

RUSSIA AND THE ECT: THE UNPLUMBED DEPTHS OF PROVISIONAL APPLICATION

The provisional application of the Energy Charter Treaty raises tricky substantive issues, says Sophie Nappert, an arbitrator at 3 Verulam Buildings, London

The policies adopted by the Russian Federation in dealing with its energy resources, notably in its gas pricing dispute with Ukraine and, more recently, its draft law on foreign investment in strategic industries, have drawn wide publicity and comment. The draft law, which envisages restrictions on foreign investors in 42 strategic sectors, including energy, natural monopolies, mineral deposits, aviation and defence, has very recently passed its third and final reading. It now has to be adopted by the upper house of Parliament and to be signed by the president to come into force. Those policies make Russia's position under the Energy Charter Treaty a topic of growing relevance.

Russia has signed the treaty, but to date has no intention of ratifying it. The (then) president, Vladimir Putin, expressed the position forcefully, last year at an international security summit in Munich: "We have stated on numerous occasions that we are not against coordinating the principles

of our relations with the European Union in the energy sphere. But we find the [Energy] Charter itself hard to accept".

The advent of Dmitry Medvedev as President Putin's successor is not expected to herald a change in Russia's stance towards the treaty. There is one peculiarity, however: the Energy Charter Treaty allows for provisional application in its article 45. (See box below.) Although "provisional application" is not a novel concept in international law, the continued non-ratification of the treaty by Russia places it in a unique position, which will no doubt be tested in the arbitration proceedings started against Russia by Yukos's majority shareholders Group Menatep, Hulle Enterprises, Yukos Universal and Veteran Petroleum Trust, for the alleged expropriation of their investment in Yukos.

This article looks at questions raised by Russia's provisional application of the treaty, and at the recent decision on jurisdiction in

Ioannis Kardassopoulos v Georgia, in which some of the implications of article 45 of the treaty are examined for the first time (see ICSID case ARB/05/18, decision on jurisdiction, 6 July 2007).

In that case, the tribunal found that provisional application by Georgia at the time of the alleged interference with the claimant's interest in a joint venture – in a period between ratification and signature – amounted to the full-fledged application of the treaty. Although *Kardassopoulos* lacks the authority of binding precedent for future tribunals grappling with article 45 issues, it does provide an indication of how these issues might be tackled by others. The unanswered questions are now:

- whether the *Kardassopoulos* reasoning applies where ratification is not anticipated; and
- whether there are time limits placed on the provisional application of the Energy Charter Treaty.

Article 45 of the Energy Charter Treaty

(1) Each signatory agrees to apply this 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.

(2) (a) Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository.

(b) Neither a signatory which makes a declaration in accordance with subparagraph (a) nor investors of that signatory may claim the benefits of provisional application under paragraph (1).

(c) Notwithstanding subparagraph (a), any signatory making a declaration referred to in subparagraph (a) shall apply Part VII provisionally pending the entry into force of the Treaty for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its laws or regulations.

(3) (a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository.

(b) In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any investments made in its Area during such provisional application by investors of other signatories shall nevertheless remain in effect with respect to those investments for twenty years following the effective date of termination, except as otherwise provided in subparagraph (c).

(c) Subparagraph (b) shall not apply to any signatory listed in Annex PA. A signatory shall be removed from the list in Annex PA effective upon delivery to the Depository of its request therefor.

(4) Pending the entry into force of this Treaty the signatories shall meet periodically in the provisional

Charter Conference, the first meeting of which shall be convened by the provisional Secretariat referred to in paragraph (5) not later than 180 days after the opening date for signature of the Treaty as specified in Article 38.

(5) The functions of the Secretariat shall be carried out on an interim basis by a provisional Secretariat until the entry into force of this Treaty pursuant to Article 44 and the establishment of a Secretariat.

(6) The signatories shall, in accordance with and subject to the provisions of paragraph (1) or subparagraph (2)(c) as appropriate, contribute to the costs of the provisional Secretariat as if the signatories were Contracting Parties under Article 37(3). Any modifications made to Annex B by the signatories shall terminate upon the entry into force of this Treaty.

(7) A state or Regional Economic Integration Organization which, prior to this Treaty's entry into force, accedes to the Treaty in accordance with Article 41 shall, pending the Treaty's entry into force, have the rights and assume the obligations of a signatory under this Article.

The treaty

The Energy Charter Treaty is the first multilateral instrument aimed at promoting and protecting investment, security of supply and transit in the energy sector. It advocates transparency and non-discrimination in the treatment of foreign investment, freedom of transit and a commitment to the progressive liberalisation of international trade in the energy sector.

Fifty-two states, including Ukraine and the EU as a unit, have signed the treaty and 20 more are observers. In addition to Russia, other signatory states which have not ratified the treaty are Australia, Belarus, Iceland and Norway.

The effect of signature without ratification, in public international law terms, is that Russia is “provisionally applying” the treaty. Having signed the treaty places Russia under an obligation at international law not to act in a manner contrary to its aims and terms.

The 1969 Vienna Convention on the Law of Treaties (the Vienna Convention) recognises the concept of provisional application (see articles 18 and 25). A treaty is provisionally applied where treaty obligations are given effect pending a state’s formal ratification of, or accession to, a treaty. Reasons for introducing provisional application in a treaty may include, for example, an element of urgency in implementing the treaty before ratification can occur; or where treaty negotiators are certain that the treaty will obtain the requisite domestic approval for ratification; or a desire to circumvent political or other obstacles to the entry into force of a treaty.

Pursuant to article 18 of the Vienna Convention, nation states that are “provisionally applying” a treaty undertake to refrain from acts that would defeat the object and purpose of a treaty that they have signed, or to which they have expressed their consent to be bound, pending its entry into force.

Article 25 of the Vienna Convention provides that a “treaty or a part of a treaty is applied provisionally pending its entry into force if: (a) the treaty itself so provides; or (b) the negotiating states have in some other manner so agreed.”

Provisional application may be terminated, seemingly at any time (see article 25(2) Vienna Convention). The Vienna Convention does not deal with the scope or detail of the provisional application of treaties, which is left to the agreement of the state parties. This aspect prompted the tribunal in *Kardassopoulos* to comment that provisional application, being left to the ad hoc agreement of states, may fall short of constituting a rule of customary international law. The tribunal went on, though, to find that there was sufficient state practice to generate a generally accepted understanding of what is meant by the notion (see the decision at paragraphs 215 to 218).

Provisional application under article 45

Pursuant to article 45(1) of the Energy Charter Treaty, each signatory state agrees to apply the treaty provisionally pending its entry into force for the signatory state in question, “to the extent that provisional application is not inconsistent with the State’s own constitution, laws or regulations”. This caveat presents challenges unique to the ECT, some of which are outlined below.

All signatory states applied the Energy Charter Treaty provisionally between December 1994 and its entry into force in April 1998, unless a state had expressly declared that it was unable to apply the treaty provisionally. After April 1998, provisional application was restricted to those states that had signed, but not yet ratified, the treaty.

In Russia, the ratification procedure commenced with the introduction of the project to the State Duma in 1996. Parliamentary hearings began in 1998 but the Duma postponed ratification several times in view of negotiations and disagreements connected with the treaty’s transit protocol.

Article 45(2)(a) of the treaty provides each signatory state with the opportunity to deposit, upon signature, a declaration that it is unable to accept provisional application. Pursuant to article 45(3)(a), provisional application may be terminated at any time on giving 60 days’ notice.

Russia has yet to register a declaration of non-application upon signature, nor has it given notice of its intention to terminate provisional application. Consequently, the Energy Charter Treaty is applicable to Russia within the framework of article 45.

It is worth noting, on this point, the finding in *Kardassopoulos* that:

There is no necessary link between paragraphs (1) and (2) of Article 45. A declaration made under paragraph (2) may be, but does not have to be, motivated by an inconsistency between provisional application and something in the State’s domestic law; there may be other reasons which prompt a State to make such a declaration. Equally, a State whose situation is characterised by such inconsistency is entitled to rely on the proviso to paragraph (1) without the need to make, in addition, a declaration under paragraph (2). (See paragraph 228).

The tribunal also found that a respondent state wishing to invoke the domestic exception bears the burden of proving its application, and that in the instant case, Georgia had failed to discharge that burden of proof.

If a similar reasoning to that adopted in *Kardassopoulos* is followed in the *Yukos* cases, then no presumption about the compatibility or otherwise of Russia’s laws and regulations with the concept of provisional application would be deduced from its inaction regarding a declaration of this type.

The “domestic exception” clause in article 45

A crucial aspect of article 45 is its “domestic exception” clause, which states that provisional application must not be inconsistent with the signatory state’s constitution, laws or regulations. This wording appears to give priority to national law over the treaty during the period of provisional application.

The language in article 45 can be interpreted in either, or both, of the following ways: (i) the very concept of provisional application must not be inconsistent with the state’s internal law; (ii) the Energy Charter Treaty’s substantive provisions must not be inconsistent with substantive provisions of internal law.

The detailed review of Russian internal law envisaged by (ii) is beyond the scope of this article. In relation to (i), however, Russian law acknowledges and accepts the notion of the provisional application of treaties. The Constitution of the Russian Federation assigns to the president the right to negotiate and conclude international treaties pursuant to its article 86(b), but leaves their ratification to the Federal Assembly (the State Duma and Council of the Federation: articles 71, 105, 106(d)).

The concept of provisional application is absent from article 15(4) of the Constitution whereby generally accepted principles and rules of international law and international treaties of the Russian Federation are made an integral part of the Russian legal system. Article 23, however, of the 1995 Federal Law on International Treaties of the Russian Federation specifically recognises the provisional application by Russia of international treaties to which it is a party, if so provided by the treaty or by agreement with the other signatories.

Scope of provisional application

There is little precedent on how provisional application affects the other provisions of a treaty. This may be because provisional application is usually followed by ratification in fairly short order.

Regarding the Energy Charter Treaty, a key issue is whether article 45 affects the capacity of an investor to invoke the treaty’s dispute resolution provisions at article 26 against Russia. In other words, does provisional application shield Russia from investor–state arbitration under the ECT? This is one of the central issues in the pending arbitration proceedings against Russia concerning *Yukos*. Although this issue remains to be decided in the case of Russia, the *Kardassopoulos* tribunal, faced with similar arguments on the part of Georgia, made the following findings:

- Provisional application of the Energy Charter Treaty is not aspirational in character; it is a matter of legal obligation (see decision, paragraph 209).
- It is the treaty as a whole and in its entirety which is to be applied “pending its entry into force” (see decision, paragraph 210).

- The language at article 45(3)(b), whereby, in the event of termination of provisional application by a signatory, part III (on investment promotion and protection) and part V (on dispute settlement) of the treaty continue to apply for 20 years, confirms that these two parts apply during the period of provisional application, and that the operation of these parts gives rise to an obligation (see decision, paragraphs 212 and 213).
- The language at article 45(1) is to be interpreted as meaning that each signatory state is obliged, even before the Energy Charter Treaty has formally entered into force in that state, to apply the whole treaty as if it had already done so (see decision, paragraph 223).

In addition, complex issues arise regarding the relationship between provisional application and articles 10(1) and 22(1) of the treaty.

A great deal of thought is being given to the ambit of the treaty obligations observance clause often found in investment treaties – the famous “umbrella clause”. The treaty contains such a clause in article 10(1). It requires each contracting party to “observe any obligations it has entered into with an investor or an investment of an investor of any other Contracting Party.” It is worth noting that articles 26(3)(c) and 27(2) allow contracting parties to exclude from the ambit of article 26 arbitration those disputes covered by the umbrella clause. Russia has not availed itself of this exclusion.

Tribunals have grappled with the scope and effect of umbrella clauses in the context of bilateral investment treaties, and notably with the possible inclusion of claimants’ subsidiaries or state sub-entities as parties. No discernible consistency on these issues emerges so far in arbitral “jurisprudence”. For a useful overview, see Nick Gallus’s recent article: “An Umbrella Just For Two? BIT Obligations Observance Clauses and the Parties to a Contract” ((2008), *Arbitration International* Vol 24, Issue 1, 157). In the context of the Energy Charter Treaty, the challenge remains of drawing a line between “purely” commercial obligations undertaken by a nation state, or one of its entities, and those obligations undertaken by the same nation acting in its governmental or sovereign capacity which would attract treaty protection.

Arguably, this distinction is the very focus of article 22 of the treaty, whereby state enterprises of the host state:

shall conduct [their] activities in relation to the sale of or provision of goods and services in its Area in a manner consistent with the Contracting Party’s obligations under Part III of this Treaty.

Part III includes the umbrella clause. Such language could potentially engage the host state’s liability for a range of actions or omissions by

state enterprises in the fulfillment of agreements for the sale of goods or delivery of services, including those undertaken on a purely commercial basis

As an aside, here, an opportunity to examine this portion of the treaty and its meaning arose in *Nykomb v Latvia*, the first arbitral award rendered under the auspices of the Energy Charter Treaty. The tribunal ultimately refrained from expressing a view on whether article 22(1) set down a norm of attribution of state responsibility as an extension of the effect of the umbrella clause (see Arbitration Institute of the Stockholm Chamber of Commerce, Case No. 118/2001, award 16 December 2003).

Limited in time or indefinite?

The final question about Russia’s current position under the Energy Charter Treaty is whether the period of provisional application is limited in time or indefinite.

Article 25(2) of the Vienna Convention, regarding the provisional application of treaties, provides that:

Unless the treaty otherwise provides or the negotiating States have otherwise agreed, the provisional application of a treaty or part of a treaty with respect to a State shall be terminated if that State notifies the other States between which the treaty is being applied provisionally of its intention not to become a party to the treaty.

This provision is reproduced almost verbatim in article 23(3) of the 1995 Russian Law on International Treaties.

Thus neither article 25 of the Vienna Convention nor article 23 of the Russian law provides an express limitation in time for provisional application. Instead, both articles envisage that provisional application will come to an end either via the entry into force of the treaty, or by express termination through notification by a signatory of its intent not to become a party to the treaty. Both these instances require an explicit expression to terminate provisional application, such that intention to do this cannot be implied. In addition, if the *Kardassopoulos* decision is right that provisional application does not form part of customary international law, then the position is also that no time term could be implied from principles of customary international law.

Looking at these two provisions, it would appear that the provisional application of a treaty, if it is set forth, will be limited in time only if so expressly stated in the treaty. Without such express limitation, provisional application may be terminated by a party to the treaty. Both articles 25(2) of the Vienna Convention and 23(2) of the Russian law require that such termination be explicit, and notified to every other party applying the treaty provisionally.

No express limitation in time is stipulated in article 45 itself. According to article 45,

provisional application comes to an end either through express termination via written notification, or by the entry into force of the treaty. Furthermore, article 45(3)(b) provides that obligations under part III and part V of the treaty survive termination for 20 years from the effective date of termination.

As things stand, then, it would appear that the provisional application of the Energy Charter Treaty may be maintained indefinitely.

Provisional application as it appears on article 45 is a deceptively simple concept. The provision brings up a number of important substantive questions that so far remain truly open. It is hoped that these issues will be examined and tackled by tribunals in future ECT cases.

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