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This set of words is dedicated:

To my dear family

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ABSTRACT

The Energy Charter Treaty is a unique multilateral treaty. It is limited in scope to the energy sector and establishes within that sector legal rights and obligations with respect to subjects such as investment, trade, transit of energy goods, environment, competition and transfer of technology and access to capital markets. It breaks away the pattern of multilateral trade agreements by making governments directly accountable to investors before non-national tribunals for important duties specified in the treaty. Different from the 1991 "European Energy Charter" and many declarations in the field of energy cooperation; the ECT is a binding and multilateral treaty. It is distinct from all other bilateral treaties by the fact that it is only applicable to energy sector.

In spite of this fact that the initiative aim of the Treaty's negotiators was guarantee of energy security in Europe, it gradually changed to a prominent agreement in the energy sector. In fact, the membership of the ECT regarded as a factor in order to evaluate the process of fundamental changes in the investment sector of the countries.

The following study tries to demonstrate that to what extent this European oriented treaty as it is claimed can protect the safe investment, transit and also trade between Contracting Parties, in general, and for Iran, in specific, as an energy exporting country and discusses the sensitive issues that Iran needs to take into account in its accession negotiation to the ECT.

Keywords: Energy Charter Treaty, investment, trade, dispute settlement, transit, Iran, transit protocol

INTRODUCTION

At the heart of any energy policy is the need to secure steady, reliable and safe sources of energy. In spite of creating a single market in the European Union for Energy, however, the creation of an effective single market within the community seems insufficient because the EU's dependency for a large proportion of its requirements of energy from outside its territory is growing. Member states of EU were interested in establishing secure and reliable sources of supply from the energy resources of the central and Eastern Europe which, simultaneously, could provide new commercial opportunities for the Central and Eastern Europe countries. As a result, these mutual interests have led to the signing of an international Treaty, Energy Charter Treaty, on energy trade and cross boarder investment.

In December 1991, the European Energy Charter was signed in the form of a non binding political statement in support of facilitating trade and cooperation between the energy sectors of the west, Eastern Europe and the former Soviet Union. Three years after the Energy charter was signed, the 50 participating governments have gathered with the final text for a legally binding Treaty to the Charter. In fact, creating an energy cooperation scheme was found important because "broader energy cooperation among signatories was essential for economic progress and more generally, for social development and a better quality of life"¹. Finally, the Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed at a formal ceremony on 17 in December 1994 and entered into force in April 1998. With regard to the link between the existence of this treaty and security

¹ . *The Concluding Document of the Hague Conference on the European Energy Charter, annexed to the Energy Charter Treaty and related Instruments (Brussels, Energy Charter Secretariat), p. 129.*

of supply, reference was made to the fact that “signatories are willing to do more to attain the objectives of security of supply and efficient management and use of resources”.² In addition, in the words of the negotiators of the ECT, the rationale for the creation of this treaty was that in exchange for guarantees of investment protection given by all the signatories, the EU Member States would ensure closer cooperation with the FSU (Former Soviet Union) and CEE States (Central and Eastern Europe) in the field of energy investment and as regards access to EU energy markets³.

Also, the fundamental aim of the Energy Charter Treaty is to strengthen the Rule of Law on energy issues, by creating a level playing field of multilateral rules to be observed by all participating governments. The Treaty’s provisions focus on five broad areas: the protection of foreign investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable); non-discriminatory conditions for trade in energy materials, products and energy-related equipment, based on WTO rules; freedom of energy transit through pipelines, grids and other means of transportation; dispute resolution; and energy efficiency and related environmental aspects.

Having regard to what mentioned, in fact, it is claimed that the provisions of the ECT protect the safe transit, investment and trade between Contracting Parties. The question is that to what extent this claim is positive in regard to Islamic Republic of Iran as an energy exporting country in order to guarantee the secure investment to promote its industrial development and protect the transit of energy and its outward trade. Thus, this study seeks to demonstrate

² . *Ibid*, p.130

³ . P Munchlinski, ‘*The Energy Charter Treaty: Towards a New International order for Trade and Investment or a case of History Itself?*’ In T Walde, ‘*Energy charter Treaty: an East-West gateway for Investment and Trade*’, p.205, [hereinafter T Walde, *East-West Gateway*].

the accuracy of above claim and address the issues which Iran should take in to consideration in its accession to the Treaty.

Moreover, this study tries to demonstrate that since the ECT is multilateral in scope, it also makes multilateral perspectives in favour or against of its applicability in a one legal system in general and in Iran in particular. It will be also revealed that considering the European oriented framework of the Treaty, in essence, it is prominent for Iran to follow its policy as a rich energy country in one hand and gains its benefit of the Treaty on the other hand and act more effectual in obtaining its potential capabilities in the process of guarantee of energy security of EU.

Hence, the first step is to analyze in detail Treaty's provisions in order to establish a comprehensive study of what this treaty seeks to achieve. The second step is to identify the shortcomings of the ECT from the point view of Iran. In this respect and for the purpose of this dissertation, the following study is divided in two main parts. In the first part the origins of the Energy Charter Treaty and the main features of the Treaty will be addressed. The aim of this part is providing a detailed analysis of the Treaty's provision in order to create a framework for the second part. In the second part, the issue of the membership of Iran to the Treaty and the plausible rights, constraints or limits which may be resulted through this membership will be revealed.

Also, it should be noted that this study is not aimed to give a definite yes or no answer in terms of acceding to the Treaty by Iran, rather observes that whether the provisions of the Treaty create a framework from which Iran could obtain utmost benefit upon accession or not.

PART I: The Energy Charter Treaty

The energy charter treaty is a unique multilateral treaty. It is limited in scope to the energy sector and establishes rights and obligations with respect to investment, trade, and other subjects such as the transit of energy goods, competition, environment, access to capital markets, and transfer of technology. The purpose of the treaty, as described in article 2, is to “establish a legal framework in order to promote long term cooperation in the energy field based on complementarities and mutual benefits in accordance with the objectives and principles of the charter, European Energy Charter”. The opening of the signature of the ECT in Lisbon on 17 December 1994, in fact, put an end to four and a half year period of the treaty’s development. This was a period of negotiations among more than fifty states and the European communities which commenced in 1990 by suggestions of prime minister of Netherlands, Ruud Lubbers, that energy cooperation could help stimulate economic recovery in Eastern Europe and the former Soviet Union (FSU). In April 1998 a second phase of the ECT started as the treaty entered in to force after collection of thirty required ratifications. Many of the Treaty’s rights and obligations are of a hard law nature, enforceable in legally binding arbitration or through dispute resolution procedures of the nature practiced within the general agreement on Tariff and Trade, although there are a number of best efforts or other soft law commitments⁴. In the parts which follows it will be explained Treaty’s origins, the Treaty’s main features and effects, and developments in the Treaty’s second phase.

⁴ .C.S.Bamberger, “An Overview of the Energy Charter Treaty”, in T Walde, *East-West Gateway*, p. 2.

A. Origins of the Energy charter Treaty

1. The 1991 European Energy Charter

The energy charter treaty was preceded by the European Energy charter adopted and signed on 17 December 1991 at The Hague. In fact, this charter represents the first formal steps in the ECT process. The charter and treaty were initiated in reaction to the collapse of Former Soviet union. In fact, after the collapse of the Soviet Union, the community was willing to take advantage of opportunities for investment in the FSU countries. Since, investment opportunities were vast but market access was limited, and the unfavourable legal and fiscal climate in these countries, along with the danger of transit disruptions, were strong barriers to western investments⁵. "The emphasis on the FSU countries was due to then intensifying conflicts between the government of Algeria and Islamic fundamentalists, which could not be controlled by the community. The Gulf was also the center of instability during the Iran-Iraq war in 1980s, and in the aftermath of the Gulf war of 1990. It was thus necessary to diversify dependence on energy resources from these countries"⁶. In 1990 prime minister of Netherlands, Lubbers, called for a European Energy Charter to answer as a political and legal foundation for East-West cooperation. In fact, the idea behind this suggestion was to support market economy status and to enhance political stability throughout Europe by promoting Eastern economic development. He suggested that the right place to start would be the energy sector, where there was a natural relationship between the vary large energy

⁵ . J Dore, 'The Negotiating History of Energy Charter Treaty' in T Walde, *East West Gateway*, p. 139, [hereinafter 'The negotiating History']

⁶ . S. Salem Haghighi, "Energy Security: The External Legal Relations of the European Union with Major Oil and Gas Supplying Countries", p. 190.

resources and energy systems of the East, and the resources of industrial strength, technology and investment funds available in the West. This idea was posed because of dependence of the western energy supply to the East as a safeguard for energy security and supply for West⁷. This was in fact beneficial for both Eastern and western countries; providing investment security and investment flows for East and supply of energy for West. Walde explained the original philosophies behind the ECT: "the idea was to support transition to market economy status and to enhance political stability throughout Europe by promoting Eastern economic development. Western energy dependence and security of supply would be safeguarded by the certain of a privileged relationship of investment and trade between East and West. The East would provide investment security, and this would trigger investment in-flows which in turn build up the Eastern economies and supply energy to the West. Liberated from regulatory hindrances, Western technology would flow eastward and Eastern products flow westward"⁸.

Also, to the East European states dependent on Russian oil and gas resources opening stable trade relations with the West could help to reduce the risk involved in a one side dependency on the Russian Federation. Then, this idea was welcomed by the European council which invited the commission of the European communities to study how best to implement such cooperation. In February 1991 the commission proposed the concept of a European Energy

⁷ . J. Dore, "The negotiating History", in T. Walde and K. Christie (eds.), *Energy Charter Treaty: Selected Topics*, p. 1.2.

⁸ . T.Walde, "Introductory Note to the European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects" in Mirian Kene Omalu, "NAFTA and the Energy Charter Treaty", p.52.

Charter. Following discussion of the Commission's proposal in the Council of the European Communities, the European Union invited the other countries of Western and Eastern Europe, the FSU, and the non-European members of OECD to attend a conference in Brussels in July 1991 to start negotiations on the European Energy Charter. The USA had a significant role to justify inviting non-European OECD countries to the Conference. In fact, The USA understood that the charter is an attempt by Western Europe to monopolize access to Eastern resources and markets, and then tried to keep access to these markets for US companies, so imposed the idea of expansion of the charter framework to embrace the non-European OECD countries. US proposal was welcomed by many countries due to the importance of US energy industry and also to be a significant trade partner. But some other countries like France and Belgium believed that the Energy Charter should remain within its European framework⁹. At the end of the day, negotiators agreed to invite US and the remaining OECD countries to the Energy Charter conference. As a result, Countries like United State, Canada, Japan, Australia and New Zealand joined the conference.

In fact, the Charter that was negotiated in this first conference consisted of major principles that the signatories declared they wished to pursue and a set of guidelines for the subsequent negotiation of basic agreement that later became Energy Charter Treaty and a set of protocols. Today the Charter is not without significance in interpreting the ECT because the ECT's preamble makes clear that the Treaty is intended to provide the basis for implementing the principles contained in the Charter.¹⁰

⁹ . J. Dore, "The negotiating History", in T. Walde and K. Christie (eds.), *Energy Charter Treaty: Selected Topics*, p. 1.3.

¹⁰ .series of publications by the Academy of European Law in Trier," *the European Energy Market: reconciling Competition and Security of Supply*", Vol 13, pp 79-80.

- Robert.H. Tudway," *Energy Law and regulation in the European Union*", pp.1201-1202.

2. Negotiation of the Energy charter Treaty

By the time that the legally non binding Charter had been agreed, negotiations were already underway on a treaty, the ECT, to implement the objectives and the principles of the Charter. In fact, the negotiations encountered numerous obstacles that included not only East-West issues but also intra-OECD disagreements which effectively extended the negotiating process to more than three years. It seems that, this was a relatively acceptable time within which to complete a treaty of such scope, complexity, novelty, and political sensitivity among so many countries by different interests.

A major time in the negotiations came when the negotiating Conference was unable to agree to apply to the pre-investment stage, the national treatment standards that had been accepted in the negotiations as a treaty standard for investment already made. The Russian Federation and other transitional countries lacked experience in applying this standard and thus had no legislation denying national treatment with respect to the making of new investments¹¹. In fact, the principle of pre-investment national treatment was more important for USA when it participated in the Charter negotiations and since many countries considered the participation of the USA significant to have a successful Treaty, they accepted to embody the national treatment at the pre-investment stage within the draft Treaty. Julia Dore explained it as: “National treatment as a guiding principle for investment was adopted as a Treaty principle on behalf of the US. Unknown as an investment protection clause to most west European and OECD countries, this concept is based directly on the US prototype bilateral investment treaty. According to a UK source, the principle of national treatment was more important to the US than

¹¹ . *Mirian.k Omalu, “NAFTA and the Energy Charter Treaty”, p.53.*

their participation in the Charter negotiations, and since the US was seen as a vital ingredient to a successful Treaty, national treatment was embodied within the draft Treaty”¹². Russians wanted to postpone subscribing to the key article on the promotion, protection and treatment of investments which embodies the main Charter principle of non-discrimination.

Finally during some diplomatic efforts, the EU suggested a new two-stage approach to the signing of the charter, in which national treatment in the pre-investment stage would be postponed for a three year period and during this time transitional states have time to design new energy and investment laws and then market access for all contracting parties would be based on most favoured nation status. Then this subject deferred to a second-phase negotiation of a Supplementary Treaty that mandated by the ECT. The ECT remained open for signature for six months from 17 December 1994 and by the time that it closed for signature; it had been signed by 49 states and the European Communities. The signatories included almost all the countries of Europe and all the republic of FSU, as well as Australia and Japan. Of the signatories to the non binding 1991 European Energy Charter, only Canada and the United States did not signed the ECT¹³. In fact, the US the most specific criticisms, which resulted in not signature of the Treaty may be listed as: First of all, there was a substantial inconsistency in the Treaty’s unconditional most favoured Nation Treatment for energy products and title IV of the 1974 Trade Act which usually referred to as the Jackson-Vanik Amendment¹⁴. In fact, it was the result of US concern for treatment of minority persons in certain countries. For those countries Jakson-

¹² . J. Dore, “The negotiating History”, in T. Walde and K. Christie (eds.), *Energy Charter Treaty: Selected Topics*, p. 1.6.

¹³ . William Fox, “the United States and the Energy Charter Treaty”, in T Walde, *an East-West Gateway*, pp. 194-201.

¹⁴ . *Supra*, note 11, p.52.(Mirian Kene Omalu, “NAFTA and the Energy Charter Treaty)

Venik prohibits the US from giving any thing more than conditional MFN status. In consultation with members of Congress, the State Department concluded that the United State Congress would not accept any narrowing of Jackson-Vanik, even in the limited context of an energy treaty. The other criticism was about ECT Article 25 which defines an Economic Integration Agreement. In the opinion of US the language of this Article could foster the creation of special relationships, especially between the European Union and central and Eastern European countries to the exclusion of non-European contracting states such as United States. Then US tried for an alternation of this provision to include alternate criteria under the GATT, specially GATT Article 24 and Article 5. But this suggestion did not welcomed by other negotiators. Also there were some objections relating to Article 18 on sovereignty. In fact in the view of US there could be the possibility that either court or arbitral decisions under the Treaty could create conditions fostering expropriation or devaluation of an investment by sovereign host state country actions without adequate compensation to the investor¹⁵. In addition, US believed that the Treaty prohibitions on performance requirements are weaker in substance than those incorporated in the US's model BIT text. In fact, it was mentioned that investor-state dispute settlement is limited to performance requirements imposed on already established investments. Then the Treaty does not prohibit host government performance requirement imposed on new investments as a condition of government approval.¹⁶

¹⁵ . William Fox, " The United States and the Energy Charter Treaty", in T Walde, *an East-West Gateway*, pp. 194-201.

¹⁶ . *Ibid*, pp 197-199

3. Institutional Arrangements

The first institution of ECT, the Energy Charter Conference, an inter-governmental organization, is the governing and decision-making body for the Energy Charter process. All states who have signed or acceded to the Treaty are members of the Conference, which meets on a regular basis¹⁷. All Treaty signatories and any states acceding before entry into force accepted the provisional application of the institutional provisions set out in Part VII, to the extent consistent with their laws and regulations, regardless of whether they applied the legal disciplines of the treaty on a provisional basis.¹⁸ The immediate consequence was that the provisional energy charter conference and a secretariat to serve it were created. The Provisional Charter Conference met nine times before it was terminated by the entry into force of the Energy Charter Treaty on 16 April 1998¹⁹. The Energy Charter Conference meets on a

¹⁷. *Members of the Energy Charter Conference:*

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

Observers to the Energy Charter Conference:

**States:*

Algeria, Bahrain, People's Republic of China, Canada, Islamic Republic of Iran, Republic of Korea, Kuwait, Morocco, Nigeria, Oman, Qatar, Saudi Arabia, Serbia and Montenegro, Tunisia, United Arab Emirates, United States of America, Venezuela.

**International Organizations:*

ASEAN, EBRD, IEA, OECD, UN-ECE, World Bank, WTO, CIS Electric Power Council, BSEC, BASREC

¹⁸. *Art 45(2) (c)*

¹⁹. *C.S.Bamberger, J Linehan and T, Walde, 'Energy Charter Treaty in 2000: in a New Phase', Journal of Natural Energy & Resources Law, Vol 18, No 4, 2000, p. 343.*

regular basis. The Treaty gives the Energy charter conference clearly defined powers and functions. These are set out in Article 34 and the voting regime for decision making is described in article 36. Among the powers and functions given to the conference are: carry out the duties assigned to it by the Treaty and any Protocols, facilitate the implementation of the principles of the Charter and the provisions of the Treaty and any protocols, facilitate in accordance with the Treaty and any protocols the coordination of appropriate general measures to carry out the principles of the 1991 European Energy Charter and encourage cooperative efforts aimed at facilitating and promoting market-oriented reforms and the modernization of the energy sectors in those countries of central and eastern Europe and the FSU undergoing economic transitions²⁰.

The charter conference is also given specific tasks such as developing additional elements for the several dispute resolution mechanisms in the treaty, for example the rules for the conciliation of transit disputes under article 7 which were adopted in December 1998. The provisional charter conference and the charter conference have combined the roles of a negotiation forum for the development of the new instruments mandated under the treaty and an oversight body for the treaty. Much of the work of the provisional conference was devoted to the normal start up tasks associated with establishing a conference of contracting parties and an international secretariat. As the treaty does not come under the umbrella of a large international organization such as the United Nations or organization for Economic cooperation and Development there were pre-determined models for rules of procedure, staff regulations, and rules. From an operational point of view it is open to the conference to decide how it

²⁰ . *Some Other of These functions are: "authorize the negotiation of and technical changes to the Annexes to this Treaty, consider and adopt texts amendments to this Treaty, decide on accessions to the Treaty, consider and adopt programs of work to be carried out by the secretariat, authorize the negotiation of declarations and approve their issuance.."*

approaches its working methods and what subsidiary bodies it wishes to establish. The Energy Charter Conference is served by a small permanent Secretariat based in Brussels. The Secretariat is staffed by energy sector experts from various countries of the Conference's constituency, and is headed by a Secretary General²¹. The Secretariat's functions are: to monitor implementation of the Energy Charter Treaty and Protocol's Obligations, to organize and administer meetings of the Conference and its subsidiary bodies, to provide analytical support and advice to the Conference and its subsidiary bodies on all aspects of the Energy Charter process, to represent the Energy Charter Conference in the development of its relations with non-member states and other relevant international organizations and institutions, to support negotiations on new instruments mandated by the Conference, to conduct or facilitate dispute resolution/conciliation procedures²². The secretariat that serves the charter conference is small by international standards, particularly when regard is had to the broad scope of the Treaty. This reflects the original intention of the negotiators that the charter conference and the secretariat should not duplicate the work of other international organizations. The Treaty provides a specific direction to the Charter Conference "through the secretariat ...to cooperate with and make as full a use as possible, consistently with economy and efficiency of the services and programs of other institutions and organizations with established competence in matters related to the treaty".²³ The Treaty also provides for periodic reviews of the functions of the Conference and Secretariat.²⁴

²¹ . *"The Energy Charter Treaty and Related Instruments"*, Brussels, Energy Charter Secretariat, p. 18.

²² . *Ibid.*

²³ . *Art 34(4)*

²⁴ . *Art 34(7)*