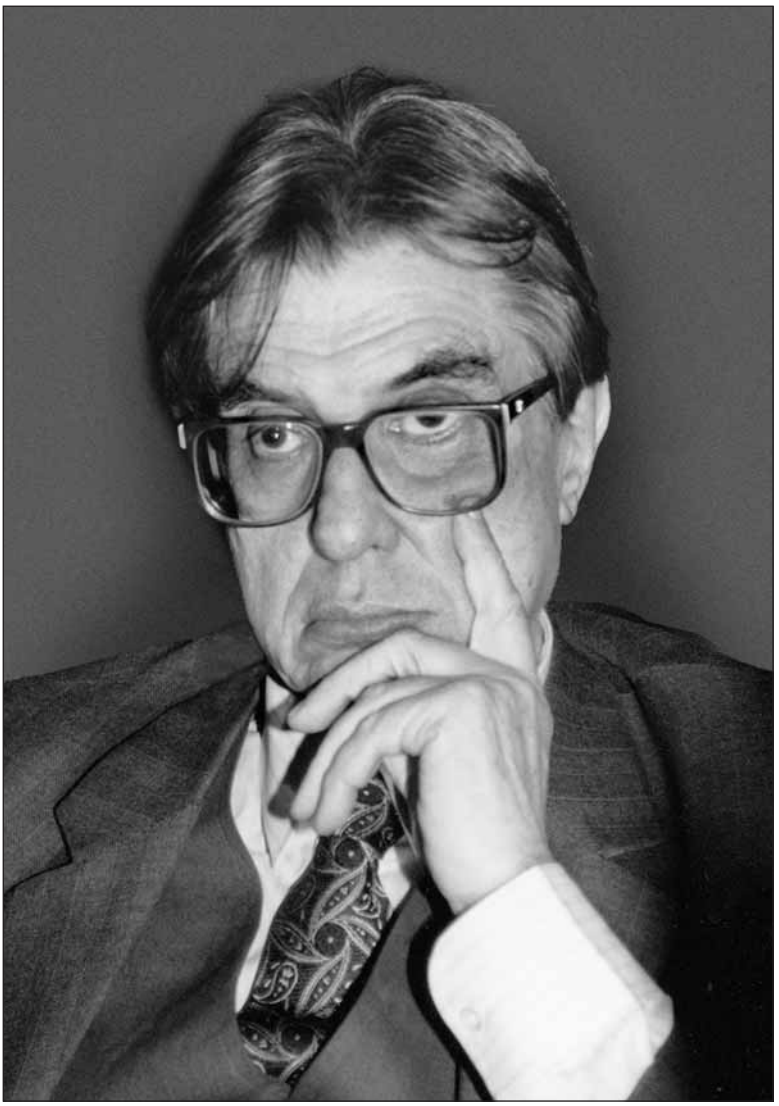
AN INTERNATIONAL LEGAL FRAMEWORK FOR ENERGY

by

ARGHYRIOS A. FATOUROS



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BIOGRAPHICAL NOTE

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Academic career: Lecturer and Assistant Professor, Faculty of Law, University of Western Ontario (London, Ont., Canada, 1960-1963); Assistant Professor, Associate Professor and Professor of Law, Faculty of Law, Indiana University (Bloomington, IN, 1964-1980); Professor of Law, Faculty of Law, University of Thessaloniki (Greece, 1980-1990); Professor (and twice chairman), Faculty of Political Science and Public Administration, University of Athens (Greece, 1990-2000). Professor emeritus since 2000. Visiting faculty member at the Universities of Chicago, Duke, Columbia, Nice, Paris-X.

Alternate Member, Administrative Tribunal, Organization for Economic Co-operation and Development (OECD), Paris. Member, International Court of Arbitration, The Hague. Member, panel of arbitrators, International Centre for the Settlement of Investment Disputes, Washington DC. Chair or member of various arbitration tribunals under ICSID auspices. Member, Institut de droit international.

Permanent Representative of Greece to the OECD (1982-1985). Secretary-General, Greek Ministry of National Education (1989-1990); caretaker Minister of Justice (1996); caretaker Minister of Press and Media (2000).

Director, Center of International and European Economic Law (Thessaloniki) (1986-1989). President, Hellenic Society of International Law and Relations (1987-1989). President, Hellenic Culture Foundation (2000-2004).

At various times, consultant to the Secretariat of the United Nations, UNITAR, UNCTAD and the UN Centre on Transnational Corporations.

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At various times, member of the Board of Editors, Board of Advisors etc., of Greek and international scholarly journals.

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PREFATORY NOTE

These lectures were delivered in the summer of 2001 at the Hague Academy of International Law. In the normal course of events, they would have been revised for publication in the final months of that year and published soon after. This did not happen, for reasons which had to do with the author's ability and availability to undertake that task at the time. Thanks to the kind patience and understanding of the Academy's Secretary-General and staff, I have been given the opportunity to undertake now, with considerable delay, the lectures' revision for publication.

In the years since there have been important and extensive developments in the world economy and international politics which have affected the energy sector in significant ways. I suspect that if I were to start preparing these lectures today, I may have adopted different approaches on a number of issues. It is too difficult, however — and would necessarily involve additional delays —, to start from scratch, as it were. Moreover, my perception of the field does not suggest that the principal points made in the lectures concerning the legal context of the energy sector have lost their validity and relevance. I have therefore decided to offer a revised version of the 2001 lectures, with only the changes that appear to be absolutely necessary. Some facts have been brought up to date, a few points have been added on the impact of recent developments, but no radical change was undertaken in the structure and contents of the lectures. It is likely that, in a few more years' time, such a radical transformation would have been necessary. As things stand now, however, most of the main features of the industry seem to remain the same; this is true, in particular, of the legal background, with all its variations, gaps and contradictions.

PROLEGOMENA

The lectures that follow are an experiment. They are an attempt to determine whether and how far it is possible to account in terms of law, in particular of international law, in the broadest sense, for a domain of activity, whose international dimension is well established and where law and legal methods and devices are all-important, but with respect to which neither customary nor conventional international law provides a clear and comprehensive structure of legal rules. No treaty founding an international organization and no comprehensive multilateral convention is in force covering the entire domain of energy. Customary international law provides a broad but imprecise and far too general background for its legal regulation and most of the pertinent rules in effect, whether in international or municipal law, are specific to particular States. Bringing together the disparate legal elements involved results therefore in many gaps and peculiarities. To avoid the misunderstandings that arise through the use of terms such as, "the international law of . . .", I shall have recourse to the notion of an "international legal framework", whose contents I shall discuss presently.

The situation in this domain of activity reflects a number of facts. To begin with, while a number of traditionally valid legal principles and rules are still in force, the exact allocation of competence between individual States and the international community on the matter is in a state of flux. At the same time, the distribution of authority, of authoritative decision-making power, among the several categories of actors involved — States (Governments), international organizations, private firms, and individuals — is at best unclear and uncertain. Thirdly, there are several kinds and levels of interests involved — partial and universal, national and international, special and common — to which correspond different types of legal rules, and the exact relationship and hierarchy among them is still fluid and uncertain.

This pattern is neither novel nor unique in present-day international society. Other areas of international activity were in a comparable situation in the recent past and some still are today, to a greater or lesser extent. The law of the sea, prior to the Montego Bay Convention of 1982, would have been a pertinent example. In this

field, as well, the conflict between national and international competence rendered impossible, for a long time, the formulation of a comprehensive set of rules and procedures. At the same time, however, the customary international law of the sea has included from early on notions and patterns reflecting the acceptance of common interests. The notion of the high seas, in particular, where no exclusive national jurisdiction is exercised, served from the very start to bring into focus the presence of common interests and the need for the exercise of international, that is to say, collective, jurisdiction and for international rules. International law concerning energy has not yet reached such a stage. On the other hand, the law on the protection of the environment is today in even less developed and less clearly structured a condition than the law on energy, with which it shares important characteristics. In a different manner, the law concerning foreign direct investment, while at a different stage of development, exhibits several of the same features. We will have to come back to the general situation in the field at the very end, after our review of it, and discuss in our conclusions how far it is possible at this point in time to provide a reasonably accurate comprehensive and structured overview of the overall situation and in particular of the legal facets of international energy relations.

CHAPTER I

INTRODUCTION: ENERGY AND THE LAW

"The beginning of learning", said Epictetus, "is the examination of names." For present purposes, this means that we need to study the meaning of the two basic terms in the title, on the one hand, "energy", and on the other, "international legal framework".

In physics, energy is usually defined as the ability to do work (or to produce change). There are several kinds of energy (for instance, kinetic, mechanical or chemical) and energy assumes many forms (heat, light, electricity, chemical energy and so on). Changes in the state of matter produce energy: through conversion from the solid to the liquid state or from the liquid to the gaseous state, through the splitting of the nucleus of atoms, through other changes, such as those from the effects of gravity (e.g., falling water) or through the impact of other natural forces (e.g., the wind, the sea etc.). Here, of course, we are not concerned with the physics or the thermodynamics of the issue, even though the phenomena we are dealing with are related to, indeed founded on them. Since this study focuses on legal matters, energy must be understood in a social context. We are interested in it, not in terms of physics, mechanics or technology, but as a social phenomenon, as a sector of human activity.

The second term adds an important element of context, since, as just noted, our emphasis will be on the legal facets of the operation of the energy sector. The term itself, "international legal framework", is relatively new, with no clearly established meaning. For this very reason, however, it is a convenient term, because the usage of alternative formulations — to speak, for example, of "the international law of energy" — would have seemed to imply a far greater degree of clarity and organization in the structure of the field than the facts warrant.

Forms and Sources of Energy

As already noted, our interest in the legal facets of the matter implies a concern with the social effects and functions of energy. In fact, we are concerned not with energy as such, but with the energy

sector, or industry, the economic industry that produces and distributes energy, and the legal relations involved. What we are discussing are fundamentally social problems. Although it is impossible to ignore the interaction between natural resources and economic, social and political factors, or the impact of technology on the whole issue, we shall be looking at energy not in terms of physics or technology, but in terms of its presence and function in human society, in the contemporary social and economic system, and of course the legal arrangements devised for dealing with it. As the discussion that follows should make clear, the usefulness of the notion of an international legal framework is precisely that, by avoiding the search for a clear hierarchy of rules and factors, it allows a constant *va et vient* between legal and economic, technological and political considerations, while retaining an emphasis on the structure of economic and social relationships, as expressed in legal regulation.

Animal power, supplied by humans or beasts, is historically the first source of energy, still very much in use. And, of course, animal power may be understood in terms of the chemical energy contained in the food animals (and humans) ingest. Chemical energy is also at the root of the heat produced by the combustion of wood, coal or other fuels. While, as already noted, the scientific study of the ways in which energy is produced is not our topic, it is important to remember that, starting with the simplest forms of animal energy, the processes of energy production become increasingly complex and diverse.

The interaction of different forms of energy is at the heart of the entire field. The steam engine is based on the conversion of the chemical energy of fuels into heat, which, when applied to water, produces steam, which is then converted into mechanical energy. Similar processes are in operation in internal combustion engines, where the chemical energy of fuel produces heat that is converted into mechanical energy.

Energy is a fundamental element of human society and history. In fact, one way to perceive history is in terms of the evolution (and accumulation) of methods for the production and use of energy. After animal energy, the most ancient method for the production of energy is the utilization of the mechanical energy derived from harnessing natural phenomena, such as the wind (for the motion of boats and windmills) and water (water mills, water wheels etc.). It is almost ironic indeed that the energy sources qualified as "renew-

able", on which so much emphasis is placed in recent policy, are among the most ancient methods utilized to produce energy. While many forms of energy production have a long history, in the last two or three centuries, essentially since the industrial revolution, the production and use of energy have developed rapidly, radically transforming the productive possibilities of mankind. Thus, the burning of wood, coal and other combustible substances has provided light and heat since time immemorial. Yet, it is only since the late eighteenth century that the invention of the steam engine made possible the conversion of heat into mechanical energy for the operation of factories and for moving vehicles (locomotives) or steamships. Through different processes, the internal combustion machine brought about similar effects roughly a century later. Hydrocarbon fuels, mainly derived from petroleum, were first used for lighting (kerosene) and then came to replace coal as the principal energy source. The harnessing of electrical energy, produced by generators utilizing the motion of the wind or of water or from burning fuels, opened up new possibilities, not only for the production but also for the transmission and utilization of energy. Chronologically last in this impressionistic, and by no means exhaustive, list of energy production modes and sources comes in the middle of the twentieth century nuclear energy, where the controlled explosions from the splitting of the nucleus of atoms are used to provide heat and thereby other forms of energy. Modern economies and societies require enormous, and constantly increasing, amounts of energy. Indeed, the side effects of its production and use are now recognized as one of the cardinal problems of the present and of the immediate future.

Two principal classes of sources of energy are currently distinguished — and their very identification underlines the social rather than material character of the issues. Conventional sources consist essentially of materials that are primarily fossil in origin, and they include various types of coal and hydrocarbons, such as petroleum and natural gas. As their appellation suggests, they consist of fossilized matter (plants and indeed entire forests) present in the soil and subsoil in various forms. While we can, at this level of generality, consider conventional sources as a single category, there are important differences between the various kinds of such sources. Energy materials become such when they are generally perceived as sources of energy. For a long time, natural gas was treated as a nuisance in the operation of oil wells, as a bothersome by-product

of petroleum extraction, and the gas was burned in the open air, just to get rid of it and avoid possible explosions. It is only when the technical means to collect and use it were invented that it was seen as valuable.

Conventional fossil sources of energy are subject to eventual depletion. Renewable sources, on the other hand, do not depend on the use of exhaustible materials. They generally involve the application of methods and devices for harnessing natural forces and phenomena, such as the wind, the water of rivers and the sea, whether in conjunction with the operation of gravity or in other ways, the tides, the sun (solar energy), and the earth's own internal heat (geothermal energy).

In some cases, moreover, they involve the use of certain types of renewable materials, some of which have been in use for a very long time (e.g., wood); others are new and they involve novel uses of long-established materials (e.g., biomass, biofuels).

Here, we shall focus on the legal dimension of energy. We shall therefore refrain from discussing most technical aspects of energy production and use, although, as is obvious from the listings just offered, technology is all important in determining what is and is not relevant to any study of energy. In fact, because of the importance of energy production considerable resources are devoted to the development of pertinent technology. On the other hand, and for different reasons, we shall neglect here certain areas of highly specialized regulation, such as nuclear energy.

Energy as an Industry

Studying energy issues in terms of their place and role in human society involves by necessity certain choices. Some phenomena and elements come to the foreground, while others are bound to stay in the background. While I am aware of their direct relevance, I am not going to be discussing the physics and engineering involved, the interaction between natural resources, economics, and technology, or for that matter most of the specifics of the legal arrangements involved — contractual practices, the types of transactions and contracts, standard clauses and so forth.

In simple terms, we might say that we are concerned not with energy as such, but with the energy industry, the economic industry that produces and distributes energy. More to the point, we are inter-

BOX I-1. AN INCLUSIVE LIST OF ENERGY MATERIALS AND PRODUCTS

Nuclear energy

Uranium or thorium ores and concentrates

- Uranium ores and concentrates
- Thorium ores and concentrates

Radioactive chemical elements and radioactive isotopes and their compounds

- Natural uranium and its compounds
- Uranium enriched in U235 and its compounds; plutonium and its compounds
- Uranium depleted in U235 and its compounds; thorium and its compounds
- Radioactive elements and isotopes and radioactive compounds other than the above
- Spent (irradiated) fuel elements (cartridges) of nuclear reactors
- Heavy water (deuterium oxide)

Coal, natural gas, petroleum and petroleum products, electrical energy

Coal, briquettes, ovoids and similar solid fuels manufactured from coal

Lignite, whether or not agglomerated excluding jet

Peat (including peat litter), whether or not agglomerated

Coke and semi-coke of coal, of lignite or of peat, whether or not agglomerated; retort carbon

Coal gas, water gas, producer gas and similar gases, other than petroleum gases and other gaseous hydrocarbons

Tar distilled from coal, from lignite or from peat, and other mineral tars, whether or not dehydrated or partially distilled, including reconstituted tars

Oils and other products of the distillation of high temperature coal tar; similar products in which the weight of the aromatic constituents exceeds that of the non-aromatic constitutents (e.g., benzole, toluole, xylole, naphtalene, other aromatic hydrocarbon mixtures, phenols, creosote oils and others)

Pitch and pitch coke, obtained from coal tar or from other mineral tars

Petroleum oils and oils obtained from bituminous minerals, crude

Petroleum oils and oils obtained from bituminous minerals, other than crude

Petroleum gases and other gaseous hydrocarbons

Liquefied:

- — natural gas
- — propane
- — butanes
- — ethylene, propylene, butylene and butadienne
- — other

In gaseous state:

- natural gas
- — other

Petroleum coke, petroleum bitumen and other residues of petroleum oils or of oils obtained from bituminous minerals

Bitumen and asphalt, natural; bituminous or oil shale and tar sands; asphaltites and asphaltic rocks

Bituminous mixtures based on natural asphalt, on natural bitumen, on petroleum bitumen, on mineral tar or on mineral tar pitch (e.g., bituminous mastics, cut-backs)

Electrical energy

Other Energy

- Fuel wood, in logs, in billets, in twigs, in faggots or in similar forms
- Charcoal (including charcoal from shells or nuts), whether or not agglomerated

Based on: Annex EM, Energy Charter Treaty.

ested in the legal processes, at the international level and in interaction with other levels, which, through rules, procedures, institutions, established practices and other arrangements, govern the production, exchange and use of energy materials, the carriage of such materials and the production and transmission of energy.

We shall in fact limit the domain of our interests, omitting some picturesque aspects and some outdated ones, as well as certain areas of specialized regulation, such as nuclear energy. We shall deal, at greater or lesser length, with the exploration and retrieval of energy resources, mainly fossil fuel and hydrocarbons, with the trade and carriage of such materials, the production and distribution of energy, as well as with some collateral, but all too important issues, mainly those concerning the impact on the environment and on society of energy processes and operations.

It is self-evident that the "energy industry" we are talking about is not a single industry but a cluster of industries which have in common the production and distribution of energy in several ways and which relate to many different energy sources. They are in fact linked by the high degree of substitutability in terms of result, i.e. energy (particularly in the form of electricity). The concept of "energy" in its social context is a relatively recent one. The perception of the extent to which energy sources may be substituted to one another, a commonplace for any study of energy these days, would have been considered almost a "discovery" in the general social understanding of a few centuries ago. Particular energy sources have for a long time been considered important for the economy and for law, but the single unitary notion of "energy" which encompasses all energy forms and sources has been addressed in everyday parlance rather than philosophy relatively recently.

A properly exhaustive study of our topic should have started from particular energy sources; we should have considered the law and economics, national and, to the extent relevant, international, of coal, petroleum and natural gas, and of alternative energy sources (such as wind, water and so forth), in order to understand how the legal patterns for energy sources and production have evolved over the centuries. The politics of the matter, the interest of political decision-makers in energy, and in particular forms and sources of energy, would have been studied in disaggregated manner: The history of the politics of coal, in each country and at the international level, differs significantly, not to say radically, from the political history of

petroleum and, of course, from that of nuclear energy. These are obvious points, I dare say, but they are mentioned here precisely because, to avoid excesssive complications and detail, these matters are not going to be considered at any length in what follows.

The principal characteristics of the energy industry are closely interrelated. It is a complex industry, where a high degree of government involvement has long coexisted with powerful private interests and in which regulation is closely linked with the market. It is politically important, in domestic as well as international politics, and it is an international industry, which cannot be understood in terms of a single State or national economy.

One complicating (and internationalizing) factor is that the natural resources that constitute the principal sources of energy, such as coal, petroleum or natural gas, are generally produced in locations other than those in which they are utilized. While this situation is not totally new, its extent is today remarkable. In the past, the geographical proximity of energy materials was a significant element for the industrial development of countries and regions. Witness the industrial development of Britain, on the basis of coal, or of the Ruhr valley in Germany. Today, there is a radical, nearly total divorce between the initial location of energy resources and the most important places of their utilization and consumption. Europe accounts for less than 10 per cent of oil production (and this includes the recent utilization of offshore petroleum) but its share of oil consumption is over 22 per cent. It accounts for 12.5 per cent of natural gas production and 19 per cent of gas consumption. North America has always been a significant producer of energy materials but today its production of oil is less than 20 per cent of world oil production, while it consumes nearly 30 per cent. There is more of a balance as far as natural gas is concerned, since the United States produces 32.8 per cent and consumes 33.7 per cent of world gas production, but this is not true of other countries and regions. The situation is even more skewed with respect to oil and gas reserves: Europe accounts for 2 per cent of world oil reserves, the United States for over 8 per cent, the former Soviet Union for over 6 per cent, while the Middle Eastern countries have over 65 per cent of world oil reserves. Similarly, Europe has less than 4 per cent of world gas reserves and North America just over 6 per cent, while the former Soviet Union countries hold over 40 per cent and the Midle East over 32 per cent of world gas reserves.

Energy materials, starting with wood or coal, have, of course, been the object of commercial exchanges for many centuries. Still, as already recalled, when coal was the principal natural resource in use for the production of energy, up until the second half of the nineteenth century, the principal producers of coal were in the same countries, or at least the same region, as the consumers. Britain, since the Industrial Revolution, consumed (and exported) huge quantities of coal, produced largely in the country itself. Similarly, coal was plentiful in Western and Central Europe, at the time of its take-off into industrial development. Even after the Second World War, coal was so important that the first European integration effort was focused on it: the European Coal and Steel Community.

As far as hydrocarbons are concerned, the major discoveries of petroleum in the nineteenth century took place in the United States, where it was also utilized. The start of the petroleum era of modern economic history is usually dated 1859, with the discovery of the oil deposits in Oil Creek, near Titusville, Pennsylvania. It took a relatively short time for the American petroleum industry to go abroad, and to abandon its nearly exclusive reliance on the hydrocarbon resources located in the territory of the United States. It is mainly in the early twentieth century and the interwar period that the pattern of expansion of American and European firms in Latin America and the Middle East took the form that is now familiar. The nearly total separation between the location of energy resources — nowadays, since at least the 1950s, in the Middle East, Latin America and Central Asia (including former Soviet Union countries) — and the place of production and use of energy — the developed countries, in particular, the United States and Western Europe — is relatively recent, even though it is today taken for granted. Even now, of course, things are not that simple; it is only recently that domestic oil production in the United States has lost its relative importance, while, in Europe, Norway is a major exporter of natural gas located in the North Sea.

It is not true, of course, that energy materials are produced solely or mainly in less developed countries or regions. As in the case of other primary products, countries and regions that are not industrially advanced are in most cases the major exporters of energy materials, both because the natural resources in developed countries have been depleted and because their consumption needs are far greater than what they themselves can provide. On the other hand,

in the specific case of energy, many developing countries are themselves consumers and not producers of energy materials.

Energy is produced and distributed by units of all sizes and kinds: the neighbourhood gas dealer is also a part of the energy industry. Yet, many of the operations are very large, some of the investments required tend to require high amounts of capital for a long period of time, and many of the enterprises involved tend to be quite large. For a long time now, energy-related enterprises, for instance, oil companies, have been at the top of all lists of large enterprises. As will be evident from the short historical overview that follows, energy firms in general and in particular firms engaged in petroleum production and distribution have for a long time been synonymous with large, economically and politically powerful, firms. These facts of life cannot be ignored in any study of related issues, especially one that focuses on the legal aspects.

The enterprises in the energy sector are quite diverse in their object and their form. Some of them engage in the exploration for and exploitation of energy sources, particularly fossil ones; others are involved in the production of energy materials from these sources (e.g., refining crude petroleum to produce gasoline and numerous other by-products); still others are "public utilities", producing and distributing electricity for public use; carriage of energy materials, whether by means of ships and rail or pipelines, is the task of still other enterprises. In many cases, the system functions on the basis of extensive vertical integration, so that the units engaged in the successive steps of energy production are controlled by the same firm, or form part of the same group of firms. Transnational or multinational enterprises were identified for the first time in the oil industry.

Both because of the importance of energy for the national economies and because high capital outlays are needed, the direct or indirect involvement of the State has long been extensive in the industry. While in the United States, State ownership of an oil company appears to have been considered only once, under the extreme pressures of the Second World War, in other key industrially advanced countries, many of the energy enterprises have been State-owned. It is, however, typical of the industry that private firms often behave as if they were State agencies, that is to say, their criteria and methods are very close to those of Governments, while, at the same time, the business behaviour of State-owned enterprises often does not differ

significantly from that of private firms. At the time the so-called "Seven Sisters" (the seven largest oil enterprises) dominated the energy market, few people would have been able easily to identify which of them were public and which were privately owned. In the last decades, privatization has set in and the number of State-owned companies has diminished. Still, the energy sector remains of immediate political interest to Governments and is, directly or indirectly, regulated in most countries and legal systems.

The diversity of the industry's components makes generalizations difficult. This is an industry in which competition, among firms as well as among States, is strong, while at the same time efforts at restrictive practices of many sorts abound. Because of the diversity and multiplicity of the actors involved, the industry's elasticity is high; high prices again and again have led to increased supply which in turn, in the absence of other interventions, brought about a fall in price. This pattern is no longer common, because of constantly increasing world-wide consumption needs and current trends consistently favour higher prices. During the past century, new suppliers have kept coming into the market, and the configurations of players have been in constant change.

The Notion of an International Legal Framework

As already noted, the expression "international legal framework" is not, not yet anyway, a term of art, that is to say, it does not have a single, well-established and generally accepted meaning. The term is used here in the same more or less manner in which it is found in United Nations (especially UNCTAD) usage. It is a useful term because it covers a cluster of phenomena in a manner no other term can do equally well. The substantive, "framework", suggests a structure which gathers together several items, without specifying the exact manner in which they relate to one another. The term is sometimes used to refer to a comprehensive international legal instrument covering a particular sector or topic — something like the General Agreement on Tariffs and Trade (GATT), for instance — although it may not involve the presence of an international organization (such as the WTO). The term is thus fairly close to what political scientists call an "international regime", although it approaches phenomena in a different perspective. One of several definitions of an international regime refers to a set of "implicit or explicit principles, norms, rules

and decision-making procedures around which actors' expectations converge in a given area of international relations". In practice, the study of international regimes has largely addressed regimes that have crystallized into international organizations, or at least multilateral conventions, although it is not necessarily so in all cases. Here, moreover, we are interested in its legal dimension, although the adjective "legal" is used, as we shall see, in a rather loose sense and covers many kinds and branches of law, in close association with non-legal — political, economic, and other — elements.

The adjectives are both quite inclusive, yet they are used in a manner that does not follow their meanings in established formal usage. "International" suggests the presence of more than one State, but it does not mean solely "interstate" or "intergovernmental" as it does in the case of a classical term such as "international law". It could easily be replaced by a term such as "transnational" (not that this would much clarify matters). And the "law" in "legal" includes several kinds of law: international, municipal, public and private etc.

An international legal framework for energy refers thus to the total legal environment within which the international energy industry operates, to all the legal norms, procedures and institutions relevant to energy transactions and operations. Such a broad notion covers several important types of legal rules and instruments, as will be apparent from the rest of the discussion.

The principal category is that of customary international law, understood not merely as a body of rules but as a process of law-making, as a way of perceiving international social reality. Emphasis is placed on the manners in which international law proceeds to create legal rules, on the one hand, and to determine the relative position of actors, on the other. Some elements of the ways in which customary international law functions are of particular importance. The principle of territorial sovereignty, as the foundation of the allocation of jurisdiction over persons, events and resources, is all-important in a field where materials are located in the ground in a particular place, are utilized for production purposes elsewhere and are distributed in various directions. Geographical and geological accident is converted in this manner into legal entitlement.

The intermediate category of "general principles of law" has been elevated to a major source of legal prescriptions in the matter by a series of international arbitral awards on "State contracts". Their dis-

advantage of relative imprecision is counterbalanced by their flexibility and adaptability to circumstances.

Conventional (treaty-made) international law is also directly relevant, operating at the bilateral, regional and multilateral level, at various levels of generality or specificity, along with rules established by international institutions of many kinds. While — to paraphrase a point made about investment several decades ago — there is "no GATT for energy", prescriptions affecting energy matters are found in several existing international instruments. These rules vary in many respects — from the number of States and other actors bound by them, to extensive variations in their subject matter, to their degree of normative intensity.

National laws are another obvious source of prescription. It covers not only special legislation dealing with energy in each country, particularly with the exploration and exploitation of energy sources and materials, the production and distribution of energy and the carriage and transit of energy materials, but also all relevant laws that have an impact on energy trade and use, including constitutional law, commercial law and tax law.

Finally, contractual arrangements between States and private firms (especially foreign-owned ones) — the so-called "State contracts" — are of direct relevance. They have had an important part in creating the legal environment for energy production and distribution. They establish the general rules but also the specific practices which apply in the sector. Although their current role is less pre-eminent, particularly since most energy-producing States have by now put into place detailed modern legislation on the matter, their importance should not be underestimated.

The interplay of national and international rules and policies is at the very heart of the matter. National law develops most of the relevant concepts, approaches and policies, and provides the bulk of the detailed regulation. International law used to limit itself to providing the outside limits of national regulation through the operation of the principle of territoriality and by permitting or limiting particular national rules and policies but it is often more specific nowadays. The relationship of national and international law is becoming increasingly complex, as will become apparent in what follows.

That's not all, however. To stay close to reality, account must also be taken of the interplay of national and international laws and rules with the practices and activities of the major economic actors in the

energy sector, whether private or public. This is an area where the practice of transnational enterprises, whether private or State-owned, especially as found in contracts and other arrangements, is all-important. The same is true of the normative practice of non-governmental bodies, including professional associations. This is one of the reasons for insisting that the term "legal" is used here in a highly inclusive, broad and flexible manner.

The Past Seventy Years: A Short Overview

When one attempts to discuss international energy issues, whether in legal, political or economic terms, there is a strong temptation to engage in the exposition of endless factual details and the narration of anecdotes from the topic's colourful history. It is true that the history of the subject is fascinating, replete with impressive and peculiar personalities and picturesque yet important events. Still, the temptation must be resisted, to avoid detracting from the substantive import of events.

Because of the prevalence of petroleum as the principal energy material, the exploitation of oil deposits in countries other than those in which they were going to be utilized acquired particular importance in the twentieth century. Like all elements of the subsoil, fossil fuel deposits were in many legal systems the property of the sovereign — the king or the State. (Use of the term "royalty" for the dues paid for their appropriation is telling.) There were many variations, of course, and eventual departures from this model. The rights for the exploitation of such resources were usually granted by Governments to private persons on the basis of "concession contracts" — a peculiar instrument, an ancestor to today's "State contracts", that combines the notion of grant (i.e., of a governmental act) and that of contract (i.e., private law), on which more later.

In the early years, until the interwar period and the 1930s, the relationship between energy-producing and energy-consuming countries was marked by a high degree of political or legal inequality, in many cases formally established. As the producing countries became more independent, a struggle ensued between them and the consuming countries, a struggle that has taken many forms and has involved various actors. In terms of international law doctrine, the struggle has become part of the broader conflict between developed and developing countries concerning the international law on the treat-

ment of alien property and in particular on the limits of a host State's ability to nationalize or otherwise interfere with foreign-owned property. Even though nationalizations, from the very start, covered other assets and resources as well, oil concessions have been at the very centre of the conflict. The international law literature of the entire postwar period abounds in cases of nationalizations of oil resources — writing in the mid-1960s, Professor Hans Baade complained that it was difficult to pursue the study of the international legal problems of expropriation of foreign property "without being almost constantly distracted by petroleum fumes". In fact, it may be argued that the nationalization of oil concessions remained the chief paradigm in official and unofficial debate long after the issue had stopped being of central importance in the broader area of host country treatment of foreign investment and when other problems had acquired greater or at least equal significance.

The conflict took several forms. The Mexican nationalizations of petroleum deposits in the 1930s (coming after a series of similar disputes on the effects of land reform, among other things) were the first major modern "international incident" involving energy resources and the State. The formal exchange of arguments between the United States and Mexico were long treated as paradigmatic of the opposing positions of host (nationalizing) countries and the countries of origin of investors. That dispute ended in the first years of the Second World War in a settlement which, because of United States war needs, favoured Mexico more than it otherwise would have. The next major case, which even managed to reach the International Court of Justice, was over the nationalization of petroleum deposits by Iran in 1948-1949. Here, the taking did not prosper, since a CIA-organized coup d'état toppled the Iranian Government and the Anglo-Iranian oil company returned triumphantly, with American partners. The third incident, of equal significance for our topic, was the 1956 nationalization of the Suez Canal by the Egyptian Government under Gamal Abdel Nasser, which although not directed at petroleum resources, affected directly the energy economy. What was at stake was the ability of Western countries to control the shortest route for the oil tankers carrying their cargo from the Middle East. While the international law issues were largely similar to those in previous cases, a number of new questions arose, regarding the impact of the Canal's role as a vital highway of commerce on the legality of the action.

After that, and especially as the decolonization process started, nationalizations, in particular oil nationalizations, multiplied. Scholarly writings on the subject were for a long time a growth industry. For several decades the United States Department of State compiled annual statistics on nationalizations of foreign property. Putting legal writing to one side, these cases were fought both on the diplomatic front and in international arbitrations and their impact on international law doctrine has been considerable.

One should place the topic in historical context, in the political and ideological atmosphere prevailing in the decade after the Second World War. Nationalizations of key industries and public utilities, including those relating to energy (coal mines, electricity), were common at the time in many Western European countries. In the next decades, while the Cold War dominated international politics, the nationalization of oil and other natural resources gained momentum from the broader movement for regaining control over their territory that developed in the newly independent (ex-colonial) countries all over Africa and Asia as well as in the (formally independent for a long time) Latin American countries.

The law on the matter developed through the incidents themselves and the official correspondence and scholarly argumentation they provoked; a variety of agreements and arrangements at many levels and numerous arbitrations on State contracts, many of them involving oil concessions (e.g., the Abu Dhabi and Qatar arbitrations in the early 1950s), contributed significantly. At the same time, the doctrine of "permanent sovereignty over natural wealth and resources" gradually developed through a series of United Nations General Assembly resolutions, starting in 1952 and finding its final formulation in General Assembly resolution 1803 (XVII) (1962). We shall return to it in the next chapter.

On the political level, relations between producing and consuming countries went in the 1960s through a new phase. A chain of events, starting with the creation of the Organization of Petroleum Exporting Countries (OPEC), altered in important ways, perhaps radically, the energy relationships prevalent since the years after the Second World War. With OPEC, the major oil-exporting countries grasped the initiative and sought to redress the balance between them and the — until then all-powerful — oil companies and their countries of origin. In fact, the Organization had come into being after a series of concerted efforts by the companies to keep oil prices and their

payments to the producing countries at the lowest possible level. The concern — and resentment — of key Latin American and Arab officials (characteristically, the main founders of OPEC were Juan Pablo Perez Alfonso of Venezuela and Abdallah Tariki of Saudi Arabia, even though they both left the picture quite soon, after having put the Organization on its way) led to the coming together, for the first time, of a group of major oil exporting countries. They demanded a far-reaching restructuring of legal and economic relations between oil companies and producing States. Their main instrument, since they could not directly control prices or even the provisions of concession agreements, was that of concerted action concerning the quantities of oil reaching the market. In the language of OPEC's first resolution, "Members shall study and formulate a system to ensure the stabilization of prices by, among other means, the regulation of production . . ."

The creation of OPEC was greeted with interest but at first with no great alarm by the officials of oil companies and consuming States. It took nearly a decade for the consequences to begin to become evident. In the meantime, the Organization's Secretariat worked carefully to develop its expertise in petroleum economics and law and to draw up a programme for the gradual increase of control by the producing States over their natural resources and of their revenues from them. By the end of the 1960s, an important new player entered, Libya's new ruler, Colonel Khaddafi, whose tumultuous relations with the oil companies marked the arbitration scene of the following decade.

The Arab-Israeli War, in October 1973, led to a major shock, the first so-called "energy crisis", when the petroleum exporting Arab States first decided to reduce their oil production by over one-fourth and then declared an oil embargo against the Western States supporting Israel. OPEC was not directly involved, since the embargo was the work of OAPEC, the Organization of Arab Petroleum Exporting Countries, founded without much fanfare in 1968 by the Arab members of OPEC. Yet, it was that embargo that brought home to the developed countries the extent of their increasing dependence on the petroleum resources of the oil-exporting countries and their exposure to the effects of concerted action by them.

The oil consuming countries' reaction took the form of creating an international organization of their own, to ensure and organize their co-operation to face the current crisis and to manage longer-range

arrangements for coping with future problems. They acted in the framework of the Organisation for Economic Co-operation and Development (OECD), which brought together the industrially advanced countries. The Organisation's limited structures for dealing with energy issues had already played a role in earlier crises. In late 1974, the principal industrially advanced countries concluded an international agreement on an International Energy Program (IEP). The Agreement provided for the establishment of the International Energy Agency (IEA), an autonomous international organization, and for a series of institutional structures and measures designed to ensure the co-operation of member countries in energy matters.

The concerted policies of IEA members involve both short-term measures, directed at possible future crises, and long-term policies, aimed at reducing their dependence on imported oil. Among the former, the systematic creation of oil stocks in co-operation with oil companies is of particular importance; it made possible the management of successive oil shortages with relatively less disruption. The long-term policies were even more important and have led to considerable changes in the use of petroleum resources and in the structure of the oil market itself.

One aspect of the oil-consuming countries' new policies proved to be of lasting significance, both in facing the successive energy crises and in influencing the operation of the energy sector. Oil companies had for a long time managed to keep the prices they paid to the producing countries at consistently low levels. The oil crises, however, made clear that the low cost of energy resources led to their wasteful utilization. In fact, during the earliest of the oil crises some petroleum ministers of oil-exporting countries took the opportunity to point out that the rising prices they were exacting would be instrumental in rationalizing energy economics and teaching frugality to the oil consumers. Despite the clearly self-serving character of such moralistic statements, the point about not squandering energy was eventually accepted as valid. The industrial countries discovered that the promotion of "energy efficiency", the saving of energy in various ways, could significantly decrease the total demand for energy and energy materials. In the years after the crises, it has become commonplace to argue that energy conservation may be considered as a new energy source, to be added to the usual listings.

A detailed history of the activities of the two major organizations involved, while interesting in itself, is outside my remit here. OPEC

as well as the IEA continue in their differing ways their work, while now and then OAPEC makes an appearance. We shall have occasion to return to some of these matters in later discussions.

Before closing the discussion of these developments, however, it is useful briefly to recall the role energy issues played at the time in the broader North/South context, in the relations between developed and developing countries. To begin with, the energy crises of the early 1970s — that is to say, the increases in the price of energy materials — had a significant impact not only on the developed economies that were the main targets of the producers, but also on the economies of many non-oil-producing developing countries. It is interesting to note that the major oil-producing countries acknowledged their responsibility to help these countries cope with the situation and acted upon that acceptance. OPEC itself but also some of the countries involved, e.g., Kuwait, created special Funds intended to provide short- and medium-term financing to the countries affected.

Perhaps more important and more effective, at least for a certain length of time, was the impact of the energy crises on international politics. In the aftermath of the oil embargo and of OPEC actions raising the price of oil and changing the terms of the contracts with oil companies in favour of the producing countries, the developing countries as a group acquired the self-assurance necessary for asserting, through the mechanisms of international organizations, a comprehensive set of claims aimed at changing the existing world economic system. For about a decade thereafter, developing countries acquired increased importance, if not power, in the United Nations and in international organizations in general. Contrary to the expectations of the developed countries, the sudden wealth (and power) of the major oil-producers did not lead to division among the developing countries — on many of which the impact of the oil crisis was much worse than on the developed countries. It enhanced instead their collective position, under the leadership of some oil-exporting countries (e.g., Algeria) as well as of other developing countries (e.g., India), in the all-too-brief period in the 1970s and early 1980s when the agenda in international organizations was set by the concerns of the "Third World". This was the time of the campaign for a "New International Economic Order", when the Charter of Economic Rights and Duties of States was adopted by the United Nations General Assembly (UN GA resolution 3281 (XXIX),

12 December 1974), negotiations began for the preparation of a "Code of Conduct for Transnational Corporations" and other such initiatives were taken.

An early illustration of attitudes and events is that of the 1977 International Conference on International Economic Co-operation, convened in Paris, at the initiative of France. It was proposed at first that there should be three categories of participants: oil-consuming industrial countries, oil-producing developing countries and other developing countries. The developing countries insisted, however, that they should form a single category and not be split in two. They had their way and this is how the Conference operated in fact, while retaining a limited emphasis on energy issues. It was succeeded in the 1980s by the so-called North-South Dialogue in the United Nations.

I realize that I have succumbed to some extent to the temptation to go into the history and anecdotes of recent years. So, I shall conclude this all-too-brief historical overview by recalling some important changes that took place in the world energy situation (and the world economy) after the 1970s and into the 1990s.

First, the technological developments which, in response to economic needs, made possible the development of oil and natural gas resources offshore, in the continental shelf of developed (in the North Sea and Alaska) as well as developing countries. New technological expertise led to the development of novel methods to harness natural forces, in the search for renewable energy sources. Technological developments have also revolutionized the transportation of energy materials, from the construction of the first oil and gas-carrying supertankers in the 1960s to the improvements in the use of high-pressure pipelines.

Secondly, the importance of the ex-Soviet Union in the production and export of energy materials increased considerably, and its competition with Middle Eastern oil has become a significant factor in the evolution of the petroleum scene. In fact, the collapse of the Soviet Union, at the close of the 1980s, radically changed the situation, in energy as in other areas. The break-up of the Soviet energy system, a system that may not have been particularly efficient, in either the economic or the energy sense, but was highly integrated, meant that the entire complex of energy relations both with and within the ex-Soviet Union was transformed. A characteristic illustration is the fate of the Soviet pipeline system, which was now frag-

mented by a multiplicity of new State borders, becoming a complex international transit, rather than merely carriage, system. It is indeed something of an historical paradox that the disintegration of an energy system coincided in time with the increasing integration of another, as the European Union developed its common energy policy and started legislating on energy issues. The prospects of radical change in the energy situation in the early 1990s led to the adoption of the European Energy Charter and later on of the Energy Charter Treaty, which will be discussed a little later.

Like the world economy at large, the energy economy has been deeply affected by the pervasive ideological changes in international (and domestic) economic policies that started in the 1980s. Reliance on the market and privatization were revolutionary ideas for the energy sector. The direct role of Governments in the sector, through State-owned corporations, has not disappeared but it is on the wane and a number of widely held assumptions have been questioned. While all phases and facets of the industry have been affected, some have been more profoundly transformed. The process of change is still going on and we do not yet know the precise manner and extent of its eventual impact on the industry. Of course, not everything has changed; some of the older patterns persist, from the continuing operation of OPEC to the role of the big oil companies.

The energy industry and economy have also been profoundly affected by another recent development, the growing concern for the ecological impact of industrial growth and of energy production in particular. Possible measures to limit the adverse impact of energy processes (whether the production or the use of energy) are at the centre of international efforts. Studies of "sustainable development" now focus on energy issues, as well, and the idea of a "sustainable energy future" is no longer typical of isolated philosophizing scholars.

We have gone pretty far afield in the search for energy issues and developments. Yet, all this is not irrelevant for a study of the legal facets of energy, as we shall try to show in what follows.

CHAPTER II

THE EMERGING INTERNATIONAL LEGAL FRAMEWORK

International law, in its classical formulation — that is to say, as it had crystallized by the end of the nineteenth century — dealt primarily with the allocation of jurisdiction between States. Its main task was to determine, with respect to any issue or problem, which State was competent to determine the rules that will apply to persons, things and events in particular circumstances. Ever since Westphalia, the fundamental principles applied to determine the allocation of jurisdiction have been those of territorial sovereignty and nationality. Despite the addition of other elements in the overall picture, their interaction remains central for international law, especially in its impact on energy issues.

The National Context

Territorial sovereignty is of crucial importance for the international legal framework for energy, in view of its concern for energy resources and energy production and utilization, all of them normally linked to a specific location. The present chapter, which deals with the actors and the substantive contents of the legal framework reflects a variety of specific facets of the application of the territorial principle.

In the first place, sovereignty over a State's territory means control over the natural resources in it. Secondly, territorial sovereignty entails jurisdiction over all events in the territory, e.g., the carriage of energy materials, the production and transmission of energy, and all associated operations. At the same time, the geographical realities of energy production and consumption and more generally the international character of energy processes make necessary agreements or other arrangements between States that facilitate or permit energy activities and expand the domain of relevance beyond that of national concerns. Thirdly, the production and use of energy have important consequences for other vital areas of international concern, at first glance rather distant from territory and energy, such as the protection of the environment and of human rights. Many other ques-

tions could also be chosen, for instance, the topic of international sanctions involving the sale of petroleum, but one has to stop somewhere.

Sovereignty over natural resources

As already mentioned, during the first decade-and-a-half after the Second World War, the efforts of the developing countries, both the newly independent ones in Africa and Asia and those that had been free for some time, led to general acceptance of the principle of "permanent sovereignty over natural wealth and resources". The principle reflects the general and well-established principle of territorial sovereignty, which has always been understood as including sovereignty over natural resources in the territory's subsoil, but it does more than that. Territorial sovereignty, in its traditional understanding, is directed at other States and serves essentially to allocate competence between States. But the new principle, that of "permanent sovereignty over natural wealth and resources" covers as well relations with private persons, primarily foreigners, and in fact is in the main directed at foreign individuals or companies that have acquired or may seek to acquire rights over a country's resources.

The significance and specificity of the principle lie in the first word of the formula. The adjective "permanent" implies an additional epithet, "inalienable", explicitly found in some of the relevant formal texts. It is the inalienable character of sovereignty over natural wealth and resources that the developing countries emphasized, that is to say, their right to the control of their natural resources, not only initially — traditional international law recognized that much — but even when the State involved (or a predecessor colonial regime) had contracted away property rights over the resources in question. The relevance of this principle for energy resources is obvious — and indeed the principle was largely created in order to deal with petroleum and mineral concessions. While it is self-evident that a State's laws will govern the natural resources in its territory, the ability of the host State to amend or cancel the initial bargain, even if under certain conditions, is a most important qualification.

It may be useful to stop here and digress, repeating a point already made. Much, although not all, of the analysis that follows relies on the distinction between developed and developing countries, with respect to their attitude on the control of natural resources.

Ever since the interwar years, developing countries have been insisting on the right which eventually came to be called, "permanent sovereignty over natural wealth and resources". As already noted, however, developed countries, too, produce energy resources — indeed for a long time some of them were able to produce most of the energy resources they consumed. Obviously, therefore, developed countries as well have an interest in affirming their control over the natural resources in their territory. That interest, however, does not generally have the importance or the priority it usually has for developing countries. And this is true for a number of reasons.

To begin with, the production and export of natural resources, while sometimes quite important for the economy of developed countries, is not generally as crucial for it as it is in the case of the developing countries, many of which entirely depend on the export of one or two primary products. In the second place, developed countries usually possess the administrative expertise and capability to protect themselves against overreaching by private, especially foreign, companies. Thirdly, economic control over or the management of natural resources in developed countries is generally not as skewed in favour of foreign-owned investors and enterprises as it is in the developing countries.

At any rate, the dichotomy developed/developing has to be taken with a grain of salt here; those developed countries that depend on their exports of natural resources often take, on topics such those discussed here, positions fairly close to those of developing, resource-exporting countries. While, for the period under discussion, this dichotomy was clearly a fundamental dimension of international economic and political relations, its present importance in international affairs varies over time and depending on the topic at stake and on its importance for the particular country.

The principle of "permanent sovereignty over natural wealth and resources" evolved in the decades after the Second World War, mainly through a series of United Nations General Assembly resolutions. The first important such resolution goes back to 1952. It is interesting to note that it focused on the problems of development financing and, treating as given the "right of free exploitation of natural wealth and resources", it recommended to States needing foreign capital to act so as to retain the confidence of investors. About ten years later, after a series of reports and studies by the United Nations Secretariat, the matter came again to the General Assembly

which, after much hard bargaining, adopted by a nearly unanimous vote (87 for, 2 against, 12 abstentions) resolution 1803 (XVII) of 14 December 1962. Like all texts of this type, the resolution reflected a compromise between the views of developed and developing countries. Yet, despite some concessions to the views of developed countries, it is the cornerstone of the position of developing countries endowed with important natural resources.

In the 1962 resolution, national sovereignty over natural wealth and resources is affirmed as an element of the fundamental right to self-determination of peoples. It is qualified as permanent and, in the Preamble, as a reflection of "the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national interests". While the resolution expresses in the main the position of developing countries, it also reflects in several ways the views and concerns of developed countries, especially in the role it attributes to international law : foreign investments, once allowed into the country, are to be governed by the terms of the initial authorization and national and international law. In cases of nationalization on grounds of public utility, "appropriate compensation" is to be paid in accordance with national and international law. And a final paragraph asserts that "foreign investment agreements freely entered into by or between sovereign States shall be observed in good faith". These references mark the elements of the compromise reached between developed and developing countries.

I must say that it seemed to me at first that it was unnecessary to analyse here this resolution — for two somewhat contradictory reasons : first, it is too well known and established, and second, it is too old and reflects a climate long gone. Still, on re-reading its text, I was struck by the extent to which, behind all the somewhat outdated rhetoric and code words, the compromise achieved at the time has held and has been reaffirmed on later occasions. The doctrine itself, in fact, has not lost its relevance. In the Energy Charter Treaty, signed in 1994, for instance, an article is devoted to "sovereignty over energy resources", in the language of which reflections of the 1962 resolution may be found.

One incidental point should be raised here. Most of the initial formulations of the principle referred to the natural resources in a State's territory. Later application, however, has expanded the geographical coverage to include not only the State's territory in the strict sense but also the areas over which a State holds "sovereign

rights", mainly the continental shelf. The expansion is reasonable, when the object and purpose of the principle is taken into account, as well as the fact that the notion of sovereign rights over areas other than the territory was not yet current at the time of the United Nations General Assembly resolutions in question was adopted. Still the point, although by now beyond contest, is worth mentioning, given the practical importance of these areas for energy resources.

For our purposes, the 1962 resolution usefully collects the chief legal elements long debated concerning energy resources and their treatment by the host country. Each of these elements has been elaborated in differing manners by different legal instruments and methods.

— Permanent sovereignty over natural resources as a basic international doctrine has evolved through its elaboration by successive declarations of international organs (mainly, the United Nations General Assembly) and by general acceptance in international practice. It has also found considerable support in domestic, particularly constitutional, law. To a limited extent, it may also be found in formal agreements; most often, it seems to be taken for granted, even if in unclear terms.
— Nationalization has also been mentioned, often in ambiguous manners, in such texts and has been considered in awards of international arbitrations. More recently, it has been addressed in several bilateral and a few multilateral agreements. The most controversial point about it has been, not whether compensation is to be paid, but how is that compensation to be determined.
— State contracts and their abrogation or renegotiation have been the subject of considerable arbitral practice — and far too much legal writing. Although generally treated as a separate category, many of the principles and rules applied to it are similar to those applicable to the issue of nationalization and expropriation.
— Finally, the applicability of national and/or international law in related issues has been generally discussed in the context of nationalization or State contracts. Few cases or arguments have mentioned the issue outside such situations. While there is a respectable body of scholarly writing which contests the view that international law, meaning classical international law and especially the international law of State responsibility, supports fully the positions of the developed countries, it is true that in

official context, in international conferences and negotiations, the developing countries have by and large acted as if they accepted that international law favours the developed countries, even to the extent of seeking to eliminate or downgrade any references to it. There is of course an abundance of routine situations, most often dealt with under the heading of private international law, which have to do with the application of national law to particular events or transactions.

Applications of the doctrine of permanent sovereignty

It may be worthwhile to start by looking at the modalities of application of the doctrine, beyond its more or less political uses in argument. In the first place, it is interesting to consider the hierarchical position of the doctrine itself in international law. It is fairly widely accepted by now as a principle of customary international law. Yet, the additional argument has been made, to the effect that permanent sovereignty over natural resources is a principle of *jus cogens,* of mandatory international law. If that were so, it could have two discrete consequences: first, any act by a Government that violates the basic principle, by granting for example to a private person rights which cannot be abrogated by the State under any conditions, would be null and void, it could have no effect in international law. Secondly, the principle would also apply to relations between States: a State would not be able to grant to another State control over its natural resources.

The first of these possible consequences may arise where a State has sought expressly or by clear implication to grant, presumably to an alien, irrevocable rights over natural resources. One may more realistically perceive this as an argument that the State that has granted such rights may make in an eventual dispute, possibly before an international tribunal. The State's argument would simply be that, although the State itself (presumably a predecessor Government) has purported to grant such rights, its act is itself invalid, since it runs counter to a *jus cogens* rule. The private person to whom these rights have been granted would thus find himself deprived of any rights, possibly even of any compensation, since the initial grant was of no effect, although such a consequence would probably be deemed excessive.

This possibility has received limited attention in the case-law and

the literature. The general verdict, however, seems to be negative, at least in the sense that it seems by now fairly well established that the real issue in such cases concerns the conditions and the manners in which such a grant may be revoked, rather than whether or not it can or cannot be. It may be that, where the initial grant had expressly made the point that it is irrevocable, the consequences of any subsequent revocation by the Government may be more burdensome for the State concerned, especially when it may be shown that that express qualification of intangibility had been "paid for" by the recipient in some way. It is however difficult to assert that the State's initial promise deprives it of its ability to revoke the initial action. The case where a grant of rights over natural resources has been made in violation of national law, in particular where there has been corruption of the public servants concerned, is of course quite distinct.

The second possible consequence of the mandatory character of the principle of permanent sovereignty over natural resources touches on broader issues of modern international law. In simple terms, the question that may be posed would be whether a State can grant to another State control over its (the first State's) natural resources. In a way, this is a venerable international law question that may be raised in connection with any cession of territory or in the context of the problématique of "unequal treaties". It is one of those circular questions that scholars love to discuss, but it seems unnecessary to devote much attention to it here.

There are, however, two other possible related questions that deserve consideration. Both of them were discussed by Professor Brownlie in his 1979 lectures at The Hague, so I shall be brief.

The first question is eminently practical and potentially quite important. It concerns the possibility of various kinds of joint action in particular situations by two or more States with respect to natural resources which, because of their location or character, may be more effectively utilized or exploited jointly. Where petroleum or natural gas deposits in "single geological structures" are concerned, whether across a border or in equivalent situations, the co-operation of the States involved is a condition for the effective exploitation of the resources. Such joint action may present difficult problems in practice, of course, in particular concerning the apportionment of costs and benefits or in the case of unfriendly neighbours, with respect to the manner or extent of presence in each other's territory. Still, in

doctrinal terms, the matter is relatively simple; fundamentally, it is a question of effective bargaining.

The second question is of a more general character. It has to do, in the first place, with the exploitation of natural resources located in areas which are not under the jurisdiction or subject to the sovereign rights of any particular State, mainly cases which, directly or indirectly, come under the general heading of "the common heritage of mankind". Writing before the final conclusion of the United Nations Conference on the Law of the Sea, Professor Brownlie had rightly included in this category both the resources of the seabed and ocean floor beyond national jurisdiction and those that may be found on the moon (and presumably other stars). In attempting to take care of the former (the high initial optimistic expectations as to the abundance of the resources in question proved rather exaggerated) the system of the 1982 Montego Bay Convention on the Law of the Sea, with its amendments and additions, has set in place an entire legal and institutional construction that looks today somewhat old-fashioned, although it is hard to imagine an alternative. We shall return to this type of question in the conclusions.

This kind of approach may be extended, however, in manners which depart from the logic of exclusive sovereignty over territory or natural resources. For it is possible to extend the approach embodied in the concept of the common heritage of mankind to other resources. Once again, Professor Brownlie has touched briefly on this topic, but it may be worthwhile further to explore the issue.

In fact, long before the notion of the common heritage of mankind was elaborated in the Third United Nations Conference on the Law of the Sea, suggestions along similar lines, although from a politically antithetical origin, had been made in other contexts. In the early debate on nationalization of natural resources, capital-exporting States occasionally raised the point that, for the sake of "fairness" (one has to be careful with that word), it would be proper for resource-rich countries to accept that resource-consuming ones also had a legitimate right to share in the control of the resources. This was an argument seriously advanced by scholars and officials from developed countries in the debate that followed the nationalization of the Suez Canal: the point was made that the Canal was an international resource, a maritime highway for commerce, which should not be under the exclusive national control of any single country. Control by the privately owned Suez Canal Company was described as sort

of international, or at any rate, neutral in terms of nationality. Similar arguments were also advanced, perhaps more self-consciously, in the general exchange of arguments over the activities of OPEC in the 1970s.

It was argued that petroleum is a vital resource for all, including the oil-consuming countries; and that it is thus contrary to the general (universal) interest for the producing countries to exact high prices for it.

Is it possible to proceed along the lines of such an approach? In the concrete context in which it was initially raised, the argument was highly biased and self-serving. The resource-consuming (and capital-exporting) countries were asking the resource-rich countries to share not merely their wealth but control over that wealth, without at the same time offering to share effective control over the elements of wealth and power in their own control — capital, for instance, or technology — as to which they retained the freedom to exact the terms they deemed appropriate. Such an argument might be taken seriously only if it were advanced in the context of something like the New International Economic Order the developing countries promoted in the 1970s. Only in an international order based on solidarity and co-operation rather than on self-interest and market principles would it be possible to argue that, as an element in a just world order, States should share their resources on terms objectively determined to be fair.

In the context of today's "globalized" world, it may be argued that in view of the close interdependence between resource-producing and resource-consuming countries, there is a common interest in the "proper" development and exploitation of energy resources. It would not be beyond human imagination to devise ways, for instance by broadening the circle of the values and resources at stake, so that the respective gains of each category of countries can be combined.

The trouble is that such approaches do not fit — more accurately, they can be made to fit, but with great difficulty — the established approaches of international law. The traditional international law method for dealing with such problems is to let control and benefits from natural resources follow jurisdiction. International law departs from this method only in very exceptional cases. Even in the case of the law of the sea, which, as Professor Brownlie has suggested, is in many respects a special case, because it has acknowledged from the start (i.e., since the time of the forefathers of the discipline) the exis-

tence of common interests among States, e.g., by according special status to the open seas or by allowing for "innocent passage", the principal way in which benefits are apportioned relies on the traditional method of allocating exclusive jurisdiction: as a rule, control over resources depends on the presence of sovereignty and sovereign rights over different categories of maritime zones. While the law of the sea accepts that there are alternative ways of allocating control over resources, other than through apportionment of geographical zones of sovereignty, it treats such cases as exceptions. The recognition of the special status of the "common heritage of mankind" in the Montego Bay Convention coexists, essentially as an exception, with the general, sovereignty-based, approach.

To avoid the traditional methods and move in the general direction of an international law of co-operation, recourse to some institutional machinery seems necessary. The system cannot rely on States behaving along the lines of solidarity or even close co-operation in the absence of an institutional component. Some of these thoughts may be useful for our conclusions.

Nationalizations and State contracts

The next topic to be addressed here, building on the listing of issues found in the 1962 United Nations General Assembly resolution on permanent sovereignty over natural resources, could be that of State contracts, their contents and their possible abrogation or amendment, including the related question of nationalization and its consequences. This is a topic that received a lot of diplomatic, political and scholarly attention in the past three quarters of a century. The very doctrine of permanent sovereignty over natural resources, in fact, is largely a by-product of legal concern with this issue. As already noted, the origins of the subject may be found in the institution of "concession agreements", the instruments utilized by Governments for the exploitation of their natural resources, through co-operation with private persons. Concessions combined public and private law elements, specifically that of a public grant by the State with that of a private law contract. As concern with the development of developing countries came into prominence, the appellation of "economic development agreements" came into use, with a view to emphasizing the ultimate aim (and the public interest character) of such agreements. International arbitral awards, international treaties

and scholarly writings have devoted considerable attention to the subject.

Although it would be foolhardy to assert that the topic has been exhausted, it is probably true that future disputes will not focus on such issues in the same manner or to the same extent as in the past. International realities have changed and the least one can say is that future debate will assume different forms and will concern other facets of the matter. At any rate, it would be futile and disproportionate to try to address this issue at length here, in the abstract, as a side-issue of a much larger topic.

National regulation

Since energy affects all aspects of social life, from matters of everyday conduct to all economic activities and events, it is subject to national legislation and regulation, which is directly influenced by the international framework here studied but at the same time has a significant impact on it. As already noted, the role of Governments with respect to all facets of energy production and use has always been significant and in modern times is all-important. National legislation governs the legal treatment of energy materials (State ownership of subsoil minerals, regulation of hydroelectric resources) as well as the production, distribution and utilization of energy, at the industrial as much as at the community and the household levels. Given the vital importance of energy and the magnitude of the resources needed, State-owned enterprises or enterprises directly or indirectly supported by the State (through special permits or concessions) were prevalent for a long time, both in the production of energy and in the trade of energy materials. Major petroleum companies, for instance, were owned by Governments, whether those of the States immediately involved or foreign ones. Even where private capital was involved, it was often directly or indirectly supported by the State.

The recent waves of "liberalization" and privatization have led to a lessening of direct involvement by the State. For instance, both the production and the distribution of energy has had considerable private participation for quite some time. The operation of energy-producing enterprises is no longer reserved to the State and is frequently open to private firms as well. Still, the domain of energy remains one in which State regulation is active and often quite strict and the domi-

nation of State-owned enterprises has often been replaced by the operation of regulatory authorities, leading to less immediate but no less strict State control.

The Role of International Organizations

As already noted, international organizations play a relatively limited role in matters of energy. There is no "international energy organization", no "general agreement on oil and gas". The activities of many existing international organizations, however, from the United Nations to the World Bank, the WTO or the European Union, have an important impact on the law and economics of energy. Here we shall limit ourselves to those organizations that are immediately concerned with energy issues.

OPEC and OAPEC may be said to belong to the broader category of "international commodity agreements", that is to say, international agreements with an institutional component, which are intended to regulate the production and trade, the market in the broader sense, of a commodity. The two organizations mentioned, however, are what is known as "producers' associations", that is to say, commodity agreements in which only the producers of a commodity, or "primary product", participate. Such agreements have existed for over a century. In the last 60 years, however, that is to say since the end of the Second World War, most such agreements have brought together both producers and consumers, usually indeed on the basis of equality between the two groups. Their chief purpose has been, to begin with, to ensure the orderly operation of commodity markets which are well known for wild fluctuations in price and quantity. The impact of these fluctuations on the revenues, and the entire economies, of the exporting (and to a different extent, the importing) countries are often disastrous, especially since, for the majority of primary products, it is the developing countries that are the main exporters. The chief exception to this generalization is the export of cereals, wheat, corn and so on, where the principal exporters are in the main developed countries.

The developing countries that are interested in such agreements and have promoted their use insist that their purpose is not only to stabilize the market from excessive fluctuations, but also to ensure a "fair" price to the producers. They argue indeed that there is a long-term downward trend in commodity prices. In the context of the

New International Economic Order in the 1970s an "integrated" commodity programme was put in place, with several agreements on various commodities. These agreements have lasted for quite a while, although they have not in the main been particularly successful — one of them, in fact, the International Tin Organization, has the distinction of being the only international organization to have declared bankruptcy. I would have liked to discuss at greater length these agreements but they are at best marginal for my topic. What is relevant, however, is that the international commodity agreements that have existed or continue to exist included, as I have said, both producers and consumers. Their whole point was to establish a degree of co-operation between these two categories so that the particular commodity's market could function more effectively.

It is highly questionable whether a similar reasoning could apply to energy materials, whose prices have for quite a long time now moved consistently upward, in response both to rising demand and to occasional crises. At any rate, it is quite clear that OPEC is not a commodity agreement of the type just described. The consuming countries do not participate in it and its purpose is to regulate production, prices and revenues in a manner that serves the interests of the producers. As a result, when the organization came into being, there was some debate whether it was lawful. More important, States that are wedded to the market principle have argued that it was in fact a producers' cartel, a grouping whose purpose was to restrict competition. That last argument would have been more effective if the oil companies that were principally affected had not been notorious for their successful efforts to control the market, restrict competition and keep producers' prices down. That organization was in fact established in the early 1970s by petroleum-producing countries in response to a particularly egregious effort by the oil companies to bring down the prices they paid to producers. On the other hand, what is true of OPEC as a producers' organization is equally true of the IEA in Paris, as its opposite number, a consumers' organization, which indeed was quite successful during the early energy crises in limiting the effects of the oil shock.

What is missing is an international organization that includes both producers and consumers. The only such organization active today, the Energy Charter Conference, is on a regional (more accurately, interregional) rather than world-wide level. We shall deal with it later at some length.

Problems of Carriage and Transit

The principle of territorial sovereignty also marks the beginning of any legal approach to carriage of goods, or in this case of energy materials. Close to half the oil produced in 1996 was traded over at least one border, and the same was true of about one-fifth of natural gas. Energy materials are carried like all other goods by rail or automobile by land and by ships over the sea. Since many important energy materials are liquid (the term may be something of an exaggeration for crude oil, which is viscous to a point not far from solidity and has to be specially treated to become more liquid) they are carried by tankers (railroad, trucks or ships) or by high-pressure pipeline. Similar means are used for the carriage of natural gas, whether in gaseous or in liquefied form.

In the energy sector, carriage raises special problems, precisely because it frequently involves processes that differ significantly from those normally found with respect to trade in goods, especially in the case of high-pressure pipelines. Even in legal terms, there are significant peculiarities and it is only in the most abstract sense that one can argue that oil or gas going through a pipeline is in the same position as a cargo of commodities being carried or transshipped over land or water. In practice, therefore, the role of fixed facilities, namely high-pressure pipelines and other permanent installations, radically differentiates the trade of energy materials from that of most other goods. Carriage of energy materials by means of pipelines requires costly investments, often as costly as those needed for production. The order of magnitude of the investments and the technical characteristics of the installations make long-term arrangements necessary and require a stable legal framework.

Pipelines and electricity transmission grids, moreover, have long been considered "natural monopolies", a term of legal qualification with a connotation of physical inevitability. For a long time now, certain facilities playing a central role in the process of collection, transportation and distribution of goods and services (railroads, grain elevators, pipelines, telephone lines) have been treated by law in a special manner, on the ground that it is uneconomic to construct more than one such facility in the same place. It was long accepted, therefore, that such facilities either had to be owned by the State or had to be operated in manners specified by the law. In reality, these conclusions were founded on certain technological assumptions that

seemed reasonable at the time. Current developments in technology, however, have made it possible either to duplicate the facilities without prohibitive cost or to allow participation of more than one party in the utilization of a (single) facility. The notion of "third party access" was thus introduced into the law governing complex systems like pipelines or telephones. Technological innovations have made possible the coexistence of several operators in the same system or grid and the measuring of their respective activities so as to charge fees. These developments have changed considerably the assumptions upon which the law governing some forms of energy materials carriage has rested and national and international measures for amending pre-existing rules have become necessary.

What is true of carriage in general is even more valid for transit of energy materials, that is to say, for their carriage over the territory of a State for delivery to another. In the past decade, the importance of transit questions has been enhanced by two developments. The break-up of the Soviet Union has put in place several new borders, thus bringing about several transit situations, where a single energy carriage system existed before. Secondly, the opening up of new production locations, as in the Caspian Sea, has created several new transit situations.

Energy transit is at this stage governed primarily by national legislation and by bilateral transit agreements (either between States or between States and corporations) and to a limited extent by multilateral international arrangements. Transit agreements often involve the two or more States concerned in each case, keeping in mind moreover that most energy high-pressure pipelines in operation (with the exception of those in the United States) are directly or indirectly State-controlled. There are only a few multilateral agreements in effect which deal directly with transit and the older ones among them are primarily directed at the trade of goods, with no emphasis or special attention to energy. They are the Barcelona Convention on Freedom of Transit of 1921, Article V of the GATT (1947) and the New York Convention on Transit Trade of Land-Locked Countries, adopted in 1965. The Barcelona Convention, which is the earliest, has provided the basic model for the others. It insists on non-discrimination in the treatment of goods in transit and requires that the tariffs applied be "reasonable".

Paragraph 2 of Article V of GATT establishes the basic principle: "there shall be freedom of transit through the territory of each con-

tracting party, via the routes most convenient for international transit". Other paragraphs provide that, subject to routine registration and to charges for transportation and reasonable administrative expenses, there shall be no restrictions or distinctions and no customs duties or other taxes on goods in transit. Such goods are to receive most-favoured-nation treatment. The import of the article's other provisions is not particularly clear. It is in fact significant, if perhaps rather peculiar, that application of the article in the decades since its adoption has not attracted serious concern or created any important disputes. It is characteristic that the *Analytical Index. Guide to GATT Law and Practice* published in 1995 by the WTO devotes a total of three rather uninteresting pages to the article's "Interpretation and Application".

The next important multilateral instruments dealing with transit are regional (or interregional) rather than universal. They are the Energy Charter of 1991 and the Energy Charter Treaty of 1994. We shall discuss them in some detail a little later. Other regional instruments, of more limited participation, are on the one hand the "CIS Agreement on crude oil and oil products transit through high pressure transmission pipelines", signed in 1996, and essentially meant to replace the unitary Soviet carriage system, and on the other hand the relevant directives of the European Union.

Given the importance of energy transit, as the necessary connection between energy materials producers and consumers but also on its own as an operation requiring high investments and careful management, the relatively undeveloped state of legal regulation at the international level is in itself a problem. The experience of recent decades in the matter suggests that a considerable number of possible difficulties can arise that need more elaborate legal treatment. The most obvious issues are those of ensuring non-discrimination, avoidance of overcharging and ensuring the continuity of operation. Recent incidents involving the operation of pipelines crossing State borders have underlined the importance of ensuring stability and avoiding interruptions through effective legal arrangements.

The Issue of Energy Efficiency

Although energy efficiency came into prominence as part of the Western countries' reaction to the Arab oil embargo in 1973, it soon became obvious that it was a major policy issue in its own right. It

represents in fact an important method for saving energy as well as minimizing the adverse impact of the production and use of energy on the environment.

Scarcity of energy resources, in view of their geographical distribution, combined with the effect of successive petroleum crises, has led to more efficient utilization of energy materials by the Western countries, which are thus able to achieve the same results with less amount of energy. The countries that were part of the former Soviet Union, on the other hand, as well as some of the oil-exporting countries, have for a long time existed in an energy-rich environment, a situation where there were no strong incentives for more efficient use of energy. As a consequence, their degree of energy efficiency was quite low for a long time and only recently has it started to improve.

The promotion of energy efficiency involves by necessity a wide range of policy measures, which normally assume legal forms, starting with legislation on industrial activities, which are principal consumers of energy, to building codes and other measures and incentives addressed to the public at large, to regulation of transports with similar aims. These measures are primarily domestic law measures. The international dimension may be found primarily in interstate cooperation to promote energy efficiency and in the exchange of experiences on the subject. The promotion of the utilization of renewable energy sources is sometimes included in the arsenal of measures concerning energy efficiency.

The Problématique of Energy Security

A fundamental policy issue for any national or regional economy is that of security of supply. In today's world, few countries or regions do not depend on the importation of energy materials, sometimes, as in the case of the industrially advanced countries, in very large quantities. As already noted, this is a relatively new phenomenon, in the sense that in the not so distant past a lot of the energy materials each of the advanced countries consumed (coal in Europe, coal and oil in the United States) were produced within their own territory. The problem becomes more acute when political relations between resource-producing and resource-consuming countries are antagonistic or inimical. During the Cold War years, Western countries sought to diversify their imports of energy materials for national security

reasons, so as to avoid depending on the Soviet Union for too high a proportion of their needs. The incident of the gas pipeline from the then Soviet Union to Western Europe is perhaps the case that received most publicity. Beyond specific cases, however, there was considerable discussion and planning among OECD (and IEA) countries directed at the avoidance of energy dependence on a single source and on the diversification of their supply sources.

Even apart from the Cold War context, however, the issue of energy supply security is an important one, given the degree to which the economy of most countries, especially economically developed ones, depends on energy. To begin with, the depletion of energy sources, fossil fuels in particular, while relatively distant is still a quite real possibility. As far as imports are concerned, a reasonable degree of energy independence is a principal aim of all countries, including the major powers. Diversification of energy supply sources is an important method to that end, since dependence on multiple suppliers provides greater security to the consuming country. Elaborate legal constructions are used in supply contracts as well as in arrangements for fixed installations (pipelines), with a view to avoiding (or penalizing, so as to discourage) interruptions in the supply of energy materials or exaggerated price hikes. At the same time, the development of local energy sources, including in particular the utilization of alternative methods based on the use of renewable energy sources and materials, is encouraged, ranging from solar and wind energy to biofuels and thermal energy. As is obvious, such concerns lead to intensive research for new sources and new methods for the production of energy.

Environment and Human Rights

The production and use of energy has an unavoidable impact on the environment. Energy, in any of its forms, is necessary for most activities in modern life and is used in most everyday contexts as well as in production processes. In both cases, it affects the environment.

Whether through the operation of factories or through the use of automobiles and other vehicles, it contributes significantly to environmental problems.

Its impact on the environment may take a variety of forms. Accidents in the carriage of energy materials may have catastrophic

effects, especially in sensitive or fragile environmental situations. The wreck of the tanker *Torrey Canyon* in 1967, when a considerable amount of crude oil was spilt into the North Sea, was in fact a major factor in the sensibilization of public opinion to the dangers confronting the environment. Later accidents with oil tankers and, to a lesser extent, with pipelines have confirmed the importance of the problem. But the non-accidental impact of energy is clearly even more important. The side-effects of energy production processes, in addition to atmospheric or sea pollution, involve emissions of many kinds which affect the local environment as well as the environment of the whole planet. It has taken considerable time, however, for the realization of this impact to become an important issue in world affairs.

It is thus possible to offer an impressive, even though not exhaustive, list of possible negative ways in which the production and use of energy may harm the natural environment:

— exhaustion of natural resources, such as fossil fuels;
— pollution of the air or of ground waters from the production of energy;
— pollution of the air from emissions of particular types of gases (particularly the so-called greenhouse gases) during the energy production process with an immediate impact upon the climate on a world-wide scale;
— pollution of the sea or of the ground from oil spills or other such accidents, including not only major accidents (e.g., the *Torrey Canyon* or the *Amoco Cadiz*) but also the gradual spillover of oil from port facilities or pipelines;
— effects from the construction of hydroelectric plants on the environment (rivers, lakes etc.);

Such listings offer only part of the picture. The relationship between energy and the environment is far more intricate. The promotion of energy efficiency and the development and use of renewable energy sources may be understood in fact, not only as measures with a definite economic value of their own, but also as measures for the protection of the environment. The scope of the environmental protection needed is quite comprehensive, and many aspects of the operation of the energy industry may interact with it in a variety of manners. In fact, even the utilization of renewable sources of energy may, under certain circumstances, have to be restricted or avoided on

the grounds of the protection of the environment — witness the legislation in many European countries on the protection of rivers and ground waters which may create obstacles to the construction of hydroelectric works or the regulation of the construction of aeolian parks.

The issue has reached a point of crisis in recent years, leading to conflict on an international scale. Despite the continuing efforts of certain countries or of industry spokesmen to contest the impact of energy production processes on the earth's climate, it is now generally accepted that this is a major current issue that needs to be dealt with at a universal level. A direct consequence of such concerns is the so-called Kyoto Protocol, which was negotiated in the framework of the New York Convention on Climate Change, adopted in 1992 and in force since 1994.

The purpose of the Protocol, adopted in 1997, was to provide for specific measures for the gradual reduction over time of emissions of six so-called "greenhouse gases", particularly carbon dioxide, methane, nitrous oxide and three other ones (HFC (hydrofluorocarbons), PFC (perfluorocarbons) and sulphur hexafluoride). These gases are produced in particular, although not solely, during the energy production process. All countries, developed as well as developing, are involved in the process.

The Protocol provides quantitative goals for the reduction of emissions, namely a reduction by 8 per cent between 2008 and 2012 and allocates the reduction among the contracting parties, in particular the developed ones, since there was an effort to avoid imposing too heavy a burden on developing countries. To make implementation easier various devices are used, such as the possibility of buying and selling "rights to pollute". In spite of such efforts to temper the impact of the necessary measures, final adoption and implementation of the Protocol has faced serious difficulties, since its implementation involves extensive and costly adjustments in the entire industrial structure of the countries involved. Many important States, including in particular the United States, have been reluctant to act, thus inducing others to delay action, as well. A recent conference in Bali, Indonesia, in late 2007 sought to gather support for the Protocol, with limited success.

An important facet of this issue is its world-wide character, the necessity to address pertinent problems on a universal basis, and not merely at the national, bilateral or regional levels at which most

energy-related arrangements operate. To the extent that relevant arrangements would come into effect, they would have to involve institutional and regulatory action embracing the entire community of nations and not only small sections of it, as has typically been the case with energy-related measures and arrangements.

It is characteristic of the universality of energy-related problems that they affect directly human rights, mainly in the resource-producing countries. The international law on the protection of human rights is a branch of international law that has evolved considerably in the past few decades. Still, the established position perceives human rights as a government-related issue: it is in the main Governments that may violate human rights or may be held responsible for not taking measures to prevent or punish actions by private actors which infringe on the human rights of people. While such positions may need to be qualified, the point remains that in most related instances government actions are primarily involved and the private companies concerned may at most have contributed to the governmental abusive activities.

It so happens, however, that many of the recent cases involving the complicity of Governments and private companies in acts of flagrant abuse against the human rights of the population in particular areas involve, one way or another, the activities of energy-related companies, particularly but not solely in developing countries. The construction of hydroelectric dams, the exploitation of oil resources, and the operation of pipelines have often involved large-scale population movements. Particular companies, such as Unocal in Myanmar (Burma), Royal Dutch Shell in Ogoniland, Nigeria, and BP in Colombia, have been accused of collaborating with the local Governments in actions which violated the human rights of the local people. In most instances, what was involved was the financing of or otherwise supporting the local Government's actions rather than directly engaging in human rights violations. Some of these cases have come before American courts, while the World Bank has adopted special procedures for dealing with cases of this kind. Regardless of the outcome in each instance, the question of the responsibility of private companies, essentially under international law, has thus been raised. It is true that the issue is not one that is directly linked to the energy industry as such (while, for instance, there is such a direct link in the case of the environmental issues we just glanced at). The oil companies concerned are involved, because

of the nature of their activities, of course, but primarily because they are big transnational enterprises whose activities may involve such questions. Even though it is unlikely that any action involving the energy industry may result from these developments, the issue is important enough to be mentioned here.

CHAPTER III

THE ENERGY CHARTER TREATY : A POSSIBLE PATTERN OF INTERNATIONAL CO-OPERATION ?

In discussing the various facets of energy law and regulation we have already referred more than once to the Energy Charter Treaty (ECT). It is useful to look at it more closely and in detail, because it is a comprehensive international legal structure (both an instrument and an organization) devoted to energy issues, even though it is of regional (or "inter-regional") rather than universal scope. It is a complex and interesting document, which provides useful concrete indications of the possible structure and contents of a multilateral instrument on energy. In view of its specific history and its political and economic antecedents, it is by no means certain that it can serve as a universal model. It seems useful, however, to deconstruct this institution, looking in some detail at its approach to energy issues, in the hope of perceiving certain facets, problems and practices which offer possibilities for less fragmentary an approach to the energy industry than the usual international (i.e. interstate) arrangements provide.

The ECT will thus be discussed in some detail, as a kind of a summary of our general topic. After a short discussion of the circumstances of its negotiation and conclusion, an outline of its contents will be presented. These will be followed by an analysis of some of the more important topics covered by the Treaty, namely, investment, transit and the protection of the environment. We will close with some conclusions on the ECT and its possibilities.

The Energy Charter and Its Treaty

The Energy Charter Treaty has its origins in the reaction of the European Union to the breakdown of the Soviet Union and its repercussions on the postwar pattern of Cold War division of Europe (and the world). This reaction led to the adoption of a declaratory instrument, the European Energy Charter, a response, initially by the European Union, to the new conditions in the European energy sector brought about by the radical changes in Central and Eastern Europe at the start of the 1990s. The — at the time impending —

break-up of the Soviet Union and of the "socialist bloc" had the potential for transforming and even destroying the pattern of political and economic relations developed during the Cold War era, especially at its later stages, between the energy-producing States in the ex-Soviet Union and the energy-consuming States in Western Europe and elsewhere. Long-prevalent assumptions concerning the production, carriage and trade of energy in the entire region were put in question and the energy market's predictability was at risk. At the same time, closer co-operation between the two groups of countries, with a view to cultivating existing complementarities, became possible on a new basis.

The initial proposal came from the Prime Minister of the Netherlands, at the Dublin European Council in June 1990. He urged the European Community (EC), as it then was called, to take the initiative in promoting new patterns of co-operation in energy with the Soviet Union and the countries in Eastern Europe. The European Commission then proposed that a formal declaration on the subject be adopted. Negotiations for a European Energy Charter were launched in January 1991 and in December of that year the Charter was signed by 50 States and the EC.

The European Energy Charter is a programmatic, not legally binding, political document. It formulates general principles for a secure framework for an efficient energy market in Europe, through promotion of trade, co-operation and investment and ensuring security of supply on the basis of market principles, essentially non-discrimination and market-oriented price formation. In order to place such political commitments on a legal basis, it was agreed to negotiate a binding international agreement, which was eventually called the Energy Charter Treaty (ECT). Negotiations started soon after the Charter's signature and lasted until mid-1994. The ECT was formally signed in Lisbon on 17 December 1994, and was at the same time opened for signature by other States, along with the Energy Charter. Although they participated in the negotiations, the United States and Canada decided in the end not to sign the Treaty. By the end of 2007, the Treaty has been ratified by 47 States and it is at various stages of approval in several others. The Treaty entered into effect on 19 April 1998, after deposit of ratification instruments by 30 States.

The Treaty's central purposes are essentially those of the Charter: to integrate and organize the energy market in Europe, so that it may

function more efficiently on market principles to the benefit of all participants. By constructing a legal and institutional framework that creates a higher degree of predictability and certainty a reasonably stable regime is provided. The instrument only covers energy and energy issues. This is a fundamental point about the ECT: it is a sectoral agreement, not a comprehensive one; it seeks to establish a special regime in the energy sector only and it deals with each topic — trade, investment, transit or the environment — solely with reference to energy. This fact, already apparent in the title and clearly implied in many provisions, especially those on definitions, is spelled out in an Understanding in the Final Act of the Conference that adopted the Treaty (Understanding IV, 1 *(a)*), according to which:

> "The representatives underline that the provisions of the Treaty have been agreed upon bearing in mind the specific nature of the Treaty aiming at a legal framework to promote long-term cooperation in a particular sector and as a result cannot be construed to constitute a precedent in the context of other international negotiations."

A specific conclusion drawn from the Treaty's sectorial character is an explicit attempt to stem any "fallout effect" from its provisions. As already noted, the treaty "cannot be construed to constitute a precedent in the context of other international negotiations" *(supra)* and it "confers no right to engage in economic activities other than economic activities in the energy sector" (Understanding IV, 2 *(a)*). The former statement appears to have been of little avail, save in the strict legal sense, since the Treaty has been often cited in the literature and in negotiations, especially with respect to investment, as an illustration of current trends. The latter point remains valid.

The Treaty's scope may be ambitious, but it is in no way arbitrary or excessive. It is dictated by important economic and political considerations. Energy resource countries in Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS) need access to the Western markets as well as increased investment capital, which can be supplied largely by Western European investors. Consumer countries in Western Europe and elsewhere need secure energy supply, while private enterprises in them are prepared to undertake investments abroad if they are assured of a stable legisla-

BOX III-1. PARTICIPATION IN THE ENERGY CHARTER CONFERENCE (AS OF DECEMBER 2007)

Members of the Energy Charter Conference

A. Charter signatories which have signed the ECT and deposited instruments of ratification

Albania, Armenia, Austria, Azerbaijan, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Cyprus, Denmark, Estonia, European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, FYROM, Turkey, Turkmenistan, Ukraine, Uzbekistan, United Kingdom

B. Charter signatories which have signed the ECT but have not yet deposited instruments of ratification

Australia, Belarus, Iceland, Norway, Russian Federation

C. Charter signatories which have not signed the ECT and participate as observers to the EC Conference

Afghanistan, Canada, Jordan, Pakistan, Serbia, United States

D. Other observers to the Energy Charter Conference (which have not signed the Charter or the Treaty)

Algeria, Bahrain, People's Republic of China, Iran, Republic of Korea, Kuwait, Morocco, Nigeria, Oman, Qatar, Saudi Arabia, Tunisia, United Arab Emirates, Venezuela

tive framework, fair treatment and reasonable security. The entire ECT process rests on this fundamental bargain: access to markets for access to resources. Common interests dictate, moreover, provisions on complementary issues: secure transit, energy efficiency, avoidance of harm to the environment and appropriate competitive conditions in the energy market.

Although justified, the broad scope of the Treaty's contents, along with the number and heterogeneity of the negotiating parties, contributed to the difficulty of the negotiations. More than 50 States were involved in them and they included, apart from the European Union and its members, all other European States, that is to say, the States then members of EFTA and the Central and Eastern European States as well as the States of the CIS, and, with the exception of New Zealand, all the other States members of the OECD, in particular, Japan, Australia, the United States and Canada (although, as noted, the last two did not sign the Treaty in Lisbon, while Australia signed the Treaty but has not yet ratified it). Thus, while the Treaty is not a world-wide arrangement, its geographical scope is in no way solely European.

The Treaty is a complex set of documents that covers, in one way or another, all areas of economic interest in the energy sector. Apart from the main body of the Treaty, consisting of a Preamble and eight Parts, it is supplemented by a series of side-texts: a Final Act that includes a series of understandings and declarations; a series of decisions; a set of Annexes; a Protocol on Energy Efficiency and Related Environmental Aspects; while a Protocol on Transit is under active negotiation. To understand therefore what the treaty provides on a particular issue, the reader may have to start from the relevant general provision, consider the way in which it may be qualified by more specific treaty language, examine the effect of optional listings in the numerous Annexes, proceed to place the result alongside an understanding or a decision and possibly complete the process by referring to a related declaration. The actual text consists of provisions of varying specificity and normative intensity; they range from the very general to the highly detailed and from the strictly and effectively binding to various degrees of "soft law" commitments. An undertaking to negotiate a "supplementary treaty" on a particular topic is also included.

The Treaty also establishes an institutional mechanism, a small specialized international organization. Its Part VII provides that the "Energy Charter Conference", as it is called, will meet at regular intervals, so that the review and monitoring procedures provided in the Treaty can be implemented and a process of revision and expansion of the Treaty's provisions can function. A Secretariat, under a Secretary-General, is created, although it is expressly provided that it should be kept to minimum size. We shall return to some aspects of this institutional construction later in this chapter.

An Outline of the Treaty

A brief rehearsal of the Treaty's contents is indicated at this point, before addressing at somewhat greater length some of the Treaty's major topics. Part I of the Treaty is chiefly devoted to definitions, although some terms are defined later, in specific context. In international treaties, as much as in domestic legislative texts, definitions are not neutral statements about concepts. They are themselves part of an instrument's normative content. They determine the object to which an instrument's rules apply and they thus delimit and complement its substantive provisions. The instrument's actual effect is

determined by the interaction between its various provisions, in particular, but not only, between the provisions on definition and other provisions. The choices made, when the definitions are formulated and agreed upon, thus affect significantly, and may indeed control, the ways in which the instrument will be applied and will affect those to whom it is addressed. Definitions also indicate the conceptual and normative choices the drafters make. In the case at hand, for instance, adoption of the term "to make investments" in the ECT reflects a decision to avoid having recourse to established legal or economic notions, such as "establishment" or "admission". And agreement on the language of the definition of the term "to make investments" involved important decisions on where to draw the line between the "pre-" and "post-" investment stage (that is to say, the requirements for admission and the treatment of already established investments.)

Part II of the Treaty deals with issues of trade, although some difficult trade questions are also dealt with in later Parts (especially Part VI). Trade is one of the foundations of the entire agreement, as the motto already cited shows: "access to markets for access to resources". The Western countries are to open up their energy markets to energy materials and products from CEE and CIS countries while the latter will allow and facilitate energy investments from the West. The opening up of the markets is to be effected by means of the application of the rules — and essentially the approach — of the General Agreement on Tariffs and Trade (GATT). It should be remembered that, at the time the Treaty was being negotiated, many CEE and CIS countries participating in the negotiation were not yet members of GATT. The desired effect was thus to be brought about by means of one of the ECT's major inventions, "GATT by reference", that is to say, the application of many but not all rules and the approximation of some procedures of GATT between ECT signatories, even those who are not GATT members. (As far as trade between GATT members is concerned, it is explicitly provided that GATT rules continue to apply.) Non-GATT members were thereby assured that their trade in energy materials would not be discriminated against and that they could take advantage of other prescriptions and procedures developed over the years in the GATT framework. In this manner, the way was opened for immediate liberalization of trade in energy materials and products in Europe.

Such a bold move entailed, of course, difficult problems. GATT has been accused of many things, but excessive ease of application is not one of them. The often lengthy negotiations prior to any country's accession to GATT illustrate the need for settling beforehand the problems that membership in GATT may create for the new member as well as for the old ones. In the absence of such a process, likely problems, both in the performance of non-GATT members, now bound by GATT rules, and in the relations of GATT members with the new "members-by-reference" needed to be taken care of. The problems are more difficult when one deals with an industry characterized by extensive State control and strict governmental regulation.

For the countries in transition, the ongoing process of changeover from a centralized regime of management and operation of energy resources by the State complicated the novel problems of conformity to GATT rules, since the latter were largely inconsistent with the trading systems prevailing earlier, all elements of which had not yet disappeared. Problems may arise for Western European countries, as well, whose trading patterns may have to change to accommodate their new GATT-by-reference partners. In a sector dominated by large monopolistic or oligopolistic corporations, many of them public or semi-public, actual access to markets requires far more than the lifting of formal barriers. To complicate things further, the GATT's Uruguay Round negotiations were taking place while the ECT was being negotiated. Since the ECT trade provisions were already drafted when the Round was completed, it was necessary laboriously to adapt the language of the Treaty, after its signature, to the new trade environment of the World Trade Organization (WTO). A formal Amendment to the Trade-Related Provisions of the ECT had to be adopted as an international treaty on 24 April 1998.

Part II of the Treaty also contains Article 7 on Transit, one of the most original and far-reaching sets of provisions in the Treaty, which will be examined in some detail later in this chapter, and articles on transfer of technology and access to capital markets, which will be briefly considered in the context of the provisions on investment. Other articles in this Part deal with Trade-related Investment Measures and competition.

Part III is entitled "Promotion, Protection and Treatment of Investments"; it deserves more elaborate consideration and it, too, will be discussed in some detail in a later section. Part IV starts with an

ideologically significant article on State sovereignty over energy resources, one of the few provisions that address directly ideological issues. This Part includes further articles on Transparency and Taxation and a long article on "environmental aspects", a topic that is central to the entire Treaty. It too will be examined later. Part IV closes with articles on exceptions. Among them one finds old acquaintances, such as "essential security interests" and "maintenance of international peace and security". At the tail end of that Part, a separate article deals with the situation of "Economic Integration Agreements". a matter of particular interest for the European Union, but also, potentially at least, for other States participating in the growing number of regional integration arrangements.

Part V of the Treaty deals with procedures of dispute settlement. The provisions on disputes between States do not depart seriously from established patterns on the matter, but the provisions on disputes between investors and States deserve separate consideration later, in the context of investment.

Part VI deals with "transitional" issues and covers a number of difficult topics that have to do mainly with relations with and the position of countries in transition (i.e., CEE and CIS countries). It is here, in fact, that the "GATT-by-reference" principle is established. A companion article allows countries in transition to suspend their full compliance with a number of specified provisions concerning particular facets of competition, transit, access to capital markets, transfer of funds, transparency and the conduct of State enterprises. Such suspension was limited in time and has in fact ended on 1 July 2001. More important, an elaborate monitoring system is established in the provisions on the Treaty's institutional machinery. Annex T of the Treaty lists the 24 contracting parties that fall in the category of "countries in transition" as well as the specific provisions to which such arrangements apply.

Part VII of the Treaty covers institutional issues and, as already mentioned, creates a small international organization, called "the Energy Charter Conference". The last Part, Part VIII, contains the usual "final provisions" of treaties, that is to say, articles on signature, ratification, accession and withdrawal, on entry into force and amendments etc. It is worth noting that, reflecting its character as an agreement establishing a sectorial regime, the Treaty allows no reservations. More important, it is provided that, even before the Treaty's entry into force, the contracting parties may apply it provisionally, to

the extent this is permitted by their constitutional law. Quite a few States chose to do so.

The Treaty is supplemented by 14 Annexes, a series of separate decisions attached to the Final Act of the Conference for its adoption and a few other documents. Of particular importance is an attached Protocol on Energy Efficiency and Related Environmental Aspects, signed (and later ratified) along with the Treaty.

The ECT on Investment

Private investment plays and will keep on playing a central role in the energy sector, since a large part of the financial resources and the technology that are needed for the development of energy production and trade are in private hands. In the case of the ECT, as already noted, a fundamental objective of the entire arrangement is to facilitate Western private investment in the "Eastern" countries — thus opening up the resources of these countries to Western firms and helping provide to them the financing and technology they need. Today's private investors are in the main large transnational enterprises and smaller firms associated or co-operating with them. These enterprises are themselves important elements of the world-wide integrated energy market. They can thus contribute additional momentum to the integration the Charter seeks to ensure.

While the Treaty mainly focuses on direct investment, i.e., investment that involves control of operations by the investor, it also deals rather summarily with indirect investment, that is to say, bank and other kinds of loan financing. Article 9 provides that the aim should be open access to capital markets. Any existing discrimination in favour of domestic investors should be kept within narrow limits. The pertinent language was initially a complex mixture of "soft" and "hard" provisions, of strictly binding rules and promises to strive to achieve desirable results. By the time the negotiations ended, the language had softened considerably, and only a number of qualifications to the non-discrimination principle retained relatively strict language. Things are different as far as direct investment is concerned.

The Treaty seeks to establish a common, although not uniform, regime for direct investments in energy, based on the one hand on rules and procedures providing a reasonable degree of protection to investors and on the other, on non-discrimination as the principal, indeed the overarching, standard of treatment of investors by

Governments. It is noteworthy that, while the Treaty applies to a single economic sector, the definition of investment in it (Art. 1 (6)) is quite inclusive. Along the lines of protection-oriented definitions found in bilateral investment agreements (known as BITs), it covers all types of assets and interests, including money claims, intellectual property and returns. All the items listed are qualified by a general limitation that seeks to reaffirm the Treaty's single-sector orientation. According to it, " 'investment' refers to an investment associated with an economic activity in the energy sector". However, the term "associated with" that is used is open-ended enough effectively to broaden the Treaty's scope with respect to investments.

Other consequences of the Treaty's sectorial orientation for investment may be of a more substantive character. From the sector's well-established characteristics, it may be possible to deduce certain likely features of the investments to which the ECT is primarily addressed. Energy investments, especially investments in the development and exploitation of energy sources and the transportation of energy materials through fixed facilities, tend to be large and long-term. While the Treaty also covers smaller and less long-lasting investments, as the relevant listing in the Final Act Understanding makes clear, its principal function remains that of establishing the legal and institutional conditions for increased medium-term predictability and security, so as to make possible the investment of the huge sums needed for the development of the oil and gas resources in the CEE and CIS countries and the carriage of related materials to Western markets through pipelines and other fixed facilities.

No wonder then that an entire Part of the Treaty, consisting of eight articles, is devoted to "Investment Promotion and Protection". That part may in fact be perceived as constituting in itself a multilateral investment treaty. While its scope is restricted by its sectorial character, most of its provisions can easily have application to any kind of investment. The central provisions on the treatment of foreign investments are those of Article 10, supplemented by a number of other provisions. The Article starts with a general paragraph providing for the application of a number of absolute standards to investments ("fair and equitable treatment", enjoyment of "the most constant protection and security" etc.). Paragraph (3) sets out the basic standard of treatment (national treatment and Most Favoured Nation treatment, whichever is more favourable to the investor). Paragraphs (2), (4) (5) and (6) deal with pre-investment treatment —

what in more traditional language is known as issues of "admission" or "entry" — and paragraphs (7), (8) and (9) cover issues of post-investment treatment (in traditional legal terms, treatment after establishment). Other articles in this Part of the Treaty deal with admission of key personnel (Art. 11), compensation for losses from civil war or armed conflict (Art. 12), expropriation (Art. 13), transfers and payments (Art. 14), and subrogation (Art. 15). The provisions of Part V on settlement of disputes are of course directly relevant, especially Article 26, on settlement of disputes between investors and States. Several other provisions of the Treaty and of the side-texts are also pertinent to various aspects of investment.

Pre-investment treatment

The manner in which the issue of "pre-investment treatment" is addressed is interesting on several grounds. Let us not overlook the fact that admission is currently emerging as the most controversial of the outstanding issues in the international law of foreign direct investment. While there is a clear trend in national legislation in favour of liberalizing conditions for admission of investments, numerous exceptions and barriers still remain, even in many developed countries, especially with respect to investment in natural resources. The same is true at the international level : most of the bilateral investment treaties accept that admission is effected on the basis of existing host country laws and regulations. Significant departures from this pattern, extending the application of national treatment to admission, are found in the North American Free Trade Agreement (NAFTA), in recent United States BITs, and in some "soft law" instruments.

During the negotiations on the ECT, it was initially proposed that the same standard of treatment that was eventually agreed to apply to "post-investment treatment", i.e., to enterprises already established, (namely, as noted, national and most-favoured-nation treatment, whichever is more favourable to the investor) would also be applicable to admission. It became clear, however, as the negotiation progressed, that application of this standard to admission faced insurmountable obstacles. The new legislative framework for investments and operations in the energy sector in Russia and most other countries in transition was not yet in place. The pertinent legislation was in a state of flux ; many relevant government decisions were made

more or less on an *ad hoc* basis and reversals of policy were not rare.

In the absence of stable and reasonably definitive domestic legislation, the basic international standards in use are likely to be of limited usefulness. Such standards as national and MFN treatment are relative (or "contingent"), in that they refer, as is well known, not to a definite treatment, but essentially to lack of discrimination, to the application to foreign investors of the norms already applicable to nationals or other aliens, respectively. Absent a definitive legislative framework, it would be meaningless for the countries in transition to bind themselves to the proposed standard, since such commitments would be at best nominal. The fluidity and uncertainty of applicable rules would make it very hard, moreover, to identify and state the exceptions or transitional measures needed for the proper application of the investment standards in these countries. Of particular interest in this respect was the prospect of privatization and demonopolization of the energy sector. As privatizations in several economic sectors in Western European countries have made apparent, this process is bound to raise a multitude of specific problems as to the treatment of foreign investors at the pre-investment phase (that is to say, as to their participation in the privatization process).

To delay concluding the negotiations until new laws were adopted would risk losing the momentum acquired. The European Union took therefore the initiative and, in the fall of 1993, proposed what became known as the "two-step approach". To allow completion of the negotiations on the Treaty, the provisions on pre-investment treatment would be provisionally covered by "soft" language, that did not impose on the parties strict obligations. After the end of negotiations and the signature of the treaty, new negotiations would begin with a view to concluding a "supplementary treaty" that would deal solely with pre-investment treatment.

The EU proposal was eventually accepted by the other negotiating parties, including, as it appeared at the time, the United States. The continuation and eventually the conclusion of the negotiations became thus possible. Accordingly, paragraph (2) of Article 10 provides that the parties "shall endeavour to accord to investors . . . as regards the making of investments" the national and MFN treatment they have agreed to provide post-investment, while paragraph (4) refers to the continuation of negotiations on the topic. A deadline for their conclusion was even set, namely the end of 1997. Negotiations

did indeed begin and by the end of 1998 seemed to have reached conclusion. At that time, however, complications arose, partly because of hesitation by some contracting parties and partly because during the same period the Multilateral Agreement on Investment was being negotiated in the framework of the OECD. As a result, although a draft text of a Supplementary Treaty had been more or less agreed, its adoption was put off and remains pending.

The issue illustrates in the first place the difficulty of reaching agreement on the question of applying non-discriminatory standards to the admission of investments, something that has been made abundantly clear by the history of BITs. As already mentioned, the prevalence of privatizations, in the energy sector as in many others, has imported additional complications. The provisions actually adopted, however, while awaiting the conclusion of the "Supplementary Treaty", illustrate the importance of the interplay between legal commitments of various degrees of normative intensity, especially when coupled with monitoring mechanisms.

As already noted, the language finally adopted was "soft". Contracting parties are bound merely to "endeavour" to grant non-discriminatory treatment in the making of investments. Such "soft" obligations are not totally devoid of legal effect, however. It has been argued indeed that, since the entire Article 10, including the "soft" provisions on pre-investment, has not been expressly excluded from the provisions on arbitration, both State-to-State and investor-to-State, it is imaginable that a State may be found, in the appropriate circumstances, to have breached the Treaty by not having made reasonable efforts not to discriminate. While such an outcome may seem improbable, other aspects of the Treaty should not be disregarded.

To begin with, the "best efforts" clause in paragraph (2) must be understood in the context of the Treaty as a whole and of the rest of the Article in which it appears. In particular, as already noted, paragraph (1) of Article 10 provides for application of a series of absolute standards of treatment. Although these standards are common in bilateral treaty practice, they are of dubious practical usefulness. While they relate to treatment of "investments", presumably after they are made, some particular clauses may also apply in pre-investment situations. More important, contracting parties are bound to report at the time of signature or accession all exceptions to paragraph (2) of Article 10 and to keep the reports up to date thereafter.

These exceptions are collected in a "Transparency Document". Parties are further bound by a "best efforts" rollback clause as to any such exceptions (para. (5) *(b)*) as well as a voluntary standstill clause (para. (6) *(a)*). Finally, a State may voluntarily declare that it will accord the treatment in question, in whole or in part, such declaration being binding under the Treaty (para. (6) *(b)* and para. (9)).

As for the draft Supplementary Treaty, apart from restating in strict terms the language of paragraph (2) of Article 10 of the ECT, it provides its own sets of exceptions and negative list possibilities, focusing in particular on ensuring non-discrimination in cases of privatization. Since then, new efforts towards its final adoption have been announced at various times, possibly with some small changes to the existing draft, but no progress towards adoption has been made.

Post-investment treatment

With respect to the treatment of enterprises that have gone beyond the pre-investment stage and are already present in the energy sector, the Treaty seeks to establish a common framework, which rests on two main pillars. On the one hand, a comprehensive guarantee of non-discrimination as the principal, indeed the overarching standard of treatment, and on the other, a set of rules and procedures destined to provide protection to the investor.

Non-discrimination

As far as the first pillar is concerned, it has already been noted that the standard of non-discrimination is formulated in the Treaty in terms of a dual National and Most-Favoured-Nation Treatment standard, whichever is most favourable to the investor. Thus, the fundamental standard applied is relative: it requires not any particular kind of treatment, but application in a non-discriminatory manner of whatever treatment is accorded to local nationals or to nationals of other countries. Host countries retain therefore their ability to adopt and apply the investment regime they deem appropriate. What the Treaty requires is that the regime they decide to establish will be applied in the same manner to all investors. The exact contents of the treatment granted may therefore vary, depending on the laws and international commitments of each country. Whatever uniformity or

similarity may exist will be due to the practices of the industry or to the bargaining power of the actors involved.

There are remarkably few exceptions or even qualifications to this fundamental obligation. There was acute debate during the negotiations as to whether any exceptions at all would be allowed. The presence and number of exceptions might even be said to have acquired a symbolic value: it became imperative for the "success" of the effort to allow as few exceptions as possible, even if that meant putting some of them off until the Supplementary Treaty's conclusion or even hiding them by means of careful language. As far as the countries in transition were concerned, the problem was resolved by deciding that the possible exceptions suggested either had to do with pre-investment problems and thereby could be deferred, or they could be treated as "transitional arrangements", that is to say, as temporary exceptions. Countries in transition were allowed to claim such arrangements. However, only one country claimed such an exception for the critical paragraph (7) of Article 10, on the grounds that its existing legislation does not allow aliens to acquire real property and requires aliens to have special permits in order to engage in a number of activities.

Strictly speaking, there are no other "exceptions" to post-investment treatment, although, with a little effort, one may discover some quasi-exceptions concealed in other provisions. Most of them have mainly to do with United States concerns, based on existing legislation, and they have remained in the Treaty even though the United States did not sign it. In fact, a principal feature of the negotiations on many specific investment matters was that it was fundamentally an intra-OECD negotiation, while, once the possibility of transitional arrangements was secure, the CEE and CIS countries just watched.

It does not seem necessary to discuss here the well-known problems of application of the MFN and National Treatment standards. These are general problems, relevant to many of the innumerable cases where these standards are used. An illustration of the kinds of problems that arise is found in a joint Canadian-United States declaration in the Final Act, where it is sought to explain what is meant by "like circumstances". As one might guess, the topic had been debated at length among OECD members.

For the sake of completeness, it should be recalled that the relative standards mentioned are supplemented, in paragraph (1) of the relevant Article, by references to a number of (more or less) absolute

standards. It is provided that parties shall "accord at all times to investments . . . fair and equitable treatment" and treatment no less favourable than "that required by international law", investments "shall enjoy the most constant protection" and no party "shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal". These general standards may be understood as supplementing both the relative non-discrimination standards and the more specific provisions on protection.

A number of other provisions are relevant to investment issues. Of these one might mention an interesting provision on transfer of technology (Art. 8), which provides in reasonably strong language (without a "best efforts" qualification) for the transfer of energy-related technology "on a commercial and non-discriminatory basis" and for the elimination of obstacles to that end. Contrary to the great majority of provisions on investment, this one deals with eventual obligations of investors' home States.

Investment protection

The obligation to accord non-discriminatory treatment is complemented by provisions on matters of "investment protection", that is to say, questions concerning the treatment of investors by the host State on a series of specific issues. Such provisions seek to exclude the possibility (or to temper the consequences) of measures taken in the exercise of a State's sovereignty that would be highly detrimental to the investors' interests. Provisions of this kind go beyond assurances that investors will not be discriminated against and seek to ensure a high degree of predictability as to their treatment by the host State, at least with respect to certain major facets of their operations. While non-discrimination involves a relative standard of treatment, that is to say, reference to a body of laws that normally changes over time, investment protection of this kind is based on absolute prescriptions, which provide the actual terms of the treatment to be accorded.

Investment protection provisions may thus be understood as seeking to provide investors with an international law safety net against host government actions that might seriously damage their interests, as contradistinguished from actions of everyday incompetence or even malevolence. Even as to the latter, however, a degree of procedural protection is available since they are normally subject to

the provisions on settlement of disputes. As long as the likelihood of direct and possibly radical government intervention in the economy was present in many States, investment protection provisions were the subject of considerable controversy. In recent years, they have become more or less standard in bilateral investment treaties and they are common in regional agreements. Host Governments accept them, albeit with innumerable variations, not only as a precondition for attracting investments, but also because they do not expect to take radical measures affecting investments. They wish indeed to make more difficult future adoption of such measures, presumably by successor Governments.

In the instant case, investment protection provisions were deemed necessary for two additional reasons. On the one hand, the domestic constitutional, legislative and administrative structures in many countries in transition had not yet fully adapted to the radical changes of the past few years. Decisions concerning foreign investments were often taken on an *ad hoc* basis and the possibility of unpredictable action, of arbitrary measures or of radical policy reversals could not be excluded. On the other hand, energy investments, in exploration, production or even transportation, tend to involve very high amounts of capital and to operate in the long term. Investors' fears are therefore more acute and so is their corresponding need for reassurance as to security and stability.

The relevant ECT provisions may be classified in three major categories: first, those against measures causing major disruptions in an enterprise's operations, such as expropriations or other takings of property and abrogation of agreements between States and investors; secondly, those concerning restrictive measures of various kinds, especially measures limiting the transfer of funds abroad and the employment of foreign key personnel; and thirdly, provisions on certain more general or more technical issues, such as the general obligation of "transparency" or the subrogation of a home State investment insurance agency to the investor's claims, after paying off on an insurance contract (usually relating to non-business risks).

The strength of these provisions lies in their specificity and detail, so that a summary will not do them justice. Moreover, as already noted, these provisions address problems of investment, not specific energy issues. We shall therefore limit ourselves to providing only a few indications, meant to suggest their general thrust as well as some of the problems they raise as far as energy is concerned.

Article 13 starts with a general clause on expropriations and nationalizations incorporating in its essentials the traditional formulation supported by the United States (known as the "Cordell Hull formula", from the position expressed by the then US Secretary of State in the correspondence with Mexico over the nationalization of land and petroleum holdings in the 1930s). Most of the developed capital-exporting countries support this position, according to which the lawfulness of an expropriation in international law depends upon a number of conditions: its purpose should be in the public interest, it should not discriminate against the foreign investor, it should be undertaken in accordance with due process of law, and in particular "prompt, adequate and effective compensation" should be paid. It is the last condition which is in fact the most controversial and probably the most important. The language adopted in the ECT seeks further to strengthen it, by specifying that the compensation should correspond to the fair market value of the property taken, before the expropriation. It is also provided that payment of the compensation should be made in convertible currency and that prompt judicial review of the valuation and compensation be available. The ECT thus aligns itself quite clearly with the traditional position of developed capital-exporting countries, rejecting the approach of the developing, capital-importing ones, which, in the recent past, had sought to substitute a more flexible standard for takings of foreign property. Starting with the United Nations General Assembly resolution on "permanent sovereignty over natural wealth and resources" and in subsequent texts, dating mainly from the 1970s and 1980s, they had sought to establish a formula which, while acknowledging the obligation to compensate, referred to "appropriate", rather than full compensation. By adopting the earlier formula, already reaffirmed in most bilateral treaties for the protection of investments, the ECT returns to a more demanding standard, essentially discouraging any attempt to regain control over natural resources.

This provision is supplemented by Article 12, which deals with losses to investors caused by war, civil disturbance or similar event. If these losses occur without any action on the part of the host State's authorities, the investor is entitled to national treatment with respect to any compensation or indemnification. If, however, they are caused by requisition or destruction of property by the forces or authorities of the host State, then the investor is entitled to restitution or prompt, adequate and effective compensation.

The question of State contracts with investors is dealt with in a rather obscure provision buried at the end of paragraph (1) of Article 10, which states unequivocally that "each Contracting Party shall observe any obligations it has entered into with an investor [or an investor's company]". All State contracts with investors or other commitments to them are thus brought under the cover of the Treaty and of its dispute settlement provisions. Contracting parties may, however, declare that they do not accept submission to arbitration of a dispute of this type and four countries have in fact done so.

Article 11 seeks to protect the investor's ability to appoint and employ key personnel of his choice, while transfer of funds outside the host country, a very important practical issue in foreign investment, is dealt with by an entire longish article (Art. 14), which combines a "guarantee" of freedom of transfer with a number of exceptions or qualifications of uneven importance.

Finally, investment protection is completed and strengthened by the elaborate provisions on dispute settlement in Part V of the Treaty. Articles 26 and 27 deal respectively with procedures for the settlement of disputes between investors and States and between States. The latter are fairly commonplace procedures for creating an arbitration tribunal, once diplomatic efforts to settle the dispute have failed. It is worth noting, however, that they are essentially under the auspices of the Permanent Court of Arbitration and do not provide for eventual recourse to the International Court of Justice. The provisions on investor/State disputes concern possible breaches of an obligation — under the investment provisions only — and they largely follow similar clauses in bilateral investment treaties. Investors are given a choice among the several alternative dispute-settlement mechanisms in existence, including the host State's judicial system. The applicable law in such proceedings will consist of the ECT itself and "applicable rules and principles of international law". Presumably, this provision allows for the application of relevant national legal prescriptions that may be found to be applicable according to international law.

Conclusions on investment

As already noted, the investment provisions of the ECT may be understood as constituting a multilateral investment mini-treaty. In justification of the extensive commentary offered here one may

invoke the importance of the topic for energy, although in all fairness the special interests of the author must be taken into account.

These provisions, at least as far as post-investment treatment is concerned, are the strictest yet to be found in a multilateral treaty (with the possible exception of NAFTA). In the first place, one might speculate that an important part of the motivation for the establishment of a basic regime on investment treatment, common to all potential host countries, is that, through its rejection of discrimination and market distortions, such a regime reduces "cut-throat-competition" for investments among energy producing countries, through promises of excessively favourable treatment to investors. It is difficult, however, to draw any conclusions as to how far these provisions will be successful in actually promoting investment in the energy-rich CEE and CIS countries.

It is self-evident that the situation of the market in energy and the political conditions prevalent in these countries will be far more important in promoting or discouraging energy investments than any set of legal rules, principles and procedures. The principal value of the ECT lies in providing a reasonably comprehensive legal structure for energy trade and investment, rather than any specific legal rules.

The negotiations on the ECT and their successful conclusion provide a compelling illustration of the sea change in international economic relations that has taken place in the last decades of the twentieth century. The negotiating parties approached the entire endeavour, not in the ideological terms of the early 1970s, but in the concrete and practical terms of the 1990s. The emphasis was not on whether and how far host countries are entitled to impose conditions on the admission of energy investments or whether they should accept a liberal admission regime. The question at issue was how national laws and international treaty rules, voluntarily accepted, can be mutually consistent and function in synergy, in order to promote the development of natural resources. On the other hand, the negotiations have made apparent the problem of the congruence (or lack thereof) between the basic legal approaches in use and current problems and prospects.

In the first place, the pre-eminence of non-discrimination as the overarching legal instrument should be noted. The standards of national and MFN treatment, when applied to investments rather than trade, require a reasonably well-established legal system to

which reference can be made. When the basic laws concerning the operation of the energy sector are in a state of flux, as was the case in the countries in transition, the application of these standards becomes problematic.

In the second place, it is not self-evident that the dominant role of investment protection is justified under present conditions. In the negotiations, the Western countries seemed overly concerned with protection, partly as a reflection, perhaps, of their experience with bilateral investment treaties. It sometimes appeared as if, for the Western countries, the ECT was a bilateral investment agreement writ large.

If this did not lead to the adoption of actual language drawn from BITs, it was mainly because the varying practice of particular countries had to be reconciled. (It is characteristic in this respect that the main reason the United States gave for not signing the ECT was that its standards of investment protection were weaker than those in the bilateral investment treaties of the United States.) It is at least an open question, however, whether BIT standards are fully appropriate for multilateral agreements. Paradoxically, this may have been one of the reasons for the high incidence of conflict on issues of investment between OECD countries. BITs are not normally concluded between OECD members, so that the possible application of BIT standards to their relations among themselves may create novel difficulties. This problem was more acute, a few years later, in the negotiations on the MAI.

More generally, doubts may be raised as to the value of the continuing emphasis on investment protection. It is usually defended on the ground that investors need to be reassured, because investments in the energy sector are likely to be large and long-lasting. It is arguable, however, that the legal dimension of such issues is essentially derivative and secondary. If today it is possible successfully to negotiate strict and far-reaching protection clauses in international agreements, it is not because they are seen nowadays as more effective or more favourable to investors and to capital-exporting or capital-importing countries, but because they appear unlikely to be invoked and effectively applied. Assurances of fair treatment and non-discrimination do not by themselves suffice to attract investment. Economic factors and political considerations are controlling. The legal framework provided by the Treaty can only serve as a useful background element.

The ECT on Transit

As the first major multilateral instrument addressing directly and specifically the transit of energy materials, the ECT devotes an entire article to it. As already noted, there is an obvious and intimate interdependence between investment, transit and trade. Not only does the carriage of energy materials over third countries provide the necessary connection between production and the market, but it involves high investments in a long-term perspective. Security of supply and the orderly operation of the energy market depend on appropriate transit arrangements. Many of the disputes arising over the trade of energy materials involve transit issues.

In 1998, the year the Treaty entered into force, at the initiative of several interested countries, negotiations started within the Energy Charter Conference, with a view to concluding a separate Protocol which would supplement and strengthen the provisions of the Treaty. While a reasonably complete draft was agreed upon by 2002, the issue was complicated by the need to ensure the participation of the Russian Federation, which was involved at the time in negotiations for its accession to the WTO. Negotiations on transit were temporarily suspended and were resumed in 2004. At the time of writing, while the bulk of the Protocol has been agreed upon, a few issues are still under negotiation. It involves, however, no excessive optimism to assume that what is already agreed is sufficient to permit a discussion of the likely contents of the ECT draft Protocol on Transit. It is a long text, covering in detail most of the legal issues relating to the construction and operation of transit facilities and to the relationships between the States concerned.

At the very start of the negotiations, when the Treaty being drafted was called the "Basic Agreement", the relevant article was entitled "Freedom of Movement." This broad heading reflected the distant origins of the provision in GATT's Article V. The heading was soon replaced by the more specific title of "Transit". Negotiations on that article coincided with and were influenced by the debate on third party access within the European Community.

Some questions of definition

It is apposite to recall here the point made earlier about definitions. With respect to transit the apparent complications that arise in

defining the scope of the term show once again that definitions in international agreements are not innocent dictionary-style descriptions. Substantive consequences may flow from definitions and the interaction of definitions and substantive provisions is of particular importance.

A preliminary point must be made: the Treaty's geographical scope extends to the "areas" of the contracting parties. This notion, which is peculiar to the ECT and has its origin in some national laws, covers not only a State's territory, in the usual understanding of that term in international law (that is to say, land, internal waters and territorial sea, over which a State is sovereign), but also those maritime zones over which a State "exercises sovereign rights and jurisdiction", namely, the continental shelf and the Exclusive Economic Zone. A State's obligations regarding transit of energy materials, therefore, may apply to those zones, too, and there are in fact direct references to related problems in the article under discussion.

The definition of "transit" in paragraph (10) *(a)* of Article 7 presents another minor complication, attributable to the special concerns of particular countries. The dictionary meaning of the term (with no legal connotations) is "to pass over, across or through". The usual legal understanding is reflected in GATT, Article V, paragraph (1): goods are deemed to be in transit across a territory

> "when the passage across such territory . . . is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes".

The ECT definition adds a new twist by distinguishing between the case where three States are involved (State of origin, of transit and of destination, all three being contracting parties) and the case where two States only are involved, the State of origin being also that of destination. The Treaty provides that contracting parties may exclude the latter situation from the operative definition of transit in the Treaty; it is enough for the two States involved to "record their decision [to do so] by a joint entry" in an Annex to the Treaty. They can easily return to the broader definition later, by another joint notification, if they change their mind (Art. 7, para. (10) *(a)* (ii)). Although the two-country situation arises in a number of cases, the only countries to take advantage of that provision are Canada and the United

States; it is interesting but perhaps irrelevant that these two countries did not in the end sign the Treaty.

Since the ECT deals with a single economic sector, it may fine-tune its provisions to cover the kinds of problems that arise only or primarily in that sector. This trait is particularly apparent when the elements in the definition of transit are considered. While the GATT definition covers all types of goods and all means of transport, it is not quite certain whether and how far electricity or gas are covered, given the peculiar characteristics of their mode of transportation. The definition in the ECT (Art. 7, para. (10) *(a)*) refers to "carriage of energy materials and products" in general and makes clear that it also covers carriage through fixed installations, such as pipelines or grids. The definition of energy materials follows the roundabout but precise manner that the Treaty favours. They are defined in the article on definitions (Art. 1, para. (4)) by reference to standard classification systems (Customs Co-operation Council and EC) and are listed further in detail in Annex EM (see Box I-1).

By referring to "carriage", without specifying the means of transport, the transit provision in the ECT, like its counterpart in GATT, covers at first sight all modes of transportation, including maritime transport. A problem could arise, however, because the definition of the key notion of "economic activity in the energy sector" in the ECT (Art. 1, para. (5)) explicitly includes only "land transport"; moreover, in one of the several "understandings" in the ECT Final Act, which lists economic activities in the energy sector for illustrative purposes, "land transportation" alone is mentioned. The reason for this limitation is to be found in United States insistence on respect for its existing legislation on maritime matters. Closer scrutiny, however, suggests that, as far as transit is concerned, maritime transport is not excluded.

The process of interpretation necessary for reaching this result is not too complicated. To begin with, the article on transit does not depend for its application on the definition of "economic activity in the energy sector", a term nowhere mentioned in Article 7. Moreover, the paragraph on the definition of transit not only refers to carriage through a contracting party's "area", a term used precisely in order to cover maritime zones over which a State has sovereign rights rather than sovereignty, but also explicitly mentions that "carriage . . . to or from port facilities [in the area of the transit State] for loading or unloading" is included. Finally, paragraph (8) of Article 7

seeks to avoid any possible untoward impact of the transit provision on the international law rules and principles concerning underwater pipelines and the continental shelf. The import of this provision is examined here a bit later, but one may note at this point that it is clearly implied that carriage of energy materials across the maritime zones over which a State has sovereignty, sovereign rights or jurisdiction may be involved. It would then be inconsistent for the Treaty to exclude maritime transport from the notion of transit, while pipelines going through a State's territorial sea are covered, since in that case the principle of freedom of transit would apply to the pipelines in the water (and over the continental shelf) but not to tankers carrying crude over the same waters.

The extent to which the ECT article on transit focuses on the peculiar forms of "carriage" that are characteristic of energy materials (more precisely, of most energy materials, for there are no provisions dealing with the special problems concerning transit of nuclear materials) is exemplified by its repeated reference to "energy transport facilities". These are defined (para. (10) *(b)*) as consisting of:

> "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 specifically for handling Energy Materials and Products".

It may well be, indeed, that Article 7 is better designed to deal with such fixed facilities than with transit involving the traditional manners and problems of carriage of goods (e.g., by rail or on tankers).

Substantive regulation

ECT Article 7 starts from, but goes considerably beyond, the affirmation of the principles of freedom of transit and non-discrimination already found in Article V of GATT. Paragraph (1) requires contracting parties to take measures to "facilitate", rather than merely allow, the transit of energy materials. It refers to (and thereby reaffirms) the principle of freedom of transit and explicitly provides that the transit State will not distinguish or discriminate or impose unreasonable delays or charges. This provision is strengthened by paragraph (3), in which contracting parties undertake to accord what is in fact national and MFN treatment to energy materials and products in transit, sub-

ject to any differing provisions in existing international agreements. It is further specified (Art. 21, para. (2)) that the "provisions" in question include taxation measures, other than those on income or on capital.

Both the paragraphs mentioned are couched in legally binding treaty language ("shall take", "undertakes"). Paragraph (2), however, moves a bit down the scale of normative intensity and provides that the parties "shall encourage relevant entities to cooperate" in developing, operating, modernizing, and "facilitating the interconnection" of energy transport facilities and in taking measures to mitigate the effects of interruptions in supply. This change in the degree of normative intensity is characteristic of the Treaty's elaborate mix of "hard" and "soft" law provisions. And, as is often the case when "soft law" language is used, the substance of the commitments in this paragraph undergoes a qualitative change. Going beyond the negative obligations of the other two paragraphs mentioned, it involves a duty of positive collaboration and action, not mere abstention from discriminating or otherwise injurious action.

A short digression is indicated here in order to point at an important trait of the ECT, common to many modern international agreements. Obviously, since the ECT is an international agreement in proper and due form, all of its provisions are legally binding. While the formulation of some of them, however, is reasonably strict, so that it is fairly clear what are the obligations (and rights) of the contracting parties, in the case of other provisions, the formulation leaves to each party, when carrying out its obligations under the Treaty, a considerable margin of freedom of action. In such cases, terms such as "the Parties will endeavour" or "will use their best efforts" to bring about the result involved are often used. In current negotiating parlance, such provisions are commonly referred to as "soft law" provisions. The issue is highly controversial in international law theory and the entire phenomenon is complex and multifaceted. It is worth emphasizing, however, that, as already noted in a number of cases, the ECT, like many other agreements, seeks to take advantage of the possibilities offered by gradations in the normative intensity of its provisions. As later discussion will show, there are more than two degrees in the binding strength (the "normative intensity") of ECT provisions and the element of time, as exemplified in the Supplementary Treaty story, is often critical.

Coming back to paragraph (2) of Article 7, and the reference to

co-operation of the "relevant entities", it is worth noting that that last term is not defined in this article, although it is utilized once again in paragraph (6) ("any entity subject to its control"). The term is used very sparingly in the Treaty ; indeed, in its entire text, it is found again only twice (in Article 17 ("Non Application of Part III [on Investments] in Certain Circumstances") and Article 22 ("State and Privileged Enterprises").) On the basis of that usage, as well as of the term's reappearance in the draft Transit Protocol, it seems that the term merely refers to juridical persons with legal personality — "any enterprise, agency or other organization or individual", according to Article 22 (5). Additional characteristics may however be involved in some instances, as in the case of Article 22 (3), which refers to entities established or maintained by a contracting party that are entrusted with "regulatory, administrative or other governmental authority".

The following three paragraphs of Article 7 are of particular significance. They establish the duty of contracting parties, of transit countries, in particular, to ensure the uninterrupted flow of energy materials and even to allow the creation of additional transit capacity.

Paragraph (4) is one of the most original provisions in the Treaty. An indication of its importance is in fact that it is the only provision in this Article as to which transitional arrangements are allowed. The paragraph provides that, if the existing fixed facilities are not sufficient for providing transit to energy materials on commercial terms, the Contracting Parties "shall not place obstacles in the way of new capacity being established". This obligation is subject to two major qualifications : on the one hand, the provisions of applicable legislation, as long as the latter are consistent with the principles of freedom of transit and non-discrimination. An understanding in the Final Act specifies that the applicable legislation would include laws "on environmental protection, land use, safety or technical standards". On the other hand, the next paragraph provides that no such obligation exists where the transit country is able to demonstrate that such new or modified facilities, or increased use of existing ones, "would endanger the security or efficiency of its energy systems, including the security of supply". Another paragraph towards the end of the article further qualifies the obligation, albeit in a rather obscure manner. Paragraph (9) states that the entire article is not to be construed so as

> "to oblige any Contracting Party which does not have a certain type of energy transport facilities used for transit to take any measure under this article with respect to that type of energy transport facilities".

The Treaty then goes on to state: "Such a Contracting Party is, however, obliged to comply with paragraph (4)." It would take an expert in energy technology to spell out the exact meaning of these sentences. Somebody who is not such an expert can only deduce that what is at issue is the transit State's margin of freedom in choosing the kind of technology and of facility that it prefers (with a view, in particular, to the choice between fixed facilities (sc. pipelines) and other kinds of methods of transport).

All these qualifications are, in their turn, subject to the overarching obligation of transit countries to "secure established flows of energy materials and products" (para. (5) *ad finem*), an obligation that is explicitly made subject to the special dispute settlement provisions on transit (ECT, Art. 7, paras. (6) and (7)).

Before turning to dispute settlement, however, it is necessary to consider the effect on the obligations in the paragraphs considered of the general exceptions set out in ECT Articles 24 and 25. Some of the exceptions appear particularly pertinent. This is true, for instance, of the possibility of taking measures to ensure the acquisition or distribution of energy materials "in conditions of short supply" (Art. 24, para. (2) (ii)). It is however significant, and clearly reflects the importance attributed to the topic at hand, that the ubiquitous exceptions for "any measure which [a party] considers necessary . . . for the protection of its essential security interests" and "for the maintenance of public order" are here expressly qualified by the statement that "such measure shall not constitute a disguised restriction on transit" (Art. 24, para. (3)).

The next two paragraphs of Article 7, paragraphs (6) and (7), have been described as "the article's most operationally relevant provisions". Paragraph (6) lays down a clear-cut obligation on the part of transit countries not to interrupt or reduce, and not to permit or require "any entity subject to [their] control" to interrupt or reduce, the existing flow of energy materials and products, because of a dispute "over any matter arising from that transit", prior to the conclusion of the dispute resolution procedures provided for in paragraph (7), unless this is "specifically provided for" in an agreement

governing the transit or is permitted by the conciliator appointed in accordance with paragraph (7).

The importance of this rule is self-evident. To begin with, any interruption may flow only from a dispute that arises "over any matter arising from that transit" — from a disagreement on the tariffs to be paid, for example and not from a dispute over other matters, for instance, a political dispute that may lead to an embargo. The point seems to be to deprive transit countries of the ability to use the threat of interruption of supplies in their dealings with the countries of origin and destination of the energy materials. The prohibition does not apply only where the possibility of action "to interrupt or reduce" the flow of materials is "specifically provided for" in the transit agreement itself or is permitted by the conciliator in his interim decision.

Accidental interruptions of supply are not covered by these provisions but are addressed in the draft Transit Protocol, according to which the parties "shall immediately notify" other parties of any accidental interruption and

> "shall ensure that owners and operators of energy transport facilities used for transit shall take necessary measures *(a)* to minimize the risk of accidental interruption, reduction or stoppage of transit [and] *(b)* to expeditiously restore the normal operation of such transit . . ." (Draft Transit Protocol, as of 31 October 2003, Art. 16).

The dispute settlement process

Article 7 ECT contains in paragraph (7) its own separate procedure for dispute settlement in cases of interruption of supplies. The procedure is one of conciliation, not arbitration. It starts after "the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed" between the parties to the dispute, whether States or independent entities. Exhaustion of possible local remedies before the transit State's judicial or other authorities (when not agreed between the parties beforehand) is not mentioned, even with respect to a dispute between "entities" rather than the Governments themselves. The Treaty's general (and rather elaborate) provisions on settlement of disputes, whether State-to-State or investor-to-State (ECT Arts. 26 and 27), are also out of the picture. The clear intent of the Treaty is to have the special conciliation procedures set

out in paragraph (7) of Article 7 as the only mode for settlement of disputes over transit issues. Detailed rules on the conduct of such proceedings were adopted by the Energy Charter Conference in late 1998.

The dispute is referred to the Secretary-General of the Energy Charter Conference by a contracting party that is a party to the dispute and the Secretary-General informs all contracting parties of the referral. In consultation with the parties to the dispute "and the other contracting parties concerned", the Secretary-General then proceeds to appoint, within 30 days from the receipt of the party's notification, a conciliator, who must be a person experienced in the matter under dispute and must not be a national or resident of a party to the dispute. According to the rules adopted by the Conference, it is up to the Secretary-General to decide on the appropriate form for these consultations, including identifying the contracting parties (other than the parties to the dispute) who may be concerned. While the rules do not require that the parties must formally accept the conciliator, they provide that, in making the appointment, the Secretary-General "shall have particular regard to the importance of appointing a conciliator who . . . has, or is likely to have, the confidence of the Parties". The rules add further the usual requirements of independence, ability to conduct the proceedings etc.

The conciliator's task is to propose to the parties either a solution to the dispute or a procedure for reaching a solution. He "shall seek the agreement of the parties" to the proposal. Up to this point, his role is fairly within the bounds of traditional conciliation proceedings. But it changes afterwards: if the conciliator fails to secure such agreement within three months from his appointment, he is to do two things: first, he will recommend a solution or a procedure for a solution, and, secondly, he will issue an interim decision fixing "the interim tariffs and other terms and conditions" for transit, which shall be observed "until the dispute is resolved". A statement of reasons must accompany both. Thus, the conciliator's recommendation is transformed into a decision, even if only an interim one, with an expiration date. The proceedings are over once the recommendation and decision are made. What happens next is something of an anticlimax: the parties — not only the parties to the dispute, but the other contracting parties concerned, as well — are bound to observe the conciliator's interim decision for 12 months after it is issued or until resolution of the dispute, whichever is earlier. If therefore the

parties to the dispute do not accept the conciliator's recommendation, their obligation to comply with it, but also their duty not to interrupt or reduce the flow of energy materials in transit, may presumably cease to exist at the end of the 12-month period.

The entire procedure, nevertheless, must be seen as a major achievement. One should take into account that this is the first arrangement for a specific international dispute settlement mechanism concerning disputes over interruptions in the transit or supply of energy materials. Given that such disputes are frequently highly charged, politically and emotionally, the procedure of conciliation not only provides a chance for a negotiated solution, but also considerably delays any radical measures the transit State or any other State concerned might take and thereby reduces the possibility that such measures may be taken for the purpose of immediate pressure or fast gains. It is also possible to have recourse to the dispute-settlement procedures, between States and between investors and States, in accordance with Articles 27 and 26 of the ECT.

Transit and the law of the sea

One last point deserves to be mentioned concerning an issue we have already touched upon. Paragraph (8) of Article 7 ECT provides that nothing in that 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".

The principal point of this statement, as the final words in it suggest, is made clearer in a declaration by the European Communities, their member States, and a few other States, in the set of government declarations that form part of the ECT Final Act. This text offers a slightly modified version of paragraph (8), by declaring that the provisions of Article 7

> "are subject to the conventional rules of international law on jurisdiction over submarine cables and pipelines or, where there are no such rules, to general international law . . . Article 7 is not intended to affect the interpretation of existing international law on jurisdiction over submarine cables and pipelines, and cannot be considered as doing so."

This effort to save the international law of the sea, as set out in the United Nations Convention on the Law of the Sea (UNCLOS), from the possible deleterious impact of the ECT article on transit should be seen in the context of the complicated legal status of submarine pipelines (and cables, but this is not what is primarily at issue here) lying on (or above) the continental shelf. A brief exploration of that underwater thicket is necessary. It is something of a digression, but it is not irrelevant to the rest of the discussion.

One should start by recalling that, according to UNCLOS, while the coastal State has sovereign rights "over the continental shelf . . . for the purpose of exploring it and exploiting its natural resources", the waters over the continental shelf retain their character as part of the high seas and the coastal State is bound not to interfere with their use for purposes of navigation etc. As far as pipelines are concerned, Article 79 of the same convention provides that "all States are entitled to lay submarine cables and pipelines on the continental shelf" (para. (1)) (note well, on "the", not "their", continental shelf). While the coastal State's consent is needed for the "delineation of the course for the laying of such pipelines on the continental shelf" (para. (3)), that State "may not impede the laying or maintenance of such cables or pipelines" (para. (2)). It is further stated that the coastal State has the right "to establish conditions for cables or pipelines entering its territory or territorial sea" and has jurisdiction "over cables and pipelines constructed or used in connection with the exploration of its continental shelf or exploitation of its resources" (para. (4) of the same article).

What follows from these careful formulations is that, while the coastal State has sovereign rights over its continental shelf and may exercise jurisdiction with respect to its exploration and exploitation, it does not have jurisdiction over the pipelines on or above the shelf, apart from pipelines that relate to the exploitation of its own continental shelf. The coastal State, however, does possess certain regulatory powers over pipelines on its continental shelf: it may "take reasonable measures" to develop the resources in it and to prevent and control pollution from pipelines. A clear distinction between the coastal State's rights and those of other States is thus established but the exact borderlines between the two, in concrete circumstances, are not spelled out in detail.

The relevance of all this to the ECT is that, among the numerous oil and gas pipelines around European coasts, there are some that do

pass over (or lie on) the continental shelf of States other than the one that has built the pipeline or whose resources are being exploited. The States involved were concerned during the negotiation that the ECT provisions on transit might be construed as expanding the coastal State's rights (and duties) over their pipelines, even if only for the purposes of regulation. Their concern was exacerbated by the use in the Treaty of the inclusive notion of "area", rather than the more limited and better established notion of "territory". As a result, they insisted on the necessity of very explicit formulations to the effect that the Treaty would not change anything whatsoever in the existing allocation of rights and jurisdiction in the Convention on the Law of the Sea. What they were struggling against is the possibility that through their practice and their interpretation of international instruments like the ECT, the coastal States might be able to bring about a gradual change in the understanding of both customary and conventional international law norms on the subject. Whether such clarification will fully protect their interests remains to be seen.

Conclusions and prospects on transit

As the first major multilateral treaty on energy transit, the ECT, its Article 7 and the Transit Protocol seek to establish a fairly detailed and in fact quite novel legal regime, primarily involving relations between Governments but also involving investors. The aim of the provisions is not to regulate the actions of the parties concerned or to shape the contents of intergovernmental agreements and private transit agreements but to establish background rules for transit operations. Relevant national legislation may set limits to private or public action in the matter or may seek to shape the contents of relevant arrangements. Even the European Community directives on the transit of gas and electricity provide elementary rules on the conditions to be included in transit agreements (non-discrimination, no unjustified restrictions, no danger to security of supply etc.). ECT Article 7 and the Protocol focus mainly on provisions concerning the duties of the States involved, in particular of the transit States, i.e., the States through the territory of which transit occurs.

The ECT in fact imposes duties primarily, if not solely, on transit States, with little mention of the relevant obligations of the other States in the relationship, or even of the corresponding rights of transit States, save to the extent that such rights set limits to their obli-

gations (cf. the discussion of paragraphs (4) and (5)). The basic legal principles established, such as freedom of transit, non-discrimination, protection of the flow of energy materials, are all understood primarily as obligations of the transit State. And Article 7, paragraph (4), deals with the possibility of inadequate transit facilities, but mentions over-capacity and the security of the transit system only as a defence against demands for expansion of facilities. It may be argued, of course, that legal regulation is primarily needed to restrict the freedom of action of the transit State and to protect the State of origin and the State of destination, because they depend on the transit State for their marketing or supply of energy materials. The transit State does not depend on them to the same extent, at least as far as transit is concerned.

The principles set out in Article 7 ECT and the draft Transit Protocol provide general directions, the frame of reference for transit arrangements between States and secondarily between States and enterprises. It is clear that, while providing useful directions for further regulation at the international level, they do not address a number of issues. It has therefore to be supplemented. In the first place, it must be supplemented by provisions in other sections of the Treaty, provisions dealing with such issues as environmental protection, competition, transfer of technology etc. It is self-evident that these provisions are applicable to transit, as they are to other operations in the energy sector. In the second place, the Article has to be supplemented by an additional instrument because its provisions are not detailed enough or strong enough to cope with the many difficult questions that arise concerning transit.

In response to these weaknesses and in particular to the perceived importance of transit issues, the Energy Charter Conference, as already noted, started negotiations early in the year 2000 on the conclusion of an additional instrument, a Protocol on Transit. The negotiations have considerably advanced, although, despite early optimism as to the speed of progress, agreement has not yet been reached on a number of points. The draft under discussion addresses a number of topics that Article 7 has not settled, such as the prevention of illegal taking of energy materials in transit, further clarification of the meaning of central terms, like "available capacity", detailed provisions on the specifics of the transit State's duty to allow construction or expansion of energy transport facilities and even such difficult technical issues as tariffs and metering. When

completed, the instrument under negotiation should constitute the first detailed binding international text on the topic, a veritable Code of Transit. At the same time, the Working Group on Transit is preparing model texts of Transit Agreements which can be used by any interested party.

CHAPTER IV

CONCLUDING OBSERVATIONS: ENERGY, LAW AND THE ONSET OF GLOBALIZATION

In describing the elements of the international legal framework for energy, particular emphasis was placed on the importance of territorial sovereignty. This was necessary in view of the fact that all phases of the energy process are strictly localized, they are linked to particular localities. This is true of the exploration and appropriation of energy materials, their carriage to the place of their utilization, the production of energy and its distribution through networks and its use for a variety of purposes. These facts of energy production and use correspond closely to the manner in which the established international legal system functions by constant reference to national territories and to the territorial sovereignty of the States involved — what is often referred to as the "Westphalia system". This system was founded on territoriality, emphasized the importance of borders as the dividing lines between States, peoples and communities and drew the appropriate conclusions for legal purposes. Nowadays, this system continues to function more or less in this manner, but is at the same time undermined by a parallel system of legal and economic relations which transcends borders and does not rely exclusively on them for allocating legal jurisdiction. In a "globalized" world, territory loses some of its governing role in legal matters. These are matters of trends and tendencies, not of established situations. The traditional system coexists along with the emerging globalized one and neither of them is fully governing.

In the case of energy, the localization, the close linkage of energy production and use to the territory, strengthens the role of the Westphalian approach to legal issues. But this approach is no longer the only one and it functions on a parallel basis with a world-wide perspective, strengthened by the importance of the environmental concerns which cannot be fully addressed in local context. It may not be indispensable to see such a universal approach in institutional terms, although it is difficult to conceive of a comprehensive multilateral agreement totally lacking an institutional component.

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