ECT and the Yukos case

LATE LAST year, various newspapers claimed Yukos' shareholders were to sue the Russian government under the Energy Charter Treaty (ECT) for the dismantling of their company to pay for alleged back-taxes. That led to a polarised debate over how successful such an attempt would be. The question deserves accurate legal analysis and might keep lawyers busy for a long time, writes Andrei Konoplyanik.

One group claimed victory for Yukos' shareholders was assured – Russia signed the ECT and under the Treaty's provision, the country would be liable for most, if not all, of Yukos' claim of between $28bn and $33bn. This camp, however, remained silent on the question of whether the fact that Russia ha not yet ratified the Treaty would preclude the use of ECT's dispute-resolution mechanisms.

The other group said it would. Russia may have signed ECT, but it has not ratified it. Therefore, no ECT rules are applicable in Russia and it does not run the risk of international arbitration. Moreover, this group argued, Moscow should avoid ratifying ECT to prevent other investors from taking legal action against the country.

ECT and dispute resolution

The ECT contains several international dispute-resolution mechanisms. The two main procedures for dispute settlement through arbitration include settlement of disputes between an investor and a contracting party (CP) (ECT Article 26) and between CPs (ECT Article 27). The model for dispute resolution between investor and CP is a bilateral investment treaty (BIT). Specific procedures have been developed for the settlement of interstate disputes in the areas of trade (based on World Trade Organization rules), transit (conciliatory settlement), competition (information and consultations) and the environment (a review by the Energy Charter Conference, the organisation's highest decision-making body).

In each case, the purpose of international dispute resolution is to provide an independent and neutral judicial forum, rather than render services to foreign investors. In general, the ECT contains an international dispute-resolution formula that is unique both because of its broad multidisciplinary scope (covering energy-related investment, trade, transit, competition and environmental protection) and the number of countries that have joined it. It is unparalleled in terms of the comprehensive dispute-resolution procedures it secures both in the CP-CP area and, especially, in the investor-CP area. It would not be an exaggeration to say the ECT is the best available multilateral mechanism for investment protection.

The Yukos claim against Russia must fall under the scope of ECT Article 26 (although whether it can be legally enforced, because of Russia's non-ratification of the Treaty, is another matter). Under this article, disputes between an investor and a CP shall, if possible, be settled amicably. Both parties have three months for consultations. If negotiations are not successful, the foreign investor may choose to submit the dispute to:

- National courts, or administrative tribunals of the host country party to the dispute;
- A body established by both parties as a dispute-settlement mechanism (for example, as provided for in the BIT); or
- International arbitration.

If the foreign investor elects to refer the dispute to international arbitration, it may choose from one of the following three arbitration options:

- The International Centre for Settlement of Investment Disputes (Icsid), established pursuant to the Icsid Convention. This option is possible if at least the investor's parent

ECT: what is it?

The Energy Charter Treaty (ECT) is composed of 52 contracting parties (CP) – 51 Eurasian states (including all European Union countries, Russia and all CIS countries) plus the EU as a collective member. Seventeen countries and 10 international organisations are observers to the Energy Charter process. The highest decision-making body is the Energy Charter Conference. The Treaty was signed in December 1994 and came into force in April 1998. Since then, it has been an integral part of international law, binding the parties that have ratified it. It seeks to set "uniform rules" within the territories of the countries that have signed and ratified it. Its scope covers the whole energy sector, ranging from energy-resource exploration and production to end-use. ECT embraces energy investment and trade, energy transit, energy efficiency and related environmental considerations. ECT facilitates political and business risk mitigation through both technological and investment cycles in energy, and seeks to form a unitary energy space within Eurasia. □

Table 1: Investor-to-state disputes under ECT Article 26*

Investor from a CP to the ECT	CP to the ECT	Case filed	Arbitration forum chosen by the investor	Subject matter	Status	Claim (award)
AES Summit Generation (UK subsidiary of the US' AES)	Hungary	25.04.01	Icsid Case ARB/01/4	Power purchase and sales agreement	Settlement agreed by the parties and proceeding discontinued at their request (03.01.02)	na
Nykomb Synergetics Technology Holding (Swedish investor)	Latvia	11.12.01	Arbitration Institute of the Stockholm Chamber of Commerce (SCC)	Electricity purchase	Award rendered on 16.12.03	SKr 8.354m/$1.191m (SKr 2.00m/$285,144)
Petrobart (Gibraltar-based UK investor)	Kyrgyzstan	2003	Arbitration Institute of the SCC	Gas delivery contract	Case registered with the Arbitration Institute	na
Plama Consortium (Cypriot investor)	Bulgaria	19.08.03	Icsid Case ARB/03/24	Oil refinery investment	Pending (the Tribunal issues Procedural Order No 2, concerning the procedural calendar on 31.03.05)	na
Alstom Power Italia Alstom SpA (Italian investor)	Mongolia	18.03.04	Icsid Case ARB/04/10	Thermal energy project	Pending (the Tribunal holds its first session, via telephone conference, on 02.12.04)	na
Hulley Enterprises (Cyprus) & Yukos Universal (Isle of Man) – subsidiaries of Gibraltar-based Group Menatep	Russian Federation (Provisionally applying ECT)	03.02.05	Uncitral arbitration rules	Discriminatory measures and expropriation of investments	Arbitrators for both parties appointed	$28.0bn-33.1bn†

*Known to the Energy Charter Secretariat as of May 2005. The information contained in this table has been obtained from various public sources (press, Icsid, SCC) and is believed, but cannot be guaranteed, to be reliable. †*Gas Matters* (27.05.05); Menatep press release (11.04.05)

country, or the host country are parties to the Icsid Convention;

- Sole arbitrator, or an *ad hoc* arbitration tribunal established under the United Nations Commission on International Trade Law (Uncitral) arbitration rules; or
- The Arbitration Institute of the Stockholm Chamber of Commerce.

Consequently, as applies to investment disputes, the ECT does not resolve a dispute directly, but secures a transparent and internationally agreed mechanism to choose one of the existing arbitration procedures to have the dispute resolved on its merits.

Hulley Enterprises (based in Cyprus) and Yukos Universal (Isle of Man), both subsidiaries of Gibraltar-based Group Menatep, the main shareholder of Yukos, say they have initiated legal proceedings against Russia under the ECT. The arbitration institution selected by the investor was the Uncitral arbitration rules. The case seems likely to be reviewed by an *ad hoc* arbitration tribunal rather than a sole arbitrator.

ECT and Yukos claim

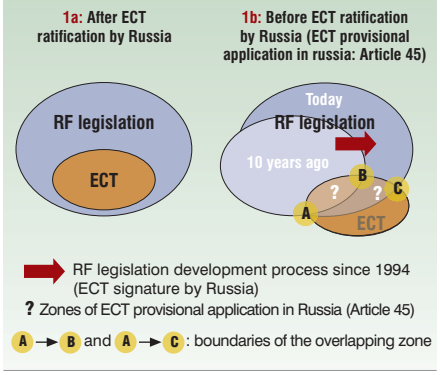
The ECT has a dual role. It provides an efficient instrument for resolution of disputes and deters CPs from violating ECT provisions. The few ECT disputes known to the Secretariat cannot determine the efficiency of the ECT dispute-resolution mechanism because it is impossible to know how many potential disputes have been prevented by CPs' awareness of ECT dispute-settlement vehicles and, consequently, of the legal implications of violating the ECT.

The Yukos suit stands out from previous dispute-resolution applications in terms of its size and its political implications

The history of potential ECT dispute-resolution applications dates back to 16 April 1998, when the Treaty came into force. Applications have started more recently (from 2001 only). Over the past five years, at least six suits have been brought under ECT Article 26 (see Table 1). One has been resolved out of court; another has been settled by arbitration in favour of the investor; three others are still in litigation; and the sixth is Yukos' claim against Russia. The total may be higher – if a dispute arises, or a suit is filed under the ECT, the parties to the dispute are under no obligation to advise the Secretariat of either the content, or even the existence of the dispute, nor is the arbitration institution in question obliged to provide such information to us.

However, the Yukos suit stands out from the others in terms of its magnitude and its political implications. The amount awarded in the Nicomb *versus* Latvia case (the only in-court settlement under the ECT) was less than $300,000, compared with the amount claimed of about $1.2m. The amount claimed in the Yukos case is about 30,000 times higher. The case is, therefore, likely to serve as a test of the stability and impartiality of international arbitration institutions.

Figure 1: Scope of application of ECT in Russia



However, the Yukos claim also stands out from the other known ECT suits because it is the only one that involves, as defendant, a country applyingto the ECT on a provisional basis – all the others against which similar suits have been brought (Hungary, Latvia, Kyrgyzstan, Bulgaria and Mongolia) have signed and ratified the ECT.

Russia signed the ECT in 1994. In 1996, the government submitted the ECT for ratification to the Duma (parliament). In the most recent parliamentary hearings on the subject, in January 2001, the government said it would return to its review after the negotiations on the Energy Charter Transit Protocol (another multilateral Treaty within the package of the Energy Charter's legally binding instruments) were finalised to Russia's satisfaction (*PE* 7/04 p34).

Not ratified

Russia is one of five countries not to have ratified the ECT (Australia, Iceland, Norway and Belarus are the others), but to be applying it (together with Belarus) on a provisional basis, in accordance with the 1969 Vienna Convention on the Law of Treaties, Part II, and the 15 June 1995 Federal Law on International Treaties of the Russian Federation, Section II.

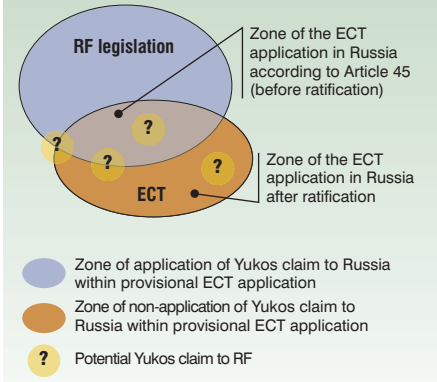
In practice, this means that in accordance with ECT Article 45 "each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent such provisional application is not inconsistent with its constitution, laws or regulations."

The form and limits of legal consequences relating to provisional ECT application by a country have not yet been studied deeply enough in international law. According to the Russian foreign ministry, its study of the county's provisional application of international treaties (pending their entry into force) indicates that each individual case requires a close preliminary review of the legal framework underlying the preliminary application of a given Treaty. In this case, that primarily means a careful review of whether or not the suit whose content is not available publicly, even to the Secretariat, falls under the legal framework of provisional application of the ECT by Russia.

After Russia ratifies the ECT, it will become an integral part of Russian legislation (see Figure 1a), but that may not yet be the case. Some of its provisions may be inconsistent with the Russian constitution, laws or regulations, so there may be an overlapping zone in which the provisions of the ECT are an integral part of Russian legislation and a zone in which ECT provisions are not applicable within Russia until is ratifies the ECT (see Figure 1b).

It is necessary to substantiate the extent to which Russia is provisionally applying the ECT today – this may be a substantial part of the disputes between both parties' attorneys. In doing so, it should be remembered that the ECT is an international Treaty whose content has remained constant since its signing by the parties, whereas Russian legislation is constantly evolving and has changed considerably over the 10 years since the signing of the ECT. Therefore, the boundaries of the overlapping zone are not constant and change with time (from A-B and A-C in Figure 1b).

Figure 2: Scope of application of Yukos against Russia claim under ECT



Does the Yukos claim fit in into the zone of the ECT provisions that do not apply by Russia until it ratifies the Treaty, or into the zone where ECT provisions are enforced while Russia applies ECT on a provisional basis? Can it be split between both zones or does a part of the claim go beyond the ECT scope?

In the absence of a detailed legal analysis, it is impossible to judge in which of the zones the Yukos claim will end up (see Figure 2). The application of ECT to each lawsuit is something to be determined by the arbitration institution selected by the investor and CP. This may be a lengthy process. But it must be a fair one. □

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