations, especially within the FSU states, the host government must create a supportive legal environment which guarantees (inter alia) the integrity of contracts, delineates property rights and provides effective fori for the rapid adjudication of disputes.[59] Robert Pritchard enunciates this view that "an open, competitive market economy which fosters private, entrepreneurial initiative is more likely to advance the living standards of people than one which does not."[60] In other words, what investors, funding providers and writers such as Pritchard require for developing nations are legal systems parallel to those of the developed Western countries. However, the legislative systems promoted are idealised. In seeking to impose upon host governments Western open-market oriented laws, the promulgators fail to acknowledge the expense, delays and injustices which are inherent in the system they so avidly promote.

Further, the rapid introduction of legislation which is at variance with the host state's extant laws, may tend to have a counter-productive, destabilizing effect upon the economic, political and legal systems, as governments and administrators struggle to adapt procedures and regulations to new conditions over the relatively short periods of time required by such guarantees.

Equal status guarantees : pursuant to equal status guarantees the host government agrees that the foreign participants will receive no less favourable treatment than host state nationals in regard to application of laws, locus standi in disputes and the

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[59] Douglas Webb, Private Sector Development in Developing Countries. In *Economic development, foreign investment and the law*, op. cit., 45-65.

[60] Ibid, Robert A. Pritchard, 1.

right of representation to public authorities. These clauses, in conjunction with other concessions contained provisions such as change-of-laws clauses, usually ensure that the foreign participants receive more favourable treatment than host state nationals.

Whilst in theory, the various forms of government guarantee clauses in FDI agreements may afford a certain amount of comfort to FDI developers, investors and funding providers, the reality may be that it is cold comfort. The host government, especially a successor government, may not regard itself as bound by the contract or may, for some other supervening reason, such as public protest, may cancel the project.[61]

Besides the political cost of a socially unpopular project, host governments may face substantial payments pursuant to a guarantee in the event of default either by the government itself or by the party for whom it was guarantor. In balancing the cost of breaking or terminating the agreement and facing a lengthy process of dispute resolution, against the prospect of expending a substantial percentage of its GNP in honouring the guarantee, a host government may opt for the former course of action as being the most cost efficient alternative.[62]

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[61] Social and environmental concerns and community protests by way of demonstrations and legal challenges may cause cancellation of a project for which agreements have been signed and construction commenced. An example of the effectiveness of community challenge to infrastructure projects is to be found in the Gordon - above - Franklin Dam in Tasmania. On 1 July 1983 the High Court restrained the Hydro-Electric Commission of Tasmania from proceeding with a hydroelectric power project in an area of unique environmental significance. Prolonged national and international protest prompted the Federal government to successfully challenge the state's right to claim the Gordon - above - Franklin river *Commonwealth of Australia v State of Tasmania* (1983) 46 ALR 625).

[62] This situation occurred in October 1998 when the Government of Pakistan issued termination notices to the Hub River Power Corporation ("Hubco"), thereby avoiding a US$240 million cash-flow guarantee facility which Hubco was about to involve as a result of a 30% cut in electricity tariff's ordered by the new Pakistani Government. Hubco instituted international arbitration proceedings at the International Chamber of Commerce in London (Sader, op.cit, 66-67).

The large delays caused by lengthy international arbitration may serve both to give the host government time to organise its finances whilst, at the same time, placing sufficient financial pressure upon the project developers to make them amenable to renegotiation of certain provisions of the agreement in terms more favourable to the host government.

In addition to contractual terms, investors, lenders, and FDI project developers look to international instruments to protect the viability and profitability of FDI projects. Whilst it is not within the scope of this dissertation to present a detailed discussion of such instruments, they are addressed briefly below.

International Instruments

The last decade of the twentieth century saw the development of a plethora of international instruments dealing with FDI. Bilateral and multilateral treaties, such as the ECT, were concluded through the aegis of entities such as the EU, the OECD, and other international alliance organisations.[63] These treaties attempt to promote the liberalization of investment regimes and provide a high level of protection to foreign investors. Signatories to such treaties are bound by their provisions in contracts made pursuant to the treaty with other signatories.

Perhaps the most recent attempt to regulate international investment has been the OECD Multilateral Agreement on Investment ("the MAI"). First mooted be the OECD Council in early 1995, the objective of the MAI was to achieve "a broad and comprehensive agreement for international investment that would set high standards concerning three areas of FDI: rule making, investment protection and liberalization

[63] Such as the North America Free Trade Agreement (NAFTA) between the US, Canada and Mexico in 1992 and the Community Statement on Investment Protection Principles in the African-Caribbean-Pacific States in 1992.

and dispute settlement."[64] Particular emphasis was to be placed in the MAI upon liberalization, especially in the areas of national/MFN treatment, rollback and transparency (Part III). Thus, pursuant to the MAI, a foreign investor would have been accorded fair and equitable treatment in the host state, including national/MFN treatment (PartIII) and stringent investment protection provisions (PartIV).

Not surprisingly, the EC had initially welcomed the opening of the MAI negotiations and had expressed support in its Communication of 14 December 1995 in glowing terms.[65] However, by the end of 1997 disagreements amongst OECD members were beginning to arise in regard to several key areas, including restrictions and exceptions to the applicability of the MAI and the practicality of achieving the liberalization first envisaged by the negotiating group.[66] In addition, both public opposition to the MAI[67] and criticisms voiced in the European Parliament,[68] together with the EU-US conflict generated by various investment issues,[69] led to the demise of the MAI negotiations in 2003.

Despite the failure of the OECD to implement the MAI, there are a number of multilateral instruments which address the issues raised by protection of foreign investment and trade liberalization, in particular the GATT and related instruments. On a more limited geographic basis are the North American Free Trade Agreement ("NAFTA") between the USA, Canada and Mexico (1994), which aims at eliminating trade barriers and facilitating cross-border investment between the three nations,[70] and the Australia/US Free Trade Agreement, to be finalised in 2004.

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[64] Sacerdoti, op. Cit., 293-294.
[65] See *A level playing field for direct investment worldwide*, OJC 17, 22/1/96, 175.
[66] For an extensive discussion of the points at issue see Sacerdoti, op.cit., 293ff.
[67] Ibid, 293.
[68] Resolution, 11 March 1998, ibid.
[69] Ibid.
[70] See J. Holbein and D. Musch, NAFTA: *Final text, summary, legislative history and implementation directory*. Oceana Pubs, New York, 1994.

In addition to the international instruments per se, in 1992 the Development Committee of the Boards of Governors of the World Bank and the International Monetary Fund issued a set of guidelines on foreign investment. These are the World Bank Guidelines on the Treatment of Foreign Direct Investment. Whilst, as the title suggests, these are merely guidelines, and theoretically have neither the mandatory application nor the enforceability of the treaties, the guidelines are significant in that they enunciate the conditions under which the World Bank and IMF as MSA's are willing to provide funding for FDI projects.

Insurance

The financial impact of force majeure and political risks may be offset, to some extent, by insurance. Most of the international insurance companies, Lloyds of London being perhaps the most famous, will provide limited cover for force majeure events, i.e. natural disasters beyond humanity's control.

Risks occasioned by war and nuclear attack are, on the other hand, uninsurable. No insurance companies have, to date, been willing to cover losses arising from international conflict. In such instances, therefore, the host country must bear the cost. However, what must be noted is that the government of a country at war, facing the devastating human and economic costs of conflict would rarely be in a position to bear the added financial burden of indemnifying project developers and FDI parties for losses occasioned by international and civil strife.

Furthermore, until 11 September 2001, some insurers were willing to accept risks arising from acts of terrorism. However, the attacks on the World Trade Centre and the Pentagon, possibly changed forever the perception and concept of risk. Until this time, the US had always been regarded as perhaps the most secure and terrorist-free nation in the world. However, in addition to the human tragedy, the attacks of 11 September 2001 produced the largest insurance losses in history and

the highest death toll of any insured event.[71] Thus, whilst "the odds of terrorist attacks may not necessarily be any higher.... the fear of them certainly is."[72] Only the passage of time will enable insurers to assess the future costs and insurability of such events.

However, although the negotiation and formation of contracts, applicable law and insurance may assist in protecting both the viability and profitability of FDI in the energy sector, it is unlikely that a project will proceed to conclusion without at least some minor dispute arising to mar the smooth course of its progress. Moreover, the substantial nature of the risks inherent in FDI present a continuous threat that at some stage in the project's life, one or another of the parties to the contract will be in default. Accordingly, an essential component of all FDI contracts are the dispute resolution provisions. These are discussed in the following section.

Dispute Resolution

Tightly drawn contractual provisions allocating and/or mitigating project risks are useless unless the FDI agreements contain effective dispute resolution clauses. The enforceability of FDI agreements is of concern to all parties, but especially to the project sponsors, investors and lenders. In many instances the financial viability of a project will depend upon the strength of the dispute resolution provisions. Should a dispute arise, poorly conceived and badly drafted dispute resolution clauses may involve the parties in years of lengthy and expensive litigation.

In Australia the issues raised by dispute resolution and the enforceability of cross border contracts were, in the mid-nineteen nineties, regarded as being of such significance that in July 1995 the Federal Attorney General at the time, Michael Lavarch, requested the Australian Law Reform Commission to report on and make recommendations regarding the effectiveness of the legal remedies available to

[71] Risk's new dimension, *The Economist*, 29 September 2001, 74.
[72] Ibid.

Australian natural and legal persons involved in international, cross border transactions.[73]

Certainly, there are disputes which will arise in connection with the project which will need to be adjudicated according to the law and in the tribunals of the host state. Disputes arising from contracts with local corporations and individuals, such as suppliers of local goods and services, will be resolved according to domestic law. Similarly with the disputes over boundaries and local issues.

However, in regard to the agreements between the principal cross border contracting parties, the question of jurisdiction for dispute resolution is often a bone of contention between the various parties and must be negotiated in conjunction with other contractual provisions. For a number of reasons, the foreign parties to the agreements may oppose any provisions which would allow contractual disputes to be subject to host state jurisdiction.

In many instances questions will arise as to the adequacy of the host nation's law in dealing with complex international commercial issues and the concomitant experience or lack thereof of the judiciary. As noted above, such problems are particularly acute in FSU states whose legal systems are still developing to cope with the commercial realities of a free market and international trade. Further, there are the additional problems caused by language. It is usual for FDI agreements to be written in English as the *lingua franca* of international trade. However, domestic court proceedings will be conducted in the language of the host state, raising problems regarding the adequacy of translation of documents and the interpreting of proceedings.

Foreign parties also experience a reluctance to subject agreements to local jurisdiction for fear of actual or apprehended bias on the part of the host state

[73] The findings and recommendations of ALRC were published as *Legal risks in international transactions*. Report No 8. Cth of Australia, Canberra, 1996.

judiciary. In countries where the corruption of government and judicial officers is an accepted *modus operandi* and in which the doctrine of the separation of powers is observed more often in the breach than application, this fear is not groundless. Finally, the network of bilateral and multilateral agreements regarding the recognition and enforcement of foreign judgements is incomplete. Accordingly, there may be no reciprocal agreements between the country/ies of origin of the foreign parties and the host state regarding the application of judgements and legislation. On the other hand, the host state party may harbour corresponding reservations in regard to the jurisdiction of the foreign parties' countries of origin. In addition, litigation in the courts of the host state may be open to public scrutiny. Therefore, it may be that in disputes regarding environmentally or socially sensitive projects, neither of the opposing parties, the investor nor the host state would wish the proceedings to be held in the public domain.

In consideration of the above issues, therefore, international arbitration is generally chosen and agreed upon by the parties, not as a matter of preference but by default. In many instances it provides the only compromise available. However, it is not sufficient to merely state in the terms of the contract that any disputes will be resolved by way of international arbitration. Failure to nominate a specific international arbitration institution can lead to expensive delays in resolving disputes. If a dispute arises and a party to the agreement fails to co-operate in instituting the arbitration procedure, the other party cannot rely upon an international arbitration institution to step in and control the resolution process. When such situations arise, the only recourse for the non-delinquent party is litigation or domestic adjudication.

International Arbitration Institutions

There are a number of international arbitration institutions whose jurisdiction be nominated in FDI contracts. These are as follows :

ICC : The International Chamber of Commerce (ICC) was established shortly after the First World War and is based in Paris. Arbitrations are conducted through the ICC's International Court of Arbitration. An arbitration submitted to the ICC is run and heard by an arbitrator subject to the ICC Rules. When parties cannot agree on matters such as the place of arbitration, or the nationality of the arbitrators, these are determined by the ICC. Once the arbitral award has been made, it is submitted to the International Court of Arbitration ("ICA") for approval. The ICA has the power to modify the award if necessary. Costs of the arbitration are divided between the parties.

Despite criticisms as to the complexity of its procedures[74] and the high cost of its arbitrations[75] the ICA has become the leading international arbitration institution both in terms of volume of case and significance of disputes.[76]

ICSID : The International Centre for the Settlement of Disputes was established in 1966 pursuant to the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("the ICSID Convention") and operates under the aegis of the World Bank. Only parties who are national of signatories of the Convention may avail themselves of its services. However, since over 80 states have ratified the Convention, ICSID is commonly cited as the international arbitration institution in FDI agreements.

Although the ICSID is based in Washington, parties may nominate an alternative venue for the arbitration. Since all states who became parties to an ICSID arbitration are signatories to the Convention, and have therefore bound themselves

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[74] Ibid, 246.

[75] Jan Paulsson, Dispute Resolution. In *Economic development, foreign investment and the law*, op. cit, 217.

[76] Ibid, 215.

to recognise and enforce ICSID awards, an ICSID award cannot be challenged in the Courts of the place of arbitration.[77]

LCIA : The London Court of International Arbitration, comprised of the Chamber of Commerce, the Corporation of the City of London and the Institute of Arbitrators, will organise arbitrations anywhere in the world. Whilst the LCIA has rigorous rules designed to avoid abuse of the arbitral process, its procedure is for more flexible than that of either the ICC or ICSID.

Whilst international arbitration institutions do not offer a perfect solution to the problem of dispute resolution to the problem of dispute resolution between parties to FDI agreements, they at least offer a far better solution than could be achieved without the use of their services. Arbitration institutions have developed responses to deal with recalcitrant parties. Further, their awards are recognised and respected, thereby obviating the pitfalls which may be inherent in either the host state or other party jurisdictions.

Finally, arbitration is a consensual process between the parties to the agreement, governed by the rules of privity and, as such, adhere to a basic framework which is more or less dependable. Thus, whilst any of the innumerable risks attendant upon FDI may eventuate during the life of an energy sector contract, workable provisions for efficient dispute resolution will assist in preserving the project's viability. Whatever discrepancies may arise between the vested interests of the project/investors/developers/ and the host state, it is to the advantage of both parties to reach consensus on the procedure for dispute resolution. However, whilst agreement upon such terms is in the interests of all parties, this consensus is often difficult to achieve and may only be reached after lengthy negotiation. Dispute resolution issues, therefore, may merely exacerbate the fraught process of contract

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[77] For a detailed description and analysis of ICISD see C. Schreuer, op. cit..

formation, thus presenting an added disincentive to project developers and investors and host states alike.

Conclusion

From the foregoing discussion it may be seen that FDI presents potential pitfalls for both project developers/investors and the host state.

Although FDI offers the host state the opportunity to acquire vital infrastructure improvements or establishment as well as the resultant economic benefits, it also represents a tangible threat to state sovereignty. Contractual provisions required by developers/investors which seek to compel or restrain the legislative and political freedom of host state governments, impinge upon the freedom of states to direct their domestic affairs. Moreover, FDI developers/investors often require protection of the investment in the form of indemnities and guarantees from the host government.

On being presented with a proposal for FDI, therefore, the host state must frequently balance the significant disadvantages offered by the investment against what may be the marginal, if not putative benefits in terms of economic development. In may instances, especially in developing nations, economic conditions may be such that the host state has little choice but to accept the proposal on whatever terms offered. On the other hand, the foreign project developer/investor is faced with a lengthy and expensive contract negotiation procedure and the ultimate possibility that the projected risks will materialise causing lengthy delays, financial loss and even the termination of the project. Despite the careful application of risk identification, mitigation and allocation procedures, financial loss may occur. It is hardly surprising therefore, that investors in and financiers of FDI in developing states approach such projects with caution if not reluctance.

The ECT therefore attempts to address those negative aspects: the risks and uncertainties faced by participants in FDI projects in the energy sector. By making implicit in all contracts formed pursuant to it provisions, terms and conditions which address the major risk factors discussed above, the ECT attempts to make FDI in the energy sectors of host states more attractive to potential investors. In this way, therefore, the ECT may be regarded as a device by which the EU states will be able to procure future energy supplies via stringently protected energy sector agreements between EU investors and energy resource suppliers.

The ECT is thereby an investor centred instrument, providing no advantages to potential host states whilst offering maximum protection to FDI in the energy sector. The manner in which this is achieved, the difficulties inherent in its application; the practical legal effects of its provisions and the patent disadvantages of its investment protection regime to host state Contracting Parties will be discussed in detail in the following Chapters.

CHAPTER IX

EFFECTS OF THE ECT UPON CONTRACT NEGOTIATION AND RISK MITIGATION

Introduction

The ECT has been variously described as "arguably the most innovative of the modern international economic treaties"[1] and "as compared with the gradual development of national protection laws and BITs . . . a quantum leap."[2] Further, as may be appreciated from the foregoing discussion of the discrete articles in Chapters IV to VII, its scope is vast, covering not only the regulation of all aspects of FDI agreements in the energy sector, but extending control beyond contractual relations between parties to the very heart of host state national integrity: sovereignty over territory, domestic law and natural resources.[3]

In consideration of the Treaty's novelty and scope, therefore, the question must be asked: upon what basis should the ECT be evaluated? It is, after all, a multilateral treaty creating rights and obligations as between States pursuant to the principles of international law. As such it falls within the long tradition of bi- and multilateral instruments, UN Conventions and Declarations and should be evaluated according

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[1] Craig Bamberger, Jan Lineham and Thomas Waelde, The Energy Charter Treaty in 2000: In a New Phase. In Martha Roggenkamp (ed.), *Energy law in Europe.* OUP, Oxford, 2000, 12.

[2] Jan Paulsson, Dispute Resolution. In *Economic development, foreign investment and the law,* op.cit., 238.

[3] The unprecedented features and ambit of the ECT are not surprising when its goal is taken into consideration. It is argued here that the objective of the Treaty is not to assist economic development in the FSU states, but to effect total control over FDI in the energy sector, thus enabling the EU states to obtain desperately needed energy resources on the most favourable and secure terms. Under such conditions therefore, the greater the obscurity of the document, the less likely it will be that FSU Contracting Parties will recognise the "hidden agenda."

to its impact upon the legal principles governing international relations and sovereign State rights.

The ECT is also a document which provides the legal framework for foreign investment in the exploitation, development and use of energy resources. It is intended that the provisions of the Treaty should be enforced and enforceable against the host state Contracting Party. As such, therefore, it governs not only State-State relations in the energy sector, but also by virtue of Article 26, both the contractual relations between investor and host state and third party interests in FDI in energy projects. This regulation of what is, essentially, "private" contractual relations coupled with its broader international application imparts to the Treaty a dichotomous nature. It is a document which influences both private commercial and international law and, as such, any analysis of its effects must reflect this duality.

However, the ECT is an obscure, ambiguous and often contradictory document which has the potential to become fertile ground for litigation and diplomatic wrangling. Whilst it is arguable that this is the result of its innovative nature, huge ambit and ambitious objectives, an appreciation of the underlying causes of its defects does not allay the difficulties raised by its interpretation and application to real FDI situations. Despite its experimental nature, the ECT is not a theoretic construct: it is intended to be applied to energy sector agreements. As a practical document, however, it is inadequate. For parties entering into energy sector contracts caught by the Treaty, it presents enormous problems in both the practical application of its provisions, arising from it lack of clarity, inconsistencies and abbreviation of the contract negotiation process, and in its legal implications, originating in its abrogation of certain principles of international law relating to FDI and sovereignty. Moreover, it is essential that Contracting Parties and their legal representatives be fully cognizant of these problems.

This Chapter will therefore examine some of the major issues raised by the practical application of the Treaty and its legal implications, the difficulties of interpretation caused by the vagaries of drafting and the attenuation of the contract negotiation process. Chapters X and XI will address the issue of state sovereignty raised by the application of the Treaty.

Practical Application of the ECT: Textual Problems

In practical terms, the ambiguities, uncertainties and inconsistencies inherent in the English text of the ECT present many difficulties and pitfalls for the unwary Contracting Party and its legal representatives. Whilst both the conceptual framework and the overall drafting of the Treaty in themselves leave much to be desired, particular problems in interpretation and application arise principally from three major areas:

- the definitions of terms (or lack thereof) used in the Treaty;
- the uncertainties as to application and interpretation due to ambiguity of expression and the illogical/ad hoc conceptual structure of some Articles;
- inconsistencies between Articles.

Furthermore, certain provisions of the Treaty attempt to remove investor-perceived impediments to FDI in energy projects, such as the difficulty in obtaining host state guarantees, deficiencies in host state commercial legislative regimes and protectionist policies. Whilst the removal of these impediments create a more secure environment for potential investors, it impacts negatively upon both the sovereignty of the Contracting Party host state, discussed in detail in Chapters X and XI below, and substantially abrogates the freedom of Contracting Parties, especially the host state Party, to negotiate some essential terms of FDI energy sector contracts. Whilst this shortening of what may be a very lengthy process offers benefits for all parties, the abrogation of the right to negotiate such aspects of the agreement as host

state indemnities and guarantees, changes of law provisions and liability to strangers to the contract, effectively place the host state at a distinct disadvantage.

It is therefore argued that where a document has such a profound impact upon the inherent rights of Contracting Parties to the Treaty, the obligations it imposes should be set out with precise clarity, leaving little if any doubt as to the intended effects, thereby reducing the necessity to resort to judicial or arbitral construction. However, the English language version of the ECT provides little in the way of textual clarity. Since English was the language used in the original document, there is no reason to suppose that the other language translations are any more intelligible. The following section will therefore briefly discuss the practical difficulties arising from the interpretation of the document.

Definitions in the ECT

The effective practical application of any statute or treaty is dependent upon the clarity and accuracy with which its provisions are drafted. The necessity for clear, unambiguous language is predicated upon the self-evident premise that unless a document can be understood, it can be neither interpreted nor implemented so as to achieve its objectives. In regard to a document such as the ECT which governs the contractual relations between parties, some degree of certainty is essential:

- to enable the parties to accurately ascertain their respective rights and obligations, and
- to facilitate interpretation of the document in the event of a dispute.

In attempting to interpret the provisions of the ECT, however, two major difficulties arise. Firstly, where definitions are given, they are often vague, ambiguous and therefore, inadequate for effective understanding of the treaty. Secondly, in some instances no definitions are provided for key words and phrases, leaving them open to any interpretation.

Whilst an extensive discussion of all examples of vague or omitted definitions is beyond the scope of this work, a few examples are addressed below.

In regard to the first point, the terms "investment" and "investor," essential terms in the context of the Treaty, present considerable difficulties for Contracting Parties to the ECT wishing to enter into an FDI agreement. As discussed at 100 ff above, the definition of "investment" in Article 1(6) is so wide as to include any conceivable activity or asset which has some connection, however remote, with economic activity in the energy sector. Similarly with the definition of "investor." Article 1(7) merely establishes that an investor may be a natural person or legal entity (corporation) of either a Contracting Party or a third state. However, taken with the definition of investment, an investor could be held to be any natural person or legal entity with either a legal or equitable interest in any activity or asset connected with economic activity in the energy sector.

The consequences for Contracting Parties of this breadth of definition are extensive. Firstly, during the negotiation of a contract for FDI in energy, both parties must not only constantly bear in mind their obligations to each other but also towards possible third parties, such as the shareholders of corporations involved in the project and even beneficiaries or unit holders of Unit Trusts which hold shares as investments. Moreover, given the provisions of Article 26 there are no limits upon the nature of an interest which would imbue a third party with the locus standi to commence an action for a breach against a Contracting Party.

Secondly, the almost limitless scope given to the definition of investor and investment in Article 1, together with the arbitration without privity provisions of Article 26, have the potential to open "floodgates" for third party litigation against parties to agreements for FDI in energy projects. Even though such litigation may not succeed, it is still time consuming and expensive. Thus, it would be advisable

for the costs of such an eventuality, albeit unquantifiable, to be factored into funding models for all proposed energy projects commenced pursuant to the Treaty.

Whilst the ambiguity and obscurity of many of the definitions included in the ECT present substantial obstacles to the precise interpretation of the document, the lack of definitions of key words and phrases used in the Treaty is even more problematic. Indeed, the ECT is so remarkably devoid of definitions that in many instances provisions which purport to impose obligations upon Contracting Parties are so imprecise as to be arguably void on the grounds of uncertainty.[4] Further, whilst many of the undefined words and phrases appear in "soft-law" or exhortatory provisions, they nevertheless impose obligations upon Contracting Parties which failure to fulfill could be construed as breach of the Treaty and thereby actionable. This "iron fist in a velvet glove" approach to the drafting of documents disguises the draconian intent of its provisions whilst, at the same time, presents hidden dangers for unwary Contracting Parties.

For example, in Article 3, Contracting Parties are exhorted to "promote access to international markets on commercial terms." Whilst it is reasonably (but by no means definitively) certain that the "international markets" referred to are international energy markets, the meaning of "commercial terms" is far less clear. Are "commercial terms" solely these terms which have the potential to maximise the profits of the investor, such as the setting of low or market interest and exchange rates, fixed/low tariffs and host state deregulation of foreign investment? Or does it mean terms which are mutually beneficial to both parties, the host state as well as the investor? Certainly, either interpretation is arguable. However, terms which are beneficial to the host state, such as the imposition of duties and tariffs, whilst "commercial" may not be beneficial to the investor. Moreover, although the Treaty

[4] A document or a term in the document may be held to be void on the grounds of uncertainty if it is "so obscure and so incapable of any definite or precise meaning that the Court is unable to attribute to the parties any particular contractual intention" (*Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd* (1968) 118 CLR 429, per Barwick CJ at 436).

requires national or MFN treatment for FDI investors, and therefore it is arguable that "commercial terms" are those terms which offer most benefit to the investor, this may not necessarily be the case. There may be certain measures imposed by a host state which may benefit the state to the detriment of the investor but which are consonant with the national/MFN treatment offered as, for example, certain value added or goods and services taxes. Are such terms to be regarded as "uncommercial" and thereby in breach of the Treaty?

Further, Article 6 obliges each Contracting Party to "work to alleviate market distortions ... in Economic Activity in the Energy Sector" (para (2)). No indication is given in the Treaty as to what constitutes a "market distortion." Even reference to the following " barriers to competition" does not clarify the issue. The only certainty is that the "distortion" in the market refers to competition in the energy sector. Does it therefore refer to such situations as discriminatory tariff structures, dominance in one area of the energy sector by a foreign multinational or state-owned enterprise or international price rises in a particular energy resource, such as crude oil? Any one of the preceding circumstances could constitute a "market distortion" but not all are within the control of the host state. Moreover, what may be regarded as a "market distortion" by an aggrieved investor may not be viewed as such by the host state. Thus, if the host state countenances the alleged "distortion" on the basis that it is a normal condition of the market, it is arguably in breach of its obligation to "work to alleviate" the same.

Similarly, Article 12 (2) provides that compensation to an investor for losses shall be "prompt, adequate and effective." No explanation is offered in the text as to what constitutes any of the adjectives. Does "prompt" mean within 30, 60 or 180 days? Does adequate and effective compensation include interest, loss of future profits, exemplary damages or merely "book value" loss? The only certainty in regard to this provision is that should Article 12(2) be invoked, it is unlikely that the

host state and the investor will be able to agree on what constitutes "prompt, adequate and effective compensation."

The above discussion covers only three examples from the multitude of the problematic and imprecise terms and language used in the ECT. The problem is further compounded by the fact that the text of the Treaty is available in English, Russian, French, German, Italian, Spanish (Article 50) and, more recently, in Chinese. Thus, lack of definitions and precision in the English text can only be compounded by translation especially in those instances where there is no corresponding term in the other language for the English expression.

From a practical, legal perspective, therefore, the imprecision, ambiguities and obscurities inherent in the language of the ECT render it an extremely difficult document to apply. It is very difficult to offer legal advice in instances where a Contracting Party's obligations are uncertain and open to argument and different interpretations. Certainly, some of the ambiguities. may be dealt with within the documentation of any agreements entered into pursuant to the Treaty. For example, definitions may be supplied in the body of the agreement, so that "commercial terms" may be given a meaning agreed upon by the parties. Similarly, issues raised by the interpretation of such phrases as "prompt, adequate and effective" (Article 12(2)) may be addressed in specific clauses of the document. Compensation for losses, therefore, could be dealt with in the following manner:

Compensation

1. Compensation for any loss occasioned by the Host State is to be referred to (a nominated institution) for assessment within 30 days of the Developer being made aware of the loss.

2. Compensation shall include interest at the commercial bank rate at the time of assessment and shall apply from the date upon which the loss arose to the date of payment of Compensation.

3. Compensation shall not include any amount or sum assessed for loss of future earnings.

4. Compensation shall not include exemplary damages unless the loss sustained by Developer was the result of any default, negligence, intentional or other action of the other party.

5. Compensation is payable in full within 120 days of the assessment.

However, the energy sector agreement can only address issues which affect the inter partes relationship. No amount of careful drafting can reduce either the likelihood of a third party action pursuant to Article 26 or the obligations imposed upon Contracting Parties by the regulatory provisions of the Treaty.

Uncertainties and Inconsistencies

Imprecision in language is not the only defect which bedevils the effective interpretation and application of the ECT. There is also a degree of uncertainty arising from within and inconsistency between the provisions of individual Articles, making it difficult for Contracting Parties to ascertain the exact intention and meaning of the Treaty in regard to particular aspects of FDI in the energy sector. Whilst these aspects of the ECT were discussed at some length in the analysis of the provisions in Chapters IV to VII above, some mention of the practical effects is pertinent.

Article 45

Firstly, and perhaps the most significant uncertainty raised by the application of the treaty emerges from the Provisional Application provisions of Article 45. Pursuant to this Article, a signatory of the treaty may choose to apply the whole of the Treaty provisionally, pending its ratification, accession or

approval ((1)) or it may declare, pursuant to para (2)(a), that it is unable to apply the Treaty provisionally, with the exception of Part VII ((2)(c)).

However, as discussed at 151ff in the analysis of Article 45, the Treaty is silent as to whether the signatory is still bound by its terms and therefore liable for breach, despite the registration of a declaration pursuant to para (2)(a). In effect, it is possible that the (2)(a) declaration works merely to postpone the benefits accruing to a signatory, but not the obligations. By signing the Treaty, the signatory has, in principle, accepted the provisions and obligations, but at the time of signing, the signatory was "not able to accept provisional application." Whilst the Treaty is silent as to what circumstances might render a signatory unable to provisionally apply the Treaty, para (1) provides that the acceptance of provisional application should not be inconsistent with the "constitution, laws or regulations." It is therefore possible that inconsistency with domestic law would be sufficient grounds for a declaration under para (2)(a). However, an inability to apply provisions is of different legal effect to a refusal to apply. Thus, if a signatory has accepted the provisions of the Treaty in principle and is, moreover, and by virtue of para (2)(c) has become a member of the Charter Conference, it is arguable that whilst the signatory does not apply the provisions, they may still be enforced against it, since it is, *mutatis mutandis*, a valid Contracting Party. Certainly, it is argued here that it is open to a third party investor to invoke Article 26 (Dispute Resolution) against a signatory state notwithstanding registration of the requisite declaration.

The situation posed by the uncertainties surrounding the application of Article 45 places a paragraph (2)(a) signatory in an extremely difficult position.

Firstly, if the signatory is aware that the effects of the Article are indeterminate, the uncertainty itself must place restraints upon government policy, decisions and understandings in regard to investment in the energy sector. Thus, whilst the signatory state is freed, by virtue of inconsistency with domestic laws, from applying the Treaty, it must also be mindful that an investor (or third party) from another Contracting Party may seek redress for any breach of the provisions of the Treaty in regard to an investment in the energy sector within its territory.

Secondly, if the signatory is unaware of the uncertainty attendant upon the practical effects of Article 45, it may find itself the unwitting defendant in proceedings pursuant to Articles 26 or 27. Even though a signatory placed in such a position may eventually successfully claim the protection of para (2)(a) in such an action, it is highly arguable that such proceedings would be unavoidable since they would "concern an alleged breach of an obligation .... under Part III."

Taxation

In addition to the uncertainties and ambiguities inherent in the ECT, the Treaty also contains a number of inconsistencies which obfuscate the intention of the Articles. The most problematic of these, between Article 13 (Expropriation) and 21 (Taxation)[5] and Article 24 (Exceptions) and 21 (Taxation) were discussed at 148 above. Such discrepancies create practical difficulties for both Contracting Parties and investors. On the one hand, a Contracting Party may impose a tax or taxation measure it believes to be consonant with the provisions of the Treaty. On the other hand, the investor may argue that the tax constitutes an expropriation for the purposes of Article 13, and therefore subject to review pursuant to Article 21(5)(b). In effect, the provisions of the Treaty offer little or no guidance to Contracting

[5] This inconsistency persists despite the provisions of Article 21(5) which go to the resolution of issues relating to Article 13 and Article 21(1).

Parties or investors regarding this issue but merely present the problem and leave the parties to resolve the issue as best they can.

Conclusion

As the Treaty stands, therefore, it raises a number of serious issues in regard to the application of certain provisions and their attendant inconsistencies with other Articles. Moreover, the problems attendant upon uncertainties and inconsistencies can only be resolved by recourse to litigation. Whilst Contracting Parties and investors may attempt to avoid potential pitfalls by careful consideration of their relative positions, the issues can only eventually be settled through judicial interpretation of the contentious provisions and their effect. Such a solution is, to say the least, unsatisfactory being both time consuming and expensive. Moreover, it is possible that the spectre of litigation as a means of resolving shortcomings in the drafting of the Treaty is more likely to discourage both Contracting Parties and investors from pursuing investments in the energy sector: an outcome dramatically opposed to its objectives

Removal of impediments to FDI and Abridgment of the Negotiation Process

In addition to the practical legal effects of the ambiguities, uncertainties and inconsistencies resulting from the language and drafting of the ECT, the provisions of the Treaty, i.e. the rights, obligations and principles expounded within the text, have a profound impact upon the negotiation process and content of FDI agreements for projects in the energy sector. The import of the provisions stems naturally from the objective of the ECT regime: to achieve secure and cost efficient energy resources for the EU states. In order to accomplish this objective, however, it was necessary to encourage investment in energy projects in both transitional/developing FSU states as

well as the energy resource rich "developed" nations such as Australia and Canada.

In regard to transitional/developing economies, FDI investors have been and still are, reluctant to commit the huge development funding and capital required for energy projects. Although these states are in desperate need of the fillip to their economies provided by FDI in the energy sector, their government administrations, legal systems, legislation (or lack thereof) and political institutions mitigate against the secure investment environment necessary to attract FDI. Naturally, investors have been reluctant to sink enormous sums into countries in which corruption and political instability at all levels of government, inadequate investment regimes, powerful SOEs, potential social unrest and future commercial and political risks threaten the profitability and viability of investments.

On the other hand, the developed states with abundant energy resources such as Australia and Canada, have had sufficient economic and international political weight to drive hard bargains with aspiring FDI developers. As a result, protectionist policies, the rights and interests of sub-national autonomous entities and groups,[6] environmental concerns, sovereignty issues and the influence of public interest groups[7] have tended to mitigate against the completion of agreements for energy resource exploitation advantageous to the investor.

Moreover, once an agreement has been concluded and the project is underway, there remains the problem of transit of both supplies and products, not merely across the host state's territory, but also across that of

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[6] Such as States within the Federal systems of Australia and Canada and indigenous peoples' interest and self-government movements.

[7] Especially environmental groups such as Greenpeace as well as local political parties such as the Greens in Australia.

third party states. There are many reasons why a third party would be reluctant or unable to grant access across its territory for the transportation of energy supplies and resources. Political and diplomatic disputes, lack of or inadequate infrastructure such as roads and pipe lines, and environmental issues may all comprise possible obstructions to transit.

Accordingly, no matter how desperate the EU states may be for energy resources and supplies, their investors have been unwilling to undertake the lengthy and expensive negotiation process necessary to conclude FDI agreements for projects which are high cost, high risk and/or low return undertakings. In effect, therefore, the ECT regime and the conditions imposed upon Contracting Parties address two essential areas of concern for FDI investors: risk mitigation and risk allocation. The risk mitigation process determines which party should take responsibility for specific, identifiable risks faced and posed by the project and how such risks might be minimised. In the risk allocation procedure, decisions are made by the parties to the FDI agreement as to which party is in the best position to bear the financial cost should a perceived risk eventuate.

Risk mitigation and allocation is generally approached initially by the development of a risk matrix. The development of the risk matrix is an expensive and time consuming but nevertheless, essential step in FDI project development. Once the risk matrix has been completed, the practical task of mitigating and allocating perceived risks becomes subject to the contract negotiation process.

There are, of course certain risks and perceived impediments within the broader context of host state government, legislative and economic organisation which cannot be addressed within the narrow confines of FDI contracts. Therefore, in alleviating the impact of such issues as

anti-competitive policies, inadequate commercial law regimes, government corruption and unco-operative sub-national authorities, the provisions of the ECT take a broader perspective by targeting government policies and administration. Thus, the provisions of the ECT attempt to counteract the perceived and actual impediments to FDI in both developing/transitional and developed states at the macro-national level and the micro-contractual level in a number of ways.

Firstly, the Treaty imposes enforceable obligations upon Contracting Parties which address both general and specific areas of concern for FDI investors. Pursuant to the Treaty, therefore, a Contracting Party must:

- effect legal and economic policy reforms consonant with free-market, competitive principles;
- accept liability for the actions of sub-national authorities, SOE's and private enterprises;
- accept liability for losses sustained by investors due to political or civil disruption, change of law or expropriation;
- facilitate the transit across its territory of energy supplies and products resulting from an agreement between an investor and another Contracting Party.

Secondly, these obligations not only substantially reduce the risks attendant upon FDI projects, but also significantly curtail the negotiation process by making implicit in any FDI energy project agreement formed pursuant to the ECT, certain conditions and terms which would otherwise be subject to negotiation, such as (inter alia) host government guarantees and indemnities, method and place of dispute resolution, change of law and taxation provisions.

As with the ambiguities and uncertainties inherent in the ECT, it is essential for Contracting Parties and their legal representatives to be aware of the practical legal implications of the rights conferred and obligations imposed by its provisions in removing the perceived risks attendant upon FDI projects and in considerably abridging the negotiation process. Whilst the perceived impediments to FDI and the terms of an FDI contract which are usually subject to negotiation and the Treaty articles which address them are set out in Table 1 at 251 and Table 2 at 253, their practical legal implications are discussed in detail below.

FDI Risk and Impediment Mitigation Provisions

Despite the rhetoric of apparent altruism which characterised the EU pronouncements upon the ECT and Charter Conference regime in the early 1990's, the creation of a secure investment environment and viable legal framework for FDI in the energy sector as a means of securing the future of EU energy supplies is now the openly avowed goal of the ECT. Dr Ria Kemper, in an address to the Centre for European Policy Studies on 17 May 2000 echoes Article 2 of the Treaty when she states:

> The Treaty enshrines, in a legally-binding form, the key principles of openness, transparency and nondiscrimination as the basis for the relations among the Charter's constituents in the energy sector. The Treaty's primary aim, from the very beginning, was to promote the necessary climate of legal stability and predictability that is required in order to attract investments and stimulate business activity in the energy sectors of, in particular, transition economies.

In order to achieve this objective the ECT provisions target five broad areas within host state governmental and legal regimens in which impediments and risks to FDI projects may occur. These are:

- governmental policy, organisation, administration and biases towards SOE's and privileged enterprises;
- domestic legislation and the legal system;
- environmental issues;
- transit of energy resources, supplies and equipment.

Naturally, these general categories are not mutually exclusive and many of the provisions simultaneously address issues raised in a number of these broad categories. However, for convenience they will be discussed separately below, although inevitably there will be some overlap between the sections.

Government Policy, Organisation and Administration

A major difficulty which has faced FDI investors in the FSU states has been the lack of understanding of and observance by the potential host state of competition rules and principles. The progression from Communism to Capitalism: from command protectionist to free market economies has not been easy for many FSU governments. Constructs such as competition policy, free trade, corporate and natural persons' property rights, and the myriad other concepts which have been integral to the capitalist system for more than four centuries have been integrated into FSU national administrative and organisational systems in less than a decade. This lack of familiarity with free market principles and practice by transitional governments therefore has proven to be a major disincentive for potential FDI investors. Accordingly, the ECT attempts to address this issue through the requirement of comprehensive reforms in government policy and administration.

Thus the "soft-law" exhortatory provisions of :

- Article 3, which requires Contracting Parties to "work to promote access to international markets on commercial terms, and generally develop an open and competitive market;"

- Article 6(1) which states that Contracting Parties "shall work to alleviate market distortions and barriers to competition;"
- Article 9(1) which requires that each Contracting Party shall promote "conditions for access to its capital market by companies and nationals of other Contracting Parties;"
- Article 10(1) which calls for the creation of "stable, equitable, favourable and transparent conditions for investors of other Contracting Parties ...;" and
- Article 14(1) which prescribes conditions for the free transfer of investments into and out of the host state,

all demand changes to government policy and its implementation which are essentially ideological in nature. By prescribing adherence to and application of free market principles and rules by a host state, the ECT attempts to ensure the most favourable political and ideological climate for FDI investors in energy projects. However, in recognition of the difficulties faced by some Contracting Parties both in implementing the extensive and necessarily profound changes required by these provisions and in facilitating and administering complex FDI projects, the Treaty provides for assistance to be given to inexperienced Contracting Parties by more experienced States and financial institutions.

Article 6

Article 6(3) exhorts Contracting Parties with experience in applying competition rules, "upon request," to "give full consideration to providing" resources and technical assistance to less experienced Contracting Parties. However, the provision of assistance is not mandatory. The experienced Contracting Party need only give "full consideration" to the provision of such support. Moreover, since the Parties providing the assistance are more likely to be the energy-hungry EU states, it is arguable that any aid given pursuant to Article 6(3) will be geared solely toward open-market competition policies possibly at the expense of host state sovereignty. Further, Article 9(3) requires Contracting Parties to "take advantage of the expertise of relevant international financial institutions" in implementing programmes to

"improve economic stability and investment climates." Although the Article does not specify any particular "international financial institutions" which may be approached for assistance, the most likely candidates contemplated by this provision would be the World Bank, IMF, IBRD and EBRD, all of which have extensive experience in macro-and micro-economic development and established policies and strategies for the facilitation of FDI. However, as funding providers and investors themselves, their approaches are oriented specifically toward investment protection. For example, in 1992, the World Bank released its "Guidelines on the Treatment of Foreign Direct Investment."[8] Produced for member countries, the Guidelines set down "useful parameters in the admission and treatment of private foreign investment in their territories."[9] Although the Guidelines provide a regime for the treatment from foreign investment by host states, they do not address the standard of behaviour to be expected of foreign investors vis a vis the host state. They are silent, therefore, as to issues such as restrictive business practices, avoidance of corruption and noninterference in host state domestic affairs.[10] Whilst it may be argued that to attract FDI host states need to provide investors with the assurance that not only are their investments protected but that the host state is willing to co-operate fully in the FDI venture, there may be instances in which the host state should be afforded protection from the activities of the FDI investor.[11]

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[8] The Guidelines were produced as a result of a request from the Development Committee, a ministerial committee of the Boards of the IMF and World Bank in April 1991 for the preparation of a legislative framework embodying essential legal principles necessary to promote foreign direct investment.

[9] Schrijver, op cit, 183.

[10] Ibid, 184.

[11] It is not unusual for a multinational FDI investor or funding provider, such as the World Bank, to exert tremendous pressure upon a potential host state in order to exact the most favourable terms for an FDI agreement. For example, in 1992 the US company Enron (now in liquidation) took advantage of a projected major shortage in electricity supply in India by negotiating an extremely favourable 20 year Power Purchase Agreement with the State Government of Maharashtra, specifying a tariff of 7.5 U.S. cents per kilowatt-hour. Not only was the State government at that time desperate to attract FDI in energy projects, but also the whole of India was facing a crippling electricity shortage due to the increasing energy demands of a burgeoning computer software development industry. However, in 1995 a new State government rescinded the PPA and successfully re-negotiated a lower tariff of 5.9

Thus, on the one hand, whilst any assistance or advice provided to Contracting Parties by "relevant financial institutions" pursuant to Article 9(3) would yield policies and strategies favourable to and thereby attractive to FDI investors, they would be unlikely to provide the Contracting Party with strategies of self-defence against an unprincipled or rapacious investor.

Energy Sector Liberalisation

A concomitant of an absence of free-market principles in FSU states has been the lack of overall energy sector liberalisation together with government funding biases in favour of state/local enterprises and government protectionist policies. In regard to energy sector liberalisation, the EU has been working doggedly towards an open, de-regulated energy market. Central to this process of liberalisation has been the promulgation and implementation of competition policies which have targeted state owned/subsidised monopolies, restrictive and discriminatory tariff structures and import restrictions. In the FSU states, however, the energy sectors have tended to retain the former centralised control over energy, with government owned and controlled energy enterprises, extensive regulations on the import and export of energy products, state subsidies for quasi-state owned enterprises and general protectionist trade and economic policies. As a result, the organisation and administration of the FSU energy sectors have posed almost insuperable barriers to aspiring foreign private investors. Furthermore, where FDI has been permitted and foreign investors have entered into agreements with FSU states in regard to energy resource exploration and exploitation, the advantages conferred upon SOEs through the regulation of foreign investment[12] and protectionist policies and government support for state owned and private domestic enterprises has tended to retard the growth and consequent profitability of the FDI project. As a result, FDI investors

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cents/k-h., Sader, op. Cit., 42-43.

[12] Through the imposition of foreign exchange regulations, taxation, domestic product purchasing and local personnel recruitment requirements.

have shied away from involvement in those states in which anti-competitive policies have made investment unprofitable, if not actually impossible.

Therefore, in an attempt to remove what have been regarded by investors as major impediments to FDI in FSU states,[13] the ECT contains a number of provisions aimed at forcing open highly regulated energy sectors, ensuring competitive markets and thereby "leveling the playing field," as it were, for foreign investors.

In addition to the exhortatory provisions of Articles 3, 9(1), 10(1) and 14(1), discussed above, the Treaty contains a number of specified provisions which target increasing competition and thereby liberalising the energy sector of a host state. In particular, Article 6 requires the Contracting Parties to institute and implement competition policies through the promulgation of legislation (6(2)) and the establishment of competition authorities (6(5)).[14] As noted above, competition policy is regarded by the EU as the bases for sector liberalisation. Accordingly, by requiring Contracting Parties to establish competition regimens both congenial and familiar to investors, access to energy sectors will be facilitated.

In addition, Article 8 requires that Contracting Parties promote "access to and transfer of energy technology on a commercial and nondiscriminatory basis." In a technology intensive industry such as the energy sector, competition is futile without free access to the technology upon which it is based. Central to energy sector liberalisation is the reduction of government regulation and interference in the energy industry. Therefore, the ECT addresses this issue in a number of Articles.

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[13] Not only FSU states, both Australia and Canada have expounded protectionist policies towards state and privately owned domestic enterprises.

[14] Whilst it is not specifically ordered that a competition authority will be established by a Contracting Party, it is implicit in the terms of Article 6(5), which requires competition authorities within a Contracting Party to initiate "appropriate enforcement action" should anti-competitive conduct be reported to it by an investor from another Contracting Party.

In order to discourage host state protectionist measures against foreign investors and eliminate biases in favour of state owned or domestic private enterprises, Article 10 requires not only that Contracting Parties shall not "in any way impair by unreasonable or discriminatory measures" the "management, maintenance, use, enjoyment or disposal" of energy sector investments ((1)), but also that foreign investments shall receive treatment which is "no less favourable than that" accorded by a Contracting Party to its own investors or those of a third state, "whichever is the most favourable" ((3)). Although the provisions of Article 10 are couched in broad terms, they convey the incontrovertible message that foreign investors are to receive the same, if not more favourable treatment than domestic enterprises and any failure by a host state to accomplish this will constitute a breach of the Treaty actionable under Articles 26 and 27.

The "level playing field" prescription of Article 10 is supported by a number of more specific requirements expressed in the Treaty. Article 11 provides that the Contracting Party, subject to its entry laws, shall allow employees of an investor to enter and remain temporarily in its territory to engage in activities associated with the investment. This Article therefore prohibits the use by a host state of both entry restrictions and domestic personnel employment requirements often imposed upon foreign investors. Whilst it is undoubtedly more beneficial for the foreign investor to be able to employ workers who have been trained and recruited in its country of origin, employment restrictions have been used by host states to help generate much needed foreign exchange by ensuring that employment is given to its own nationals whose earnings naturally, will remain in the country and therefore constitute a valuable source of taxation revenue. Therefore, whilst the removal of restrictions upon foreign workers by a host state may offer some comfort to a potential foreign investor, it substantially curtails the economic advantages of FDI which flow to the host.

The key personnel provisions of Article 11 are bolstered by Article 14 which provides for the free and unfettered transfer of funds related to an investment, from any source, into and out of a Contracting Party's territory. Essentially, the requirement prohibits the imposition of any foreign exchange or international funds transfer regulations which might have been enacted by the host state to :

- restrict the outflow of valuable foreign currency;
- prevent investors from taking advantage of a weak domestic currency through payment of domestic purchases in a stronger foreign currency;
- control the exchange rate of domestic currency.

The importance to a foreign investor not only of the ability to repatriate returns and shareholder earnings but also of free access to overseas development funding cannot be underestimated. Restrictions upon the cross-border transfer of investment related funds significantly curtail the ability of the investor to finance both the development and operation of a project and have therefore traditionally been regarded as a substantial deterrent to FDI. However, although the requirements of Article 14 may make FDI projects more desirable to a foreign investor, they constitute a considerable interference in the micro-and macro economic fiscal policy of the host state.

A further restraint upon host state fiscal policy which attempts to remove a substantial perceived impediment to FDI is to be found in Article 21. Article 21 demands that national/MFN treatment be accorded to foreign investments by Contracting Parties in regard to taxation. Discriminatory taxation measures have traditionally been employed by host states to (inter alia):

- raise much needed foreign currency from foreign investments
- provide an advantage to domestic industry by financially constraining foreign investments;
- supplement protectionist import / export regulations.

Thus, the requirement that foreign investments be accorded national / MFN treatment ensures that FDI proejcts are able to compete effectively with domestic private and state owned enterprises. It also alleviates the fear of FDI investors that the host state will use taxation as a means of imposing expost facto penalties upon a project.

Further attempts to achieve parity between foreign and domestic investors is to be found in Articles 5 and 22. Article 5 prohibits the use by the host state of trade related investment measures such as domestic purchasing requirements and import/export restrictions aimed at foreign products related to the energy industry. Such measures are used by host states to:

- ensure that domestic industry receives financial benefit from increased sales of products in relation to the FDI investor.
- protect domestic industry from competition from imported goods.

Whilst from an investor's point of view the prohibition of trade related measures in Article 5 may increase the efficiency and profitability of a project in that (inter alia) the removal of restrictions would allow the importation of necessary products and materials at a possibly lower cost and of higher quality than available in the host state, it removes some of the incentive, based upon the stimulation of domestic production, for the host state to entertain a development proposal. The economic advantages of FDI to the host state flow not merely from the activities of a project but also from the provisions of ancillary services and supplies during the development and operational stages. Use of domestically produced goods encourages industry and injects money into the local economy. Thus, by removing the host state ability to impose trade related measures, particularly domestic purchasing requirements, the ECT is, to some extent, defeating its original and much vaunted objective of assisting FSU state economies.

Article 22 addresses the issue of government biases in favour of state owned and private/privileged domestic enterprises. Previous to the ECT, FDI investors,

particularly in regard to FSU states, viewed the existence of state owned and privileged private enterprises in the energy sector and related areas, with distinct distrust. State owned monopolies and privileged enterprises receive state funding and government concessions which enable them to out-compete and operate more profitably than private FDI projects. Moreover, the positioning of SOEs and privileged enterprises in vital sectors such as telecommunications, transport and energy has meant that they are able to either block or significantly reduce the efficiency of private FDI projects in these areas.[15] Accordingly, Article 22 requires that contracting Parties ensure that state and privileged enterprises conduct their activities in a manner consistent with the Contracting Party's obligations pursuant to the Treaty regarding:

- the sale or provision of goods and services ((1));
- competitive conduct ((2));
- the exercise of any regulatory authority ((3)).

The Contracting Party is, moreover, held vicariously liable for any breach of these provisions by a state or privileged enterprise, thus providing the Contracting Party concerned with significant incentive to ensure compliance.

Further, the Contracting Party is also prohibited from granting any special privileges to state or private enterprises inconsistent with its obligations under the Treaty ((4)), i.e. state and privileged enterprises may not be accorded more favourable treatment than a foreign enterprise.

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[15] As an example of this, in 1993 Econet, a domestic privately owned corporation, attempted to establish the first cellular telecommunications network in Zimbabwe. However, the country's state owned telecommunications monopoly PTC refused to grant Econet a licence. Accordingly, Econet appealed against the refusal to the Supreme Court, which in 1995 upheld the appeal. Econet therefore began to establish its operations. However, in 1996 President Mugabe issued a Presidential Decree which declared private mobile phone operations to be illegal and imposing a prison term of two years for directors of companies in breach of the decree. Econet once again appealed successfully to the Supreme Court. After further difficulties (discussed in Fn [16] below) Econet finally re-commenced operation in July 1998.

Transparency

Related to the issue of government biases and protectionist policies is that of lack of transparency in host state decision making processes and the resultant and/or concomitant opportunities for corruption this engenders at all levels of government. Naturally, FDI investors are particularly wary of investing huge capital outlays for projects in developing countries in which there is a lack of transparency in the decision making process and which have a reputation for corruption amongst government officers and officials. This is not, however, an unwarranted fear. Lack of transparency and corruption have been endemic in the administrative governmental systems of many developing nations. Totalitarian or centralised government,[16] poorly paid public officials, chaotic and ad hoc bureaucratic procedures,[17] and organised crime[18] increase the probability that corruption will be a permanent feature of government administration. Whilst developed nations have legislated against the bribery of public officials,[19] little can be achieved unless the host state takes internal measures to prohibit and prevent corruption. Transparency in the administrative process and government decision making, i.e. the publication of the criteria and reasons for administrative and judicial decisions, may not completely abolish corruption in developing/transitional states, but a more public decision making process may go some way towards discouraging it. Accordingly, the ECT contains various provisions which require transparency in the decision making process, the principal of which is Article 20.

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[16] For example, in the Econet situation discussed in Fn [15] above, subsequent to the second Supreme Court appeal by Econet, PTC established its own cellular network and granted a private licence to a Zairian corporation controlled by relatives of President Mugabe and his Telecommunications minister.

[17] In countries such as Vietnam, India, Thailand, Malaysia and Indonesia, payment of government officials for "favours" in regard to granting of licences and permits is regarded as part of the "usual" course of business.

[18] In some FSU states, particularly Russia and Ukraine, organised crime, often referred to as the Russian / Ukrainian "Mafia," have established close-ties with public officials at various levels of government.

[19] For example, Australia, New Zealand, the U.S. and U.K. have anti-corruption legislation whilst the OECD has issued a prohibition to its members on bribery of public officials.

Article 20 provides that all "laws, regulations, judicial decisions, and administrative rulings" which "affect economic activity in the energy sector are subject to the transparency disciplines of the GATT and Related Instruments" ((1)). Further, each Contracting Party is to designate a contact point from which information regarding laws, regulations, judicial decisions and administrative rulings may be obtained ((3)). The provisions of Article 20 apply to all aspects of economic activity in the energy sector addressed by the Treaty. However, Article 18 (4) includes the specific requirement that the granting of "all authorizations, licences, concessions and contracts to prospect and explore for or to exploit or extract energy resources" be made "on the basis of published criteria." As may be gathered from the examples given in Footnotes [15-19], the granting of licences, permits etc. is an area particularly vulnerable to manipulation and the recognition of this fact by the Energy Charter Conference is indicated by the specific inclusion of Article 18(4) as a supplement to the more general provisions of Article 20.

Government Guarantees and Indemnities

A further impediment to FDI has been presented by the difficulties experienced by potential foreign investors in obtaining host state government guarantees and indemnities to cover civil unrest, international conflict (force majeure events), and changes-in-law relating to foreign investments and taxation. Although the procurement guarantees is integral to the contract negotiation process it is also a substantial impediment to FDI addressed at length by the ECT and will therefore be examined here.

Risk mitigation and risk allocation in regard to force majeure events and changes-in-law are of considerable concern to FDI investors. Potential political, civil and legislative instability pose substantial threats to the viability and profitability of FDI energy proejcts and therefore merit careful evaluation and allocation of risk between the parties to an FDI agreement. Traditionally, in FDI

project agreements the host state is expected to provide certain guarantees that (inter alia):

- the host state laws affecting the project will not change so as to disadvantage or impair the project;
- taxation and imposts relevant to the project will not be increased;
- no impediments will be placed in the way of the foreign investor obtaining necessary licences and permits (including easements and rights-of-way);
- tariffs and charges levied by the investor for the production / output of the project will not be decreased by the host state government

In addition, the host state government is expected to indemnify the investor for any losses occasioned by any acts of the government or a sub-government authority in breach of the agreement.

However, despite the apparently fundamental nature of such conditions vis a vis a foreign investor, it is notoriously difficult to persuade host governments to give such guarantees and indemnities. Moreover, even should they be given, the host government may not necessarily observe them, resulting in an actionable breach and ensuring protracted and expensive dispute resolution.[20] Furthermore, indemnity for force majeure events such as civil and international conflicts and strikes is often secured by the foreign investor through insurance with major insurance companies. However, cover for such events may be difficult to obtain and extremely expensive, thus increasing project costs and thereby acting as a further disincentive for investors to embark upon major projects. Accordingly, the ECT attempts to remove

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[20] There are numerous reasons why a government may be unable or unwilling to honour guarantees and indemnities given pursuant to a contract. For example: following a change of government, the new government may regard any guarantees and/or indemnities entered into by its predecessor, as occurred in relation to the Dahbol power project in India (discussed in Fn [11]); there may be a shortage of government funds to meet the losses indemnified; capriciousness or lack of transparency in government decision making processes (as discussed in the Econet situation in Fns [15] and [16]) or even intervening civil strife as occurred in the Balkan states during the 1990's.

these obstacles by requiring host states to provide certain guarantees and indemnities in regard to all contracts formed pursuant to the Treaty.

Firstly, the Treaty in its investment protection provisions of Part III, particularly Article 10(1), prescribes a stable economic environment for FDI by prohibiting actions of host state which impair "by unreasonable or discriminatory measures" the operation of any project in the energy sector. Therefore, any change of law or regulation promulgated by the host state which adversely affects investment in energy projects would be in breach of this provision. Secondly, Article 21 prohibits the use of discriminatory tax measures which similarly adversely affect projects. Thirdly, Article 12 requires the host state to compensate an investor for any losses arising from "war or other armed conflict, state of national emergency, civil disturbance or other similar event." This "blanket" indemnification is further supported by Article 15, which prevents a Contracting Party from refusing to compensate a foreign investor for such losses merely on the basis that the investor's may also be covered by insurance. In such circumstances, the insurance company is entitled to recover against the Contracting Party by virtue of the doctrine of subrogation.

Whilst it is questionable whether the above provisions will, in fact, encourage foreign investors to undertake FDI projects in host states subject to political instability and civil unrest, the protections offered by the terms of the Treaty are sufficient to ameliorate what have been regarded as traditional impediments to FDI should a potential investor decided to take the risk. Certainly it is arguable that if a host state government is bound pursuant to the provisions of the ECT to compensate a foreign investor for losses occasioned by civil unrest or war, it may be expected to expend time and effort in protecting the project from loss and damage, arising form either physical attack or government requisition.

Nationalisation/Expropriation

A further discouragement confronting FDI investors is the risk that a host government will expropriate or nationalise the investment. Whilst such measures may be necessitated by war or national emergency, nationalisations may also occur as a result of changes in government policy.[21] Although the current politico-economic trend even in socialist countries is towards the privatisation rather than the nationalisation of industry and infrastructure, the threat posed to FDI proejcts from expropriation and nationalisation is nonetheless very real. This is particularly the case in those FSU states, such as Ukraine, in which the apparent failure of free market policies to improve the living conditions of ordinary people is causing a groundswell of nostalgia for the previous communist regimes.

The ECT, therefore, addresses this issue in Article 13 which prohibits expropriation or nationalisation of investments in the energy sector unless they are in the public interest, carried out in a nondiscriminatory manner, pursuant to the due process of law and are accompanied by adequate compensation (Article 13(1)). Further, pursuant to Article 21(5) the imposition of taxation may also constitute an expropriation for the purposes of Article 13 as does the requisitioning of an investment in time of war or civl disturbance (Article 12(2)). Should a host state, for any reason, or in any way expropriate investments in the energy sector it will be subject to the dispute resolution procedures set out in Articles 26 and 27 and be constrained to prove that its actions were carried out in accordance with Article 13.

Succession of Obligations

Finally, the risk that a new host state government will renege on an FDI contract entered into by a previous administration is a cogent danger faced by investors, especially in transitional and developing states.[22] It is difficult to draft a contract so

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[21] For example, during the terms of Labour governments in Britain during the late 1940's and then again in the 1960's, the UK's coal and transport industries were nationalised and subsequently "rationalised."

[22] In addition to the Dahbol Project discussed in Fn [11] above, there are numerous examples of the uncertainty generated amongst FDI investors by changes of

as to bind subsequent governments to obligations created by predecessors and even more difficult to ensure compliance. Certainly, an aggrieved investor may commence proceedings against the new government for breach of contract, but such litigation is often protracted and expensive. However, the ECT largely overcomes this difficulty by enshrining the obligations of host states in the form of a Treaty, thus ensuring that successive governments are bound as closely as their predecessors.[23]

Therefore, the FDI investor is able to glean a measure of comfort from the fact that whilst a new government may not regard itself as bound by the terms of a contract executed by its predecessor, it is, however bound by the terms of the ECT.

Conclusion

Whether the ECT has been successful in its attempt to remove perceived impediments to FDI posed by government policy, organisation and administration remains to be seen. Certainly, the Transitional Measures contained in Article 32(1) provide for phase-in periods for 24 Contracting Parties in relation to Articles 6, 9(1), 10(7), 14(1), 20(3) and 22(3). Whilst the deadlines for the expiry of the transitional

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government. In March 1994 the government of Pakistan devised a policy whereby the government offered guarantees and indemnities for political, force majeure and change of law risks for FDI projects. Twenty one energy projects were commenced under this policy. In February 1997 when a new government came to power, the new administration immediately reviewed the contracts of these projects and revoked the guarantees and indemnities.
Similarly in 1991 France Telecom and the US corporation Amertech signed a letter of intent with the Polish government to provide analog mobile telephone technology in a joint venture with Poland's telecommunications monopoly to be called Centertel. By 1996 Centertel had 120,000 subscribers. However, when the Global System Mobile (GSM) technology was introduced in late 1996, the Polish government called for tenders for provision of the new system. When Centertel reminded the government of the 1991 letter of intent, the government responded that the letter was not binding since it had been executed by a previous administration. Consequently, the tender was awarded to another foreign corporation, (Sader, op. Cit., 54)

[23] United Nations, Vienna Convention on Succession in Respect of Treaties, 1978.

arrangements has now expired for all Contracting Parties who took advantage of Article 32, few Contracting parties have been able to comply.[24]

Despite this, however, the ECT regime is sufficiently comprehensive and effective to ensure that once compliance by all Contracting Parties has been achieved, its provisions provide a significant measure of protection for FDI investors in the energy sector irrespective of the inadequacies and vagaries of host state government policy, organisation and administration.

Domestic Legislation and the Legal System

Closely allied to the problems facing FDI investors from host state government policies and administrations are the difficulties facing would be investors arising from the inadequacies of host state legislation and legal systems. As discussed in some detail above, the legal systems of the FSU states subsequent to the collapse of the Soviet Union, were not sufficiently developed to cope with free market, capitalist conditions, including competition, private investment and private property. During the 1990's, therefore, most FSU states needed to re-create their legal and judicial systems to accommodate private enterprise and ownership of resources and the means of production. However, the complete restructuring of the commercial, political and social framework of a state is essentially a lengthy process, especially when the resources and expertise to do this are scarce. However, FDI in the energy sectors of FSU states could not begin until the commercial and legal framework sufficient to afford both encouragement of and protection to foreign investment was in place. The ECT, therefore, attempts to both accelerate the process of legislative reform in FSU states and, in the interim, address the major impediments to FDI arising form the commercial inadequacies of transitional legal systems.

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[24] For example, Russia, perhaps the most stable of the FSU states, did not enact legislation permitting private ownership and sale of agricultural land until May 2002.

A detailed analysis of the provisions of the ECT which require a Contracting Party to adapt its legal system to meet free market conditions was given in Part II, whilst a discussion of the effects of these requirements upon host state sovereignty is set out in Chapters X and XI below. Therefore, the issues raised by the inadequacies of domestic legislation and legal systems will be addressed only briefly here.

A major disincentive for FDI investors in regard to energy projects in FSU states has been, since the collapse of the Soviet Union, the perception that existing host state legislation operates to prevent effective private sector participation in energy resource exploration and exploitation. Although this aspect of FSU states' governance has lessened since 1991 as more states have both passed legislation encouraging private sector participation and undertaken extensive privatisation of local industry, the exhortatory and prescriptive provisions of the ECT dealing with such issues are still relevant, if not as harbingers of change, then certainly as reminders to FSU states of the degree of "open-market" in the energy sector required by EU investors.

In regard to the inadequacies of host state legislation, in addition to the general exhortation in Article 3 that Contracting Parties shall "work to promote access to international markets in commercial terms," Article 5 specifically prohibits protectionist trade-related measures whilst Article 6 requires that a Contracting Party "shall ensure that within its jurisdiction it has and enforces such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct" ((2)). Moreover, both Articles 9 (Access to Capital) and 10 (Promotion, Protection and Treatment of Investments) require the observance of free-trade principles irrespective of the adequacy of the Contracting Parties' legal systems to cope with this. Further, the whole of Part III of the Treaty addresses the issue of investment protection, thereby providing a stringent regimen of measures to be adopted by host state Contracting Parties.

Difficulties in regard to the enforcement of contracts and the appropriate fora for the adjudication of disputes are largely addressed by both the enforceability of discrete "free-market" and investment protection provisions and the dispute resolution procedures laid down in Articles 26 and 27. Moreover, Article 26 further increases the comfort offered to FDI investors, as opposed to developers, by giving investors who are not parties to an energy sector contract, the locus standi to commence proceedings against a host state Contracting Party for breach.

Accordingly, both investors and developers of FDI energy sector projects may receive some encouragement from the fact that despite any inadequacy of the host state legal system to deal adequately with FDI, they are able to rely upon the provisions of the Treaty to enforce the rights and obligations it confers.

Environmental Issues

Corporations operating in the energy sector, particularly in oil and gas exploitation and nuclear power generation, are seldom regarded as champions of environmental protection. Over the last half a century, numerous environmental catastrophes in the energy sector have focused public and governmental attention upon the impact created by all stages of activity in energy production upon the environment. The extraction of energy resources, such as drilling for oil and natural gas, coal extraction either by open-cut or sub-terranean mining and uranium mining, all pose threats to the environment, not merely from the invasive nature of the extraction process itself but also from environmental contamination from spillages, seepage and explosions. Nuclear power plants are a particular environmental bone of contention,[25] whilst the marine transport of oil in super tankers and VLCCs (Very Large Crude Carriers) has a history fraught with wrecks, groundings and explosions causing devastating environmental damage from resultant oil spills.[26] Further, the

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[25] It might be argued, with good reason. In addition to the horrific Chernobyl catastrophe in April 1986, there have been other less spectacular but no less environmentally harmful incidents involving nuclear power plants.

[26] Numerous oil spills from tankers have been recorded over the last forty years, the most notorious are as follows:

energy production projects themselves raise contentious environmental issues, such as the flooding of areas of great natural beauty to create dams for hydro-electric proejcts[27] and the siting of nuclear power plants and waste disposals depots. However, whilst most energy projects proceed despite public opposition,[28] increased public scrutiny and government regulation of the environmental aspects of energy corporation activities has produced a greater self-consciousness amongst multinational energy producers, prompting them to project media images which emphasize an awareness of environmental issues in conflict with their histories.[29]

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* March 1967 the *Torrey Canyon* (118,285 tons) ran aground in the Scilly Isles off the south-west coast of Britain causing the first major incident of massive marine pollution.
* December 1975 the *Berg Istra* (224,313 tons) exploded south of Mindanao.
* December 1976 the *Argo Merchant* (28,238 tons) was stranded off Cape Cod, USA.
* March 1977 the *Amoco Cadiz* (228,513 tons) was driven aground in a storm, releasing more than 250,000 tons of crude oil onto the beaches of Brittany.
* December 1977 the tankers *Venpet* and *Venoil* (both 325,000 tons) collided off the Cape of Good Hope spilling 26,000 tons of oil into the sea from the *Venoil.*
* January 1979 the tanker *Betelgeuse* (61,776 tons) caught fire in Bantry Bay whilst discharging its cargo.
* July 1979 the *Atlantic Empress* (292,666 tons) and the *Aegean Captain* (210,257 tons) collided off Tobago in the Caribbean spilling 279,000 tons of oil.
* In March 1989 the VLCC *Exxon Valdez* (211,469 tons) ran aground on Bligh Reef in Prince William Sound, Alaska, spilling 250,000 barrels of crude oil into an area previously of outstanding natural beauty and ecological significance (see Richard A Cahill, *Disasters at sea: Titanic to Exxon Valdez.* Random Century, London, 1990).

[27] Whilst public opposition and action was ultimately successful in preventing the damming of the Gordon above Franklin River in Tasmania in 1983, it was not so effective in the case of the Dhabol hydro-electric power project in India and the damming of the West Seti river for the proposed West Seti project on the Nepal-India border.

[28] Especially in developing and third-world nations.

[29] For example, in 2001 in Australia Shell launched a television advertising campaign in which the corporation is portrayed as being both environmentally aware and committed to the development of alternative energy resources. More recently, it has placed a number of full page advertisements in such publications as *Time* and *The Economist* describing its efforts to preserve flora and fauna in Malampaya, the Philippines viz:

"Before extracting what's underground we listen to experts who know how to

This media representation of environmentally concerned energy corporations extracting energy resources with ecologically sound methods appears inconsistent with images of landscapes ravaged by coal mines and beaches and marine fauna coated in crude oil washed ashore from wrecked tankers.

Accordingly, energy corporations, especially those engaged in FDI are confronted by conflicting public and governmental attitudes towards their approach to environmental issues. As Waelde writes:

> There is one view looking at foreign investors as environmental malfeasors, seeking eternally for laxer regulation and cheaper operating cost and creating environmental disasters through their control of dangerous technology in large-sized facilities. There is also the opposite view which views foreign investors as developing under home society pressure advanced environmental management methods and trying to impose [these] on their competition in countries with a laxer environmental climate.[30]

However, whilst there may be an underlying sincerity in the overt concern demonstrated by energy corporations for environmental issues, environmental awareness may also be prompted by financial considerations. Apparent conformity and lip-service to environmentalist policies are more likely to allay public and governmental opposition to large energy projects which pose potential dangers to the environment than open resistance. Environmental Impact Studies (EISs), local

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restore what's above. During exploration, problems can arise that we can't solve on our own.

At the Malampaya deep water gas to power project in the Philippines, for example, the removal of trees (many small scrub trees) to accommodate a temporary structure proved unavoidable.

Shell asked local botanists to look at the likely impact before felling. And with the structure now gone, specialists then helped us to replant 10 saplings for every tree removed. This is not just replenishing those removed, it's also providing a new habitat for endangered Philippine giant fruit and flying fox bats. By enlisting help like this, we're ensuring that the extraction of one natural resource doesn't mean the destruction of another" (*Time*, 24 July 2002, 19).

[30] Thomas Waelde, Sustainable development and the 1994 Energy Charter Treaty. In *International economic law with a human face.* Kluwer Law, The Hague, 1998, 223-270 at 227 .

community consultations, well-publicised environmental protection and regeneration programs are all effective in assuaging public and governmental fears regarding environmental degradation. Such measures, however, are not only time consuming and expensive, but also harbour the potential to provide opponents to large energy projects with fuel for their opposition.

Furthermore, the issue of environmental regulation by host governments can prove daunting to potential FDI investors in energy proejcts. On the one hand, the cost of even punctilious compliance with environmental protection regulations can be prohibitive. Anti-pollution measures, regeneration projects and indemnities for environmental damage are all expensive concomitants of energy resource exploitation and production.

On the other hand, lack of environmental protection regulation by a host government must inevitably raise the possibility of future control. Such unpredictability as to the introduction the future of environmental protection laws acts as a disincentive to FDI developers to proceed with a project. As Waelde states, "from the investor's perspective, it is not environmental objectives per se which cause difficulty, but the transaction cost, in particular, caused by inefficient regulation."[31] Regulatory certainty is productive of a more cost-effective investment milieu than regulatory uncertainty. It is far more economic for corporations to institute environmental protection measures at the development stage of a project than to install and implement such measures once the project is operational or face the possibility of closure of the project.

However, whilst energy investment in a host state with an existing environmental protection legislative regime may prove to be a far more attractive investment prospect than one with little or no regulation, an overly rigorous regulatory regime may prove as equally discouraging.

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[31] Ibid, 229.

Article 19

It is against this background, therefore, that the ECT environmental protection provisions of Article 19 and the Energy Efficiency Protocol operate. In effect, they attempt to create a balance between the lack of regulation and the resultant uncertainty as to the stringency of future regulation and existing government requirements for costly environmental protection measures, whilst, at the same time, injecting a fashionably "politically correct" environmental protection/alternative energy slant to the Treaty. The nature of this delicate ideological juggling is reflected in both the language and practical effects of the provisions of Article 19.

The requirements placed upon Contracting Parties to develop environmental protection policies are exhortatory rather than prescriptive. Contracting Parties shall:

- "strive" to minimize the harmful environmental impacts of energy production (1);
- "take into account" environmental considerations when formulating energy policies ((1)(a)); and
- "promote" and "encourage" environmental awareness and alternative energy sources ((d)(h)).

Such facultative "soft law" provisions do not place onerous burdens upon Contracting Parties to develop workable and efficient environmental protection policies. However, they do impose a sufficient duty upon the host state to formulate an approach to environmental issues so as to enable potential FDI investors to invoke the provisions of the Treaty to require the host state to create a predictable environmental regime in regard to proposed and existing energy projects. Moreover, any such regulation cannot be overly rigorous. Any environmental protection measures of a host state must be taken "in an economically efficient manner ... without distorting investment in the energy cycle or international trade"(1).

Thus, the introduction of any expensive pre-or post-project regulations may be challenged by the investor pursuant to Article 19 on the basis that they are either or both economically inefficient or serve to distort international trade.

A further safety net is provided to both the investor and host states by Article 19(2), which provides that in the event of a dispute concerning the interpretation or application of Article 19 "to the extent that arrangements for the consideration of such disputes do not exist in other appropriate international fora", it shall be "reviewed by the Charter Conference aiming at a solution."

The extent to which the environmental protection provisions of the ECT provide comfort for potential FDI investors in the energy sector is arguable. Certainly, it attempts to compromise between the need for environmental regulations in host states, the economic implications raised by both over and under regulation for investors and the contemporary public concern with environmental issues. However, as with any compromise, its effectiveness has been prejudiced by its attempt to accommodate widely differing requirements. Moreover, "soft law" by its nature is open to argument and interpretation and therefore impossible to enforce. Even Waelde, whilst regarding the Treaty as taking "a prudent approach towards environmental regulation,"[32] holds that it contains:

> ... a considerable element of make-believe. It pretends action is taken, but action is at low cost in terms of money and practical commitment ... . The use of legal form - without legal content allows to create [sic] the impression of particularly serious action.[33]

Although such an approach to environmental issues offers encouragement and a sense of security to environmental protection organisations, it provides so little practical comfort to either investors or host states that for practical legal purposes

[32] Ibid, 263.
[33] Ibid, 265.

the provisions of both Article 19 and the Protocol could easily have been omitted. As such, therefore, as an attempt to allay the fears of FDI energy investors the environmental provisions of the Treaty could better be described as a sleight of hand rather than a juggling act.

Transit Issues

Whilst the environmental concerns likely to deter potential investors and project developers in FDI in the energy sector are based upon public, social and governmental policy, the issue of transit of energy supplies across the territory of a third state are grounded firmly upon geographical, political and economic factors. Energy supplies are transported in a number of ways:

- by road or by rail (coal and uranium ore);
- by terrestrial or subterranean pipeline (oil and natural gas);
- via a grid system (electricity);
- by sea in tankers (oil) and bulk-carriers (coal and uranium ore).

Where the source of the energy supply or resource is in a state other than the home state of the purchaser, unless the source and destination are geographically contiguous, the supplies will need to be transported across the territory of another country, a "third state." This necessity poses threats form numerous sources to both the economic viability and reliability of the supply.

Firstly, political factors such as hostility arising from diplomatic and/or ideological sources between a party (or country of origin of a party) to the energy supply agreement and the third state could result in the refusal or withdrawal of energy transit permits or the imposition of embargoes and boycotts by the third state.

Secondly, the transit of energy products and materials may be interrupted by civil unrest, armed conflict, terrorism or other such national emergencies. The destruction of pipelines and power-grid infrastructure and the disruption of road and rail systems within a third state are obvious consequences of armed conflict.

However, a less apparent but equally possible result of a national emergency is the expropriation of energy infrastructure by the host state to bolster a war-time or beleaguered economy.

Thirdly, protectionist government policies such as the imposition prohibitive and discriminatory tariffs and imposts upon the transit and storage of energy supplies by a third state pose a distinct threat to the economic viability of an energy project. In FSU states, particularly Ukraine and Russia, SOEs in the energy sector, such as Naftogaz and Gazprom, are defensive of their energy transit infrastructure. Despite increasing moves towards privatisation of energy industries in these states, competition for limited and often outmoded facilities is fierce. Moreover, this competition provides an excellent opportunity for governments both to protect energy SOEs and to benefit economically from the transit of energy by charging foreign investors higher tariffs and tolls for transit permits than domestic entities. Whilst such opportunism may be sanctioned and indeed justified by the third state's political and economic policies, it nevertheless constitutes a decided deterrent to those FDI investors in the energy sector concerned for the profitability of the project.

Political factors are not the only potential checks upon the transit of energy supplies. In some instances the third state may lack the infrastructure the roads, railways, grid-systems and pipelines necessary to allow the efficient transport of energy products and materials. Alternatively, if the infrastructure exists it may be in such poor condition as to render secure and economic transit of energy supplies impossible.[34]

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[34] This is the case in many of the FSU states. Where the infrastructure exists, it is often so old and badly maintained that transport of energy supplies (particularly oil and natural gas) poses a threat both to the populace and environment of the third state. For example, in the Ukraine it was estimated in 1999 that 30% - 50% of the oil pipelines were obsolete and dangerous (World Bank, *Ukraine: fostering growth with equity* : Washington, 1999 at 41), whilst road and rail facilities are in hardly better condition due to the lack of government funding in infrastructure since 1991.

Thus, despite the advantages offered to an FDI investor by a host state regarding an investment in the energy sector, the problems posed by the necessary transit of the resulting energy products and materials across the territory of a third state are sufficient to discourage investment. An investor or project developer would be loath to commit the vast sums needed to develop energy projects if the secure and efficient transport of the energy products and materials from source to destination were in any way uncertain.

Moreover, the investment in energy transport infrastructure is a "long-term" investment. In addition to the time, technical expertise and cost of developing transit facilities is the fact that they are intended for use for many years. Thus, investors and project developers of transit infrastructure in a third state require long-term protection of their investment and enterprise within a stable legal regime which regulates host and third party treatment of and approach to transit issues.

The principle of freedom of transit as Bryan Blank notes, is not "a particularly new or novel idea. Cognizance has been lent to this notion since the 17th century when Grotus opined that there was a general right of transit across the territory of another state in the interests of the community of nations."[35] More recently, Article 5 of GATT set out the general legal principles relating to international transit of goods by providing that "... there shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international travel" (Article V(1)). Moreover, "no distinction shall be made based on the flag of the vessel, place of origin, departure, entry exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport" (Article V(2)). However, comprehensive as the GATT provisions are, it has been questioned whether energy products and materials come within the definition of the term "a

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[35] Bryan Blank, "Transit and the Energy Charter Treaty: Rhetoric or Reality" [1998] 5 Web Journal of Current Legal Issues, 4 http://webjcli.ncl.ac.uk/1998/issue5/clark5.html.

good,"[36] nor is it likely that the GATT provisions could be applied to access to existing energy transit infrastructure or the building of a new pipeline.[37] Accordingly, the ECT attempts to address the issues raised by the transit of energy materials and products across the territory of both host and third states through the provisions of Article 7.

Article 7

As discussed at 113 ff above, Article 7 requires that all Contracting Parties shall "take the necessary measures to facilitate the Transit of energy Materials and Products" without "distinction as to the origin, destination or ownership" in regard to pricing and without "imposing any unreasonable delays, restrictions or charges" (Article 7(1)). Compliance with paragraph (1) involves:

- co-operation in the modernisation and development of energy transit facilities ((2)(a) and (b));
- taking measures to reduce the risk of interruptions to supply (2(c));
- facilitating the interconnection of energy transit infrastructure (2(d));
- co-operation in the development of new energy transport facilities ((4) and (5)); and
- the granting of national/MFN treatment to investors/regarding imposition of tariffs and regulations regarding the transit of energy products and materials ((3)).

Furthermore, the provisions of Article 7 are further bolstered by Article 12, which provides that Contracting Parties are liable to pay compensation to investors for any financial loss arising from civil disturbance within the Contracting Party's "area."[38]

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[36] Ibid, 5.

[37] Blank does suggest, however that there may be a "contrary argument" to this view (ibid) put forward by M. Roggenkamp in Transit of Network-bound Energy: the European Experience, in T. Walde (ed.), *The Energy Charter Treaty: An East-West gateway for investment and trade.* Kluwer Law, The Hague, 1996, 506-507.

[38] "Area" being defined in Article 1(10) as any territory, land, internal waterway, or territorial sea over which the Contracting Party exercises sovereignty.

Since the indemnity offered by Article 12 applies to loss or damage to "any" energy-related investment, the Article is couched in sufficiently broad terms as to catch not merely the losses accruing to energy projects situated and operating within a Contracting Party's "area," but also to energy transit infrastructure which crosses that territory.

Articles 13 and 21

Similarly, Article 13 arguably protects energy transit facilities from expropriation by a third state. As with Article 12, Article 13's protection from expropriation covers "investments of investors" and therefore is in sufficiently general terms to apply to energy transit facilities. Should expropriation occur, the investor must be given "prompt, adequate and effective compensation" (Article 13(1)(d)).

Furthermore, protection is offered against the imposition of discriminatory tariffs and taxation by Article 21, which requires that national/MFN treatment be accorded to investors in regard to taxation. Whilst customs duties are explicitly excluded from the definition of "tax provisions" and "taxes" as used in the Article by para (7)(d), there is no similar exclusion of periodic imposts charged for transit permits. It would be possible for an investor to argue, therefore, that in addition to the obvious forms of taxation imposed upon (inter alia) income, payrolls and goods and services, Article 21 also applies to levies on transport of energy products and materials.

Although the potential energy FDI investor or project developer may derive some comfort from the terms of the treaty vis a vis the transit of energy products and materials over the territory of a fellow Contracting Party, the provisions do not apply to states which are not signatories. However, as may be gathered from any map showing those European and Central Asian countries which are signatories of the ECT, sufficient Eastern European and Central Asian states are signatories of the Treaty to ensure that the valuable oil and gas supplies from Russia, Kazakhstan and

Turkmenistan may be transported via pipelines to European states across the territories of other Contracting Parties. Moreover, as the Energy Charter Conference net widens and other more distant energy rich states[39] are induced to become signatories, the transit provisions of Article 7 and the Transit Protocol will become increasingly important to the maintenance and security of the EU's energy supplies. However, whether these provisions are sufficiently rigorous to allay the fears of potential FDI investors in energy projects remains to be seen.

Conclusion

Despite their comprehensive nature, the effectiveness of the provisions of the ECT and its Protocols in overcoming the traditional reluctance of investors to invest huge amounts of capital in large scale energy projects in foreign countries in uncertain. It is understandable that the protection offered to FDI in energy should cover the major issues which have in the past proven to be problematic in regard to the development, operation and economic viability of energy projects. However, the success of the practical application of these provisions is still unclear. Much will depend upon both the investor's perception of the enforceability of the provisions and the efficacy with which they are enforced in practice. To a great extent the two contingencies are interdependent. Investor confidence in the adequacy of investment protection is contingent upon practical examples of enforcement of the provisions. Certainly, Articles 26 and 27 offer an efficient dispute resolution regime which is more than adequately supported by the pro-active role accorded to the Charter Conference and Secretariat in dispute resolution by the Treaty.[40]

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[39] Such as China, Uruguay, Venezuela, Indonesia and Malaysia.

[40] For example, Article 7(7)(b) appoints the Secretary-General as optional conciliator in regard to transit disputes, in addition to the role accorded pursuant to Article 27. The Charter Conference, in addition to its duties of surveillance and review pursuant to Article 34 is also empowered to arbitrate in disputes concerning the environmental provisions of the Treaty (Article 19(2)).

However, to date, no action has been taken to enforce the Treaty's provisions in any fora and, accordingly, the effectiveness of the protection provisions remains untested. Therefore, despite the apparent strength of the investment protection requirements, potential investors in FDI in energy projects are still required to place their faith in the enforceability of agreements negotiated with host states. Thus, the following section will examine the potential effects of the ECT on the negotiation process.

The Effects of the ECT upon the Contract Negotiation Process

The pre-project negotiation of FDI agreements and contracts is a lengthy and expensive procedure. On the one hand, the investor/developer will be concerned with enhancing and preserving the profitability of the endeavour, whilst the host state government and associated entities will wish to preserve its sovereignty and authority whilst, at the same time, reaping as much practical and economic benefit from the project as possible. Therefore, this balancing of competing interests and the production of workable written project documentation is a difficult task and most FDI projects flounder at the contract negotiation stage. Moreover, the FDI investor/developer usually needs to negotiate agreements not simply with the host state government but also with sub-national and SOE's and sub-government service provision entities. Accordingly, not only does the negotiation of terms such as government guarantees and indemnities, compensation for default, changes of law and taxation provisions, raise contentious issues, but often the FDI investor/developer must undergo the process on a number of occasions. It is not surprising therefore, that the lengthy and expensive negotiation procedure required to produce effective project agreements often proves a disincentive to potential investors and developers alike.

A major feature of the ECT, therefore, is that it attempts to obviate the necessity for protracted negotiations by making implicit in all agreements and contracts entered

into pursuant to the Treaty, certain terms and conditions which are normally subject to negotiations between the parties (see Table 2 at 253). Moreover, the ECT further simplifies the process by rendering host governments, vicariously liable for any state/privileged enterprises (Article 22) and sub-regional authorities (Article 23).

Articles 22 and 23

The successful development of any large infrastructure project depends not merely upon the co-operating the host state government, but also upon that of SOE service providers and sub-national or regional authorities. Agreements for the sharing of infrastructure with and provision of goods and services by SOEs, authorisations and permits from sub- and regional authorities are vital to the success of any FDI project and must be negotiated separately with each entity. Thus, even though an FDI project may have the full support and compliance of the host government, the imposition by an SOE of a discriminatory levy for the use of its facilities or the refusal of a regional government to grant a licence to occupy land may prove fatal to the viability of the development and/or operation of a project. Thus, difficulties encountered by project developers in negotiating mutually acceptable contractual terms with local/sub-national entities, the high risk of future breaches and problems of enforcement have a tendency to discourage even the most enthusiastic foreign investor.

Moreover, SOEs and sub/regional governments are not parties to the ECT and therefore not directly bound by its provisions. However, by rendering the host state government vicariously liable for the actions of sub-national entities the Treaty regime provides a definite incentive for the government to secure their compliance and co-operation.

Furthermore, Article 22(1) provides that a Contracting Party's liability extends to SOEs and privileged enterprise authorities in relation to the "sale and provision of goods and services," and Article 23(1) stipulates that it is the duty of the Contracting

Party to ensure that regional and local governments and authorities observe all the provisions of the Treaty. The language of both Articles is sufficiently general to cover all aspects of the contractual relations between the investor and the relevant host state entity. Naturally, since the host state government is liable for any default by an SOE or sub-national entity any action by the investor for breach of an energy project related contract will lie against the host state government. It is arguable that this implied liability will provide the host state government with an incentive both to direct and monitor contractual relations between the investor/project developer and its SOEs, sub-national and regional authorities. Thus, such vicarious host state involvement in the contract negotiation process would it is argued, facilitate the negotiation process vis a vis energy project investors/developers and sub-national entities.

Change of Law Provisions

Whilst the negotiation of contractual terms with sub-national entities can prove problematic for investors/developers in the energy sector, by far the most difficult and protracted dealings are those with host governments, especially in regard to change of law and taxation and revenue provisions and the securing of host state guarantees and indemnities.

Negotiations in regards to change of law and revenue provisions which relate to the project are generally protracted because the right of a host state to amend domestic legislation and impose or change taxation/revenue measures lie at the heart of a government's sovereignty over internal governance. Governments are therefore loath to yield the right to direct legislative and economic polices through changes in legislation and revenue raising measures, especially where the proposed project is of national significance and a potentially lucrative source of income.

The investor/developer, on the other hand, requires assurances that:

- laws and regulations affecting the project will remain stable;

- the investment will not be subject to ex post facto trade-related measures; and
- the investment will not be subject to excessive or discriminatory taxation measures.

Thus, in addition to the general provisions of the treaty which place upon each Contracting Party a duty to:

- develop an open and competitive market for Energy Materials and Products (Article 3);
- formulate and enforce laws to prohibit anti-competitive conduct (Article 6(2));
- encourage and create stable, equitable, favourable and transparent conditions for investment in the energy sector (Article 10(1)),

the ECT contains certain strictures against discriminatory trade and taxation measures.

Article 5 provides that a host state Contracting Party shall not impose legislative or regulatory trade-investment measures which restrict the discretion of an enterprise in its purchasing, importation and export of products. Further, Article 21 places a prohibition on the host states' right to impose discriminatory taxation measures. The proscription in Article 21 against such measures is so strict that an impost caught by this Article may arguably be classified pursuant to Article 21(5) as an expropriation for the purposes of Article 13 and thereby, subject to compensation. Moreover, both Articles 9 and 14 prohibit restrictions upon the movement of capital both within and out of the host state. Article 9(1) requires the host state to promote "conditions for access to its capital market by companies and nationals of other Contracting Parties," whilst Article 14(1) requires that each Contracting "guarantee the freedom of transfer [of capital] into and out of its Area."

National/MFN Treatment

Indeed, the investment promotion and protection provisions of Parts II and III of the ECT are so stringent that the regimen both implicitly and explicitly accords the investor/developer national/MFN treatment. National/MFN treatment clauses in project agreements are not unusual but are, nevertheless, extremely difficult to negotiate. On one hand, the investor/project developer wishes to secure as cogent an advantage as possible regarding exemption from over-regulation, discriminatory taxation and restrictions upon movement of capital. On the other hand, the host state government is generally concerned to protect domestic industry and foreign exchange reserves whilst, at the same time, reaping the financial and practical benefits of the project. Although bi-and multilateral national/MFN treatment trade agreements may be extant as between certain states, these are by no means universal nor do they necessarily cover all aspects of bi-lateral economic and trade relationships. Accordingly, in circumstances in which the host state is not party to such an agreement with the home-state of the investor/developer, national/MFN provisions must be negotiated between the parties.

The ECT, however, precludes the necessity to negotiate national/MFN clauses by making such provisions implicit in all contracts formed pursuant to the Treaty. Thus, Articles 7(3), 9(1), 10(1), 12(1) and 21 all contain the requirement that investors/developers of energy projects be accorded in either treatment equal to that received by domestic entities or MFN treatment, whichever is the most favourable.

Key Personnel

Closely related to the issue of national/MFN treatment and the anti-protectionist provisions of the ECT is the prescription in Article 11 that key personnel of the investor/developer be permitted to enter and reside in the host state for purposes of engaging in activities connected with the project. Although the freedom of entry and residence of foreign personnel is not generally a contentious issue in regard to FDI agreements, the provisions of Article 11 nevertheless reduce the risk that the

host state will use its entry and residence regulations as a "bargaining chip" against the investor/developer either in the negotiations or at a later stage in the project's development and operation.

Guarantees and Indemnities

Further points of contention in the negotiation and formation of energy project contracts are encountered when attempting to secure host government guarantees and indemnities. Not surprisingly, host state governments are reluctant to indemnify FDI projects against occurrences which may be unavoidable and/or beyond their control. Moreover, it is arguable that since insurance cover is available for most, if not all force majeure events, additional host government indemnities are *de trop*. Thus, the negotiation of clauses providing compensation for certain force majeure events such as war, civil unrest and strikes and for the expropriation or nationalisation of the project as a result of changes in host government policy or states of national emergency can prove onerous for all parties. In order to alleviate this situation, therefore, the ECT contains provisions which render government guarantees and indemnities implicit in any energy project agreement.

Article 12 provides that when an investor/developer suffers losses due "to war, or other armed conflict, state of national emergency, civil disturbance or other similar event" ((1)), the host state shall provide "restitution, indemnities, compensation or other settlement" which is equal to that accorded pursuant to national/MFN treatment, whichever is the most favourable. Moreover, Article 15 provides that this compensation may be provided either to the investor/insurer or, pursuant to the doctrine of subrogation, to the investor/developer's insurer.

Further, Article 13 contains a prohibition of expropriation of investments except in cases of states of emergency. When expropriation proves necessary the investor/developer shall be awarded "prompt, adequate and effective compensation" (Article 13(1)(d)).

Transit

In addition to concluding contracts with host states and sub-national entities an investor/developer of an energy sector project may also need to conclude agreements with third state governments if there is the necessity to transport energy materials and products across the territory of the third state. Such agreements may prove problematic to negotiate, especially in instances where there are diplomatic tensions between the project host and a third state, or alternatively, in circumstances in which energy transport infrastructure is either inadequate or nonexistent.

In order to nullify this risk (as well as ensuring the uninterrupted, secure transit of energy materials and products) Article 7 requires a third state Contracting Party to allow either the unhindered transit of energy products and materials or the upgrading/construction of energy infrastructure unless it can demonstrate that such transit would endanger the security or efficiency of its own energy systems ((5)). Further, any contract negotiated with a third state in regard to transit would also be subject to all other provisions of the ECT, including those relating to co-operation by sub-national and regional authorities, taxation and government indemnities discussed above.

Dispute Resolution

Irrespective of the care with which project documents are negotiated and drafted, it is almost inevitable that disputes will arise. Consequently, provisions detailing dispute resolution procedures are a *sine qua non* in an energy project contract. Whilst stipulations as to applicable law, jurisdiction and method of dispute resolution are generally non-contentious, the ECT further strengthens the enforceability of its provisions by the inclusion of a dispute resolution regime in Article 26 (Disputes Between Investors and a Contracting Party) and 27 (Disputes Between Contracting Parties). In view of the comparative lack of dissension generated when negotiating the dispute resolution clauses of a contract in

comparison to other more problematic provisions, it is arguable that Articles 26 and 27 are superfluous within the ECT regimen. However, two major features of Articles 26 and 27 render them significant within the scheme and objectives of the Treaty.

Firstly, Article 26 abrogates the doctrine of privity, thus conferring on an investor (as opposed to developer) who is not a party to the project development agreement, a right of action against a host state government for damages in the event of breach of contract. This obviates the necessity either for each individual investor or group of investors to enter into a separate agreement with the host state in order to be able to sue on the contract or for each investor or group of investors to be made parties to the original agreement.

Secondly, the procedures laid down by Article 26 and 27 ensure that the Charter Conference and Secretariat are able to monitor any disputes arising from contacts formed pursuant to the Treaty.

Conclusion

Whether the stringency of the provisions of the ECT are successful in both overcoming the reluctance of investors/developers to initiate energy sector projects in those FSU and developing states which are signatories of the Treaty is yet to become apparent. However, what is obvious from the scheme of the ECT is that all the provisions are weighted heavily in favour of protection of the interests of the investor/developer, whilst the host state Contracting Parties are left with little or no recourse other than the dispute resolution provisions of Article 27 when faced with a rapacious or recalcitrant project developer. It is arguable, therefore, that whilst investors/developers may take some comfort from the high degree of investment protection offered by the Treaty, the obvious bias against the rights of a host state would mitigate against a desire by the government of a Contracting Party to enter

into agreements in the energy sector. This emphasis upon investment protection at the expense of host state prerogatives goes a long way towards explaining Russia's initial reluctance and the refusal of the U.S. to sign the Treaty.

Moreover, the abrogation of host state rights in favour of investment protection by the provisions of the Treaty, is symptomatic of the propensity of the ECT not only to erode host state sovereignty, but also run counter to certain tenets of international law. Accordingly, this aspect of the Treaty will be examined in detail in the following chapter.

TABLE 1	
Perceived Impediments to FDI in Energy/ Infrastructure in Developing /Transitional Economies	***Energy Charter Treaty Articles which attempt to address impediment***
Lack of observance by and understanding of host state of free market rules and principles.	3-6(1)-9(1)-10(1) -14(1)
Lack of experience in host countries of facilitating and administering complicated FDI projects	6(3) - 9(3)
Lack of overall energy sector liberalisation	3-6-8-9(1)-10(1)-14(1)
Government biases in favour of state funding, local investment participation and protectionist policies	3-5-6-7-8-9-10-14-18(4)-21-22
Lack of transparency and corruption in host country	18(4)
Difficulties in obtaining host government guarantees and indemnities to cover civil unrest/political risk and changes of law	10-12-15-21
Risks posed by changes in law relating to FDI	10(1)-12-13-20-21
Political/social instability within host country and risk of civil disturbance	12-15
Disruption from political and/or social protests against individual projects	10(1)-12-15
Expropriation by host government through nationalisation or increase in taxation	12-13-21
Government reneging on contracts signed by previous administrations	Provisions of ECT as a whole
Conflicting governmental authorities and regulations	22-23

Conflicting host government and sub-regional government regulations	23
Lack of co-operation from existing state owned service providers	3-6-7-9-10-18(4)-22-23
Existing host state legislation impeding effective private sector participation	3-5-6(1)-9-10-14
Existing legislation offers inadequate protection for FDI	Part III 26-27
Lack of appropriate / experienced fora to adjudicate in disputes arising from FDI	6-9-26-27
Difficulties re: enforcement of contract provisions, applicable laws, dispute resolution generally	26-27
Lack of observance or existence of environmental protection policies in host country	19-Protocol
Potential risks posed by third party states to transit of energy supplies across their territory e.g. refusal of access; inadequate infrastructure.	7-12

TABLE 2	
Contract term/condition imposed upon host state usually subject to negotiation.	***Energy Charter Treaty Articles which make term/condition implicit in agreement***
Obtaining authorisations and permits from government and sub-government authorities	7(2)-22-23
Guarantees that public sector entities will co-operate with project parties	7(2)-22-23
Compensation for default by public sector entities.	22-23
Protection for investor from changes in trade-related law which affect project	3-5-6-10
Guarantee that investor not be subject to harsh/excessive taxation/duties	13-21
Freedom for investor from foreign exchange restrictions	9-14
National/MFN treatment of investment by host state government	7(3)-9(1)-10(1)-12(1)-21
Work/residence permits available to investor's foreign workforce	11
Compensation for losses suffered by investor caused by war, civil unrest and strikes	12-15
Transit of energy products and materials across third state territory	7
Guarantee that investment will not be subject to expropriation and compensation in the event of expropriation	13
Dispute resolution	26-27

CHAPTER X

THE ECT: SOVEREIGNTY AND INTERNATIONAL LAW

Introduction

As an international legal document developed as a result of debate, deliberation and, finally, consensual determinations between and by the EU and other states, the ECT purports to provide a legal framework for the exploration, exploitation and supply of energy materials and products, pursuant to which relevant commercial agreements may be concluded. As such, therefore, it could be expected that the provisions of the Treaty will seek to impose obligations and confer rights equally upon both the investor/developer in the FDI energy sector and the host state Contracting Party, with each participant bearing burdens and reaping benefits commensurate with their intended contractual relations and relative contributions. However, it is argued here that the ECT does not apportion obligations and rights equitably. Certainly, the investor/developer receives abundant protection for their investment. Part III of the Treaty is devoted solely to the investment protection regime, whilst Article 26 (Resolution of Disputes between an Investor and Contracting Party) confers locus standi upon investors who are not parties to an energy sector agreement vis a vis a host or third state Contracting Party. Indeed, the terms of the Treaty, in attempting to encourage increased investment in the energy sector, prescribe so stringent an investment protection scheme that the host state Contracting Party is burdened with onerous if not draconian obligations to effect major changes not only to its legal system but also to governmental fiscal policy, its administration and organisation and, to some extent, its ideological orientation.[1]

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[1] The influence upon the ideological orientation of a Contracting Party government may be illustrated most succinctly by the example of an FSU state, such as Poland or the Ukraine, both of which retain Socialist majority governments. The provisions of Parts II and III of the ECT in effect require a socialist Contracting Party to adopt the classical Capitalist economic policies of the encouragement of open markets and private enterprise and the prohibition of protectionist,

In addition, pursuant to Article 12, Contracting Parties are deemed to be liable for losses to investors resulting from certain force majeure events and vicariously liable, pursuant to Articles 22 and 23, for the actions of SOEs, privileged enterprises and sub-and regional governments and authorities. Thus the government of a Contracting Party[2] in which such entities enjoy a degree of autonomy may find it necessary to legislate to revoke, or at least decrease the independence of sub-government entities to ensure their compliance with the provisions of the Treaty. So oppressive are the obligations imposed upon Contracting Parties and so extensive the effect of the ECT upon their internal affairs, that the requirements exacted by its provisions arguably constitute both an abrogation of a Contracting Party's sovereignty and run contrary to certain precepts of international law in regard to the conduct of FDI investors within the host state territory.

Accordingly, this chapter will examine the concept of sovereignty in general and discuss the impact of the ECT upon Contracting Party sovereignty over domestic legislation, territory and the issue of the infringement by the treaty of certain international legal principles relating to FDI. The question of sovereignty over natural resources will be addressed in Chapter XI.

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anti-competitive conduct. Failure to comply with this demand constitutes a breach, and despite the "transitional periods" granted to most FSU states in regard to the substantive requirements of Articles 6(2) and (5), 7(4), 9(1), 10(7), 14(1)(d) and 20(3) pursuant to Article 32, the requirement that a Contracting Party consents to effect ideological changes vis a visa government policies or be penalised, arguably constitutes and unsubtle form of internationally sanctioned "greenmail" perpetrated by the EU upon the FSU nations.

[2] Despite the movement over the last decade towards privatisation of government controlled industries, SOEs and privileged enterprises especially in energy and communications are still common in FSU states. Moreover, many Contracting Parties (not merely FSU states) are complying with internal and international pressures to grant autonomy to minority ethnic/indigenous groups within their territories, for example, in Australia Aboriginals are granted autonomous areas over which the inhabitants exercise certain rights through Land Councils.

The Traditional Concept of Sovereignty

In order to appreciate fully the effect of the ECT upon Contracting Party sovereignty over territory, domestic legislation and natural resources, it is necessary to present a brief discussion of the development, substance and applications of the traditional concept of sovereignty.

As the concept that an independent State has unfettered governance in the conduct of its affairs within its territory and in its dealings with other States would appear to be a truth as self-evident as any in the US Declaration of Independence. Indeed, the concept of sovereignty has long been regarded as "the cornerstone of international rhetoric about state independence and freedom of action"[3] and "has been the foundational doctrine for political theory and practice."[4] Any attempt by other States, either individually or in concert through international organisations such as the United Nations, to limit the freedom of action of another State has usually elicited the invocation of the concept of State sovereignty and its concomitant doctrine of sovereign immunity as talismans against extra-territorial interference.[5]

However in a post-Cold-War milieu in which "globalisation," international co-operation and peaceful co-existence have become essential to the global normative order, such concepts as sovereignty, autonomy and even Statehood, are being viewed with increasing suspicion and scepticism in support for the proposition

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[3] Hurst Hannum, *Autonomy, sovereignty and self-determination: The accommodation of conflicting rights* . Uni of Pennsylvania Press, Philadelphia, 1990, 14.

[4] Neil MacCormick, *Questioning sovereignty : Law, state and nation in the European Commonwealth.* OUP, Oxford, 1990, 124.

[5] In the most recent invocation of the doctrine of sovereign immunity, the *Pinochet* cases *(Ex-parte Pinochet (No 2)* (1999) 1 All ER 577; *Ex-parte Pinochet (No 3)* (1999) 2 All ER 108), it was argued by General Pinochet's defence counsel, in response to an extradition application against him by the Spanish Government made to the British Government, that, irrespective of the crimes committed by Pinochet whilst he was in office, he was immune from the jurisdiction of both British and Spanish Courts.

that a State possesses fundamental rights in much the same way as individuals, and despite a vigorous crop of U.N. declarations on the subject,[6] appears to be waning. Thus, the notion of sovereignty, with its attendant rights and obligations is regarded by some commentators as being at best, "merely a term which designates an aggregate of particular and extensive claims that states habitually make for themselves in relation to other states,"[7] and at worst, defunct.[8]

Even the promulgators of sovereignty as a continuing, valid and relevant feature of international law admit that "sovereignty is not a fact. It is a concept which men in certain circumstances have applied - a quality they have attributed or a claim they have counterpoised - to the political power which they or other men were exercising."[9]

In many respects, the concept of sovereignty has become analogous to the elephant in the poem "The Six Blind Men and the Elephant." Every writer who has addressed the issue has ascribed to it different features. Philosophically, they have seized the protuberance closest to hand, and in this instance, closest to their own theories, and pronounced upon its nature accordingly. Thus, one grasping the tail, will proclaim the elephant like a rope, another holding the trunk will liken it to a snake, whilst another, seizing a leg, will proclaim authoritatively that it is indubitably like a tree.[10] Thus, in examining sovereignty, each of the various writers on the topic have tended to ascribe to sovereignty certain predominant features which, when viewed *in toto*, present a comprehensive impression.

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[6] For example, the UN Covenant on Economic, Social and Cultural Rights, the OECD Declaration on Multinationals and the Charter of the U.N.

[7] Hannum, op.cit., 14.

[8] FH Hinsley, *Sovereignty*, 2nd edn. Cambridge Univ. Press, Cambridge, 1986, 214-222 and MacCormick, op.cit., 123 ff.

[9] Hinsley, ibid, 1.

[10] An example of this divergence of opinion is exemplified by the conflicting views of the authors cited in fns [7] and [8] above.

Perhaps the common view of sovereignty and the one supported most vigorously by such writers as F.H. Hinsely and H.L.A. Hart[11] is that the concept of sovereignty expresses the idea that there is an "absolute authority in the political community"[12] of a State. The State, by virtue of this absolute authority is able to impose "a structure of command upon the community in which it rules or attempts to rule."[13]

This imposition of "a structure of command" is both the result of and effected by the supreme power to make laws within the state.[14] Thus, the concept of sovereignty may be regarded as an attribute of political authority which confers upon the holder of such authority absolute power to govern, without interference or hindrance from a higher authority. This absolute power to govern includes the ability and right to control both the internal legislative system and external relations with other autonomous states.

Historically, the concept of sovereignty, is said to have developed from Roman law. [15] However, it was not until the sixteenth century that the concept was thoroughly explored by the French lawyer, Jean Bodin. Bodin was writing at a time in European history which had seen rise of many independent states whose rulers were not necessarily sovereign in the legislative sense. Indeed, many European rulers were subject to the overriding authority of the Papacy in both internal affairs and international politics. In addition to the canonical sanctions, such as interdict and excommunication which could be imposed by the Roman Catholic Church upon any recalcitrant Heads of State, the Church during this time also took a pro-active role in European politics, using both its secular and religious influences to dominate international relations[16] and direct the internal policies of individual states.

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[11] Hinsley, ibid., and H.L.A. Hart, *The concept of law.* OUP, Oxford, 1988, 215-219.
[12] Hinsley, ibid, 1.
[13] Ibid, 16.
[14] Dennis Lloyd, *The idea of law.* Penguin, London, 1961, 170.
[15] Ibid, 172.
[16] A case in point is the secession of England, under Henry VIII, from the Roman Catholic Church in 1536. Whilst Henry's proclamation of himself as "Supreme

It was in this context that Bodin posited his theory of sovereignty: that every independent state[17] possessed supreme legislative power. This legislative power was supreme in two significant ways. Firstly, it was a completely autonomous power which acknowledged no superior or overriding authority. Secondly, the power to legislate was completely unfettered and could be wielded without hindrance from any internal and external source. Although Bodin accepted that law making was subject to certain natural law principles,[18] he appears to have ignored the all pervasive influence in European state affairs of the Church, thus presenting the concept of sovereignty as a normative rather than realistic proposition.

A normative view of sovereignty was accepted by Jean Jacques Rousseau and the Hegelians in the eighteenth century. To Rousseau sovereignty signified supreme legal authority, but only in so far as it was a completely moral authority. On the other hand, John Austin, the nineteenth century English philosopher and disciple of Jeremy Bentham, regarded sovereignty from a positivist view. Sovereignty, in the legal sense, was properly concerned with the power to command. Thus, the law embodied the commands of the sovereign and nothing can be law which is not commanded by the sovereign.

Naturally, both Rousseau's and Austin's interpretations of sovereignty were influenced by the intellectual climates of their times. Rousseau, as the natural philosopher tended to regard sovereignty, as noted above, from a normative perspective, in the sense that sovereignty could only exist or be allowed to exist if it

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Head of the Church in England" was prompted in part by his desire to obtain a divorce from his wife Katherine of Aragon, he was also motivated by a desire to limit the influence of the Papacy and the control of the Roman Catholic Church upon the internal policies of England, which had been brought into stark relief by the Popes refusal to grant the divorce (see D. Starkey, *The reign of Henry VIII: Personalities and politics*. Vintage, London, 2002).

[17] "Independent" in the sense that it was not the vassal of any other State.

[18] Lloyd, op.cit., 172.

arose from a moral authority, which embodied both the will of the people and the principles of natural law. Austin, however, took a more pragmatic approach to sovereignty. By proposing that law could only be authoritative if it were commanded by the sovereign, he was reflecting not only the nineteenth century positivist attitude to the law, but also the paternalistic perception of government; the idea that the sovereign is omnipotent, omniscient and infallible. Apart from the fairly obvious deficiency in this perspective, however, this authoritarian view of sovereignty also raises the question as to "who is the sovereign." Certainly, by the early nineteenth century much of the substantive power of the English throne had been curtailed by Parliament and the legislative autonomy and political control exercised, to his cost, by Charles I in the early to mid-seventeenth century had become a mere shadow of authority by the time Victoria ascended the throne in 1837: Austin's sovereign drew upon the concept posited by John Locke in the seventeenth century and was identified with the "people."

Despite the differing bases of authority proposed by Rousseau and Austin, however, both views of sovereignty embodied the concept that sovereignty was independent of all external influence. Therefore, both Rousseau and Austin regarded sovereignty as "the power of law-making unrestricted by any legal limit."[19]

In the twentieth century the concept of sovereignty underwent a change of focus. As a result of the political and geographical changes wrought by the Russian Revolution, the First and Second World Wars and the demise of imperialism, the source of sovereign power came to be ascribed not to a sovereign or ruler, but to the State itself. Indeed, after the First World War it became impossible for political philosophers and jurists to ignore the effects of the political and legal upheavals upon traditional international legal theories. The establishment of the League of Nations in 1919 pursuant to the Versailles Peace Settlement was an attempt by European nations to provide some species of normative structure whereby

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[19] Dicey, quoted by MacCormick at 127.

international disputes could be arbitrated and economic, political, diplomatic and military issues addressed in an open forum. It may be argued that the achievements of the League of Nations were limited by the inability or reluctance of member states to place international interests before national concerns. Treaties designed to effect arms reduction and peaceful resolution of international disputes were regarded by some nations, particularly Italy and France, as not only weakening their ability to ensure national security, but also as attacks upon their sovereignty, by subjugating national autonomy to a higher international order.

Despite this apparent failure to implement the principles of collective security, co-operation and peaceful co-existence embodied in the League Covenant, the League nevertheless served to provide the design of a prototype for an international legal order based upon mutual obligations and the recognition of inherent, individual state rights through the promulgation and ratification by concordant States of Treaties, Conventions and Declarations. Of course, it is not intended to suggest that prior to the League of Nations there was no international legal order. On the contrary, prior to 1914 international legal principles, especially those dealing with international trade, diplomacy and state rights were firmly established, and if not observed at least acknowledged by most nations. Moreover, international treaties had long been used as a means of securing certain mutual obligations and cessation of hostilities between nations.

The League of Nations, however, served to present the model for an international forum which could formulate multilateral international agreements pursuant to which collective objectives could be prescribed and achieved. This model was adopted and expanded in 1944 and 1945 by the Allied nations in creating the United Nations.

Certainly, the UN, with its multifarious, multilateral Treaties, Conventions and Declarations and its many subsidiary organs such as the International Court of

Justice, the Security Council and General Assembly, has done much to develop an international order in which the rights and mutual obligations of nations are recognised and fostered. Furthermore, whilst it may be argued that the enforcement of UN policies, as with those of the League of Nations, is and always will be, problematic, it has established a system of normative rules which are, theoretically, binding on each of its member States. These rules, embodied in the many UN instruments, and which provide a system of international law which subordinate the individual "will" of each State to the international common good, have been seen as merging State sovereignty into a pervasive international entity which impinges upon state autonomy through communal authority.

Perhaps the clearest and most detailed examination of this modern view of sovereignty is to be found in F.H. Hinsley's *Sovereignty*.[20] Hinsley argues that the concept of sovereignty is closely linked to the origin and history of the state, the state being "the name we attach to one among various political institutions which societies develop. It is a distinctive political institution, the particular means of organising political power which societies have adopted at a particular state in their evolution."[21] Indeed, Hinsley ignores the historical identification of sovereignty with the person of the sovereign, and postulates that the genesis of sovereignty lies totally within the realm of politics, and independently of the society or community over which the sovereign power is exercised. The concept of sovereignty, he argues, is not found in societies in which there is no state,[22] and that "the political institutions of societies should not be confused with the societies themselves."[23] This view would appear to ignore the fact that in democratic societies with universal suffrage, the political institutions if made up of elected representatives, at least theoretically, represent the "will of the people."

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[20] Hinsley, op.cit.
[21] Ibid, 3.
[22] Ibid, 22.
[23] Ibid, 23.

Similarly, Hannum in *Autonomy, Sovereignty and Self-Determination*[24] draws the distinction between the State, which is the political entity which exercises the functions of government and in which sovereign power resides, and the nation, which is the cultural or social grouping with shared characteristics, such as language and/or ethnicity.

MacCormick,[25] on the other hand distinguishes between two distinct types of sovereignty: legal and legislative sovereignty and political sovereignty. Both are territorial in character. Legal sovereignty embodies the unrestricted power of law-making, whilst political power is "unrestrained by any higher political power."[26] Under this paradigm, law is dependent upon political sovereignty. MacCormick also classes sovereignty as being either internal or external. Internal sovereignty is the exercise of unrestricted power within the territorial boundaries of the state. External sovereignty, on the other hand "is the authority granted by international law to each state to exercise legal control over its own territory without deference to any claim of legal superiority made by another state or organisation."[27] It would appear, therefore, that MacCormick, unlike Hinsley, Hannum and Austin, views sovereignty as having a dual nature, rather than being the historical comprehensive and homogeneous source of totalitarian power.

From the foregoing discussion it would appear, therefore, that sovereignty has historically been used as a unipartite, inclusive term to connote political and legal autonomy and the exercise of absolute supreme power within a particular territory without the interference of any higher authority. However, it is argued here that sovereignty in the twenty-first century is not a single, or even bipartite attribute of statehood, but is rather a term more appropriately applied individually to various aspects of independent statehood.

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[24] Hannum, fn [3] above.
[25] MacCormick, fn [4] above.
[26] Ibid, 127.
[27] Ibid, 126.

Thus, a State may have constitutional and political sovereignty, which denotes the right to determine its constitution free of the necessity to have constitutional decisions ratified by a higher power, but at the same time, be restricted by treaty or international law, in the manner in which it is able to deal with other "sovereign" states. Thus, Alan James, in his work *Sovereign Statehood*[28] sets out the proposition that constitutional sovereignty is an essential pre-requisite for a state's eligibility for "full participation in inter-state relations."[29] Similarly, a state may have absolute, unfettered control over the law-making within its territory, but may, at the same time, be restricted by treaty or international law from promulgating legislation which impinges upon its economic relations with other states.

Furthermore, Bengt Broms in the article "States" ascribes to modern states certain inherent rights which comprise the indicia of sovereignty. These include the rights to :

- self-determination
- international commerce
- independence
- self-defence against armed attack
- equality
- local jurisdiction.[30]

So basic are these rights that they have been enshrined in various Charters, Conventions and Declarations of the United Nations, and more particularly the UN Charter of Economic Rights and Duties of States.

Each of these rights correspond to a discrete, but at the same time interrelated area of State governance. Therefore, if sovereignty can be viewed as a collection of

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[28] Alan James, *Sovereign statehood.* Allen & Unwin, London, 1986.
[29] Ibid, 45.
[30] Bengt Broms, States. In Mohammed Bedjaoui (ed.), *International law: Achievements and prospects.* Martinus Nijhoff, The Hague, 1991, 57.

separate but independent rights, could it not also be argued that rather than a comprehensive sovereignty, each State has sovereignty as a separate and independent right over each area of governance? Thus, a State has sovereignty over its internal legislation, territory, natural resources, economic development, political affairs, international relations, culture and the environment.

Certainly, it is argued, the concept of a multi-faceted rather than the historical unipartite sovereignty accords more closely to modern political, economic and social factors. Whilst a theory which propounds the comprehensively absolute power of the sovereign state may accord with the relatively simplistic international political and economic conditions of pre-nineteenth century Europe, it cannot adequately embrace the complex and multifarious nature of twenty first century intranational and international relations.

Moreover, it is argued, that it is this extremely circumscribed, restricted approach to the concept of sovereignty which has given rise to what is regarded as a major paradox international law and which, in turn has led to the questioning of sovereignty as both a relevant and an applicable concept. This paradox was stated by Hart as the difficulty "in accepting or explaining the fact that a state which is sovereign may also be 'bound' by, or have an obligation under, international law."[31] Despite the restrictive nature of the concept, in international practice the existence of sovereign authority within an independent state has universally been recognised as an essential qualification for its membership of the international community.[32] However, this membership of the international community and the attendant rights this confers, also comprises concomitant duties upon member states. These duties, according to Broms, include the following:

- not to interfere with the internal affairs of another sate
- to refrain from supporting insurgent movements
- to resort only to peaceful means of dispute resolution

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[31] Hart, op.cit., 215.
[32] Hinsley, op.cit., 215.

- to respect human rights
- to uphold international treaties.[33]

It is precisely these duties which give rise to the paradox, since it could be said that under international law the sovereign rights of states are limited by the equally sovereign rights of other states.

Various attempts have been made by writers to explain or dismiss the paradox with varying success. Lloyd explains the paradox by proposing that subordination of state law to the norms of international law does not merge or subjugate the sovereign state in or to a higher entity, but rather, signifies the recognition by the sovereign state of a system of legal rules which is binding on all states.[34] Moreover, whilst the system of international rules may restrict a state in the international sphere, a sovereign state retains domestic sovereignty and may legislate or act in disregard of international obligations.[35]

Attractive as this explanation may be, however, it fails to take into account those international instruments, such as those which stipulate that parties to the ECT must modify certain aspects of their domestic legislation.[36] Thus, the retention of even domestic sovereignty on this basis may be questioned. Had Lloyd been writing after the ratification of the Treaty, it is a matter for speculation whether he would have continued to maintain this view.

Bengt Broms, on the other hand, argues for the persistence of sovereignty as a unified and viable concept on the basis that even if the "fundamental rights of a particular State" were "considerably curtailed, this does not by itself result in the loss of the sovereignty of the State."[37] Indeed, Broms goes so far as to propose that States have taken great pains to preserve their sovereignty in the face of the

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[33] Broms, op. cit., 57.
[34] Lloyd, op. cit., 189.
[35] Ibid, 190.
[36] For example: Article 10(5), Article 13, Article 14 and Article 21.
[37] Broms, op. cit., 57.

increasing plethora of subjects of international laws.[38] This sentiment was echoed in 1931 in the Permanent Court of International Justice ("PCIJ") decision on the customs regime between Germany and Austria (PCIJ, Series A/B, (1931) 88, 4), in particular by Anzilotti in his Individual Opinion.[39] The principal issue revolved around whether the free trade agreement between Germany and Austria was in breach of Article 88 of the Treaty of Saint Germain[40] and the Geneva Protocol. Both Germany and Austria had submitted that the provisions of both the Treaty and the Protocol compromised Austria's independence. However, this was rejected by the court. Moreover, Anzilotti, in his individual opinion, stated that:

> . . . The legal conception of independence has nothing to do with a State's subordination to international law . . . . [R]estrictions upon a State's liberty, whether arising out of ordinary international law or contractual engagements, do not as such in the least affect its independence. As long as these restrictions do not place the State under the legal authority of another State, the former remains an independent State however extensive and burdensome these obligations may be.[41]

On the other hand, MacCormick in his work *Questioning Sovereignty,*[42] in which he discusses the status of the sovereignty of European states in the wake of the European Union, sees the increasing Pan-European regulation, through the laws and charters of the EU, as marking the
demise of the sovereign state in Europe. Of the EU, he writes: "Neither politically nor legally is any member state in possession of ultimate power over its own internal affairs."[43] Politically, the EU affects certain vital interests, and hence exercises political power on some matters over member states. Legally, EU legislation binds

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[38] Ibid, 62.
[39] At 53 ff.
[40] Which required that Austria abstain from certain acts other than with the consent of the Council of the League of Nations, at 56.
[41] At 58.
[42] MacCormick, op.cit
[43] Ibid, 132.

member states and overrides internal state law within the respective criteria of validity. Thus, "the states are no longer fully sovereign states externally, nor can any of their internal organs be considered to enjoy present internal sovereignty under law... ."[44] MacCormick, however, does not regard the "demise" of the sovereign state as a retrograde movement. On the basis of the fact that "the international order of sovereign states has been a bloody one, marked by struggles over the establishment and maintenance of empires,"[45] he sees in the greater emphasis upon co-operation and community the development of a new legal and political order which once formulated has the potential to obviate further European conflicts.

Between the two extremes of opinion; between those who assert that sovereignty as a practical, political concept continues to thrive and those, like MacCormick, who regard its influence as negated by the welter of international agreements which proscribe the rights and prescribe the duties of participating states, there is, it is submitted, a common ground.

Certainly, it can no longer be stated with confidence that in the modern world the concept of sovereignty embodies the notion that within its own territory the State is legally and politically totally autonomous and that no higher authority exists to override the authority of the State. Changes in international law, politics, and technology have all served to alter the dynamics of international relations. The proliferation of treaties, which in principle attempt to regulate both the internal and external conduct of states and the increasing trend towards "globalisation" in economics, driven by advances in technology and the resulting greater economic inter-dependence of States, have served to undermine the autonomy of States within their territories and to demolish the political and territorial isolation which fostered the development of sovereignty.

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[44] Ibid, 133.
[45] Ibid, 126.

Historically, in the pre-technological era prior to the late eighteenth century it could be argued that it was geographical boundaries which circumscribed the borders of individual states and circumscribed the extent of sovereign power. Each sovereign State was a discrete unit. What took place within its borders did not necessarily affect a State's immediate neighbours or the wider world. Occasionally, a State would attempt to extend the ambit of its power over the territory of other states. Such expansionist ambitions generally resulted in wars, which were concluded either by victories and/or treaties, which sought to reiterate and re-inforce the sovereignty of the parties involved. International trade certainly existed, but was regulated and confined to a great extent by the exigencies of travel and communications.

Under such conditions, philosophers such as Bodin, Hobbes, Locke, Rousseau and even Austin could theorise with impunity about sovereignty as a concept which appeared if not immutable, at least undeniable. It was not until the end of the nineteenth century, therefore, with improvements in transport and communications and the reduction of the insularity of nations, that the concept of sovereignty became threatened.

Throughout the twentieth century devastating wars, political upheavals, improved global communications and the increasing realisation by politicians that all nation states are irrevocably interdependent has resulted in the reliance upon treaties and international law to govern the conduct of nation states. Those like MaCormick, who argue that sovereignty no longer exists, see the acceptance by states of the regulation of their conduct in both internal and external affairs as a ceding of sovereignty to a higher authority. This is especially so where the yielding of state control occurs in an area of a state's internal affairs, which would not become subject to external regulation pursuant to the strict application of the concept of sovereignty.

However, it is pertinent to inquire here whether the elements of sovereignty as propounded by pre-twentieth century philosophers appropriately describe the type of independence enjoyed by States in twenty-first century international relations, politics and law. Can a concept which was used to define the power and autonomy wielded by the nation states of the seventeenth century be applied, unmodified, to states in the twenty first century?

It is suggested here that those areas in which a state agrees to conduct its internal affairs in accordance with the principles and rules laid down in treaties and by international laws are usually those areas or activities which impinge upon the well-being of other states. For example, environmental matters, trade and the passage of goods and persons across territories, human rights and military activities, are all issues which affect other states and which are controlled by international law and treaty. Nation states of the twenty-first century must be aware of their duties towards other states for a variety of reasons. Similarly, those areas of a state's external affairs which are governed by international law or treaties generally relate to inter-state relations.

However, in both cases, a government of an independent state theoretically has the right to choose whether it will abide by international law or ratify a treaty. Each state has the choice as to whether it is willing to participate in a scheme of mutual obligation. There is no higher authority or power which can direct this choice or force the government of an autonomous state to act against its inclinations. Further, once the state has accepted the mutual obligations it has the choice as to whether or not these will continue to be observed. Of course, this view does not take into account the external pressures which may be exerted upon a state to exercise its right to choose in a particular way. Nor does it allow for internal exigencies, such as economic difficulties, which may impinge upon a states freedom of choice.

Furthermore, as noted above each state under international law and in certain treaties, is accorded certain rights which must be observed by other nations. It is true that concomitant to these rights are reciprocal obligations and duties. However, it is arguable that the mere fact of observing certain obligations does not abrogate inherent rights.

Moreover, it was suggested above that the concept of sovereignty is, today, a multifaceted concept which exists both because of and within the framework of international law. Thus, a state may be said to exercise sovereignty over its natural resources, its political organisations, its cultural traditions, its social policy, and the multitudinous other areas which make up the modern state. Therefore, whist the modern concept of sovereignty does not conform to the traditional, absolute power paradigm, each autonomous state still exercises a species of control over its own affairs. Thus, even though, as MacCormick suggests, the traditional concept of sovereignty no longer has application to the twenty-first century *real-politik*, it cannot be said that states have lost the power to control their own destinies. There may be certain factors which impinge upon the freedom of action of individual states, but theoretically at least, a specie of sovereignty persists in international law. Perhaps the difference between sovereignty in the seventeenth century and sovereignty in the twenty first century is a difference of emphasis and degree rather than of kind. Irrespective of whether sovereignty is regarded, as suggested above, as a multifaceted concept or, in the more traditional sense as a unified, catch-all attribute of the autonomous state, certain issues in relation to the concept of sovereignty and the provisions of the ECT arise.

Firstly, if an autonomous state has sovereignty over its domestic law-making in those areas and purposes which do not impinge upon the rights of other states, as suggested by MacCormick (op. cit.) or which do not infringe international law, does an interference with this domestic legislative autonomy constitute an abrogation of sovereignty?

Secondly, since the concept of territory and borders is both at the heart of the concept of sovereignty and physically defines the geographical area over which the state exercises control, do the transit provisions of Article 7 infringe internal sovereignty, the inherent right of a government to control activities within its boundaries?

Finally, do the prescriptive, imperative provisions of the ECT in regard to the exploration, exploitation, sale and transit of energy products and materials infringe a Contracting Party's sovereignty over the energy resources within its territory?

These issues will be discussed in detail in the following sections.

Legislative and Constitutional Sovereignty

James in *Sovereign statehood*[46] postulates that the distinguishing feature of a sovereign state is its independence: the fact that "in terms of constitutional law, it has no superior, that there is no other state to whose constitutional set-up the first state is subordinate." In other words, sovereignty is signified by legal autonomy. It is the ability of the state to formulate its constitution, to enact laws and regulations affecting the well-being of its citizens and to order its government within its territorial area without reference to or interference from another state. Certainly, there is a physical element to sovereign statehood, as represented by both the size, strength and resources of the territory over which the state claims sovereignty and the physical activity of government. However, the significant factor is that a sovereign state is able to govern its territory, utilise its resources and enter into relationships with other states independently, without the sanction of or compulsion from an external entity. Irrespective of the indicia imposed upon the concept of sovereignty and whatever the paradigm favoured by the various writers discussed

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[46] Op. cit., 40.

above, it is arguable that these are the distinguishing characteristics of sovereign statehood. Therefore, it is immaterial whether the essence of sovereignty is regarded as being a collection of discrete rights, as suggested by Broms (264 supra) or as a conglomeration of interrelated attributes forming a coherent and indivisible, unipartite construct. Moreover, it could be asserted that irrespective of the way sovereignty is viewed, it is irrelevant to the efficacy of the totality of the concept if some aspect, one area of rights, is abrogated, provided the remaining parcel of rights remains intact.

It is argued here, however, that any check on the ability of a state to direct its internal affairs and external relations is a breach of sovereign statehood[47] and that sovereignty either exists or does not exist.[48] Thus any interference however slight by another state or group of states in any aspect of the ability of a sovereign government to exercise autonomy would constitute an infringement of sovereignty. Accordingly, it is postulated here that the substantive requirements of the ECT curtail the domestic legislative, constitutional and political freedom of choice and action of a state, thereby constituting a violation of the sovereignty of Contracting Parties.

The ECT contains a number of provisions which implicitly or explicitly require a Contracting Party to amend its domestic legislation to accord with its objectives. The relevant Articles and the areas of law affected are summarised in Tables 4 and 5. Moreover, whilst the substance of the discrete provisions of the ECT was discussed in detail in Chapters IV to VII, the practical impact of the implicit and explicit prescriptions upon both domestic legislative autonomy and political policy will be addressed below.

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[47] There are however, exceptions to this as discussed at 301 ff below in regard to violations of human rights and certain aspects of one state's relations with other states.

[48] Just as it impossible for a woman to be a "little bit" pregnant, it is suggested here that it impossible for a state to be a "little bit" sovereign. The well known apothegm of Gertrude Stein that "a rose is a rose is a rose" could equally apply to sovereignty.

Implicit Requirements: Facultative v Mandatory Provisions

The preponderance of the duties imposed by the ECT and which impinge upon domestic legislative and regulatory freedom of Contracting Parties are often described as exhortatory or "soft" in nature: i.e. they do not impose explicit obligations. Therefore, they are generally regarded as statements of principle to which each Contracting Party subscribes.[49] For example, Article 3, International Markets, provides that Contracting Parties "**shall** work to promote access to international markets on commercial terms, and generally to develop an open and competitive market for Energy Materials and Products." Certainly, the Article contains no specific prescription that Contracting Parties should, in any way, enact specific legislation to create an "open and competitive market." As such, therefore, it appears, ostensibly to be a mere statement of intent or *desideratum* of international commercial activity. However, the use of the word "shall" creates an obligation, thereby turning what superficially appears to be a directory prescription into a mandatory provision.[50] The words "shall" and "may" play a vital role in the construction of legal instruments and statutory interpretation. As Robinson states:

> The two words are related in that the rejection of the one will often mean the use of the other. They represent the device of making clear whether an obligation or a power is cast, on the legal subject. The use of 'shall' indicates that the legal subject is under an obligation to act in accordance with the terms of the provision... To express a provision in the form that a person 'shall' do something is to cast on that person an obligation to do that thing. Failure to comply with a mandatory provisions gives rise to a course of action in favour of the person having the benefit of the provision.[51]

Moreover, as discussed above in regard to Article 26, the ECT provides the mechanism whereby this cause of action may be pursued. Certainly, had the

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[49] For an example of this approach see Bamberger et al., op. cit., 11.

[50] See Lord Penzance, *Howard v Boddington* (1877) 2 PD 203 at 210-211. For a discussion of the legal construction of "shall" see Stanley Robinson, *Drafting.* Butterworths, Sydney 1973, 38-41.

[51] Robinson, op. cit., 38.

intention of the Charter Conference been to create a facultative instrument: a manifesto rather than an enforceable legal regime, alternatives to "shall" could have been used. For instance, it could have provided that Contracting Parties *"will"* or "*agree to* work to promote access to international markets etc...," thereby creating a statement of intent. Instead, however, the Treaty is expressed in peremptory terms, creating actionable obligations upon Contracting parties to achieve the goals set out in the various Articles.

Of course, it could be argued that the language of Treaties is always intentionally vague: that they are multilateral, multinational expressions of concordance rather than enforceable instruments.[52] In such a context, the word "shall" would be read down to become exhortatory or "soft." However, the ECT is, as Waelde describes it, "an example of a 'treaty with teeth'."[53] Not only does it contain provisions for its enforcement, primarily but not exclusively in Articles 26 and 27, but it has been acknowledged to the international community by the Charter Conference and Dr Kemper, as providing the legal framework for investment agreements in the energy sector. As such, therefore, the ECT goes beyond being a mere multilateral statement of tenets and accord to become a legally binding document creating enforceable obligations. Accordingly, the words used in the text become imbued with legal effect. Therefore, "shall" becomes neither exhortatory nor soft, but, on the contrary, imposes mandatory responsibilities to put the Treaty's precepts into effect.[54] Therefore, whilst those Articles listed in Table 3 appear to be mere statements of principle regarding particular areas of economic activity in the energy sector, they in

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[52] Moreover, they are the products of international diplomats and civil servants, not legal drafters and therefore, it would be futile to expect any degree of precision or lexicographic fluency from such documents. Notwithstanding this, Waelde in his article "Sustainable Development and the 1994 Energy Charter Treaty" (op. cit.), 267 offers some trenchant and justifiable criticism of the traditional treaty-making process, particularly in regard to the ECT.

[53] Ibid.

[54] Perhaps it is significant that the only substantive Article of the Treaty which does not impose explicit or implicit mandatory obligations, is Article 19 which merely requires some form of environmental regime.

fact impose stringent and enforceable obligations upon Contracting Parties to effect major changes in their legal systems and administrative procedures to accommodate the mandatory requirements of the ECT.

Effects of the Implicit and Explicit Requirements

As may be appreciated from Tables 3 and 4 the legislative changes required by the ECT embrace all aspects of the commercial, fiscal and administrative regulatory systems of Contracting Parties. Whilst some Articles, such as Articles 5, 7 and 19 are targeted towards specific areas, others, such as the provisions of Articles 3, 9, 10 and 14 encompass so broad a spectrum of domestic legislative systems that they are arguably impossible to implement.

Article 3 addresses the obligation of Contracting Parties to model the whole of their legal system to meet the demands of an open and competitive international market in energy products and materials. For most FSU states compliance therefore requires the restructuring not only of their domestic commercial and property law regimes, but also import/export regulations, foreign exchange and revenue controls, securities and corporations law and regulations, as well as ensuring that the legal system is supported by the necessary fora and administrative institutions. Similarly, Articles 9 and 14 place an obligation upon Contracting Parties to provide "open capital markets" (Article 9(1)) and "freedom of transfer" of capital and income related to investments. Article 10 prescribes a comprehensive investment protection regime.

Although couched in general and apparently exhortatory terms, those former FSU Contracting Parties who have not fully geared their legal systems to meet the demands of free-market conditions are faced with the necessity of implementing major legislative and administrative changes to their commercial systems in order to ensure compliance. Further, it must be born in mind that all of the requirements, implicit and explicit, are arguably mandatory and failure to comply thereby constitutes an actionable breach of the Treaty. Not even the transitional provisions

of Article 32, Transitional Arrangements, whereby former FSU states are given a period of time within which to comply with the provisions of certain Articles as set out in Annex T, offer little comfort to impoverished, inexperienced and ill-prepared governments.

Such comprehensive changes represent not merely enormous commitments in resources, time and, ultimately, money for those Contracting Parties affected, but also arguably constitute blatant infringements of Contracting Parties sovereignty over their domestic legislative systems.

Under normal conditions, decisions concerning the restructuring of domestic legal systems and the enactment or amendment of legislation and regulations are made by the duly elected parliaments and legislatures of sovereign states. Whilst the ideological, political and philosophical bases of the democratic process is beyond this dissertation, suffice it to say that pursuant to political theory, a democratically elected government is representative of the "will of the people," thereby rendering all legislative revisions an expression of this "will." Accordingly, the proposals for change are open to parliamentary debate and, when finalised, are theoretically the result of consensus. Whilst not all of the citizens of a state may agree with proposed enactments, the system of democratic checks and balances usually ensures that significant legislative amendments are publicly debated and generally, the result of consensus and/or compromise.[55] Pursuant to the ECT, however, Contracting Parties are obligated to enact and effect reforms. Changes to those areas of law set out in Tables 3 and 4 are mandatory. Thus, whilst the government of a Contracting Party may submit proposed legislative changes being made pursuant to the ECT to its usual parliamentary procedure, such submission can only be nominal. The assent of the parliament becomes irrelevant in that the failure by the Contracting Party to effect required modifications within the time specified will render it in breach of the Treaty. The legislative autonomy of Contracting Parties is therefore in thrall to the

[55] All FSU state governments currently operate pursuant to democratic principles and are elected by the people.

requirements of the ECT, thus abrogating the right of the citizens of Contracting Parties to direct not only the legislative direction but also the political policies and ideology upon which this is based.

Certainly, the "developed" Western nations have always been anxious to pay "lip-service" to the concept of state political and legislative sovereignty.[56] However, it is argued here that the effect of the ECT is to abrogate this sovereignty. Its demands for legislative, political policy and systematic reforms set out in Table 5 represent a violation of the rights of citizens to choose the direction of government through the democratic process. This is particularly apparent in some FSU states, such as Russia, Ukraine and Poland, which retain socialist governments. The commercial reforms demanded by the ECT run contrary to the traditional economic policies enshrined in Socialist ideology. To this extent, the Treaty constitutes an enforced and comprehensive conversion to capitalist commercial principles since the changes in economic and fiscal policy direction affect not merely the energy sectors, but all aspects of commerce in Contracting Parties.

There are instances in which the interference in the domestic activities of a sovereign state by outside entities is justified. As Cardenas comments in *Economic Development, Foreign Investment and the Law*: "The international community will not stand by idly if basic human rights are systematically violated inside a state."[57] Thus, diplomatic or armed physical intervention in the domestic policies and/or actions of a state to prevent genocide,[58] terrorism[59] and other crimes against humanity are justifiable upon humanitarian principles. However, whilst the violation of a state's sovereignty may be justified to prevent crimes against

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[56] It would be interesting to observe the reactions of the citizens of the UK or France to any overt or covert attempt by neighbouring states to curb their political or legislative freedom.

[57] Op cit, 20.

[58] Chillingly referred to as "ethnic cleansing" in the media.

[59] *Vide* the "War Against Terrorism" conducted by the USA and its "coalition" in Afghanistan in 2001-2002.

humanity, can it also be justified to achieve economic advantages for other states? It is argued here that it is not.

In response to this proposition, it could be asserted that each of the Contracting Parties entered into the ECT freely; that no pressure was placed upon the FSU states to subject themselves to the Treaty's regime and that each state was fully aware of its obligations pursuant tot he Treaty prior to signing. However, there are two major factors which mitigate against this view.

Firstly, it has been argued that the legal effects of the ECT are "hidden." In so far as it is a "treaty with teeth," the enforceability of the Treaty against Contracting Parties from the time of signature is cloaked by the language used to frame the obligations imposed. Accordingly, the full import of the Treaty may not have been immediately apparent to the signatories.

Secondly, the inducement of economic advantage through FDI in the energy sector offered to the FSU states in return for participation in the ECT regime, coupled with the diplomatic and political pressure applied by the EU states was arguably coercive.[60] Certainly, the relative bargaining positions of the EU and FSU states were unequal in that the carrot of economic development was held out to a financially starving eastern bloc. Therefore, whilst the extent to which this offer overbore the will of each individual FSU state is debatable, that it had some effect is evidenced by the fact that all FSU states, except Russia, both signed and ratified the Treaty.

It is possible that had the Treaty been presented to the FSU states merely as a legal framework for energy sector agreements, without the ancillary inducement of

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[60] During the negotiations of the Vienna Convention on the Law of Treaties (1969) a group of 19 Afro-Asian and Latin American countries suggested that the definition of "force" should include economic and political pressure. This suggestion was not put to the vote at the Vienna Conference (See Robert Y. Jennings, Treaties. In *International law: Achievements and prospects*, op, cit, 153).

economic development, few FSU states could have submitted to its regimen. Whilst this point may be open to speculation, it cannot be doubted that the provisions of the Treaty in toto require that each Contracting Party ensure that its commercial, legislative and administrative systems are commensurate with the creation of an enforceable investment promotion and protection regime in the energy sector. Moreover, this could not be achieved without serious infringement of domestic legislative and constitutional sovereignty of those Contracting Parties in transition from communism to open market economies. This violation of this aspect of sovereignty, together with the abrogation of sovereignty over territory and natural resources, discussed below are not incidental but integral to the objectives of the ECT.

Sovereignty over Territory

Whilst the inviolability of a state's geographic area and its sovereignty over natural resources are linked, in that both involve the exercise of control over the physical land mass and the resources within it, they will be addressed below as two distinct concepts which impute different parcels of rights.

In the *Texaco Award*[61] territorial sovereignty was defined as "conferring upon the State an exclusive competence to organize as it wishes the economic structures of its territory and to introduce therein any reforms which may seem to be desirable to it. It is an essential prerogative of sovereignty for the constitutionally authorized authorities of the State to choose and build freely an economic and social system. International law recognizes that a State has this prerogative just as it has the prerogative to determine freely its political regime and its constitutional institutions." Whilst the *Texaco Award* dealt with the Libyan oil-nationalisation issue, the above quotation serves to highlight the pivotal role of territorial sovereignty as a defining and determining aspect of State sovereignty.

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[61] *Texaco v Libyan Arab Republic* (1978) 17 ILM 3-37, para 59.

Territorial sovereignty therefore implies not merely the right of a sovereign state to control the movement of goods and people into, out of and across its territory, but also the right to determined freely and without interference the uses made of the land within the borders of territories under its control.[62] These rights are subject to the proviso that whatever is done within the boundaries of a state does not infringe the human rights of or cause harm to its own citizens and those of another state. However, within these constraints, a sovereign state is able to exercise control over its territory as it sees fit. In relation to economic activity in the energy sector, sovereignty over territory therefore includes the right of the state:

a) to restrict or prohibit the carriage of potentially hazardous energy materials and products across its territory;
b) to allow or prohibit the import of certain goods;
c) to grant or refuse permits and licences relating to land use;
d) to enact environmental protection legislation;
e) to determine the terms and conditions upon which and against whom the above rights are exercised.
f) to enact and administer entry and residency regulations in regard to citizens of other states;

However, Article 7 (Transit) and Article 11 (Key Personnel) restrain the above rights in relation to energy products and materials, to the extent that a state is unable to exercise sovereignty over transit and transport in the energy sector and the entry and residence of foreign nationals and the entry and residence of foreign nationals within its territory.

Article 7 provides for a non-discriminatory freedom of transit regime in the energy sector. To achieve this it sets out a number of requirements upon Contracting Parties which severely restrict their ability to exercise territorial sovereignty. Paragraph (1) provides that each Contracting Party "shall take the necessary

[62] Nico Schrijver, *Sovereignty over natural resources*. CUP, Cambridge, 1997 at 15, suggests that "territory" also includes artificial islands and oil platforms.

measures to facilitate the Transit of Energy Materials and Products consistent with the principle of freedom of transit and without distinction as to the origin, destination or ownership of such Energy Materials and Products... ." Whilst the "measures" to be taken are not specified, it may be assumed that they would include inter alia the revocation of transit restrictions, the de-regulation of transport and transit facilities, the amendment of any import/export regulations which affect energy transit, as well as ensuring access to energy infrastructure within the Contracting Party's territory. Further, Contracting Parties are obligated to ensure the co-operation of "relevant entities" in facilitating and achieving energy transit ((2)). Moreover, para (4) requires that where the existing energy transit facilities are inadequate or do not exist within their territories, they "shall not place obstacles in the way," i.e. must allow new capacity to be established. Failure to comply with this provision would render the Contracting Party in breach of the terms of the Treaty, unless it can be demonstrated to the "other Contracting Parties concerned" that the new facility would "endanger the security or efficiency of its energy systems" ((5)). In addition, para (3) requires that national/MFN treatment be accorded to all energy products and materials.

In effect, Article 7 imposes such stringent obligations upon Contracting Parties vis a vis the transit of energy supplies that territorial sovereignty in the areas (a) to (e) above is effectively abrogated. Contracting Parties have no control over the type or quantity of energy supplies which are transported across their territories, nor can they refuse to allow new transit facilities to be constructed within their boundaries, thereby abrogating their right to determine land usage. Whilst Contracting Parties may object if the transit threatens the security or efficiency of existing energy systems, no right is conferred upon a Contracting Party to refuse transit or construction of new facilities on the basis that the energy product or supply in question may be hazardous to its citizens and/or the environment.

Further, Article 11 provides that Contracting Parties must allow key personnel employed by investors in energy projects to enter and remain within the territory. Although a proviso is made that the requirement is "subject to its laws and regulations relating to the entry, stay and residence of natural persons" ((1)), it is possible that the provisions of Article 10(1) could be invoked in the event that the laws and regulations prohibited the entry and residence of particular key personnel. It may be argued that a state's right to control the entry and residence of foreign nationals is a minor aspect of sovereignty. There are situations, however, in which the exercise of this right may be of major political and/or diplomatic significance. For example, if the proposed entrants are nationals of a state with whom the Contracting Party has broken off diplomatic relations or against whom sanctions have been imposed. Moreover, entry and residence controls are part of the aggregate of rights which make up territorial sovereignty, interference with which constitutes a violation of a state's prerogative to direct matters in relation to its territory.

CHAPTER XI

SOVEREIGNTY OVER NATURAL RESOURCES

Introduction

As discussed in Chapter X, integral to the concept of sovereignty over territory is a state's sovereignty over its natural resources. However, before examining the effects, if any, of the ECT upon the concept of sovereignty over natural resources, it is pertinent to discuss briefly what constitutes natural resources and what sovereignty over them entails.

Definition of Natural Resources

Although there does not appear to be a general definition of the term "natural resources" in the canon of international law,[1] certain treaties and international instruments dealing with natural resources include definitions of certain "resources" which come within the purview of the content. Whilst such definitions are illuminating in so far as they serve to determine and highlight the resources to which the instrument applies, when considered together, the purpose specific nature of such definitions render them conflicting and therefore achieve little by way of clarification of the concept. For example, the UN Declaration on Permanent Sovereignty over Natural Resources (1962) uses the terms "natural resources" and "natural wealth and resources" interchangeably, without offering any useful definition of either, whereas Article XX(g) of the GATT uses the term "exhaustible natural resources" to indicate not merely non-renewable natural resources but also "renewable" flora and fauna. On the other hand, Article 2 of the UN Convention on the Continental Shelf [2] provides that natural resources:

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[1] Schrijver, op.cit., 15.

[2] Reprinted in Carter and Trimble, *International law: Selected documents*. Little, Brown and Co, Boston, 1995, at 545-546.

> consist of the mineral and other non-living resources of the seabed and subsoil together with living organisms belonging to sedentary species, that is to say, organisms which, at the harvestable stage, either are immobile on or under the seabed or are unable to move except in constant physical contact with the seabed or subsoil.[3]

Article 2 of the Rio Convention on Biological Diversity (1992),[4] however, refers to "biological resources" which are defined as: "genetic resources, organisms or parts thereof, populations or any other biotic component of ecosystems with actual or potential use or value for humanity." Whilst it is not surprising that a Convention dealing solely with biodiversity should restrict the ambit of "natural resources" to include only "biological resources," the Convention confuses the issue in Article 3 by providing that:

> States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies ... .[5]

By referring to "resources" without the qualification of "biological" and which are not defined in Article 2, the Rio Convention leaves open the question as to whether "resources" refers to non-biological resources, such as minerals. Moreover, Principle 2 of the Stockholm Declaration (1958)[6] casts the net of the definition of natural resources to include "the air, water, land, flora and fauna and especially representative samples of natural ecosystems."

Although only four examples of definition are presented above, they are, on the whole, representative of the various attempts to define "natural resources" in international instruments, i.e. either content specific, as found in the Convention on

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[3] This definition is repeated in Article 77(4) in the UN Convention on the Law of the Sea (1982), reprinted in Carter and Trimble at 604.
[4] Ibid., 830.
[5] Ibid., 831.
[6] Ibid., 760.

the Continental Shelf and the Rio Convention or extremely broad, as with the definitions contained in the GATT and the Stockholm Declaration.

As an alternative to the definitions found in international instruments, it is possible to classify natural resources according to a comprehensive, bipartite classification, viz:

- non-renewable or stock resources of finite quantity which are depleted by exploitation and
- renewable or flow resources which naturally replenish within one human generation.[7]

Thus, in relation to energy resources, coal, oil, natural gas and uranium could be classed as non-renewable whilst solar and geothermal energies, wind power, water[8] (hydroelectric generation) and ethanol[9] would be regarded as renewable resources. However, although in the above bipartite classification flora, fauna and particular natural environments would be included in the renewable category, due to their ability to regenerate, they do not fit comfortably into either the definition of renewable or non-renewable resources. Whilst flora and fauna may reproduce sufficiently to sustain viable populations given optimum conditions, they are also subject to extinction if they are overexploited and/or their habitats destroyed.

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[7] Schrijver, op. cit., 13.

[8] It is, however, a moot point as to whether water should be regarded generally and without qualification as a renewable resource. Whilst in some geographical regions large rivers, such as the Nile and the West Seti (Nepal) are capable of providing sufficient flow to satisfy the requirements of hydroelectric plants, in other regions which are subject to drought and/or the effects of El Nino, water cyclically becomes a scarce and non-renewable resource.

[9] Ethanol ($C_2H_5OH(l)+3\ O_2(g) \rightarrow 2\ CO_2\ (g)+3H_2)(g)$) is renewable bio-fuel produced by the fermentation of bio-mass, usually sugar cane. Whilst ethanol is "greenhouse neutral" and 10% - 20% ethanol may be added to petrol for use in ordinary car engines, its effectiveness as a "green" and "sustainable" fuel is debatable. Not only are large areas of agricultural land needed to grow crops suitable for ethanol production, but also the disposal of the toxic fermentation waste products present environmental problems. see Roland Smith, *Conquering Chemistry),* (Sydney, McGraw-Hill), 2001, 30-32.

Similarly, sensitive ecological areas such as rain forests, wetlands and indeed all natural environments, once subject to degradation from pollution or destruction from over-exploitation are generally unable to recover and, therefore, disappear. As Schrijiver states: "Forests, plants, animals, fish and soils are, in principle, renewable resources, but their renewability and regeneration will often depend on actual use levels and human decisions relating to investment management."[10] Thus, even the bipartite classification of natural resources becomes problematic. However, whichever definition or classification is used to delineate the constituents of the term "natural resources," what does become apparent is that biological resources, i.e.. flora, fauna and the natural environment, are included with minerals and other resources which come within the ambit of the term natural resources, over which the State exercises sovereignty. The rights and obligations conferred by sovereignty over natural resources is discussed in the following sections.

Permanent sovereignty over natural resources

Throughout his work on the topic, Schrijver (op. cit.) qualifies the noun *sovereignty* with the adjective *permanent to* "emphasize its hard-core status"[11] as a central doctrine in international law. The adjectival form thereby confers a number of characteristics upon sovereignty by indicating that a State's sovereignty over its natural resources is "absolute," "inalienable," "free" and "full" and thereby the notion that permanent sovereignty over natural resources and the rights it connotes cannot be abrogated except by a free and overt act of the State.

Schrijver attributes the inception of the development of the concept of permanent sovereignty over natural resources to the influence of post-World War II, post-colonial UN debates which culminated in the drafting of the UN Declaration on Permanent Sovereignty over Natural Resources (1962). It is, he states, "one of the more controversial new principles of international law" which developed "in order

[10] Schrijver, op cit., 14.
[11] Ibid., 2.

to underscore the claim of colonial peoples and developing countries to the right to enjoy the benefits of resource exploitation and in order to allow 'inequitable' legal arrangements under which foreign investors had obtained title to exploit resources in the past, to be altered or even to be annulled ab initio, because they conflicted with the concept of permanent sovereignty."[12] Thus, Schrijver views the development of the notion of permanent sovereignty as a reaction to the inherent inequalities of political and economic power between the developed nations and post-colonial developing states. It is, as it were, a legal shield against the infringement of the rights of newly independent states by other wealthier states and large foreign operations.

Rights Conferred by Permanent Sovereignty

What are the rights conferred upon a State by permanent sovereignty over natural resources? Article 1(2) of the International Covenant on Civil and Political Rights (1966) provides that:

> All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation based upon the principle of mutual benefit and international law.[13]

Whilst the above statement of principle does little to enlighten as to the exact nature and extent of the rights conferred, it is possible to formulate a set of prerogatives attached to the notion of permanent sovereignty which in essence relate to the absolute freedom of the State to determine issues relating to the exploration for and exploitation of its natural resources. A brief discussion of those rights relating to permanent sovereignty and which are impinged upon by the provisions of the ECT is presented below.

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[12] Ibid., 1.

[13] Carter and Trimble , op. cit.. 388.

(a) Right to dispose freely of natural resources

The right to explore for and exploit the natural resources found within its territory for the benefit of its people is at the heart of a State's permanent sovereignty. This concept is expressed in Article 1(2) of the Covenant on Civil and Political Rights quoted supra and includes the freedom to enter into contracts with domestic or foreign nationals regarding the exploitation and exploration of natural resources. As Arbitrator Dupuy in the *Texaco Award* (op.cit.) states:

> The State, by entering into an international agreement with any partner whatsoever exercises it sovereignty whenever the State is not subject to duress and where the State has freely committed itself through an untainted consent (at paragraphs 66-67).

It is important to note that Arbitrator Dupuy placed an emphasis upon the freedom to contract and the absence of duress. The choice as to whether natural resources should be disposed of to a foreign party must not be influenced by covert or overt external pressure.

Furthermore, the right to dispose of and exploit natural resources includes the absolute discretion of the State in the management of its resources. Thus, management includes the imposition of environmental protection regulations, the designation of territorial areas which are available for exploration and exploitation of resources, as well as the regulation as to the methods by which resources may be extracted.

Although there has been some discussion as to the extent to which permanent sovereignty in regard to the exploration and disposal of natural resources is absolute,[14] it would appear that whilst "Permanent sovereignty ... is inalienable," a State may accept "obligations with regard to the exercise of such sovereignty by treaty or by contract freely entered into."[15]

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[14] See Schrijver, op. cit., 262 - 264.

[15] The Seoul Declaration, Principle 52.

(b) Right to regain control over natural resources

A corollary and ancillary right to explore for and exploit natural resources freely is the right to regain control over natural resources disposed of by revoking prior agreements. The basis of this right lies in the inalienability of permanent sovereignty. Thus, whilst a State may permit an entity (either domestic or foreign) to explore for or exploit the natural resources within its territory, in so doing it does not in any way cede its rights to control the resources, since they are inalienable and therefore cannot be assigned to another party. Thus, this right to resume control includes the right of expropriation and nationalisation of the means of exploration and exploitation.

(c) Right to regulate FDI in natural resources

The prerogative of a State to regulate FDI in natural resource exploration and exploitation within its territory is both a concomitant of territorial sovereignty and integral to the notion of permanent sovereignty over natural resources. It is arguably the consequence of the notion that a State has the right to direct its domestic economic policy, legislation and constitution; to maintain the inviolability of its geographic territory from foreign incursions and the inalienable nature of its permanent sovereignty over its natural resources. Further, the right to regulate FDI is comprised of a number of discrete powers, including:

- the right to regulate the admission of FDI;
- the right to exercise control and authority over FDI;
- the right to expropriate or nationalise FDI;
- the right to determine the level of compensation.

These rights are expressed in both international law and international instruments and whilst tempered by principles of equity and fairness, give rise to the corollary that an FDI investor shall not interfere in the domestic administration of a sovereign state as expressed in the Calvo Doctrine and Neer Claim. Although it is beyond the scope of this dissertation to discuss in detail the various decisions and international

instruments which are applicable to and reflect the notion of a State's right to regulate FDI, a few notable examples are addressed below.

Calvo Doctrine The Calvo Doctrine was developed in the nineteenth century by Argentinean lawyer Carlos Calvo (1822-1906) who promulgated a set of principles upon which FDI should operate. Calvo postulated that in relation to FDI, the concept territorial sovereignty requires:

- the subjection of both foreigners and nationals to domestic law and jurisdiction;
- equal treatment before the law of foreigners and nationals;
- non-interference by other States in disputes over the treatment of foreign investors and their property rights;
- the absence of obligation for a State to pay compensation for damage suffered by foreigners resulting form civil war or disturbances, unless the obligation is mandated by domestic law.

In essence, the Calvo Doctrine was a response to the abuses of Western powers of the right to diplomatic protection of citizens abroad and the use of this right to exploit natural resources in Latin American countries. Moreover, it attempts to "level the playing field" between the economically disadvantaged but resource rich host nation and the economically powerful foreign investor.

The Doctrine has been adopted by most Latin American as well as some Asian and African States as a standard for host state/foreign investor relations. Moreover, to a certain extent, the essence of the Doctrine has been enshrined in the UN Declaration on Permanent Sovereignty over Natural Resources (1962). However, despite the apparent acceptance of the principles enunciated, the validity of the Doctrine has been questioned, most particularly in the *North American Dredging Company of Texas Case* (1926) 4 RIAA, 29, and the stringent, fairly uncompromising approach to FDI finds little favour with foreign investors.

IMS In regard to the treatment of foreign investment, therefore, the preferred standard is that first enunciated in *USA v Mexico* (1926) 4 RIAA, 60 ("the *Neer Claim*"), later refined into the "international minimum standard of civilization" (IMS). Whilst stressing the primacy of host State domestic law and jurisdiction, the IMS also demands equitable treatment of investors in regard to expropriation, taxation and application of domestic law. In regard to the issue of expropriation, the IMS places requirements upon the host State which are echoed in Article 13, viz, that any expropriation must be:

- non-discriminatory;
- for a public purpose; and that
- prompt, adequate and effective compensation will be given.

However, in contrast to the provisions of the ECT, the IMS also imposes particular obligations/duties upon the investor. These are:

- respect for and observance of domestic law of the host state;
- non-interference in the domestic laws of the host state;
- submission of disputes to local fora.

Clearly, therefore, the IMS creates a relationship between host state and investor of mutual obligations. Both parties must respect their respective rights and interests, in contrast to the ECT, in which the assertion of rights is confined largely to the investor whilst the obligations are placed firmly on the shoulders of the host state. In addition to the Calvo Doctrine, the Neer Claim and the IMS, a number of international instruments deal with the right of a host state to regulate FDI.

Article 12 of the Havana Charter (1948) provides that each State has the right "to determine whether and to what extent and upon what terms it will allow future foreign investment. This broad statement of principle is expanded in Article 2(3) of the Covenant on Economic, Social and Cultural Rights which deals with the issue of national/MFN treatment for foreign investors by providing that:

Developing Countries, with due regard to human rights and their national economy, may determine to what extent they would guarantee the economic rights recognized in the present Covenant to non-nationals.[16]

Thus, Article 2 (3) recognizes a right of developing nations to treat foreign investors according to different standards than those applying to domestic entities. Further, both the Draft UN Code of Conduct on Trans-National Corporations (paragraph 48) and the World Bank Guidelines on the Treatment of Foreign Investment (1994) acknowledge the right of States to regulate the admission and establishment of foreign investment, but whilst in the UN Draft Code this is expressed as a prescriptive right, the World Bank Guidelines, not surprisingly, recommends a more open approach to FDI regulation.[17]

As Schrijver states, "a good summary of the relevant law as to the right of States to regulate foreign investment"[18] is to be found in Section 5.5 of the Seoul Declaration, which provides:

> States have the right to regulate, exercise authority, legislate and impose taxes in respect of natural resources enjoyed and economic activities exercised and wealth held in their own territories by foreign interests subject only to any applicable requirements of international law. Except as otherwise agreed by treaty or contract, no state is required to give preferential treatment to any foreign investment.

In regard to Section 5.5 of the Seoul Declaration, it is important to note that the right to regulate FDI may be modified by contract or bi- or multilateral investment treaties. It is argued here, however, that so inherent is the prerogative of permanent sovereignty over natural resources, that any agreement entered into by the State which detracts from its rights to permanent sovereignty must be entered into freely, without taint of duress or inequitable inducement.

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[16] Charter and Trimble, op. cit., 411.
[17] See Schrijver, op. cit., 282 - 283.
[18] Ibid., 285.

A further right inherent in the concept of permanent sovereignty is the right to expropriate or nationalise foreign investment. The right of a State to expropriate or nationalise property stems directly from the nation of the inalienability of sovereignty over natural resources and applies not merely to foreign but also domestic property. In addition to the Neer Claim and IMS, discussed above, the principles relating to the expropriation of foreign property by the host state have been reaffirmed in international decisions, most of which are concerned with the legal issues arising from the seizure of foreign investments in the oil industry in the Middle East. In *UK v Iran* (1952) ICJ (*"the Anglo-Iranian Oil Company Case"*)[19] although the ICJ found that it had no jurisdiction to deal with the merits of the Iranian nationalisation of foreign (UK) property situated in Iran, the principle of a State's right to nationalise was accepted and has since became generally established. A number of subsequent cases such as the *Texaco Case* (supra), *Liamco v Libya* (1981) 20 ILM 120 *Kuwait v Aminoil* ("Aminoil Case') (1982) 21 ILM, 1, and *Amoco v Iran* (Amoco Award) (1987) 26 ILM, 243 have held that nationalisation is "a right fundamentally attributed State sovereignty" and "commonly used as an important tool of economic policy by many countries both developed and developing" and is a "right which cannot easily be surrendered."[20]

Ancillary to the right to expropriate or nationalise is the right to determine the level of compensation in the event of expropriation or nationalisation of natural resources. Resolution 3171 (XXVIII) of the UN General Assembly provides that:

> ... the application of the principle of nationalisation carried out by States as an expression of their sovereignty ... implies that each State is entitled to determine the amount of possible compensation and the mode of payment.

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[19] *The Anglo-Iranian Oil Case* dealt with the liquidation and transfer of assets of an enemy alien pursuant to peace treaties.

[20] *Amoco Award*, paragraph 179.

However, whilst the compensation payable is determinable by the State, it must be appropriate, just or reasonable,[21] which takes into account the "legitimate expectations" of an investor in regard to the profitability of the investment.[22] The right to expropriate or nationalise, therefore, does not confer a *carte blanche* upon a State to resume control of foreign-owned investments in the natural resource sector without the provision of adequate compensation. It does, however, underscore the inalienability of permanent sovereignty and emphasises the nation that even though a State has granted a foreign investor permission to explore for or exploit natural resources, within its territory, the ultimate ownership of the resources remains with the State.

However, despite the alienablility of sovereignty over natural resources, the State's permanent sovereignty is qualified by certain obligations and duties in regard to its exercise of these prerogatives. One of these obligations, discussed supra is the duty to provide adequate compensation for expropriation or nationalization. Others are discussed briefly below.

Duties Concomitant with Permanent Sovereignty

As noted above, permanent sovereignty is not unfettered. Whilst rights in regard to natural resources are inalienable, they are accompanied by certain duties arising from both international law and international instruments. These duties, therefore, circumscribe the way in which permanent sovereignty is exercised and impose obligations upon the State in regard to the uses to which it puts its natural wealth. The nature of these obligations range from those requiring strict observance, such as the duty to compensate for expropriation discussed supra, to "soft" law exhortations and statements of principle, as found in UN Declarations and Covenants. However, regardless of the legal "weight" of such duties, they nevertheless prevent the

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[21] In both the *Texaco* (supra at paragraph 87-88) and *Aminoil* (supra at paragraph 143) Awards referred to "appropriate" and "adequate" compensation.
[22] The *Aminoil Award* (supra) at paragraphs 143-144.

unrestricted dealings in natural resources by the State. Unfortunately, there is little scope within this dissertation to address in depth the nature of and issues raised by such duties.[23] However, those relevant to the operation and effects of the ECT are discussed below. These are the duty:

- to exercise permanent sovereignty for national development and the well being of the people;
- to co-operate for international development;
- to treat FDI investors fairly.

The exercise of permanent sovereignty for national development and the well being of the people

Various injunctions have been formulated according to which states have to exercise their right to permanent sovereignty in the interests of their populations and to respect the rights of indigenous peoples and minority ethnic groups to the natural wealth and resources of their regions. Although it would appear axiomatic that a State should utilize its natural wealth for the benefit of its population, the obligation to do so is expressed in a number of international instruments. Both Articles 1(2) of the Covenant on Economic, Social and Cultural Rights (1966) and the Covenant on Civil and Political Rights (1966) provide that not only may "all peoples for their own ends freely dispose of their natural wealth and resources" but also that: "In no case may a people be deprived of its own means of subsistence."[24] In context, the broad terms in which this last pronouncement is couched lends itself to the interpretation of "subsistence" as including natural resources.

Moreover, Article 21(1) of the African Charter on Human and Peoples' Rights (1981) stipulates that: "All peoples shall freely dispose of their wealth and natural resource," but also that this right "shall be exercised in the **exclusive** interest of the

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[23] A detailed and comprehensive examination of the duties attendant upon permanent sovereignty is to be found in Schrijver, op. cit., at 306-364.

[24] Carter and Trimble, op. cit., 388 and 411 respectively.

people"[25] (emphasis added). Similarly, the UN General Assembly Resolution 523 (VI) predicated the rights of developing nations to determine freely the use of their natural resources upon the requirement that: "they must utilize such resources in order to be in a better position to further the realization of their plans of economic development."[26]

Although a number of international instruments recognise the principle that natural resources should be exploited for the benefit of the people of a State, as Schrijver points out, in international jurisprudence and awards "no direct indication of duties at a national level with respect to the use of natural resources can be found"[27] and that "international law literature has not addressed the question of exercising permanent sovereignty over natural resources in the interests of national development and the well-being of the people."[28] Whilst the lack of attention to this issue in international law may appear anomalous, it is argued here that the reason for the dearth of jurisprudential comment and commentary arises not from the triviality of the principle but from the fact that no international litigation has revolved upon either its substance or application. Indeed, the greater proportion of litigation regarding permanent sovereignty has involved the questions of the treatment of FDI investments by the host State, particularly in regard to expropriations and nationalisations. Therefore, the question of a State's duties towards its own population vis a vis the use of natural resources has not been addressed in international fora, being, essentially a domestic issue.

However, "domestic" issue in relation to the duties attached to permanent sovereignty which has been brought into the international sphere in recent decades is that of the rights of ethnic minorities, particularly of indigenous people[29], in relation

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[25] Ibid., 513.
[26] Schrijver, op.cit., 9.
[27] Ibid., 309.
[28] Ibid., 310.
[29] It might be useful here to distinguish between indigenous and ethnic minorities. An indigenous people constitute the original inhabitants of a territory prior to an

to natural resources on their lands. Because of the potentially deleterious impact of the provisions o the ECT upon these rights, a brief discussion of the development and substance of the concept of indigenous land rights is presented below.

Permanent sovereignty and indigenous peoples' land rights

Concern for the rights of indigenous people, and their rights in relation to traditional lands in particular, is very much a product of the late twentieth century. Prior to 1960, the issue of the rights of indigenous populations was very much on the periphery of international law.[30] Schrijver[31] suggests that the development of an awareness of the rights of indigenous populations arose parallel to concerns regarding human rights law and the recognition of the rights of minorities. In 1971 the UN Sub-Commission on the Prevention of Discrimination and Protection of Minorities instituted a study on "The Problem of Discrimination Against Indigenous Populations." In 1982 the Sub-Committee established a working group on Indigenous Populations which in 1993 completed its Draft Declaration on the Rights of Indigenous Peoples, which was adopted in 1994. Moreover, in addition to the work of the Sub-Committee, Principle 22 of the Rio Declaration stressed the need

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invasion/colonisation by a technologically more advanced culture. Generally, such populations are both tribal and nomadic, the ecosystem comprising their major resource for subsistence through hunting, gathering and basic agriculture. As a result of their dependence upon the environment for survival, indigenous peoples generally have as a basis for their belief-system, a strong mystical bond to their land.

Indigenous claims, therefore, usually entail assertions of title to traditional lands based upon religious and cultural principles, together with evidence of continuous occupation and usage. Examples of indigenous peoples who have instituted successful land claims are the Native Americans of the United States and Canada, the Maoris of New Zealand and the Aboriginals of Australia.

Ethnic minorities, on the other hand, are not necessarily indigenous peoples and may indeed have ousted original owners from their territories. They are, however, distinguished from the majority population within the State by cultural, racial and/or religious factors. Minority claims therefore tend to require self-determination, regional autonomy, and religious and/or cultural freedom. Examples of ethnic minorities include the Tartars in the Crimea and the Basques of the Pyrenees.

[30] In the same way that indigenous populations were marginalised and neglected to the periphery of the domestic law and societies of the States in which they live.

[31] Schrijver, op. cit., 312.

"to recognize and support the identity, culture and interests of indigenous communities," whilst various other declarations and conventions such as the ILO Convention No 169 (1989), the Amazon Declaration (1989), and the Dessertification Convention (1994) recognise the duty of States to respect the rights and interests of indigenous peoples in the exercise of permanent sovereignty over natural resources.

In addition to the various international instruments which touch upon the issue of indigenous land rights, there have been a few notable decisions on the subject. However, only one of these, the *Western Sahara Case*[32] was decided by an international forum, the others came before domestic tribunals. The reason for this, it is suggested here, lies in the fact that claims to land rights asserted by indigenous populations essentially come within the purview of domestic law, in that they involve the question of the relationship between the rights of indigenous peoples and the State. Thus, it is only in those situations in which the assertion of rights affect a number of States that questions arise within an international context, as occurred in the *Western Sahara Case*. In this case, ICJ considered claims by the nomadic peoples of the Western Sahara to lands included in the territories of Morocco, Algeria and Mauritania, as well as the issue of mining rights to rich phosphate deposits within the area claimed which were held by Spain. In its Advice, the ICJ held that territories inhabited by socially and politically organised but nomadic peoples could not be regarded to *terra nullius*, or free for occupation and acquisition. Accordingly, the peoples who traditionally inhabit the territory are entitled to claim the application of the principle of self-determination through a free and genuine expression of the will of the peoples of the Western Sahara. In effect, therefore, the decision supported the principle that indigenous populations have, in fact and law, rights which may be asserted against the State/s within which their traditional lands lie. In addition to the *Western Sahara Case,* there have been a

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[32] *Advisory Opinion on Western Sahara* (1975) ICJ Reports, 12.

number of cases within domestic jurisdictions, notably in Canada and Australia, in which indigenous peoples have asserted their sovereignty over traditional lands.

In the Canadian case *Delgamuukw v British Columbia* [1998] ICNLR 14 (SCC) it was held that indigenous title to land involved "the right to exclusive use and occupation of land and includes the use of land for non-traditional purposes, such as exploiting the subsurface minerals and oil and gas" (paragraph. 12). In addition, the Court stated that the subsurface minerals are part of what is possessed by an Aboriginal nation holding indigenous title. Thus, in Canada at least, indigenous title constitutes a proprietary interest which can stand against and compete with both the Crown's title and lesser property interests. Accordingly, in regard to natural resources within lands held by indigenous peoples, the State has, in effect, no right which can be exercised, since permanent sovereignty in the resources lies with the indigenous peoples holding title. Thus, in Canada the question of the duty of the State to consider the rights of indigenous peoples in exercising its permanent sovereignty over resources within indigenous title areas does not arise.

In Australia, however, the situation is very different. In *Mabo*[33] the High Court of Australia, echoing the ICJ in the *Western Sahara Case*, held that at the time of first European settlement in 1788, Australia was not *terra nullius* and that therefore Aboriginal peoples had land rights over their traditional lands which preceded and thereby could be asserted against the Crown and lesser title holders. However, whilst the High Court held that Aboriginal title could be asserted, it left unanswered the question as to whether or not the grant of pastoral leases over traditional land not subject to an Aboriginal title claim, extinguished native title and the right to claim it.

This issue was addressed in the *Wik Case*[34] in which it was held that a pastoral lease did not extinguish native title and that where there was no conflict between the rights and interests of the holders of the pastoral lease and native title, the two

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[33] *Mabo v Qld (No.2)* (1992) 175 CLR 1; (1992) 107 ALR 1.
[34] *The Wik Peoples v Qld* (1996) 141 ACR 129.

interests could coexist. However, if there were a conflict, the pastoral lease prevailed. However, despite its apparently "liberal" approach to native title, the High Court of Australia has not progressed so far as the Canadian Supreme Court in *Delgamuukw* in ascribing a totality of rights to traditional owners by confirming their rights to subsurface minerals, oil and gas. Indeed, Australian courts have traditionally been loath to confer rights in natural resources away from the Crown and in *Western Australia v Ward* [2002] HCA 28, the High Court held that native title did not include rights to subsurface minerals, oil and gas.

As an attempt to achieve a balance between native title and existing grants to explore for and exploit minerals, the *Ward* case is arguably consistent with Australian law[35] but not with the concept that permanent sovereignty over natural resources is inalienable. It implies that since permanent sovereignty over natural resources in Australia rests with the Crown (State), although the title to the land passes to the indigenous people, the accompanying right to control and exploit the natural resources remains with the Crown.

However, the decision is arguably inconsistent with the principle expressed in *Mabo* that Australia was not *terra nullius* in 1788 and that therefore indigenous peoples hold rights to the land which was occupied prior to European settlement and which has been traditionally occupied by them since that date. Thus, the *Mabo* decision provides for a continuity of title to land subject to native title stretching back before European settlement and continuing to the present. Therefore, where native title to

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[35] In Australia the common law doctrine that *cujus est solum ejus est usque ad coleum et usque ad inferos* ("the owner of the land is entitled to all that lies above or below the surface") has been abrogated during a long and complex history by various statutes in all states. Accordingly, mineral resource ownership in Australia is in public rather than private hands. Pursuant to a series of "reservation" statutes all major minerals in Australia are "reserved," i.e. they are not included as part of land title but vest in the Crown/state. Thus, leases may be granted to explore for or extract minerals on private land without the consent of the owner or occupier. This aspect of resource ownership in Australia, with particular reference to individual states will be discussed in greater detail in Chapter XIII below.

land has been recognised and affirmed pursuant to a successful native title claim, it is arguable that the indigenous owners exercise the same rights to the land as existed prior to 1788. Moreover, if permanent sovereignty over natural resources is inalienable, it could not have vested in the British Crown upon its seizure of that land subsequent to European settlement.

It is suggested, therefore, that to some extent Aboriginal native title holders are in a position analogous both to that of former colonial nations upon receipt of independence from imperial powers and the FSU states upon the disintegration of the Soviet Union, and accordingly, should be accorded title commensurate with this position. On this basis, therefore, it is argued here that the *Western Sahara Case* and *Delgamuukw* view of indigenous title is more consistent with the traditional and internationally recognised concept of permanent sovereignty than the Australian decisions.

In those States, such as Australia in which indigenous peoples are not granted rights over the natural resources on their land as an integral parcel of rights contiguous with native title, it is argued here and by Schrijver[36] that States have a duty to ensure that the exercise of permanent sovereignty is consistent with the well being and ancillary rights of indigenous peoples. However, the duty to exercise permanent sovereignty to promote the well being of the population as a whole and to assist national development may not necessarily be compatible with the duty to protect the rights of indigenous peoples. National development and economic pragmatism may require the exploitation of resources situated on traditional lands, and whilst compensation or profit-sharing may be accorded to the people on whose lands the resources are situated, this does little to mitigate the damage caused by the destruction of traditional hunting grounds, social structure and lifestyle often attendant upon such "development." Moreover, the obligation of the State to utilize its natural resources for the well-being of its population may also conflict with the

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[36] Schrijver, op. cit., 308-319.

duties of a State to co-operate with other States for the purposes of global development and to act fairly towards FDI investors. These latter duties are discussed below.

The Duty to co-operate for international development

The increasing trends toward globalisation, the growing interdependence of autonomous States and the consolidation and augmentation of regional and economic blocs such as the EU, OPEC and ASEAN, has imposed upon States a greater necessity to consider the impact upon the global economy of the manner in which they exercise permanent sovereignty over their natural resources. International instruments such as the GATT, the UN Conventions and the ECT itself, stress the need for long-term co-operation between States to achieve global economic development.

The various energy crises of the latter half of the twentieth century provide examples of how States are able to use their natural resources, especially energy resources, for political and/or economic advantage at the expense of those nations dependant upon these resources. Similarly, the destruction of old-growth and tropical rain forests for timber in Asia and Latin America which has contributed significantly to global climate change and present a stark example of States exploiting natural resources for national economic development to the detriment not only of their own population's well-being but also to the global community. Therefore, the exploitation of natural resources must involve a fine balance between domestic and international interests.

The Duty to treat FDI investors fairly

The duty of a State to treat FDI investors fairly and equitably in regard to the exploration for and exploitation of natural resources raises a number of issues.

Firstly, the host State must not exercise its right to expropriate or nationalise foreign investments in natural resources capriciously. If foreign property is expropriated or nationalised, the State must provide the investor with adequate compensation.

Secondly, the host State must not engage in arbitrarily discriminative conduct towards foreign investors, either as regards the treatment of foreign vis a vis domestic, or other foreign investors. Prescriptions that certain foreign investors should be treated equally with national and/or other foreign investors are generally contained in bi-r multilateral treaties dealing with trade and investment and, as such, are subject to negotiation.

However, as with the issue of consideration of global interests, the duty of the host State to treat FDI investors equitably often involves a balance between the national interests and those of the foreign investor. For example, equal treatment accorded to wealthier, more efficient foreign enterprises may work to the disadvantage of domestic concerns in that the foreign entity is able to out-compete, outsell and eventually oust the national enterprise. Thus, the encouragement of FDI may serve to repress rather than assist domestic economic development.

Therefore, whilst both the duties to exercise permanent sovereignty so as to encourage international development and to treat foreign investors fairly are significant obligations, they may also be inconsistent with the national interests of the State. In such situations, therefore, the right to exercise discretion as to how these conflicting duties are resolved is inherent in the overall concept of State sovereignty. However, in regard to the ECT, these duties are imposed upon Contracting parties through the provisions of Parts I, II and III, which mandate economic co-operation and the protection of FDI in the energy sector. Although these prescripts are of significance to resource rich Contracting Parties, especially FSU states, in general they do not impose undue burdens upon the wealthier signatories since the duties to co-operate economically in a global context and

protect FDI are common features of other bi- and multilateral treaties and trade agreements. What is material, however, is the impact of the ECT provisions upon the discrete rights implied by the notion of permanent sovereignty over natural resources and the duties of the State to exercise permanent sovereignty for the benefit of the population and national development and to consider the well-being of indigenous / minority populations. These aspects of the effects of ECT upon permanent sovereignty over natural resources are discussed below.

The Impact of the ECT upon Permanent Sovereignty over Natural Resources

Introduction

Certain provisions of the ECT have significant impact upon both the rights and duties implicit in the concept of permanent sovereignty over natural resources. Prior to the examination of this impact, however, it is important to note that the provisions of the ECT are couched in terms which imply that for the purposes of the Treaty, permanent sovereignty is presumed to be vested in the Contracting Party, i.e., the State or nation as a whole. This is not always the case. Some States are organised and operate according to a federal structure, i.e. the rights and duties of government are divided between the State and individual autonomous regions. For example, Australia, is a Federation of independent states, in which the Federal or Commonwealth Government is responsible for those matters affecting the country as a whole, such as defence, foreign affairs, overseas trade, whilst the individual states administer matters related to internal affairs, such as education, health and transport. Naturally, the division of powers pursuant to the Constitution is not rigid. Some of revenue raised by the Commonwealth from the taxation and other imposts is distributed to individual states for health, education, welfare etc. However, the rights to land, and thereby the rights to natural resources, are divided between the Commonwealth and the individual states, all of which are referred to loosely as "the Crown." Thus, whilst minerals found on land vested in the individual states are

reserved (belong) to the Crown in the guise of the state government, minerals found on Commonwealth land are reserved to the Crown in the guise of the Commonwealth. Therefore, in Australia, it is very arguable that the Commonwealth exercises permanent sovereignty solely over those minerals found on Commonwealth land. Permanent sovereignty over the remainder vests in the individual states.

The significance of this facet of the ECT will be explored in greater detail in Chapter XIV below, in relation to the impact of the Treaty upon Australian energy resource exploration and development. The discussion below, therefore, will address the issue of the effect of the provisions of the ECT in more general terms, whilst a summary of this impact is presented in Table 6.

Provisions of Article 18, Sovereignty over Energy Resources

The ECT purports to recognise sovereignty over energy resources through the inclusion of Article 18. Article 18 provides that Contracting Parties "recognize state sovereignty and sovereign rights over energy resources" (1). Accordingly, the rights acknowledged by the Treaty as being inherent in sovereignty over energy resources and as set out in Article 18(3) are the rights:

> to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises.

Moreover, paragraph (2) provides that: "the Treaty shall in no way prejudice the rules in Contracting Parties governing the system of property ownership in energy resources." Ostensibly, therefore, Article 18 appears to present an affirmation of the principle of permanent sovereignty over natural resources. On closer examination, however, this is not the case in that Article 18 offers a severely attenuated and thereby limited version of the concept through qualification and implicit restriction imposed by the language in which the provisions of the Article are expressed.

Firstly, Article 18 circumscribes the notion of permanent sovereignty by hedging the apparently comprehensive pronouncements of paragraphs (1), (2) and (3) with qualifications and reservations. Thus, in paragraph (1), whilst recognizing sovereignty, it must nevertheless be "exercised in accordance with and subject to the rules of international law." However, no definition of "international law" is offered, i.e. whether the phrase relates to treaties, bi- or multilateral agreements or precedents expressed in case law, and it is therefore open to interpretation.

Furthermore, paragraph (2) qualifies its injunction that a Contracting Party's "system of property ownership of energy resources shall not be prejudiced" by the caveat this will only apply to the extent that the system does not vitiate "the objectives of promoting access to energy resources and exploration and development thereof on a commercial basis ... ." This implies, therefore, that in circumstances in which the system of property ownership of a Contracting Party is in conflict with the objectives of the Treaty, the latter shall prevail.

Moreover, paragraph (4) obliges Contracting Parties "to facilitate access to energy resources, inter alia, by allocating in a non-discriminatory manner on the basis of published criteria authorizations, licences, concessions and contracts to prospect and explore for or to exploit or extract energy resources." Whilst this provisions requires a reasonable level of transparency in the granting of permits, etc. in regard to energy resources, it also mandates national/MFN treatment for potential FDI

projects, thereby severely curtailing the discretion of a host Contracting Party to determine the conditions under which an FDI project is approved.

Secondly, the nature and extent of the concept of prerogatives over energy resources is circumscribed by the terms in which it is designated. The Article refers to mere "sovereignty" and not "permanent sovereignty" over energy resources. There is, it is argued here, a marked distinction between the two nomenclatures which has a significance beyond semantic quibbling. As discussed supra, a right which is "permanent" is inalienable, unassignable and immutable. It is a right which cannot, under any circumstances be abrogated or transferred on a permanent basis. Whilst the holder of a "permanent" right may temporarily grant an entity permission to exercise control over the object of the right, the ownership and legal interest in the object remains with the grantor. On the other hand, the use of the term "sovereignty" without the qualification "permanent" connotes a right, title and/or interest which may be subject to alienation by assignment or waiver.

Thus, it is argued here, that in Article 18, the use of the term "sovereignty," without the usual[37] qualification of "permanent," is an attempt by the drafters of the ECT to read down the cogency of the concept by nominally divesting sovereignty of its inalienable quality. Thus, by omitting "permanent" from the description of the nation, the ECT acknowledges merely an evanescent attribute rather than an immutable prerogative of sovereign statehood. When viewed within the context of the ECT as a whole, the effect of this "sleight of hand" is to place any breaches of permanent sovereignty in energy resources arising from either the implications or application of other provisions of the Treaty, beyond challenge by disaffected (and dispossessed) Contracting Parties.

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[37] "Usual" in the sense that "permanent sovereignty" is the expression used to denote inalienable rights in natural resources in both international law and other international instruments.

Thirdly, Article 18 merely recognizes sovereignty over "energy resources." As discussed supra, the term "natural resources" includes not simply minerals, but also flora, fauna and ecosystems. The ECT, therefore, recognises a specie of sovereignty solely over energy resources. Flora, fauna and ecosystems do not come within the ambit of the Article. Moreover, neither Article 19 nor the Protocol acknowledge sovereignty, permanent or otherwise, over the natural environment beyond the politically correct exhortations in regard to sustainable energy resources and development.

When examined closely, therefore, the practical effect of Article 18 belies its apparent intention. Rather than acknowledging that the application of other provisions of the ECT are subject to the exercise by Contracting Parties of their permanent sovereignty over natural resources, Article 18 both detracts from the force of the concept and subsumes it to the ulterior and avowed objectives of the Treaty. The notion of permanent sovereignty over natural resources acknowledged by the ECT is a very poor shadow of the substance of prerogatives enshrined in international law. It is because of this attenuation of the concept that the litany of "rights" recited in Article 18(3) are abrogated by the other provisions of the Treaty. The discussion below will therefore address the impact of the ECT upon the various prerogatives inherent in the concept of permanent sovereignty over natural resources.

Effect upon the right to dispose freely of natural resources

As discussed above, the right to dispose of and/or exploit natural resources includes the absolute discretion of the State to manage its natural resources howsoever it thinks fit. Thus, the imposition of environmental protection legislation, the designation of geographical areas available for resource exploration and exploitation and the regulation of the methods by which energy resources are extracted are inherent in the concept of permanent sovereignty. Whilst these rights are recited in

Article 18(3), they are circumscribed, if not abrogated by other provisions of Treaty.

In addition to the reservations expressed in Article 18(2) and (4) in regard to the exercise of sovereignty over energy resources, Article 19(1) places a caveat upon environmental protection regulations by providing that any such scheme must be both "economically efficient" and "cost effective." Whilst this prescription may appear to be a contingent or even trivial incursion into the prerogatives of permanent sovereignty, "sovereignty" as a concept *per se* is absolute, either it exists or it does not exist. Arguably, therefore, in a situation in which a Contracting Party needs to consider the imposition of environmental protection and resource exploitation regulations, it must also consider whether the nature of the regulations will render it in breach of the Treaty and/or are open to challenge by potential FDI investors. Thus, if the freedom to manage natural resources (including flora, fauna and ecosystems) is abrogated then permanent sovereignty is also abrogated.

Effect upon the Right to Control FDI

It is argued here that the bundle of rights in regard to FDI conferred by permanent sovereignty constitutes a major target of the provisions of the ECT. The freedom and ability of a State to regulate FDI within its territory are not merely concomitant prerogatives of permanent sovereignty, but are also, in practical terms, essential to the economic development and well-being of a State. The ability of a State to protect local economies and domestic enterprises and the exercise of the right to preserve its economic autonomy from the incursions and influence of powerful and often unscrupulous multinational commercial entities are particularly important to developing nations. The ECT, however, imposes significant restrictions on the ability of a host state to control FDI within its borders.

In regard to FDI in energy infrastructure and transit, Article 7 requires a Contracting Party to accede to requests by foreign investors to develop or improve energy transit

facilities within the Contracting Party's territory. Failure to comply with such a request will render the Contracting Party in breach of the provisions, unless it can be proved to the "other Contracting Parties concerned" that such new or upgraded facilities would adversely affect domestic energy supplies (Article 7(5)). Therefore, neither the protection of sensitive ecosystems nor the safety of the population of the State would constitute a sufficient reason for or defence to the refusal of a request pursuant to Article 7.

Similarly, the right to control and exercise authority over FDI in the energy sector by a host State through the imposition of trade-related, investment and foreign exchange regulations are severely circumscribed by the ECT.

As previously discussed, both Parts II and III provide extensive and stringent protection for FDI from potential host state attempts at FDI regulations. Article 5 prohibits any trade-related measures designed to protect domestic enterprises by imposing domestic purchasing requirements and import restrictions. Article 9 prescribes open access for investors to capital markets, whilst Article 14 demands the freedom of transfer of capital related to FDI in the energy sector. The host State Contracting Party is thereby denied the ability both to regulate the access of FDI investors in the energy sector to its domestic capital and its foreign exchange markets.

Further, Article 13 abrogates the right of a host State Contracting Party to resume control through expropriation or nationalisation of energy resources subject to FDI, unless the expropriation is in the public interest, is non-discriminatory, is effected through the due process of law and is accompanied by the payment of "prompt, adequate and effective compensation" (Article 13(1)). Whilst the above requirement may appear reasonable in that the provisions of Article 13 ostensibly do little to infringe the right of a Contracting Party to reassert its title over energy resources, in the possession and control of a foreign investor, it should be noted that

expropriation may only take place if it is "in the public interest." Although not defined in the Treaty and despite the resultant uncertainty of meaning, the term "public interest" arguably connotes situations of national emergency alone, and implicitly excludes expropriations pursuant to changes of government policy. Thus, should a host State Contracting Party government determine that all energy resources within its territory should be exploited solely by the State for the sole benefit of the people, any expropriations carried out pursuant to this determination could be held to be in breach of the Treaty.

Moreover, although the prescripts of Article 13 recite the principles relating to expropriation enunciated in the IMS discussed above, when read in the context of other obligations imposed by the Treaty upon host states, together with the implied restricted ambit of the concept of sovereignty over energy resources, the impact of the Article goes beyond the notions of fairness and equity propounded by the IMS and becomes oppressive. In effect, therefore it is arguable that Article 13 purports to abrogate the inalienable right and title of Contracting Parties to the energy resources within their territories.

In addition to the abrogation of rights, the provisions of the ECT impact upon the duties attendant upon the exercise of permanent sovereignty over natural resources by curtailing the ability of Contracting Parties to fulfill their obligations in regard to the exploitation of energy resources. A brief examination of this aspect of the ECT is presented below.

Duty to exercise permanent sovereignty for the benefit of the population and national development

As mentioned supra, the proposition that it is the duty of a state to exercise permanent sovereignty for the benefit of its population and national development would appear to be axiomatic. The State is the embodiment of the people, therefore the population is entitled to expect that the natural resources of their country will be

used for their benefit. Even taking into account the duty of a State to co-operate with other nations in the interests of global development, it would not be unreasonable to assume that the duty to ensure the well-being of the people would take priority.[38] Accordingly, in circumstances in which a foreign investor benefits from the exploitation of a natural resource rather than a domestic entity, there are a number of ways in which the host State government is able to glean some advantage from the FDI project for its population, viz:

- the imposition of trade-related measures;
- the imposition of taxes, tariffs, levies and other imposts;
- the imposition of restrictions upon employment of foreign nationals;
- foreign exchange and capital inflow/outflow controls.

By means of trade-related investment measures imposed upon a foreign investor, the State is able to both protect and encourage domestic industry. The requirement that foreign investors should purchase domestic goods and restrictions on foreign imports oblige a foreign investor to obtain supplies for a project from producers in the host State. Accordingly, the local economy is stimulated through higher employment, increased profitability of industry and, in many cases, improvements in infrastructure. Therefore, although the profits from the FDI project may benefit a foreign entity, the local population, theoretically, reaps flow-on advantages. However, Article 5 of the ECT prohibits the imposition of such measures, thereby denying the host State Contracting Party and ultimately, the local population the potential benefits which might accrue from the exploitation of their natural resources by a foreign entity.

Similarly, the imposition of taxes, duties, tariffs and other imposts levied upon FDI projects in energy resources both provide the host State with a secure revenue source

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[38] Of course, this would occur, to quote Voltaire, in "the best of all possible worlds." Unfortunately in the most imperfect world, this does not happen and the well-being of the population often appears to be the last priority considered by a State in the exploitation of its natural resources.

and enable the government to recoup any losses caused by incursions of the project into local economies and environmental damage. Moreover, the levy of higher imposts upon an FDI project enables the State to raise revenue, whilst, at the same time, providing a measure of protection for domestic entities involved in the same or similar industries. However, Article 21 restricts the rate of imposts on FDI to national or MFN levels, whichever is the lowest. Although the host Contracting Party is, nevertheless, still able to raise revenue from FDI, the provisions of Article 21 both abrogate the discretion of the State as to the rate of taxation imposed upon FDI and, consequently, substantially curtails its potential to reap financial benefits from the project.

The imposition by the host State of restrictions upon the number and professional standing of foreign nationals employed by an FDI investor in a project are intended to assist in encouraging the development of the skills/professional base of the local population. Moreover, such restrictions on foreign employment also serves to stimulate the domestic employment market, with consequential beneficial flow-on effects for the local economy. Article 11 of the ECT, however, obliges a host state to permit the entry and residence of such foreign personnel as are necessary to the project. Although in the energy sector such key personnel are generally members of the higher echelons of management and the technical/scientific professions, the requirements of Article 11 substantially limits the opportunities for suitably qualified host State nationals to gain employment in the energy sector, thereby retarding the development within the host State of a skilled/professional workforce in that sector.

Finally, the imposition by a host State of foreign exchange controls and capital inflow/outflow restrictions in relation to FDI both protect the exchange rate of the domestic currency and assist in building foreign and domestic currency reserves. Article 14, however, prohibits controls on the transfer of capital related to FDI projects. This, in essence prevents the host State from deriving the benefits of such

controls, including the stabilisation of exchange rates, inflation control and lowering of interest rates.

The provisions of the ECT, therefore, severely hamper the host State Contracting Party in the execution of its duty to exploit natural resources for the benefit of its population and national development. In view of the fact that the original major objective of the Treaty was declared to be the assistance of FSU states through the encouragement of FDI in the energy sector, this result must appear to be anomalous. However, if, as is argued in this dissertation, the sole purpose of the ECT is to achieve economic and secure energy supplies for the EU, the adverse impact of the ECT upon the potential profitability of FDI in energy resources for the host State is less surprising.

Duties to Consider the Rights and Interests of indigenous Peoples

A corollary to (and some might say, a caveat upon) the duty of a State to exploit permanent sovereignty over natural resources for the benefit of the population and national development, is the duty to consider the rights and interests of indigenous populations. Although, as noted above, these duties may conflict, the State is nevertheless empowered with the discretion to determine how such contradictory obligations might be reconciled. It is, therefore, a matter of domestic legislation/law and government policy. Moreover, the increased awareness in developed countries of the plight of indigenous people and ethnic minorities, together with corresponding assertion of rights and movements for self-determination has resulted in these countries of greater recognition by governments of indigenous and minority claims.[39]

Article 23 of the ECT, however, requires Contracting Parties to ensure that regional and local governments and authorities within its territory comply with the provisions of the Treaty (Article 23 (1)). This is achieved by rendering the Contracting Party

[39] For example, successful claims by Native Americans it he United States and Canada, Maoris in New Zealand and Aboriginals in Australia.

vicariously liable for any breaches by a regional/local government or authority (Article 23(2)). In energy sector agreements formed pursuant to the ECT, the State is a Contracting Party. Where such agreements are concluded in regard to energy resources on lands to which indigenous peoples hold title, the government of the Contracting Party is therefore obligated to ensure that the title holders co-operate fully with the FDI project. If the co-operation of the traditional owners is not forthcoming, the Contracting Party is faced with the necessity of either abrogating the rights of the indigenous people or remaining in breach of the ECT. Further, although Article 24(2)(iii) provides that the provisions of the Treaty shall "not preclude any Contracting Party from adopting or enforcing any measure ... designed to benefit investors who are Aboriginal people ... ." the exception applies only to indigenous people who are investors. The Article does nothing to protect the rights of traditional land owners, nor does it acknowledge the existence of legal, social, cultural or religious interests. Consistent with the rest of the Treaty, it is economic interests which are predominant.

Conclusion

As may be gathered from the foregoing discussion, it is argued here that the provisions of the ECT impact negatively upon the sovereignty of Contracting Parties. The legislative/constitutional and territorial sovereignty, as well as permanent sovereignty over natural resources, inherent in the notion of sovereign Statehood are all subsumed to the overriding objectives of the ECT. Moreover, as argued previously, sovereignty as an absolute concept cannot be "merely" infringed. If a State is prevented by influence from an external entity from the unfettered exercise of the powers conferred by sovereignty, that sovereignty is revoked. Of course, it could be argued that the Contracting Parties entered freely into the Treaty that by signing and, in the majority of instances, ratifying the instrument, participants willingly waived their sovereignty in the interest of the ECT objectives.

However, it is open to question whether the assent of some of the Contracting Parties, especially the impoverished FSU states was, in fact freely given.

Between 1991-1994, during the Energy Charter Conference and Treaty negotiation process, the concept of the ECT was presented to the FSU states on the basis that its **sole** purpose was to encourage and assist economic development in those States through FDI in the energy sector. Moreover, the greater economic parity between the FSU and EU states was touted as a *sine qua non* for a post-Cold War Europe. The provision of adequate, even abundant energy supplies to a energy-hungry EU was merely an ancillary benefit. Not surprisingly therefore, the incentive of substantial investment in their energy sectors and the resultant economic development offered to FSU states proved irresistible. Indeed, all FSU states except Russia have, to date both signed and ratified the Treaty.

It has been argued, that economic pressure and/or inducement could and should constitute coercion or duress sufficient to vitiate a Treaty. This view was argued by 19 Afro-Asian and Latin American nations during the debates of the Vienna Conference in 1968-69. The resulting Vienna Convention on the Law of Treaties ("the Vienna Convention") (1969) does not include economic pressure in Article 55 as constituting coercion. However, the Final Act of the Conference includes a Declaration which strongly condemns the use of threats or pressure of any kind by one State in order coerce another into concluding a Treaty on the basis that such action constitutes a violation of sovereign equality of states and the freedom of consent. Further, the Preamble of the Vienna Convention acknowledges (inter alia) the principles "of sovereign equality and independence of all States, of non-interference in the domestic affairs of States."[40]

Thus, it is arguable that the validity of the ECT is vitiated by a number of factors. Firstly, it would be possible to assert that the consent of FSU Contracting Parties to

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[40] Carter and Trimble, op. cit., 55.

the Treaty was not given freely on the basis that coercion in the form of strong economic inducements were provided to procure their agreement.

Secondly, if it is established that:

- a State became a party to the ECT on the basis that the sole purpose of the Treaty was to assist the economic regeneration and development of FSU states; and that
- the Contracting Party signed the Treaty on the strength of this representation; and
- the representation has subsequently been proven to be inaccurate and even false,

it is possible that the consent of the Contracting Party could be invalidated on the basis of either error or fraud.

Article 48(1) of the Vienna Convention provides that:

> A State may invoke an error in a treaty as invalidating its consent to be bound by the treaty if the error relates to a fact or situation which was assumed by that State to exist at the time when the treaty was concluded and formed an essential basis of its consent to be bound by the treaty."[41]

Thus, if a Contracting Party could establish that its predominant reason for signing and ratifying the ECT was the erroneous belief that the sole purpose of the ECT was to provide economic assistance to the FSU states, its consent to the Treaty could be invalidated.

Similarly, Article 49 of the Vienna Convention provides that:

> If a State has bee induced to conclude a treaty by the fraudulent conduct of another negotiating State, the State may invoke fraud as invalidating its consent to be bound by the Treaty.[42]

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[41] Ibid., 69.
[42] Ibid.

Thus, if it could be established that the EU states willfully and knowingly misrepresented the purpose of the ECT to the FSU states during the Conference and negotiation process, the consent of an FSU State could be invalidated on the basis of fraud. Certainly, in all press releases and Conference documents prior to the signing of the Treaty on 16 December 1994, its sole purpose was touted as being FSU economic assistance and development. The establishment of secure energy supplies for the EU in the twenty first century was very much a "hidden agenda."

Although it is interesting to speculate on the means by which Contracting Parties might escape the onerous and intrusive provisions of the ECT, the possible invalidation of a Contracting Party's consent can only be tested by a direct challenge of the Treaty. To date, this has not been done and the issue must remain, for the time being, in the realms of conjecture.

However, what is certain is that it is the EU states which receive most advantage from the Treaty. Contracting Parties such as the developing FSU states and non-European resource-rich signatories, such as Australia, are most affected by the draconian provisions of the Treaty, particularly the abrogation of sovereignty, as discussed above. It is those Contracting Parties which will constitute the host states for the purposes of contracts in the energy sector, whilst it is the investors of the EU who will reap the benefits of the stringent competition and investment protection regime and increase in energy supplies.

The following and final chapter of this dissertation will therefore examine the potential practical implications for Australia of membership to the ECT regime.

TABLE 3	
Articles imposing implicit obligations	
Article	**Area/s of Law Affected**
3	domestic and international commercial law, in particular, trade - practices and competition law, import/export law and regulations, exchange controls, securities law and regulations, property law
6(1)	trade-practices and competition law and regulation
7	transit and environmental law
8(1) and (2)	intellectual property law, competition law and policy, contract law, property law
9(1)	foreign exchange law and regulations, securities and corporations law and regulations, the creation of f/x and securities markets (if not already extant)
10(1)	investment protection law generally, corporations law, competition law
14	foreign exchange laws and regulations
18(1) and (4)	energy resources law
19	environmental protection regulations
21	revenue law
22	laws and regulations relating to the autonomy and accountability of SOEs and privileged enterprises
23	laws and regulations relating to the autonomy and accountability of regional and sub-government authorities

TABLE 4	
Articles imposing explicit obligations	
Article	**Area/s of Law Affected**
5(1)	import/export law and regulations, protectionist laws and regulations, trade practices laws and regulation
6(2)	Trade practices and competition laws including the establishment of appropriate fora and institutions for enforcement
8(1)	intellectual property law, property law in general
11(1)	immigration/residency laws
26	contract law and the abrogation of doctrine of privity (if extant)

TABLE 5	
Articles requiring changes to government policy	
Article	**Policy Area Affected**
3	competition, economic/fiscal, revenue
5	protectionist and fiscal
7	transit of potentially hazardous substances transit of third state goods across territory
8	competition, economic/fiscal, revenue, private v state property
9	free-market v command economy, foreign exchange, securities creation and competition, establishment of securities and f/x markets
10	investment protection, allocation/recognition of national/MFN treatment
12	provision of government guarantees and indemnities
13	privatisation/nationalisation
18	energy resources
19	environmental protection and sustainable energy
20	transparency of administrative procedures
21	revenue raising/fiscal policy
22	protectionist policies, privatisation
23	autonomy of sub-national groups and regional governments

TABLE 6	
Impact of ECT upon Permanent Sovereignty over Energy Resources	
Article	**Right / Duty Affected**
	(a) Right to dispose freely of energy resources
7 and 19	• to impose environmental protection regulations • to designate territorial areas available of exploration / exploitation. • to regulate the methods by which energy resources are exploited.
	(b) Right to control FDI in energy resources.
7	• right to regulate admission of FDI
5-9-11-4	• right to exercise control and authority over FDI.
13	• right to expropriate / nationalize
5 and 21	*(c) Duty to exercise permanent sovereignty for the benefit of the population and national development.*
24	*(d) Duty to consider the interests of indigenous populations.*

PART IV

IMPLICATIONS OF THE ECT FOR AUSTRALIA

CHAPTER XII

INTRODUCING AUSTRALIA AND ITS ENERGY RESOURCES

Introduction

The implications of membership of the ECT regimen are perhaps most vividly demonstrated by reference to the impact of the Treaty provisions upon a particular Contracting Party. Whilst speculative discussion may highlight the manner in which certain obligations and principles operate in theory, it is only through an examination of their application to a specific illustration that the consequences of ECT subscription can be appreciated. Accordingly, Australia has been chosen to illustrate the various effects of the ECT discussed in the previous chapters upon the legal, administrative and commercial systems of a Contracting Party. Although an "outsider" to the EU and Eastern European blocs, it is argued here that Australia is an appropriate choice for a case study for a number of reasons.

Firstly, Australia is a signatory to the ECT. To date, however, the Treaty has not been ratified or acceded to by the Commonwealth Parliament. This situation raises important issues as to the enforceability of the Treaty against Australia and Australian entities involved in energy resource exploration and exploitation.

Secondly, Australia possesses a wealth of energy resources such as coal, oil, natural gas and uranium oxide, as well as an established sugar cane growing industry in North Queensland which would be suitable for the production of ethanol. All of the above energy resources, apart from ethanol, are exported and therefore subject to agreements which may be caught by the provisions of the Treaty.

Thirdly, Australia has other natural resources in abundance, particularly sensitive ecosystems of great beauty. Unfortunately, some of the deposits of energy materials, such as uranium oxide and natural gas, are situated in the midst of these delicate

natural environments. The exploration and extraction processes needed to exploit these resources have the potential to cause considerable damage to the ecosystems in which they are found, thereby posing problems for the Commonwealth and State/Territory governments vis a vis achieving a balance between environmental protection and resource exploitation.

Fourthly, Australia's population includes a minority indigenous people, the Aboriginals. In the last decade of the twentieth century Aboriginals were finally accorded limited land rights and title over traditional lands. However, many of the areas subject to Aboriginal title and claims also contain energy resources. The conflict of rights, i.e. between aboriginal entitlements and Commonwealth and State/Territory grants of exploration and mining licences, that this presents and the ultimate resolution of the conflict could be adversely affected by Australia's position as a Contracting Party to the ECT.

Further, Australian governments and corporations have been and continue to be, parties to energy sector contracts with entities and governments of other Contracting Parties. Not only are oil, liquid natural gas, coal and uranium ore exported to Japan and EU member states, but also the Commonwealth government, through the aegis of the Australian Geological Survey Organisation, has formed a joint venture with TGS-Nopec [1] to conduct seismic exploration for oil on the Great Barrier Reef in Commonwealth waters.[2] Therefore, as a major source and exporter of energy products and materials to other Contracting Parties, the obligations imposed by the ECT have particular relevance to Australia.

Finally, Australia is a Federation of autonomous States and Territories. Therefore, there arises the possibility of conflict between the obligations of the Commonwealth

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[1] A multinational corporation based in Houston, Texas, but listed on the Oslo Stock Exchange.

[2] Australian Conservation Foundation Media Releases, 23 January 2001 and 30 January 2001.

government as a Contracting Party and State rights, a conflict which has the potential to impact upon the constitutional division of powers between Federal and State governments.

Chapter XIII will therefore examine the effects of the ECT upon the potentially contentious areas listed below:

- the enforceability of the Treaty against the Commonwealth;
- Commonwealth liabilities v State/Territory rights;
- Aboriginal title to traditional lands;
- protection of sensitive and unique ecosystems and resources exploitation.

However, before these issues are addressed, it would be of assistance to present a brief description of the nature and extent of Australia's energy resources, followed in Chapter XIII by an explanation of what appears to be the Commonwealth's understanding of and attitude towards its obligations pursuant to the ECT.

Australia's Energy Resources

Australia has vast coal, oil, natural gas and uranium oxide deposits, the exploitation and export of which contribute significantly to GDP. Coal (at A$8.33 billion) and oil and gas ($A7.85 billion) alone represent Australia's fourth and fifth most profitable exports after nonferrous metal manufacturing, metal ores and agricultural products.[3] Whilst Australia's major trading partners are currently Japan, the US and China, a Department of Foreign Affairs and Trade ("Defat") *Report on the Composition of Australian Trade: 1999-2000*, released in October 2000, predicted a marked shift in the direction of exports away from Asia to the EU, particularly in the area of energy resources. A brief description of each of Australia's energy resource exports is presented below.

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[3] Australian Bureau of Agriculture and Resource Economics Statistics 2001, quoted in *Business Review Weekly*, **23** (11), 23 March 2001.

Coal

Australia is the largest exporter of coal in the world, exporting 189 million short tons (Mmst) in 1999, and has estimated recoverable reserves of 52 billion short tons (bst) of black and 47 bst of brown coal primarily situate in two States, New South Wales and Queensland. Australian coals have low sulfur and phosphorus content making them if not "greenhouse friendly," at least marginally less environmentally harmful than coals found in most of the deposits of Europe and the FSU. Indeed, 15% of Australian coal exports are to Europe.

In December 1993 Australia and the EU entered into the Australia-EU Coal Agreement, pursuant to which the EU agreed progressively to reduce coal subsidies so as to encourage Australia coal exports to the EU. In return, Australia undertook that it would not:[4]

- impose export measures on coal;
- develop or apply barriers to FDI in the coal industry; and
- invoke WTO provisions on coal policies against the EU for the duration of the agreement.

During the EU-Australia Coal Conference in Aachen, Germany on 24-25 September 2001 it was agreed to extend the duration of the agreement to the end of 2002. In addition, NSW, Queensland and Germany entered into the Aachen Declaration pursuant to which the respective governments agreed to expand coal research - exchange and strengthen trade links between coal industries.[5]

Oil

Australia's proven oil reserves (excluding shale oil) in January 2001 were estimated at 2.9 billion barrels. Whilst insignificant in comparison to the vast reserves of some Middle Eastern, Latin American and South-East Asian countries, exploitation

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[4] Department of Foreign Affairs and Trade ("Defat") Media Release, 28 September 2001.
[5] Ibid.

of Australia's oil reserves is substantial enough to contribute significantly to GDP and attract both domestic and overseas entities to invest in exploration and development projects.

The major oil producing regions in Australia are the Bass Strait, Victoria, and the North West Shelf (the Carnarvon Basin) off north-western Western Australia. Oil exploration and development investment is also taking place in the Timor Sea, whilst a project is under way to exploit shale-oil deposits (an estimated 3 billion barrels) in Queensland. Also, as noted above TGS-Nopec is currently surveying the Great Barrier Reef off Townsville in North Queensland, for further oil reserves.

Gas

As of January 2001, Australia has proven reserves of natural gas of 44.6 trillion cubic feet with substantial deposits being found in the Northern Territory and all states except Tasmania. The largest developed fields are in the North West Shelf, Western Australia, although there are also substantial off-shore reserves in the Bass Strait/Gippsland Basin of Victoria and on-shore deposits in the Palm Valley natural gas field in the Amadeus Basin near Alice Springs in the Northern Territory and the Cooper Basin in Queensland/South Australia /New South Wales. Australia is also the third largest exporter of liquid natural gas (LNG) in the Asia-Pacific region with approximately $A1.5 billion (FOB) worth of exports annually.[6]

Uranium

Australia has over one quarter of the worlds known uranium oxide reserves. In 1999-2000 8,023 tonnes of uranium ore concentrates were exported: a quantity sufficient to produce electricity for 45 million people. However, since 2000 the amount of uranium oxide exported has steadily increased, so that for the half-year 1 January - 30 June 20002 7366 tonnes had already been exported, 39% of which was

[6] Natural Gas becomes liquid at -161°C. LNG is more suitable for shipping since in its liquid state it occupies only 1/600 of the space of natural gas.

sold to Japan, 36%[7] to the US, 11% to South Korea, 9% to the EU and 5% to Canada.[8]

Uranium oxide deposits are found in New South Wales, South Australia, Queensland, Western Australia and the Northern Territory. The two major mines are the Ranger Mine in the Northern Territory and the Olympic Dam Mine, South Australia. The Jabiluka Mine, situated in the Kakadu National Park in the Northern Territory, was estimated to contain Australia's largest reserves and highest quality uranium oxide ore. However, the development of the mine was halted in early September 2002 after many years of public protest against the environmental damage caused by the contaminated run-off and tailings from the mine.

Conclusion

In view of the quantity and quality of Australia's energy resources, its stable political milieu and reliable track-record in energy resource exports, it is hardly surprising that the EU was anxious for Australia to become a Contracting Party to the ECT. Secure coal, oil, natural gas and uranium supplies are crucial to the economic development and viability of the EU in the twenty first century.

However, despite Australia's involvement in the ECT process since the first Energy Charter Conference in December 1991, it is arguable that the Commonwealth government is not fully aware of the obligations imposed by virtue of its position as a signatory nor the potential implication of its role as a Contracting party upon domestic legislative and constitutional issues. Indeed, as discussed in the Chapter XIII below, it would appear that the Commonwealth government is in total ignorance of the potential ramifications of its obligations pursuant to the ECT. No official communiqué regarding the ECT has even hinted at the possibility that

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[7] Japan, a major energy resource trading partner of Australia, deposited its instrument of ratification of the ECT on 25 October 2002.

[8] Figures from Defat, op. cit..

membership of the ECT regime might have not only potential disadvantages for Australia and its energy resource sector, but that it could have disastrous consequences for Commonwealth/State rights, Aboriginal land rights and the environment.

CHAPTER XIII

AUSTRALIA AND THE ECT

Introduction

When Australia signed the ECT in December 1994 it was one of the few non-European/Eurasian States to become a party to the Energy Charter Conference process. With its apparently limitless mineral and energy resources, including oil, natural gas, coal and uranium, Australia's participation in the ECT regime has made available to EU nations the potential to procure energy products and resources pursuant to the rigid investment provisions of the Treaty. Whilst Australian entities had entered into agreements to supply energy resources to EU countries prior to 1994, the terms of such agreements had been circumscribed by Australian Commonwealth and State regulations, tarriff/levy structures, and government protectionist policies.

It is arguable, however, that any agreements executed between Australian and European entities for the exploration or supply of energy resources and products are caught by the provisions of the ECT. The advantages of such a situation to EU parties is obvious. The restrictions placed upon and regulation of energy resource exploration and exploitation by foreign entities by Commonwealth and State governments are automatically mitigated by the various national/MFN treatment requirements of the Treaty without the necessity of negotiating separate agreements. The investment protection provisions ensure the continuing supply of the subject resource upon secure and immutable terms irrespective of changes in Commonwealth and State government trade policy. Moreover, the vicarious liability of the Commonwealth government imposed by Article 22 and the Dispute Resolution provisions of Article 26, provide EU investors in the energy sector in

Australia with immediate recourse to the Commonwealth for any breaches of the ECT by state or autonomous regional governments.

The benefits of the ECT, as has been discussed previously, are therefore weighted exclusively in favour of the investor, with little or no advantage accruing to Australia in terms of either resource protection or increased revenue potential. However, on reviewing the Commonwealth government literature in regard to the ECT, particularly the briefings released by Defat, which was responsible for the negotiations and signing of the Treaty, it appears that neither Defat nor the State governments are aware of the implications of signing the ECT. In effect, it is possible that the ECT is applicable to all agreements concerning Australia's energy resources concluded with entities from the EU and other Contracting Parties since 1998.

The ECT: A Dubious Benefit

In Defat's *European Union Brief* of 31 July 2002[9] it is stated that the ECT was signed by the Commonwealth government "following extensive consultations with Australian industry and State and territory government." It goes on to state that "Australia is yet to ratify the Treaty, but retains observer status in the organisation [i.e. is a member of the Energy Charter Conference]." Moreover, "the ECT contains investment protection and trade provisions relating to the energy sector which would be of benefit both to Australia exporters of energy products and to companies seeking to invest in the energy sectors of other Contracting Parties of the Treaty."[10] These blandly optimistic assertions regarding the Treaty should indicate a major cause for concern and signify a profound misunderstanding by Defat of both the practical effects of the provisions of the ECT and Australia's position vis a vis other Contracting Parties arising from its role as both a signatory of the Treaty and member of the Charter Conference.

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[9] www.dfat.gov.au/geo/europeanunion/eu_brief.hotmail.
[10] Ibid., 2.

Firstly, whilst the application of the provisions of the Treaty may indeed benefit Australian corporate investors in the energy sector, such as BHP-Billiton, which may wish to enter into energy sector investment agreements in FSU states, it is highly unlikely that either Commonwealth or State/territory governments will be in a position to reap substantial financial benefits from energy sector agreements with EU entities.

Secondly, from the statements quoted supra, it appears that Defat is totally ignorant of the obligations accepted by the Commonwealth upon signing the Treaty and the impact those obligations could have upon Australia's domestic laws and governance, Commonwealth and State/territory relations, Australia's sensitive ecosystems and environmental protection legislation and indigenous land rights.

Moreover, there is a tendency to regard the ECT as a Eurocentric instrument, possibly because the original title was the European Energy Charter Treaty and its disclosed objective was initially to promote economic growth through FDI in the energy sector of FSU states. However, it must be remembered that the ECT applies to all agreements in regard to energy supplies between all states who are currently signatories, including Australia, and those States which become signatories in the future. Therefore, the effect of the ECT upon Australia is not limited to energy sector contracts entered into with EU states but applies equally to agreements with Japan and any future signatories to whom Australia exports energy supplies and products.

Essentially, Australia's obligations depend initially upon the legal effect of its position as a signatory of the ECT. It appears from the Defat statement quoted supra that the Commonwealth government is labouring under the impression that the provisions of the Treaty are only effective after ratification. However, as argued in the following section, this impression is possibly erroneous.

Australia's Obligations as a Signatory

Objections to ECT Provisions: Too Little too Late?

As noted above, Australia signed the ECT, together with other participants in the Energy Charter Conference, on 17 December 1994, but it has not, to date, ratified the Treaty. The reasons for the failure to ratify are uncertain. There are no indications to be found in Energy Charter Conference documents, Commonwealth government or Defat briefings. However, despite the lack of explication, it is possible to discover clues to this reluctance in Australia's position during the negotiations regarding the proposed Supplementary Treaty and the reservations relating to Australia set out in certain ECT Annexures.

During the negotiations on the Supplementary Treaty, Australia, together with Iceland and Norway, demonstrated strong opposition to the application of Articles 26 and 27 (Dispute Resolution) to the provisions of the Supplement. Subject only to certain Reservations, Understandings and Declarations, the Supplementary Treaty attempts to impose an obligation upon Contracting Parties to undertake privatisations and demonopolisation in their energy sectors. Moreover, it contains a number of significant provisions which extend the operation of the national/MFN treatment requirements of the ECT so as to render national/MFN treatment for the admission of FDI legally binding and thereby subject to legal control.

Australia's objections to the Supplementary Treaty to relate to the application of the investor-Contracting Party dispute resolution procedures of Articles 26 and 27 to a refusal by a potential host state to apply mandatory national/MFN status to the admission of new FDI.

Australia's reluctance to accept the dispute resolution provisions of the ECT is further emphasised by the reservations contained in three Annexes to the Treaty, viz,

ID, IA and P. Pursuant to Annex ID, Australia (and 24 other Contracting Parties) is not required to allow investors to resubmit a dispute to international arbitration which has been determined by a domestic court or tribunal.

Annex IA lists Contracting Parties, including Australia, who do not consent to an investor (Article 26(3)(c)) or a Contracting Party (Article 27(2)) being allowed to submit a dispute involving the last sentence of Article 10(1) to international arbitration. Article 10(1) states that "Each Contracting Party shall observe any obligations it has entered into with an investor or an investment of an investor or an investment of an investor of any other Contracting Party." In effect, therefore, Annex IA enables Australia to retain disputes arising from the promotion, protection and treatment of energy sector investments provisions of the Treaty within the jurisdiction of domestic tribunals. However, it should also be noted that the reservation also applies to disputes with other Contracting Parties by virtue of the reference to Article 27(2). It is suggested here that it is unlikely that another Contracting Party involved in a dispute with Australia would consent to an adjudication of issues by an Australian tribunal and would insist, probably successfully, that the dispute be referred to an international tribunal as being a more appropriate forum. Moreover, pursuant to s51 (xxix) of the Constitution [11] the Australian tribunal will be bound to apply the provisions of the Treaty.

Finally, Annex P relates to Article 27(3)(i), the resolution of disputes between Contracting Parties pursuant to Article 23 and which provides that "where in making an award a tribunal finds that a measure of a regional or local government or authority within the area of a Contracting Party listed in Part I of Annex P is not in conformity with this Treaty, either party to the dispute may invoke the provisions of Part II of Annex P." Only Australia and Canada are listed in Part I of Annex P. Part II provides a precise procedure for the enforcement of a tribunal finding made pursuant to Article 27. This procedure allows for a lengthy compliance timetable

[11]Discussed at length at 371 below.

supervised by the Charter Conference. The flexibility for compliance conferred by Part II serves to provide the party in default with sufficient time to place pressure upon the regional or local government or authority to revoke or rectify the offending measure.

It would appear, therefore, that Australia's major objections to the ECT are centred upon the dispute resolution procedures of Articles 26 and 27, particularly in relation to:

- the resubmission of disputes adjudicated by domestic tribunals to international arbitration;
- the international arbitration of disputes arising from the promotion, protection and treatment of energy sector investments; and
- the immediate enforcement of determinations in disputes brought pursuant to Article 23.

Despite Australia's notification of its reservations regarding the Dispute Resolution provisions and the inclusion of these in the Annexes of the ECT, it is evident from the Defat statement quoted supra regarding Australia's "observer status," that the Commonwealth regards itself merely as a member of the Charter Conference without being subject to the obligations imposed by the Treaty regime. It is argued here that this is a misunderstanding of Australia's position vis a vis the ECT. Rather than being a mere "observer," as a signatory Australia is bound by obligations and liabilities imposed by the Treaty. At the very least, these involve financial contributions to the Charter Conference. At worst, Australia is bound to accept liabilities in relation to all energy sector contracts concluded with investors of other Contracting Parties since the ECT became effective on 16 April 1998.

Accordingly, Australia's position regarding the Treaty's obligations depends upon whether, by becoming a signatory in December 1994, Australia consented to be bound by its provisions prior to formal ratification, or alternatively, whether by

signing Australia agreed only to be bound by the Treaty after ratification. Thus, Australia's possible exposure to proceedings for breach will be determined by both the provisions of the Treaty itself and international law concerning the necessary indicia of a State's intention to be bound by a Treaty. These will be discussed briefly below.

Provisions of the Treaty

The ECT recognises the fact that not all states which became signatories of the Treaty on 17 December 1994 would ratify immediately. Accordingly, Article 44 provides that the Treaty should enter into force 90 days after the receipt of the thirtieth instrument of ratification by the Depository. This occurred in April 1998.

Furthermore, Article 45(1) provides that prior to entry into force:

> Each signatory agrees to apply the Treaty provisionally pending its entry into force for such signatory in accordance with Article 44 ... to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.

Article 45(2) provides that although a signatory may declare that it is unable to accept provisional application, it is nevertheless bound by the provisions of Part VII and thereby obligated to take part in and make financial contributions to the Charter Conference ((2)(c)). Moreover, by declining to apply the ECT provisionally, neither a signatory nor its investors is entitled to claim the benefits of provisional application ((2)(b)). As noted above, Australia was one of the six Contracting Parties which elected to demur from provisional application of the Treaty. A number of issues must be noted in regard to Article 45.

Firstly, Article 45 throughout refers to "signatories." This implies that the provisions of the ECT relate to states which have merely signed the Treaty and that, consequently ratification is irrelevant to its application.

Secondly, although Article 45 was relevant only until the Treaty entered into force in April 1998, it was merely the concept of "provisional application" vis a vis signatories which became redundant on this date. Thus, based upon an interpretation of the language used, the resulting implication is that after April 1998 the provisions of the Treaty apply to all **signatories**, irrespective of whether or not they have ratified the Treaty.

Very little clarification is offered as to the obligations of signatories by Article 39, which purports to deal with ratification. Although Article 39 provides that "The Treaty shall be subject to ratification, acceptance or approval by signatories," there is no elucidation as to precisely what the term "subject" involves. Does it mean that the Treaty is binding upon signatories only after their ratification, or does it mean, as is argued here, that the Treaty is enforceable against all Contracting Parties only after ratification by a prescribed number of signatories? Indeed, if Articles 39, 44 and 45 are read together, it is possible to argue that Article 39 qualifies Article 44 by prescribing the manner in which the ECT is to come into force, rather than specifying when the terms and conditions became binding upon individual signatories. In so far as the application of the Treaty is concerned, therefore, it is signature and not ratification which indicates a Contracting Party's consent to be bound.

International Law

Reference to international law offers little elucidation of the position of a signatory vis a vis the application of the provisions.

Article 2(1)(f) of the Vienna Convention on the Law of Treaties ("the Vienna Convention") 1969 provides that a "contracting State means a State which has consented to be bound by [a] treaty whether or not the treaty has entered into force." Similarly, Article 2 (1)(g) defines a party as a "state which has consented to be bound by the treaty and for which the treaty is in force." The provisions relating to

what constitutes an indication of consent to be bound is contained in Articles 11-17 of the Convention. Article 11 sets out the methods by which a State may indicate its consent to be bound by a Treaty, viz: "... by signature, exchange of instruments constituting a treaty, ratification, acceptance, approval or accession or by any other means if so agreed."[12] A State consents to be bound by a Treaty on signing when:

> (a) the treaty provides that signature shall have that effect;
>
> (b) it is otherwise established that the negotiating States were agreed that signature should have that effect; or
>
> (c) the intention of the State to give that effect to the signature appears from the full powers of its representatives or was expressed during the negotiation. (Article 12).

On the other hand, pursuant to Article 14 a State is bound by a Treaty after ratification, acceptance or approval when:

> (a) the treaty provides for such consent to be expressed by means of ratification;
>
> (b) it is otherwise established that the negotiating States were agreed that ratification should be required;
>
> (c) the representative of the State has signed the Treaty subject to ratification; or
>
> (d) the intention of the State to sign the treaty subject to ratification appears from the full powers of its representative or was expressed during the negotiation.

No clarification is offered by the Vienna Convention for situations such as that presented by the ECT, in which there is no unambiguous, express statement that consent to be bound is indicated by either signature or ratification.[13]

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[12] Malagasia Fitzmaurice in her essay, Expression of Consent to be Bound by a Treaty. In *Essays on the law of treaties*. Martinus Nyhoff, The Hague, 1998, 59-80, discusses the various other ways by which consent to be bound may be indicated, 63-80.

[13] In his work *Modern treaty law and practice*, CUP, Cambridge, 2000, Aust addresses the issue of consent at 75-99. However, like the Vienna Convention itself, he approaches the topic with the presumption that the treaty will provide explicitly in its terms as to what constitutes consent, i.e. either signature or ratification, or

The position is no clearer pursuant to general law. For many years both prior and subsequent to the operation of the Vienna Convention, debate has continued in regard to the supremacy of signature or ratification as an indication of consent to be bound, without any definitive or even satisfactory conclusion having been reached.[14]

Conclusion

Since neither the Vienna Convention nor general international law are able to offer assistance in determining the effect of signature of the ECT upon the obligations of Contracting Parties prior to ratification, the ambiguities must be left to resolution by international adjudication.

However, it is suggested here that based upon the arguments set out supra:

- the ambivalence of the ECT in relation to signature/ratification as an indicia of intent; together with
- the emphasis placed in Article 45 upon the term "signatory;" and
- the fact that a Contracting Party's signature of the Treaty is indicative of both its approval of the provisions and an agreement to be bound by them,

there is a strong indication that signature and not ratification binds parties to the Treaty. Thus, by virtue of its position as a signatory, it is arguable that Australia is bound by the provisions of the ECT irrespective of the fact that it has not yet been ratified.

However, to some extent the issue of whether Australia is bound by the provisions of the ECT prior to ratification is academic unless or until an investor of another Contracting Party or another Contracting Party itself commences an action against the Commonwealth for breach. If this occurs, the matter will be determined by an appropriate tribunal.

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both.

[14] See Fitzmaurice, op.cit., for a discussion of this debate.

Certainly, it would be advisable for the Commonwealth to consider its position in regard to the Treaty very carefully before taking steps to ratify. As noted above, until ratification, Australia's liabilities pursuant to the Treaty are ambivalent. After ratification, however, there will be no doubt as to the obligations imposed upon Australia in regard to FDI in the energy sector and the consequential enforceability of the ECT. Therefore, should Australia choose to remain a member of the Charter Conference, sooner or later, either pre-or post ratification, it will be faced with the necessity to contend with its potentially deleterious affects upon Commonwealth/State relations, environmental protection measures and Aboriginal title. These will be discussed below.

Commonwealth Liabilities v State/Territory Rights

Article 23 of the ECT renders a Contracting Party vicariously liable for measures imposed by autonomous and regional governments which are in breach of the Treaty. Pursuant to the Article, therefore, a Contracting Party is obligated to ensure the compliance of autonomous or regional governments within its territory or face possible proceedings for breach of the Treaty. In effect, Article 23 provides a means of extending the operation of the investor protection provisions to catch regional governments which were not parties to the Treaty by placing the responsibility and liability for their compliance firmly in the hands of the Contracting Party.

In Australia, it is the Commonwealth and not the States and Territories ("States") which is the Contracting Party. The States, therefore, are not bound by the provisions of the ECT. Moreover, as Mason J stated in *Koowarta v Bjelke-Petersen and Ors* (1982)153 CLR 168 at 224:

> It is a well settled principle of the common law that a treaty not terminating a state of war has no legal effect upon the rights and duties of Australian citizens and is not incorporated into Australian law on its ratification by Australia.

However, in *Minister for Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR, in considering the effect of Australia's ratification of the UN Convention on the Rights of the Child upon administrative decisions, the High Court addressed the question of the effect of international instruments upon domestic legislation. In a joint judgment, Mason CJ and Deane J (at 287) stated:

> But the fact that the Convention has not been incorporated into Australian law does not mean that its ratification holds no significance for Australian law. Where a statute or subordinate legislation is ambiguous, the court should favour the construction which accords with Australia's obligations under a treaty or international convention to which Australia is a party, at least in those cases in which the legislation is enacted after, or in contemplation of, entry into, or ratification of, the relevant international instrument. That is because Parliament, prima facie, intends to give effect to Australia's obligations under international law.

Thus:

> ...ratification of a convention is a positive statement by the executive government of this country to the world and to the Australian people that the executive government and its agencies will act in accordance with the Convention. That positive statement is an adequate foundation for a legitimate expectation, absent statutory or executive indications o the contrary, that administrative decision-makers will act in conformity with the Convention.

Therefore, whilst Mason CJ and Deane J advised caution when contemplating the incorporation of international instruments into common law (at 288), the ratification by Australia of an international instrument raises the legitimate expectation that the principles enunciated in the instrument will guide the determinations of decision-makers.

Thus, although the provisions of an international instrument may not have been incorporated into domestic legislation, subject to an indication to the contrary, it is a legitimate expectation that they will be applied.

However, any attempt by the Commonwealth government to enshrine the terms of the ECT into domestic law in regard to energy resources must inevitably impinge upon the right of a State to govern those matters which arise within its borders. The only powers granted to the Commonwealth to incorporate an international treaty into domestic legislation are those pursuant to the provisions of the *Commonwealth of Australia Constitution Act* 1900 (Cth) ("the Constitution"). Any attempt by the Commonwealth to exert powers not conferred by the Constitution would render the Commonwealth in breach and thereby be ultra vires. Therefore, whether the Commonwealth has the power to enforce compliance by the States with the ECT through legislation, depends upon whether the control of energy resources found within the boundaries of a State comes, nevertheless, within the ambit of Commonwealth powers conferred by the Constitution. This issue will be examined briefly below.

Commonwealth powers over intra-State energy resources

Since Federation on 1 January 1901, the Commonwealth and States have jealously guarded their respective rights. As a Federation, relations between the Commonwealth and States are regulated by the Constitution, which allocates specific powers to the Commonwealth and residual powers to the States. Since Commonwealth powers are concurrent and not exclusive, the States may regulate any areas which fall within Commonwealth competence but in which the Commonwealth has failed to intervene. When State and Commonwealth legislation conflicts, however, Commonwealth law prevails pursuant to s109 of the Constitution.[15]

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[15] For a detailed discussion of Commonwealth and State powers see P.H. Lane. *A manual of Australian constitutional law* .(3rd edn.) Law Book Co, Sydney, 1984.

Despite the close regulation of Commonwealth and State powers by the Constitution, over the last century there have been numerous High Court decisions concerned with the powers of the Commonwealth to intervene in or legislate to control mattes which the States regard as solely within their purview.[16] Despite the wealth of judicial decisions, however, grey areas remain, one of which concerns the Commonwealth's power to regulate activities concerning mineral resources within State boundaries.

As noted above, all mineral resources within Australia are reserved by legislation to the Crown, as represented by the State government within whose boundaries they are located. Moreover, whilst the regulation of intra-State mineral resources is not listed in the Constitution as a matter upon which the Commonwealth may regulate, it is arguable that certain powers confirmed by s51 of the Constitution are couched in such broad terms as to encompass aspects of the energy resource sector relevant to compliance with the ECT, viz: exploration, exploitation and export. The specific powers listed in s51 which may arguably relate to these activities are:

(i) trade and commerce power;

(xx) corporations power;

(xxix) external affairs power.

Although it is not within the scope of this dissertation to examine the history of the application of the s51 powers in detail, a brief discussion of the impact of the individual subsections upon the energy sector is given below.

Section 51(i) Trade and Commerce Power

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[16] For example: *Huddart, Parker & Co Ltd v Moorehed* (1909) 8 CLR 330
Amalgamated Society of Engineers v Adelaide Steamship Co Ltd (1920) 28 CLR 129
Bank of New South Wales v The Commonwealth (1948) 76 CLR 1
Strickland v Rocla Concrete Pipes Ltd (1971) 124 CLR 468
State of Victoria v The Commonwealth (1975) 134 CLR 338

Section 51(i) of the Constitution confers power on the Commonwealth government to legislate in respect to matters involving "trade and commerce with other countries and among States." Accordingly, the sub-section empowers the Commonwealth to enact any legislation relating to the export of resources, i.e. "trade and commerce" in the energy sector "with other countries." However, the power refers solely to overseas or interstate trade. It does not encompass the exploration for an exploitation of intra-state resources. Although common sense would suggest that the exploration and exploitation of energy resources is related to their export, it is questionable whether it is within Commonwealth jurisdiction to intervene in these activities pursuant to s51(i). In *Wragg v New South Wales* (1953) 88 CLR 353 it was held that although the distinction between interstate or export trade and domestic trade within a state may be fine, "it is a distinction adopted by the Constitution and must be observed" (at 385-386). On the other hand, in *O'Sullivan v Noarlunga Meat Ltd* (1954) 92 CLR 565 it was suggested that when an intra state activity ultimately involves the export of a product, the Commonwealth has the power "to enter the factory, the field or the mine" (per Fullager J at 598). Although this statement appears to confer wide powers on the Commonwealth pursuant to s51(i), it was obiter dictum and the issue was not examined in greater depth. Moreover, whilst the Commonwealth may exert the power conferred by s51(i) to legislate in regard to the mining of energy resources intended for export, the situation is more tenuous in regard to exploration. Certainly, the Commonwealth could invoke the power to prevent a State from imposing measures in the energy sector in breach of the ECT, but the question remains as to whether such an assertion of rights would be successful before the High Court.

Section 51(xx) Corporations Power

This sub-section confers the power on the Commonwealth government to make laws regarding "foreign corporations and trading and financial corporations formed within the limits of the Commonwealth" (s51(xx)). Pursuant to this power the Commonwealth, therefore, is authorised to enact legislation relating to the

regulation of corporations formed overseas as well as domestic entities.[17] Whilst the corporations power is fairly broad in scope, it is uncertain whether the power extends to the regulation of intra-state exploration for and exploitation of energy resources.[18]

In the *Commonwealth v State of Tasmania* (1983) 46 ALR 625 ("the Tasmanian Dam Case") the Commonwealth invoked the corporations power for the first time outside the area of trade practices. Pursuant to the first part of the *World Heritage Properties Conservation Act* 1983 (Cth) the Commonwealth government purported to regulate the activities of "a territorial or foreign corporation or a trading corporation formed within the limits of the Commonwealth"[19] in relation to any damage caused by such a corporation in the pursuit of its activities. This part of the Act was upheld only by Mason, Murphy and Deane, JJ., i.e. not a majority. On the other hand, a later section of the Act which "dealt only with a trading corporation formed within the Commonwealth"[20] and damage caused for the purposes of its trading activities was held by a majority[21] to be caught by the corporations power.

However despite the attempt by the Commonwealth to extend the ambit of s51(xx), since the States individually administer the corporations law through their own tribunals, it is suggested here that s51 (xx) could not be applied unless the end product of the energy resource project or some part thereof, is destined for export, in which case it is arguable that the Commonwealth would be able to invoke s51(i), the trade and commerce power.

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[17] Whilst s51(xx) empowers the Commonwealth to enact legislation controlling domestic corporations, the Uniform Corporations Law is administered within the jurisdiction of the Supreme Courts of the States. The Australian Securities and Investments Commission ("ASIC"), however, is a Federal body. Thus, action taken by ASIC against corporations and/or corporate officers in breach of the Corporations Law is pursued through the State Supreme Courts.

[18] For an extensive discussion of this aspect of s51(xx) see J.R.S. Forbes and A.G. Lang *Australian mining and petroleum laws.* Butterworths, Sydney, 1987, 36-38. For a general review of the power see P.H. Lane, op. cit., 99-118.

[19] Ibid, 108.

[20] Ibid

[21] Mason, Murphy, Brennan and Deane, J.J.

Section 51 (xxix) External Affairs Power

Of all the powers conferred upon the Commonwealth by the Constitution, it is the external affairs power which is most applicable to the ECT. Pursuant to s51 (xxix) the Commonwealth is empowered to regulate the domestic implementation of international treaty obligations. A number of High Court decisions,[22] particularly the Tasmanian Dam Case (supra), have established that provided the agreement is "external" in character[23] or "indisputably international"[24] and the Commonwealth legislation implementing the treaty adheres to the terms of the treaty,[25] the legislation is a valid exercise of the power.

In the Tasmanian Dam Case (supra) the High Court held that the Commonwealth had the power to control the use of the Gordon-above-Franklin Wilderness in Tasmania pursuant to the terms of the Convention for the Protection of the World Cultural and National Heritage ("the World Heritage Convention") to which Australia is a party. In considering the application of an international convention to what was, essentially, a matter for the Tasmanian government, Mason J said:

> ... the purely domestic character of the matters dealt with by the law enacted in the discharge of the Convention obligation is not in itself ... an objection to the exercise of the power (at 121).

Indeed, he went on to state that s51 (xxix) authorises any Commonwealth legislation "which gives effect to an obligation imposed on Australia by a bona fide international convention or treaty to which Australia is a party ... so long as the subject matter of the conventions is one of international concern or of concern to the relationship between Australia and the other party or parties" (at 122).

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[22] For example, *Airlines of NSW v New South Wales* (no. 2) (1969) 113 CLR 54; *New South Wales v The Commonwealth* (1976) 134 CLR 81: 8 ALR 1; and *Koowarta v Bjelke-Petersen* (1982) 39 ALR 417.

[23] *Rv Burgess: Ex Parte Henry* (1936) 55 CLR 608.

[24] Ibid, 688.

[25] Ibid, 692-693.

These sentiments were echoed in *Richardson v Forestry Commission* (1988) 164 CLR 261, in which the High Court upheld the validity of the *Lemonthyme and Southern Forests (Commission of Inquiry) Act* 1987 (Cth) which also adopted and gave effect to the World Heritage Convention. Subsequent decisions, such as *Victoria v The Commonwealth* (1996) 70 ALJR 680 have, as John Perry writes; "unquestionably cemented into place for the foreseeable future the broadest of views as to the scope of the external affairs power."[26]

Thus, on the above views, it is very likely that the Commonwealth could successfully invoke the external affairs power to force the States to comply with the provisions of the ECT.

Conclusion

As may be gathered from the foregoing discussion, therefore, the Commonwealth could invoke s51(i) and, more relevantly, s51(xxix) to enact legislation compelling the States to comply with the provisions of the ECT. Moreover, any incipient objections harboured by State governments to further regulatory impositions by the Commonwealth pursuant to the ECT would be met by the invocation of s109 of the Constitution, thereby giving the Commonwealth legislation precedence over any prior or subsequent enactments. However, whilst such action would enable the Commonwealth to discharge its obligations pursuant to Article 23 of the ECT, it would do little to improve Commonwealth/State relations.

Certainly, Federal/State conflicts are not confined to Australia but appear to be inherent in all nations which operate on the federal system.[27] As Christopher

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[26] John W. Perry, At the Intersection: Australia and International Law. (1997). 71 *ALJ*, 841-859 at 846.

[27] States such as the USA, Canada, Germany and Austria have federal and regional autonomous governments. The provisions of Article 23, therefore, has relevance to all states in which the constitutional and administrative structures conform to this model, not merely Australia.

Schreuer states in his article "The Waning of the Sovereign State: Towards a New Paradigm for International Law:"[28]

> While the capacity of the State to enter into treaty commitments is unlimited, in principle, sub-State entities and international organisations are typically confined to the powers assigned to them either explicitly or by implication international organizations have shown a remarkable ability to expand their treaty competence through doctrines such as implied powers. Sub-State entities, on the other hand, usually remain under strict federal supervision. The increasing scope of regulation through treaties has sometimes led to a conflict between the constitutional powers of the sub-State entities and the treaty-making monopoly of the central government.

In Australia, particularly since the Tasmanian Dam Case, there have been various submissions made by both members of the Federal and State parliaments expressing concern at "the distorting effect of the growth areas of Commonwealth control at the expense of the States."[29] Such concerns were received by the Commonwealth Constitution Commission, which was established by the Commonwealth government to address the issue of Federal-State powers, and cited in its Final Report released in 1998.[30]

Moreover, grave reservations were expressed during the 1991 Premiers Conference in regard to the consultation (or lack thereof) by the Commonwealth with the States on the negotiation process and implications of international treaties. Accordingly, in 1991 the Commonwealth-State Standing Committee on Treaties was established to devise a set of "Principles designed to ensure early consultation with the States when Australia is considering participating in a treaty."[31] This was followed in November 1995 by the report of the Senate Legal and Constitutional Affairs

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[28] *European Journal of International Law* (1993) **4** (4), 447.
[29] John W. Perry op. cit, at 847.
[30] Ibid.
[31] Ibid.

References Committee, entitled *Trick or Treaty? Commonwealth Power to Make and Implement Treaties.*[32] The Report contained recommendations regarding improvements to the Commonwealth-State consultation process.

However, although Commonwealth efforts to foster greater involvement by States in the treaty process is ostensibly laudable, three points in regard to these efforts must be made.

Firstly, any implication of the recommendations of Commonwealth-State committees set up to examine State involvement in the treaty negotiation process came too late to forestall or ameliorate any potential adverse implications of the implementation of the ECT in energy sector contracts in Australia. Most of the substantive recommendations were made after 17 December 1994, when Australia became a signatory to the Treaty. Whatever consultation occurred between the States and Commonwealth regarding the treaty, they would have been unlikely to have involved either the tabling of the treaty 15 sitting days before signature or consideration of the Treaty by a joint parliamentary committee as recommended by the Minister for Foreign Affairs and the Attorney-General (Cth) in May 1996.[33] Indeed the Defat statement quoted supra merely refers to "extensive consultations," giving no hint as to either how extensive or thorough such consultations were. In view of the lack of consultation between Commonwealth and State governments regarding the pre-1995 treaties and conventions, it would be safe to assume that the consultative process concerning the ECT was neither as extensive nor as informative as the implications of the ECT for State rights would require.

Secondly, the vigour with which the Commonwealth has historically pressed its legislative authority over the States in the High Court through the invocation of its

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[32] Commonwealth of Australia, Canberra, 1995, ISBN 0642244189.

[33] These recommendations were contained in a joint statement issued by the Minister and the Attorney-General proposing extensive reforms to Australia's treaty making procedure (see Perry, op. cit., 847).

s51 powers and s109 of the Constitution, suggests that both the investigations into and imposition of the consultative process itself are putative rather than actual. State rights accorded pursuant to the Constitution, albeit residual, must in the final analysis be dependent upon the political orientation of and the resulting view taken by the Commonwealth government as to the economic and political significance of any treaty it seeks to implement. Any legislation imposed by the Commonwealth to enforce a treaty upon the States constitutes a further erosion of State powers.

Thirdly, irrespective of the consultation process between the Commonwealth and the States in regard to the implications of a treaty, any attempt by the Commonwealth to compel compliance by States constitutes the enforcement by the Commonwealth upon the States of the provisions of an agreement to which the States were not Parties. It may be argued that few of the citizens of a State would object to such a procedure vis a vis the application of human rights and environmental protection treaties. However, if or when the Commonwealth attempts to impose the provisions of the ECT, which embody serious implications for Australia's sovereign statehood, as discussed in Chapters X and XI supra, it is likely that voices expressing dissent will be raised from both State parliaments and the citizenry.[34] Thus, attempts by the Commonwealth government to enforce the provisions of the ECT could arguably have serious repercussions not merely upon Commonwealth-State relations but upon State rights. Throughout the century since Federation, the powers of the States have been gradually eroded as a result of the vigorous assertion by the Commonwealth of its Constitutional prerogatives and authority.

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[34] Any protest by the public against the application of the provisions of the ECT, however, must inevitably depend upon how widely information about the Treaty and its effects has been disseminated. To date, research into the distribution and availability of information regarding the ECT in Australia has served to discover only two Defat briefings both of which make scant mention of the Treaty generally. No press releases or Commonwealth publications have been discovered which deal in even the most cursory manner with the Treaty. This apparent lack of candour and/or disclosure on the part of the Commonwealth government in regard to the ECT strongly suggests an attitude of "ignorance is bliss" vis a vis the Australian public.

Accordingly, whilst most States would possibly welcome the economic advantages offered by FDI in the intra-state energy resource sectors, Commonwealth control of the contractual terms whereby this could be achieved would be arguably less acceptable. Strictures placed upon the States in regard to their freedom to impose trade-related measures, such as domestic industry protection regulations, licence and permit levies and domestic employment requirements would substantially reduce the appeal of energy resource exploration and exploitation agreements entered into with entities from other Contracting Parties of the ECT.

Moreover, enforcement by the Commonwealth of the provisions of the Treaty would not only affect the ability of States to regulate energy sector contracts. It is arguable that strict compliance with the ECT by the Commonwealth would also abrogate the States' right to promulgate environmental protection legislation, thereby possible endangering many the fragile ecosystems in which energy resources are found. The possible impact of the enforcement of ECT upon environmental protections are therefore explored in the following section.

Impact of the ECT upon Environmental Issues

As noted at 353 above, many of Australia's energy resources lie within sensitive ecosystems of great natural beauty. For example, the Ranger and Jabiluka uranium mines are situated within the Kakadu National Park in the Northern Territory, the Northwest Shelf and Gippsland Basin Oil and natural gas reserves are found off the coasts of Western Australia and Victoria, whilst seismic exploration of oil and gas reserves are currently being undertaken on the great Barrier Reef.

Moreover, once energy resources have been extracted they must be transported from the deposits to point of use. If the resources are destined for export, they need to be carried to the port of departure and from thence, through Australian waters to the

country of destination. Therefore, whilst the extraction itself may pose no threat to the surrounding environment,[35] the necessity to construct infrastructure such as roads and pipelines, as well as the opening of marine transit routes for container ships and tankers, substantially increase the risk of environmental contamination from accidents.

Therefore, both Commonwealth and State governments are faced with apparently insoluble conflicts between the preservation of unique environments and the economic advantages to be gained from the exploitation of energy resources. Perhaps the most trenchant example of this conflict is to be found in the case of the Ranger and Jabiluka uranium mines in the Northern Territory. Both mines are situated within the 1.98 million hectares of the Kakadu National Park, a World Heritage site protected both by the World Heritage Convention and the *World Heritage Properties Conservation Act* 1983 (Cth). The Ranger mine is situated 230 kms east of Darwin. The initial uranium deposit was discovered in 1969 and in 1974 a joint venture was formed between Peko Wallsend Operations Ltd ("Peko"), the Electrolytic Zinc Company of Australia Ltd ("EZA") and the Australian Atomic Energy Commission ("AAEC"), pursuant to which Ranger Uranium Mines Pty Ltd was incorporated.[36] Mining at Ranger commenced in 1980 with full production being reached in October 1981.[37] It continues operations to date.

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[35] Although it is arguable whether the extraction of any mineral can be totally environmentally safe. Despite stringent environmental controls and an environmental protection system much vaunted by Energy Resources Australia Ltd ("ERA"), it was revealed in April 2002 by a former ERA radiation officer and environmental chemist, that uranium from the Ranger Mine had contaminated Galangal Creek, inside the Kakadu National Park, with radiation levels 70 times higher than the reporting standard (Australian Conservation Foundation, Media Release 14 April 2002).

[36] Ranger Uranium Mines Pty Ltd is currently owned by ERA whose major shareholders are Rio Tinto Ltd (68%) and Cameco (6.45%).

[37] It is interesting to note that the exploration and mining leases for the Ranger mine were granted by the Commonwealth government in 1969 and January 1979 respectively, prior to the Northern Territory's accession to independence as a State. The mining lease was issued to the joint venture of which the AAEC was a partner. AAEC sold its interest in the joint venture in August 1979. Moreover, Stage 1 of

Jabiluka, on the other hand, is situated 20 kms from the Ranger Mine and is estimated to contain the world's largest deposit of high grade uranium oxide ore. In October 1997, on recommendations from the Commonwealth Minister for the Environment, the Minister for Resources and Energy approved the Jabiluka Environmental Impact Statement. However, the establishment of the Jabiluka mine did not proceed as smoothly as for Ranger. Between the opening of the Ranger mine in 1980 and the EIS for Jabiluka in 1997, there had been a number of significant developments. Firstly, Kakadu had been listed as a World Heritage site, thus bringing it both within the ambit of the UN Convention and the Commonwealth World Heritage Act. Moreover, pursuant to *Mabo* (supra) indigenous peoples had found both a voice in and a right to claim native title. Accordingly, despite an agreement signed by the Northern Lands Council with ERA in 1991, the Mirrar People, the indigenous title holders of the land, have revoked their consent regarding mining on their land. Further, public awareness of environmental issues has increased. Since the Tasmanian Dam Case in 1983, the Australian public have recognised that intense public pressure can affect government environmental policy. Thus, political lobby groups such as the Australian Conservation Foundation and the Greens political party have developed considerable political and popular weight. Therefore, as a result of opposition to the Jabiluka Mine, development was halted after the completion of Stage 1 in September 1999.[38]

The contrast between the rapid progress made in establishing the Ranger Mine and the difficulties experienced by Jabiluka is significant. In essence, the history of the two mines highlights the distinction between pre-and post Tasmanian Dam Case resource development projects in regard to environmental protection and the effect of public opinion. Moreover, balancing the competing interests of environmental

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the Kakadu National Park was nominated for World Heritage Listing in October 1981, with Stage 3 being listed in 1993.

[38] A cynic might also suggest that the cessation of development was also due to the decline in international uranium prices. (See ACF Media Release, 5 September 2002).

protection, indigenous title and economic development is not a simple task and, in the case of Jabiluka, has created an impasse which has, at least for the time being, halted development on the mine. However, the question remains whether such an outcome would have been achieved had the agreements regarding the development of Jabiluka been signed after the ECT came into force in April 1998. Indeed, the issue of Jabiluka emphasises the potential impact of the ECT upon Australian environmental protection regulations in a number of ways.

Firstly, the enforcement of ECT provisions through legislation by the Commonwealth could result in an anomalous result vis a vis the Tasmanian Dam and Lemonthyme Forest Cases.

Secondly, pursuant to its powers under the Constitution, the Commonwealth government could enact legislation enforcing the transit provisions of Article 7 of the ECT to allow the transit of potentially hazardous energy resources through State territory contrary to State laws.

Thirdly, pursuant to Article 23 the Commonwealth could be forced to apply the ECT irrespective of its policy and views upon the importance of environmental protection and State rights.

The Tasmanian Dam Case Anomaly

It is arguable that should the Commonwealth government impose the provisions of the ECT upon the States through legislation, it would produce an outcome contrary to the import and decision in the *Tasmanian Dam Case* (supra). In effect, the Commonwealth could use its external affairs power to over-ride State environmental protection regulations rather than, as in the two cases supra, using its powers to protect sensitive ecosystems.

The Tasmanian Dam Case involved the question of the Constitutional validity of the *World Heritage Properties Conservation Act* 1983 (Cth) ("World Heritage Act") passed by the Commonwealth government in response to the public protects against the proposal of the Tasmanian Hydro-Electricity Commission ("the Commission") to claim the Gordon-above-Franklin river in the West Tasmanian Wilderness National Park. As a sensitive ecosystem, the integrity of the West Tasmanian Wilderness would have been destroyed by the construction of the proposed dam. In response to prolonged and co-ordinated public pressure to protect the area, the Commonwealth government enacted the World Heritage Act which applied the provisions of the World Heritage Convention. The Tasmanian government and the Commission objected to the World Heritage Act on the grounds that it was ultra vires, submitting that the Commonwealth had neither the power to intervene in State affairs nor the Constitutional imprimatur to impose an international Treaty upon Australian domestic law. The issue went to the High Court which decided in favour of the Commonwealth, upholding the validity of the World Heritage Act on the basis that the application of the World Heritage Convention into Australian domestic legislation was sanctioned pursuant to s51(xxix) the external affairs power, of the Constitution.

Thus, in prosecuting the Tasmanian Dam Case, and similarly the Lemonthyme Forest Case,[39] the Commonwealth was applying an international Treaty to protect Australia's valuable natural heritage as represented by the West Tasmanian Wilderness and Lemonthyme forests.

On the other hand, the imposition of the provisions of the ECT by the Commonwealth upon the States through domestic legislation could have a contrary effect to the Tasmanian Dam Case. The external affairs power could be used by the

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[39] In *Richardson v Forestry Commission* (1988) 164 CLR 261, the High Court upheld the validity of the *Lemonthyme and Southern Forests (Commission of Inquiry) Act* 1987 (Cth), which had also been enacted to apply the World Heritage Convention for the purposes of environmental protection.

Commonwealth to permit energy resource development in sensitive ecosystems such as Kakadu and the Great Barrier Reef irrespective of State opposition. Indeed, it is arguable that had:

- the proposal for the Gordon-above-Franklin Hydroelectric Project been put forward after April 1998;
- the Commission or an entity involved in the Project been a national of another Contracting Party to the ECT; and
- the agreements regarding the Project been formed subject to the ECT,

there would have been very little the Commonwealth government could have done to prevent the Project from proceeding without breaching the provisions of the ECT. Therefore, had the ECT been in force in 1983, it is very unlikely that the Tasmanian Dam Case could have succeeded.

Transit

The potential imposition of the ECT is particularly relevant in regard to the Transit provisions in Article 7. Pursuant to Article 7 a Contracting Party must allow the transit of energy resources and products across its territory on a national/MFN basis ((1) and (3)). If the Contracting Party does not have adequate infrastructure to comply with the requirement of free transit, it must allow the establishment of new or upgraded facilities ((4)). The sole defence to a refusal to allow transit is that the transit would endanger the Contracting Party's own energy supplies ((5)). Thus, environmental protection cannot constitute grounds for a breach of Article 7.

The application of Article 7 could have significant import for Australian States' environmental protection policies and regulation. Pursuant to their Constitutions all States are empowered "to make laws for the peace, welfare and good government"[40] of their citizens. In New South Wales, for example, the State government enacts laws to protect the health and well-being of its people and the environment through such legislation as the *Radiation Control Act* 1990 (NSW) regulates the licensing,

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[40] *Constitution Act* 1902 (NSW), s5.

use and disposal of ionising and non-ionising radiation substances and devices. Similarly, the *Environmentally Hazardous Chemicals Act* 1985 (NSW) regulates the use and disposal of hazardous substances. Moreover, pursuant to the *National Parks and Wildlife Act* 1974 (NSW) the State government is able to regulate the management and protection of all National Parks within NSW, apart from those areas with World Heritage Listing and thereby caught by the *World Heritage Act.*

However, the application by the Commonwealth of the ECT could be used to override State power to the detriment of the safety of both the citizens of NSW and their environment. The following hypothetical situation will serve to illustrate the point. The NSW government prevents the transit across state territory of uranium oxide ore produced pursuant to a contract subject to the ECT regime on the grounds that it poses a threat to the health and safety of citizens and the environment of NSW. In support of the refusal of transit, the State government invokes State environmental protection legislation. Pursuant to Article 23 of the ECT, the Commonwealth as a Contracting Party, is liable for the NSW government's breach of Article 7. It is therefore obliged to ensure that the breach is rectified and transit of the uranium oxide ore is permitted. To achieve this, the Commonwealth would need to invoke s51(xxix), the external affairs power, of the Constitution to enact legislation compelling NSW to allow transit pursuant to the ECT and s109, the inconsistency provision, to over-ride the State environmental protection and public health legislation. Unlikely as the realisation of such a hypothetical situation may be, it is, nevertheless, possible.

Further, the enforcement of Article 7 has even greater relevance to the shipment of oil, thorough the waters of the Great Barrier Reef ("the Reef"). The Reef lies in Queensland and Commonwealth territorial waters and any marine disaster involving an oil tanker could have a devastating effect upon this unique ecosystem. On a number of occasions over the last 18 months the Australian Conservation Foundation ("ACF") has called upon both the Queensland and Commonwealth

governments[41] to prohibit all shipping from Reef waters on the basis that: "allowing oil tankers, coal transports and other major overseas shipping to travel through the complex and dangerous reef systems is just inviting a major accident to happen."[42]

Unfortunately, if the oil shipments are the result of extractions subject to ECT contracts, on the basis of the discussion of Article 7 above, there would be few steps either the Commonwealth or Queensland governments could take to prevent transit. Irrespective of the Commonwealth's desire to protect the environment, it is bound by the provisions of the ECT either form the date of ratification, or as argued above, as a signatory of the Treaty from April 1998.

Nuclear Waste

Furthermore, in contrast to Europe and in addition to its extensive energy resources, Australia has vast tracts of uninhabited and, to European perceptions, uninhabitable land which might be regarded as suitable repositories for nuclear waste products.

Pursuant to Annex EM of the ECT, "energy materials and products" include both radioactive chemical "mixtures and residues" (28.44) and "spent (irradiated) fuel elements (cartridges) of nuclear reactors" (28.44.50). Accordingly, the provisions of the ECT apply not only to the exploration, exploitation and sale of energy resources, but also to agreements concerning the disposal of radioactive wastes.

In view of the comparative population density of most EU countries and the resultant dearth of geographical regions suitable for nuclear waste disposal, it should not come as a surprise were the EU to look to Australia for nuclear waste storage sites.

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[41] See ACF Media Releases, 30 January 2001, 7 August 2002 and 21 August 2002.

[42] ACF Media Release, 7 August 2002, promoted by the grounding of the bulk carrier the Doric Chariot on Piper Reef. Whilst oil spill from the vessel was minimal, the impact of the huge vessel destroyed a major part of the coral reef upon which it was grounded.

Unlike the operation of the transit provision, the ECT cannot be invoked to compel a Contracting Party to accept energy waste products. However, any agreement made pursuant to the Treaty in relation to waste disposal or which includes provisions regarding the disposal of energy waste products, is enforceable pursuant to its terms.

Conclusion

Thus, as may be gathered from the foregoing discussion, the potential impact of the application of the provisions of the ECT in Australia goes beyond the infringement of State rights. The ECT regime also poses a possible threat to the viability of environmental protection legislation, preventing both Commonwealth and State governments from resisting attempts by other Contracting Parties or entities from enforcing provisions of energy resource contracts which could have damaging environmental repercussions. Furthermore, the application of the ECT could also impact upon the already beleaguered "bundle" of indigenous land rights, as will become apparent from the discussion below.

Impact of the ECT upon Indigenous Land Rights

In 1992 when the High Court of Australia handed down its landmark decision in *Mabo v Queensland (No. 2)* (1992) 175 CLR 1 *("Mabo")* which recognised "native title over at least unalienated Crown lands"[43] it created "wide-ranging implications for governments granting land titles, commercial enterprises dependent upon land titles and potential native title holders."[44] Thus, pursuant to the Mabo decision, Aboriginals were accorded the ability to claim rights of access, use and occupation over traditional land: rights previously unrecognised in Australian law. In 1993 Mabo was enshrined in legislation through the *Native Title Act* 1993 (Cth) and State counterparts, which (inter alia):

- validate pre-1994 grants of title;

[43] Brian Horrigan and Simon Young (eds), *Commercial Implications of Native Title* (Sydney, Federation Press, 1997), 2.
[44] Ibid.

•determine government liability to provide compensation for impaired or extinguished native title; and

•outline procedures for future grants of title in areas in which native title survives.

Whilst Mabo established the concept of native title, however, it left certain issues unaddressed, particularly the question of the co-existence of concurrent titles and rights conferred upon past lease and native title holders. This issue was resolved in *Wik Peoples v Queensland* (1996) 134 ALR 637 ("*Wik*").

Despite the examination in both *Mabo* and *Wik*, and the Commonwealth and various State Native Title Acts, of the nature and extent of native title, no decision had been made as to whether native title extended to the ownership of minerals on the land subject to the title.

As discussed at 324 above, minerals in Australia are owned by the Crown, ownership devolving either by statutory reservation or prerogative in the case of gold and silver (the "royal metals"). Accordingly, after Mabo and Wik, academic speculation was sparked in regard to the issue of the ownership of minerals on land subject to native title. One school of thought had suggested that whilst the ownership of wild animals, forest products and riparian water not subject to State legislative control rested with the traditional owners, all rights to minerals, particularly the "royal metals" remained with the Crown. This viewpoint was based upon the assumption that native title consisted of a "mere bundle of rights"[45] which were severable, rather than an indivisible, holistic "communal right to land" (ibid). Thus, in regard to ownership of mineral resources, indigenous title holders were in no better position than Torrens title or lease holders.[46]

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[45] *Ward v Western Australia* (1998) 159 ALR 483 at 508.

[46] For an examination of the pre-*Ward* mineral ownership debate see David Yarrow, Ownership and control of natural resources: The impact of native title. In Horrigan and Young, op. cit., 126-157; G D Meyers, C.M. Pipe and H. E. Rumely, Asking the Mineral Question: Rights in Minerals as an Incident of Native Title, (1997) 2(2) *Australian Indigenous Law Reporter*, 203, and M. W. Hunt, Mineral

On the other hand, an alternative line of thought [47] had suggested that since the Crown prerogative to the foreshore may be extinguished by native title,[48] by analogy, the Crown's rights to minerals is similarly divested.[49]

However, despite the arguably strong line of precedent suggesting that by analogy, native title included the right to minerals, speculation in the issue was ended by the High Court decision in *Western Australia v Ward* [2002] HCA 28 (8 August 2002), in which it was held that:

- native title consists of a "bundle of rights" which are severable and not indivisible communal rights;
- native title may therefore be partly extinguished by the revocation of one or more rights;
- any extant native title in minerals can be extinguished by State legislation;
- native title and mining and pastoral leases can co-exist.

Development and Indigenous People - The Implications of the Mabo Case, (1993) 11 *Journal of Energy and Natural Resources*, 155.

[47] See Mark Newton, "Native Title and Royal Metals" (2001) 6(1) *Australian Indigenous Law Reporter*, 1-17, who presents an argument of impeccable logic based upon extensive research in support of this view.

[48] In the New Zealand case Re: *The Ninety Mile Beach* [1963] NZLR 461, it was held by the Court to Appeal that Maori title extinguished the Crown's prerogative right to the foreshore. This approach has a long history in common law dating back to *Attorney-General of Southern Nigeria v Holt* [1915] AC 599, in which the Privy Council held that in regard to the British acquisition of Lagos, "the foreshore became vested in the Crown, subject to the existing rights of the riparian owners" (at 601).

[49] As suggested at 324 ff above, a preferable approach to the issue is to be found in international law (the *Western Sahara Case*), the rejection of the concept of terra nullius, and the Canadian cases cited at 324 supra. Indeed, the Privy Council decision in Holt (FN 40) appears to be based upon the presumption that prior inalienable indigenous rights cannot be supervened by Crown prerogatives on invasion.

The *Ward* decision applies specifically to Western Australian and Northern Territory mining leases, relating to a claim to 8,000 kms of the East Kimberly in Western Australia and the Northern Territory. As such, the Court did not address the application of the principle to other States. Thus, although the question of the extinguishment of native title in mineral resources in other states has been left open by the decision, its application in other States with comparable legislation in regard to minerals as exists in Western Australia and the Northern Territory will no doubt be pressed in litigation as soon as an opportunity presents itself.

Moreover, irrespective of the soundness of the decision,[50] it has done little to advance the cause of native title in Australia and, as such, can only be regarded as a retrograde step.

Apart from its deleterious effect upon the progress of the establishment of full native title in Australia, the significance of *Ward* lies in the fact that prior to the decision, the provisions of the ECT would have adversely affected indigenous rights to energy resources found on land subject to native title. Pursuant to Article 23, the Commonwealth would have been obliged to ensure that in relation to such energy resources, the sub-regional, autonomous Aboriginal Land Councils and ownership groups, complied with Parts II, III and IV of the ECT in respect of the encouragement, promotion and protection of foreign investments in these resources.

Since *Ward* the issue of the impact of the ECT upon indigenous rights to energy resources has become otiose, such rights being extinguished or extinguishable by State legislation. However, the decision has not completely obviated the impact of the ECT upon native title. The issue of the transit of energy resources over land subject to native title, remains. To date, indigenous owners of traditional lands hold a "bundle of rights" (*Ward*) in relation to their title. These rights include the right to

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[50] And it is suggested here that on the basis of both the finding in *Mabo*, ie. that Australia was not terra nullius, and international law (the *Western Sahara Case*) the decision in *Ward* is unsound.

control access to and over the land by outsiders for whatever purpose, including the transit of goods. Whilst existing access in the form of roads and rail lines subject to State legislative control will, on the basis of Ward, be permissible,[51] a question remains in regard to the creation of new facilities. Perhaps the points best illustrated by the example of access to the Jabiluka Uranium Mine.

The original mining lease for the Jabiluka Mine was granted by the Northern Territory government in August 1982 for a period of 42 years. One month prior to the grant, in July 1982 Pancontinental, the original owner of the project, had signed an agreement with the Northern Lands Council ("NLC") in regard to the mine. At this stage the NLC represented the interests of the Aboriginal peoples of the area. However, in the late 1980's the Gagudju Association was formed by the Mirra people and other traditional owners affected by the Ranger and Jabiluka projects. The NLC agreement was assigned to ERA, the new owners, in 1991. In 1995 a group of 25 disaffected members, including the senior traditional owner, broke away from the Gagudju Association and formed the Gundjehmi Corporation. The Gundjehmi people were concerned about the possible environmental threat posed by Jabiluka to surrounding wet lands and in May 1999 commenced proceedings pursuant to the *Aboriginal and Torres Strait Islander Heritage Protection Act* 1984 (Cth) proceedings were discontinued in October 1999. In the same month the NLC, as the representative of all traditional Aboriginal owners, advised ERA that it would not consider granting permits to transport uranium oxide are from the Jabiluka Mine to Ranger for processing until at least 1 January 2005. Thus, the NLC decision effectively halted all further development at Jabiluka until this date.

Currently, therefore, indigenous title holders have the right to control the development of mineral resources on their traditional lands through the granting (or denial) of access permits and licences. Should such a situation pertain to a uranium

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[51] Existing land access subject to legislation would extinguish the right of the native title holders to prohibit or restrict usage of roads and rail lines on their property.

mining development undertaken pursuant to a contract under the ECT, however, the right of indigenous owners to control access across the land could be abrogated since refusal of access would constitute a breach of Article 7. As noted above, Article 23 holds the Commonwealth liable to ensure the compliance with the Treaty of sub-autonomous groups. Therefore, the Commonwealth would be obliged to compel the native title holders to comply, either by enactment or legislation[52] or by reference to the State Supreme Court or the High Court. It is suggested here, that the statutory enactment pursuant to s51(xxix) of the Constitution would be the most likely response. Failure to procure compliance of Article 7 would render the Commonwealth liable to action for breach pursuant to Articles 26 and 27.

Thus, given the already substantial erosion of the "bundle" of native title rights resulting from *Ward*, the application of the ECT to indigenous lands would further compromise both the integrity and security of native title, rendering Pyrrhic the victory of Eddie Mabo in 1992.

Conclusion

As may be appreciated from the above discussion, the impact of the ECT, if or when[53] it comes into force in Australia, upon Commonwealth/State relations, environmental policy and regulation and indigenous land rights in Australia, is substantial. Certainly, in response to the rather bleak analysis of the effects of the ECT upon Australian energy sector agreements, it could be argued that Australian corporations, and thereby the Australian economy generally, stand to benefit from not only potential increases in exports, but also increased opportunities to invest in energy sectors overseas.[54] However, it must be remembered that Australia's energy trade sector is and has been extremely profitable for many years. Moreover, whilst it

[52] Which, on the authority of *Ward* would extinguish the right to control access.
[53] Indeed, it is argued here that it is very likely that the ECT is and has been applicable to all Australian energy sector agreements concluded since 16 April 1994.
[54] BHP-Billiton is particularly active in energy exploration in FSU states such as Ukraine and the Central Euro-Asian "-stans."

is possible to deprecate the environmental damage caused by energy resource extraction and exploitation in Australia, its efficiency cannot be doubted. Therefore, it is argued here that the Commonwealth government has placed itself in a position analagous to that of Dr Faustus to the EU's Mephistopheles: the price to be paid by the Australian people may be far too high for the putative benefits received or receivable.

Moreover, although the Commonwealth is undoubtedly empowered to impose the provisions of the ECT upon Australian law pursuant to ss51(xxix) and 109 of the Constitution, it is suggested that the fact of Constitutional validity does little to mitigate the adverse effects of the invocation of such powers upon State and indigenous rights. Rights once abrogated are difficult to reinstate.

Further, the Commonwealth's liability pursuant to the ECT is unconnected with government policy. Whatever ideological approaches a current Commonwealth government may hold toward State rights, environmental protection and indigenous title are irrelevant for the purposes of its obligations to enforce the provisions of the Treaty. Thus, neither public protest nor recourse to the High Court could ameliorate the potential threat posed to the equilibrium of Australian sovereignty.

Finally, the liabilities imposed by the ECT are to be borne by successive Commonwealth governments, irrespective of their political orientation. As a signatory, it is possible for Australia to opt out of the ECT regime after 16 April 2003[55] pursuant to the provisions of Article 47. However, even if Australia avails itself of this option, the ramifications of any agreements made pursuant to the ECT will continue to reverberate through the Australian economic and legislative systems and the environment for a further twenty years (Article 47 (3)).

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[55] Five years after the entry into force of the Treaty (Article 47 (1)).

Therefore, in consideration of the extensive effects of the ECT upon Australian political and legislative sovereignty, it is essential that the Commonwealth's obligations as a Contracting Party be clarified.

If, as suggested supra, that Australia may already be obligated[56] to apply the terms of the ECT to all contracts in the energy sector formed with other Contracting Parties or their domestic entities, the effects discussed in this Chapter may already be operant. On the other hand, if Australia's obligations do not crystallise until the Treaty has been ratified by Federal Parliament, it is suggested here that further consideration of the terms of the ECT and more "extensive" consultations with the States, indigenous groups, commercial interests and other energy resource stakeholders is essential. Australia as a nation has too much to lose and too little to gain from a blind, unquestioning application of the ECT.

[56] By virtue of its status as a signatory.

CONCLUSION

When the concept of the ECT was first mooted by Ruud Lubbers in June 1990, it was proclaimed that it would offer economic largesse to the FSU through the provision of foreign investment in the energy sector. After more than seventy years of Spartan communist rule, the FSU states with their antiquated industrial facilities, disintegrating infrastructure and systemic political chaos, were in desperate need of technological and financial assistance. The securing of EU energy supplies for the twenty first century was touted as being merely incidental to the overriding purpose of providing assistance to the FSU.

In practice, however, it has been argued that the legal framework for FDI in the energy sector created by the Treaty operates in a manner totally different from the originally publicised conception. Rather than providing the FSU with both assistance and incentives to redevelop its industrial and energy sectors, the ECT prescribes a rigorous regime which abrogates state rights to direct domestic affairs by requiring changes to legislative, economic, political and international policy. Thus, any economic benefits accruing to the host state Contracting Party from an increase in investment is far outweighed by the deleterious effects upon the internal sovereignty of the nation. On the other hand, the EU states and their investors are poised to derive substantial advantages from the application of the Treaty.

FDI investors from the EU are able to plan energy projects in the FSU and Australia, secure in the knowledge that the provisions of the Treaty will shorten the formation and finalisation process for project related agreements, thereby saving both time and expense. Contractual terms normally subject to negotiation between the parties are made implicit in any energy sector agreement formed between Contracting Parties or their nationals. Thus, change-of-law, national/MFN treatment, government guarantees and indemnity clauses are almost rendered otiose by the provisions of the Treaty.

Secondly, the host state Contracting Party will be "locked-in" to providing the most favourable legislative and commercial environment for the proposed FDI. Any changes made by the host state Contracting Party to legislation, tariff, tax or levy structures or, indeed, any regulations affecting the subject agreement are actionable as breaches of the Treaty.

Thirdly, the rigorous obligations imposed upon the host state will ensure that any investment is fully protected. Not only is the host state Contracting Party liable for its own actions, but by virtue of Articles 22 and 23, it is rendered vicariously liable for any potential breaches by either sub-regional or autonomous authorities (Article 23) or state/privileged enterprises. Moreover, should a Contracting Party breach any of its obligations, the ECT sets out a detailed dispute resolution procedure which operates in regard to disputes between Contracting Parties and also between host state Contracting Parties and investors of another Contracting Party.

The EU states will also reap substantial benefits from the operation of the Treaty by securing energy products and supplies to meet the predicted increase in demand, well into the twenty first century. Unlike the EU states,[1] which are decommissioning their nuclear power plants, the FSU countries, particularly Russia and Ukraine, are willing if not eager to construct new nuclear power generating facilities capable of producing sufficient electricity at reasonable rates for sale to the EU. Moreover, new technologies, such as "superconductors" for electricity transmission, will enable electricity generated by power plants in Eastern Europe and Central Eurasia to be transmitted into the EU grids with relatively little loss of energy,

Further, the transit provisions of Article 7 and the proposed Transit Protocol will ensure that all energy products and supplies destined for the EU, irrespective of mode of transport, will be accorded right of way across the territory of a third state

[1] Apart from France.

Contracting Party. Thus, the construction or redevelopment of pipelines and electricity transmission infrastructure, and rail, road and sea transportation of energy products and supplies cannot be prevented by the third state Contracting Party within whose borders the energy transit is proposed.

In contrast, the Contracting Party producing the energy supplies or over whose territory the supplies are transported, are offered little in the way of benefit other than the putative economic advantages which may accrue from the project. By rendering implicit in energy sector agreements conditions which are normally subject to negotiation, the ECT effectively removes from the host state Contracting Party the ability to control the terms upon which FDI in the energy sector is conducted within its borders. Moreover, the stringent investment protection provisions of the Treaty require that all Contracting Parties effect legal reforms consonant with a free-market economy, irrespective of the political ideology or economic policies of the host state Contracting Party government.

The vicarious liability provisions of Articles 22 and 23 which hold a Contracting Party liable for the actions of sub-regional and autonomous authorities and SOEs and privileged enterprises, potentially threaten the independence of these entities, particularly of minority or indigenous groups.

Further, the obligations of Contracting Parties are extended by Article 26 to include duties to investors in energy projects who are not parties to the project agreements, thereby abrogating the doctrine of privity of contract.

The provisions of the ECT are therefore weighted solely in favour of the EU states and their investors whilst at the same time offering little advantage to host state Contracting Parties.

It is difficult to state definitively that the EU/EU investor bias of the ECT was in fact the Treaty's original but undisclosed objective. However, it is argued here that when placed within the context of EU energy policies from 1945 to the present, it appears to be the most likely rationale. The disintegration of the FSU between 1989 and 1991 suddenly made available to the EU the vast oil and natural gas resources of Central Eurasia whilst the Eastern European states offered potential sources of economically and politically low-cost electricity from nuclear power plants in such countries as Russia and Ukraine. It would appear to have been an opportunity the EU could ill-afford to ignore.

Certainly, had the EU members of the Charter Conference initially declared that the primary objective of the Treaty was to secure EU energy supplies and protect EU investments in the energy sector, they would have experienced even greater difficulty in persuading the FSU and other non-EU states to participate in the Treaty process.

It must also be remembered that the ECT is no longer a European instrument, but is subscribed to by countries normally regarded as being outside the European sphere of influence, such as Mongolia, Turkey, Japan and Australia.[2] China has become an Observer to the Charter Conference and the Secretariat is working doggedly to draw oil-rich Asian-Pacific and Latin American nations into the ECT regime.

It is understandable why developing and impoverished nations with exploitable energy resources may wish to become subject to the ECT. In regard to the FSU states, the need for economic assistance to restructure and revivify their moribund economies rendered them vulnerable to the ostensibly beneficial inducements

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[2] Neither Canada nor the US have yet subscribed to the Treaty. Whilst Canada has declared its "intention" to sign the Treaty at some stage, it is unlikely that the US will ever become a member of the ECT regime, considering the cogency of its objections to the investment protection provisions.

offered by the ECT.[3] The participation of a developed state like Australia is harder to rationalise.[4]

Australia has little need of the putative benefits offered by the ECT. Unlike the EU states and Japan, Australia has a wealth of discovered and potential energy resources. Despite the overseas activities of BHP-Billiton,[5] Australia has few other entities involved in FDI in the energy sector.
Moreover, Australia has a strong economy and therefore does not need the proposed economic development offered by FDI in its energy resource sector.

Finally, investments in Australia do not require the protective regime laid down in the ECT. Australia has a well developed and comprehensive commercial legislative system conquerable to that offered by the EU states and the US and pursuant to which competition policies and investment protection are rigorously applied.

Alternatively, the effects of the ECT are likely to cause major difficulties for Australian domestic policies and administration. The vicarious liability provisions of Article 23 have the potential to endanger not only Commonwealth/State relations[6] but also to abrogate even further the rights to native title of Aboriginals. Further, the transit provisions of Article 7 could compromise the safety of sensitive ecosystems such as Kakadu and the Great Barrier Reef. Pursuant to Article 7, environmental

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[3] Only Russia, the economically and politically strongest of the FSU states, was proof against the imbalance of bargaining power to the extent that on the night prior to the signing of the Treaty it was able to withhold its signature in order to obtain a deferral of certain trade-related provisions, which are now to included in the Supplementary Treaty.
[4] Japan's involvement is explicable in view of the fact that like the EU it is technologically dependant and a net energy importer. The advantages of the ECT to Japan are therefore the same as those accruing to the EU states.
[5] BHP-Billiton has, for many years, engaged in oil exploration and exploitation in areas such as Central Asia and has recently been chosen to construct a major natural gas pipeline in China.
[6] Which are always precarious even at the best of times.

protection is not sufficient reason to prevent transit of energy supplies across territory.

Finally, there exists the possibility that all energy sector agreements entered into by Australia or Australian entities with other Contracting Parties since 16 April 1998 are subject to the provisions of the Treaty by virtue of the Provisional Application requirements of Article 45. If this is the case, the adverse effects of the ECT upon Australia could crystallise in the very near future. Since Australia exports energy resources to both Japan and the EU, this is not a fanciful scenario.

In view of the Treaty's potentially deleterious effects, therefore, it is pertinent to ask why Australia became a signatory of the Treaty in the first place. What impelled Australia's representatives, despite their minor objections to certain provisions, to sign the Treaty on 17 December 1994? Were they propelled by a lemming-like impulse towards the acceptance of onerous and unnecessary obligations or were they merely dazzled by the bright lights of Brussels?

Australia's peremptory subscription to the ECT is even more puzzling in the light of its continuing refusal to sign the Kyoto Protocol on Greenhouse Emissions.[7] In comparing the relative environmental, constitutional and commercial advantages and disadvantages of the two instruments, the Kyoto Protocol offers far greater potential benefit that the ECT.

Whatever the reason for Australia's involvement in the ECT regime, it appears extremely unlikely that the Commonwealth government [8] either fully explored or understood the impact the ECT could have upon Australian domestic policies and affairs.

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[7] The UN Convention on Climate Change.

[8] And the State governments and other interested entities with which the Commonwealth conferred prior to subscription.

Putting aside the issue of the impact of the ECT upon non-EU states, however, it is not surprising that the EU was anxious to secure its energy supplies in the latter decade of the twentieth century. The greater reliance upon technology in all spheres of economic and social activity means an increasing dependence upon energy. Moreover, the need to protect FDI investments is comprehensible. It is a commercial reality that FDI in energy projects require huge funding commitments from investors. Therefore, unless project developers have assurances that their investment will receive both favourable treatment and adequate protection, they are unwilling to proceed. However, although the impetus behind the ECT is comprehensible, it cannot be condoned.

Had the ECT merely followed the pattern of other multilateral instruments, exhorting the signatories to adopt best practices and propounding principles and soft-law, the ECT would have been an innocuous document. As it stands, however, it imposes draconian and enforceable obligations upon signatories and in doing so exacerbates all of the traditional disadvantages of FDI to the host state. Certainly, it is not unusual for multilateral instruments to require that signatories cede some degree of autonomy in the areas covered by the document. For instance, human rights conventions and trade-related[9] treaties often require signatories to implement significant changes in their domestic legislation and political and economic policies. In particular, the General Agreement on Trade and Services (GATS), one of seventeen international trade agreements subject to WTO rules, "specifically targets domestic laws, regulations and policies with potential for discrimination towards foreign service providers."[10] Consequently, such incursions into what has traditionally been regarded as domestic issues are accepted without significant demur by signatories.

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[9] For example, GATT/WTO.

[10] Elaine Harrison, Globalization, that chameleon-hued word democracy, multinational enterprise and human rights. UTS dissertation, 2003, 95.

The obligations imposed by the ECT, however, are different. As noted in the discussions presented in the preceding Chapters, many of the obligations imposed by the ECT are enforceable. They are not couched in the exhortatory language of best-practice requirements or soft-law, but impose specific duties. If the terms of the ECT are breached, compliance may be enforced through rigorous dispute resolution procedures. Moreover, enforcement proceedings may be commenced not only by parties to the energy sector agreement, but also by an investor in an FDI energy project who was not a party to the subject agreement (Article 26). The ambit of potential litigants is therefore extended far beyond that generally conferred by contract law. It is in its enforceability and the abrogation of the doctrine of privity that the unique qualities of the ECT as an international instrument lie.

The question remains, therefore, as to whether the objectives of the ECT could have been achieved in any other way. Could the provisions have been framed so as to interfere less with the sovereignty of host state Contracting Parties whilst, at the same time, offering some degree of protection to FDI in the energy sector? Perhaps if the objective of the ECT had genuinely been to provide assistance to impoverished FSU states by economic development in their energy sectors, then the answer might have been "Yes." More liberal commercial legislation "phase-in" provisions: the recognition of the importance to the host state of the negotiation of contractual terms through less rigorous guarantee and government liability provisions: the provision of compulsory rather than facultative technical assistance by the developed nations and the allowance of certain trade-related protectionist measures by the host state would, perhaps, have produced a document more conducive to economic development than the ECT.

If, however, as is argued here, the fundamental motive behind the ECT is the security of EU energy resources into the twenty first century, it is difficult to envisage in what way the Treaty could have been framed so as to offer the maximum protection for EU investments and, at the same time, maintaining the sovereignty of

host state Contracting Parties. The two objectives appear to be incompatible. The Treaty must address one or the other: it cannot serve both ends.

Given the rigor of the obligations imposed upon host state Contracting Parties, the importance of securing FDI investments and energy supplies to the EU and the uncertainties and ambiguities inherent in the Treaty text, it is predicted that compliance with and enforcement of the provisions of the ECT will prove to be extremely problematic for all Contracting Parties. Despite the efficiency of the Treaty's supporting bureaucracy and its prescribed dispute resolution procedures, it is possible that a few of those Contracting Parties disadvantaged by its provisions will resile from the ECT regime and/or resist attempts by other Contracting Parties, project developers or investors to enforce its provisions. Certainly, it would be advisable for such Contracting Parties, especially Australia, to re-examine the ECT in the light of their potential liabilities, rather than relying upon assurances from the EU and the Secretariat as to the potential benefits it offers. Moreover, those Asian-Pacific and Latin American nations currently being wooed by the Secretariat to become signatories of the Treaty would be advised to undertake both a careful appraisal of the provisions of the ECT and a thorough cost-benefit analysis vis a vis membership of the regime.

In conclusion, therefore, the ECT does not offer the cornucopia of economic advantages to the energy resource supplier as was represented by its proponents in Europe. On the contrary, for non-EU nations the ECT represents a potential minefield of strictures and liabilities coupled with the abrogation of sovereign rights. Only the energy purchasers, i.e. the EU states, are likely to reap any substantial benefits from the application of its provisions. Thus, if not exactly a confidence trick perpetrated by the EU nations upon the impoverished FSU states and countries such as Australia, with energy resources for sale, the ECT could at least be described as a particularly deft example of sleight of hand.

APPENDIX I

Status of Ratification of the Energy Charter Treaty

as at 26 June 2003

1. Energy Charter Signatories which have deposited instruments of ratification/accession of the Treaty with the Depositary:

1.	12.07.1995	Georgia
2.	16.10.1995	Slovakia
3.	15.01.1996	Latvia
4.	12.03.1996	Uzbekistan
5.	17.06.1996	Czech Republic
6.	22.06.1996	Moldova
7.	06.08.1996	Kazakhstan
8.	19.09.1996	Switzerland
9.	15.11.1996	Bulgaria
10.	25.06.1997	Tajikstan
11.	07.07.1997	Kyrgyzstan
12.	17.07.1997	Turkmenistan
13.	12.08.1997	Romania
14.	04.09.1997	Greece
15.	10.09.1997	Slovenia
16.	27.11.1997	Luxemburg
17.	09.12.1997	Croatia
18.	12.12.1997	Liechtenstein
19.	16.12.1997	Austria
20.	16.12.1997	Denmark
21.	16.12.1997	Finland
22.	16.12.1997	Germany
23.	16.12.1997	Italy
24.	16.12.1997	Netherlands
25.	16.12.1997	Portugal
26.	16.12.1997	Spain
27.	16.12.1997	Sweden
28.	16.12.1997	United Kingdom
	16.12.1997	European Communities
29.	23.12.1997	Azerbaijan
30.	16.01.1998	Cyprus
31.	19.01.1998	Armenia
32.	12.02.1998	Albania
33.	27.03.1998	The Former Yugoslav Republic of Macedonia
34.	08.04.1998	Hungary

35. 04.05.1998 Estonia
36. 08.05.1998 Belgium
37. 14.09.1998 Lithuania
38. 29.10.1998 Ukraine
39. 15.04.1999 Ireland
40. 28.09.1999 France
41. 19.11.1999 Mongolia
42. 05.04.2001 Turkey
43. 24.04.2001 Poland
44. 17.05.2001 Bosnia and Herzegovina
45. 10.07.2001 Malta
46. 25.10.2002 Japan

2. Charter Signatories which have not yet deposited instruments of ratification / accession of the Treaty with the Depositary:

a. and the Parliaments of which have approved ratification of the Treaty

b. and the Parliaments of which have not approved ratification of the Treaty

47. Australia
48. Belarus*
49. Iceland
50. Norway
51. Russia Federation*

* apply the Treaty provisionally

Source: Energy Charter Treaty, website http://www.encharter.org

APPENDIX II

Table of Abbreviations

ACF	Australian Conservation Foundation
ACUS	Atlantic Council of the United States
AJIL	American Journal of International Law
ALRC	Australian Law Reform Commission
ALR	Australian Law Reports
All ER	All England Reports
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of South East Asian Nations
BSEC	Black Sea Economic Co-operation
BASREC	Baltic Sea Regional Electricity Co-operation
BLT	Build-Lease-Transfer
BOO	Build-Own-Operate
BOT	Build-Operate-Transfer
CIS	Commonwealth of Independent States
CLR	Commonwealth Law Reports
co	carbon monoxide
co2	carbon dioxide
CUP	Cambridge University Press
Defat	Commonwealth Department of Foreign Affairs and Trade
D-G	Directorate-General of the European Council
DPC	Dabhol Power Corporation
EBRD	European Bank of Reconstruction and Development
EC	European Community
ECIECP	European Community International Energy Co-operation Programme
ECS	Energy Charter Secretariat
ECSC	European Coal and Steel Community
ECT	Energy Charter Treaty
EEC	European Economic Community
EECT	European Energy Charter Treaty (the ECT prior to 1994)
EEP	ECT Protocol on Energy Efficiency and Related Environmental Aspects
EIA	Economic Integration Agreement
EIB	European Investment Bank
E/M	electromagnetic radiation
ESA	Euratom Supply Agency
EU	European Union
EUR	euro
Euratom	European Atomic Energy Community
FDI	Foreign Direct Investment

FSU	Former Soviet Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Co-operation Council
HCA	High Court of Australia
IAEA	International Atomic Energy Agency
ICA	International Court of Arbitration
ICC	International Chamber of Commerce
ICSID	International Centre for the Settlement of Investment Disputes
IEA	International Energy Agency
ILM	International Legal Materials
IMF	International Monetary Fund
IMS	international minimum standard of civilisation
kw	kilowatt
LCIA	London Court of International Arbitration
LPG	liquid petroleum gas
MFN	most favoured nation
MoU	memorandum of understanding
MSA	Multilateral Support Agency
mw	megawatt
NAFTA	North American Free Trade Agreement
NIS	newly independent state
NLC	Northern Land Council
n2o	nitrous oxide
nox	nitrogen oxide
OECD	Organisation of Economic Co-operation and Development
OPEC	Organisation of Petroleum Exporting Countries
OUP	Oxford University Press
PCIA	Permanent Court of International Arbitration
PCIJ	Permanent Court of International Justice
Phare	Programme of technical assistance for Central and Eastern Europe
PPA	power purchase agreement
R & D	research and development
SEA	Single Europe Act 1987
so2	sulfur dioxide
SOE	State Owned Enterprise
Synergy	Programme for international co-operation in the energy sector
Tacis	Technical assistance to the Commonwealth of Independent States
TEN	Trans-European Network
UN	United Nations
UNCITRAL	UN Commission on International Trade Law

VLCC	very large crude (oil) carrier
WHO	World Health Organisation
WTO	World Trade Organisation

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