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SERIES OF NOTES ON THE ENERGY CHARTER TREATY

Note 4

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A BIRD'S EYE VIEW OF ARTICLE 18 OF THE ENERGY CHARTER TREATY

Sovereignty over Energy Resources

INTRODUCTION

1. This is the 4th note of the newly launched MENA Chambers *Series of Notes on the Energy Charter Treaty*. The main aim of this note is to provide a brief exploratory foray into the so-called "sovereignty article", namely, Article 18 of the Energy Charter Treaty ("ECT"). After this introduction, the note consists of three sections. The second section provides a brief textual interpretative analysis of two central provisions of Article 18. The third section offers a brief outline of the negotiating history of Article 18. The last section concludes this note.

2. Article 18 of the ECT entitled "Sovereignty over Energy Resources" is located in Part IV of the ECT, entitled "Miscellaneous Provisions".[1] It reads as follows:

> (1) The Contracting Parties recognize state sovereignty and sovereign rights over energy resources. They reaffirm that these must be exercised in accordance with and subject to the rules of international law.
>
> (2) Without affecting the objectives of promoting access to energy resources, and exploration and development thereof on a commercial basis, the Treaty shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources.[2]
>
> (3) Each state continues to hold in particular the rights to decide the geographical areas with its Area to be made available for exploration and development of its energy resources, the

[1] Other Articles that have been placed in Part IV of the ECT are: Article 19 "Environmental Aspects", Article 20 "Transparency", Article 21 "Taxation" (on which another note to be published in this *Series* soon), Article 22 "State and Privileged Enterprises", Article 23 "Observance by Sub-National Authorities", Article 24 "Exceptions", and Article 25 "Economic Integration Agreements".
[2] Footnote omitted.

> optimalization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises.
>
> (4) The Contracting Parties undertake to facilitate access to energy resources, inter alia, by allocating in a non-discriminatory manner on the basis of published criteria authorizations, licences, concessions and contracts to prospect and explore for or to exploit or extract energy resources.

3. Two statements that are appended to the ECT are directly relevant to the interpretation and application of Article 18. The first is Declaration V;[3] the second is the Chairman's Statement at Adoption Session on 17 December 1994 ("Chairman's Statement").[4]

4. Declaration V read as follows:

> The representatives declared that Article 18(2) shall not be construed to allow the circumvention of the application of the other provisions of the Treaty.

5. The Chairman's Statement made at the Adoption Session provides, in pertinent part, as follows:

> Finally, I note that the representative of Norway supported by the representatives of Armenia, Belarus, Estonia, European Communities, and their Member States, Finland, Iceland, Lithuania, Liechtenstein, Kazakhstan, Moldova, the Russian Federation, Sweden, Switzerland and Ukraine have declared that the ECT shall be applied and interpreted in accordance with generally recognized rules and principles of observance, application and interpretation of treaties as reflected in Part III of the Vienna Convention on the Law of Treaties of 25 May 1969. *In particular in the context of Article 18(2) they recalled that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.*[5] […]

TEXTUAL INTERPRETATION OF ARTICLE 18 PARAGRAPH (1)

6. At the outset, it is noteworthy to mention that the language of paragraph (1) of Article 18 is declaratory, i.e. "*recognize*" and "*reaffirm*".

7. Thus, in the first sentence of Article 18(1), the Contracting Parties *recognise* two fundamental principles of international law: (a) state sovereignty and (b) sovereign rights over energy

[3] *The Energy Charter Treaty and Related Documents*, p. 30.
[4] CONF 115 document of 06 January 1995. See Annex 1 of Note 3 of this *Series* for part of the original document. The Chairman's Statement in full is also in *The Energy Charter Treaty and Related Documents*, pp. 157-158.
[5] Emphasis added.

resources (derived from the widely known principle of international law: permanent sovereignty over natural resources). Neither of those two principles is deniable, even though the meaning and scope of application of each has evolved in conjunction with the development of international law.

8. Second, in the second sentence of paragraph (1) of Article 18, the Contracting Parties *reaffirm* their commitment to the rule of law: in other words, each Contracting Party *reaffirms* its commitment to exercise its sovereign rights and rights over energy resources "*in accordance with and subject to the rules of international law*".

9. The second sentence of paragraph (1), therefore, clearly indicates that the two principles recognised in the first sentence are not absolute in nature. In other words, they are relative principles: each principle must be exercised/applied in accordance with, and subject to, the rules of international law.

10. *Pacta sunt servanda* is a fundamental rule of customary international law, which has been codified in Article 26 of the *Vienna Convention on the Law of Treaties* and provides that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[6] It follows, therefore, that the two principles mentioned in the first sentence of paragraph (1) of Article 18 must be exercised in accordance with the principle of *pacta sunt servanda*.

11. Thus, applying the general rule of treaty interpretation,[7] it could be argued that each State that is a Contracting Party to the ECT must exercise its sovereignty in general, and its sovereign rights over energy resources in particular, in accordance with its specific obligations as set out in the rest of the ECT, including those obligations found in Part III.

12. As a matter of proper interpretation, it could be suggested that Article 18(1) provides the overall context within which the rest of the provisions of the Article should be construed, including paragraph (2), which is considered below.

[6] Needless to say, that this international law rule is subject to another international law principle of *jus cogens*.

[7] See Note 3 of the *Series*.

PARAGRAPH (2)

13. The normative segment of this paragraph reads that "[…] the Treaty shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources." Read in isolation, the scope of these provisions could be (and indeed has been) subject to misunderstanding/misinterpretation. However, the scope and effect of the relevant part of Article 18(2) can be clearly ascertained if read in context, and in light of the object and purpose of the ECT.[8]

14. Relevant to the context are Declaration V and the Chairman's Statement quoted above in paragraphs 4 and 5 respectively. Each of these two statements clarifies the scope and effect of the normative part of Article 18(2). The first clarification is provided by Declaration V, which states that "[…] Article 18(2) shall not be construed to allow the circumvention of the application of the other provisions of the Treaty." The Chairman's Statement notes that "[…] in the context of Article 18(2) […] a party [to the ECT] may not invoke the provisions of its internal law as justification for its failure to perform a treaty."

15. Reading the provisions in the context of the two statements above, it is clear that Article 18(2) must mean the following: a Contracting Party has the right to prescribe the rules governing the system of property ownership of energy resources in its Area.[9] This right must not, however, be interpreted or applied in a way to allow such a Contracting Party to circumvent its specific obligations under the ECT: most notably, the obligations set out in Part III of the ECT. Neither can that Contracting Party rely on its domestic law rules as justification for breaching any of its obligations under the ECT. It follows that a Contracting Party may not take any measures, which are, for example, discriminatory and/or expropriatory and then contend that these measures were taken in exercise of its right(s) under Article 18(2).

16. Furthermore, as noted below, the relevant provisions of Article 18(2) was inspired by what was then Article 222 of the European Communities Treaty (now Article 345 of the Treaty on the Functioning of the European Union ("TFEU"); formerly Article 295). Therefore, it might be

[8] See Note 2 of the *Series*.
[9] For definition of "Area", please see Article 1(10) of the ECT.

helpful, for present purposes, to briefly touch upon how the European Court of Justice ("ECJ") has construed the scope and effect of Article 345.

17. On several occasions, the ECJ has made clear that the application of "[…] the rules in [Member States] governing the system of property ownership" must be in conformity with the EU Treaties. Thus, for example, in the *Konle* case, the ECJ ruled that "[…] although the system of property ownership continues to be a matter for each Member State under Article 222 of the Treaty, that provision does not have the effect of exempting such a system from the fundamental rules of the Treaty."[10] Furthermore, in the *Commission v Germany*, the ECJ recalled "[…] that [Article 345 of the TFEU] does not have the effect of exempting the Member States' systems of property ownership from the fundamental rules of the Treaty."[11]

18. The same logic applies to the ECT. Therefore, a Contracting Party may not invoke the operative part of Article 18(2) of the ECT in order to justify a breach of any of the ECT's obligations; particularly those set out in Part III of the ECT.

PARAGRAPH (3) AND (4)

19. The remaining two paragraphs of Article 18 are clear in their scope. Paragraph (3) provides illustrative examples of the *system of property ownership* confirmed in paragraph (2) examined above. Article 18(4) of the ECT, however, establishes a commitment on the side of the Contracting Parties to act transparently and not to discriminate in allocating "[…] authorizations, licences, concessions and contracts to prospect and explore for or to exploit or extract energy resources."

SUMMARY OF THE NEGOTIATING HISTORY OF ARTICLE 18

20. An early version of the "sovereignty article" was included in the various draft texts of the Treaty.[12] In late 1992, Norway introduced a proposal for a new article (then Article 26A) entitled "Property" to the draft text of the ECT. Norway's proposed article read that "[t]his Agreement shall in no way prejudice the system existing in Contracting Parties in respect of property."[13]

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[10] *Konle v Austria*, Case C-302/97, [1999] ECR I-003099, paragraph 38. See also, for example, *Salzmann*, Case C-300/01, [2003] ECR I-04899, paragraph 39; *British American Tobacco*, Case C-491/01, [2002] ECR I-11453, paragraph 147.

[11] Case C-503/04, [2007] ECR I-06153, paragraph 37.

[12] For earlier versions, for example: Article 5 entitled "Sovereignty over Natural Resources" of BP 2 document, dated 11 September 1991; Article 4 entitled "Sovereignty over Energy Resources" of BA 12 document, dated 9 April 1992.

[13] See, for example, BA 26 document, dated 25 November 1992 and BA-37 document, dated, 1 March 1993.

However, this proposal was dropped from the Chairman of Working Group II's Compromise text of the ECT, dated 15 March 1993, and the Sovereignty over Energy Resources article was moved into Part IV entitled "Contextual".[14] The 5th version of the draft ECT is to be noted here. Commenting on the sovereignty article (then Article 21), the Chairman at the plenary "decided to leave this Article open until there was a better understanding on whether provisions of the Charter Treaty could interfere with the concept of sovereignty over energy resources established in international law."[15]

21. The successive versions of the sovereignty article were not subject to much discussion by the negotiating parties. However, when it was thought that the negotiations of the Treaty were at an end, Norway submitted Room Document 7, dated 7 June 1994,[16] in which it was proposed, *inter alia*, to include a new article (then 21bis) to the Chairman's compromise draft ECT text, dated 22 April 1994.[17]

22. On 11 June 1994, with the aim of securing Norway's signature of the ECT and on the basis of informal consultations (with a handful of parties) concerning Norway's Room Document proposals mentioned above, the Chairman of the Plenary proposed an amendment to Article 18 (then Article 21) of the ECT.[18]

23. The Chairman's proposed amendment to the sovereignty article, particularly the "ownership" provisions introduced into paragraph 2 of Article 18 was a cause of concern to many. The Chairman of the Legal Sub-Group, after consultation with other members of the group, produced a lengthy note on what he thought would be the potential consequences of the amendment.[19] Other members of the Legal Sub-Group commented on an earlier version of the Chairman's note, while others expressed their views on the proposed amendment. The Australian member of the Group, for example, expressed his government's position as follows:

> Australia would like to have it clearly recorded that it can accept Article 21 as currently drafted on the basis that it is merely a declaratory of existing international law. We do not read it as

[14] CONF 50 document, dated 15 March 1993.
[15] CONF-72 document, dated 11 October 1993.
[16] Document available in file.
[17] See CONF 98 document, dated 22 April 1994. Notable here is that the wording of the Chairman's proposed text for Article 18(2) is different from the text, which has been adopted in present text of the ECT.
[18] See Room Document 37, dated 11 June 1994.
[19] Document available in file.

> overriding any other provision of the Treaty. In particular, our understanding is that Article 21 does not override the core obligations contained in Article 13 in relation to the standard of treatment to be provided to investments. This is in line with the view expressed by Norway that Article 21(2) and (4) are not intended to undermine or 'gut' the Treaty.[20]

24. It is in order to avoid some of the potential uncertainties surrounding the interpretation of Article 18(2) that Declaration V was made by all representatives (paragraph 4 above). The Chairman's Statement made at the ECT's Adoption Session was thought necessary exactly for the same reason (paragraph 5 above). The end result was a political compromise: a compromise between those representatives, predominately Norway, which wanted a sovereignty article in the text of the ECT, and those who feared any late amendment might have a detrimental impact on the substantive provisions of the Treaty. However, all participating representatives of the Contracting Parties agreed on one thing: "*[…] Article 18(2) shall not be construed to allow the circumvention of the application of the other provisions of the Treaty*."

SUMMARY AND CONCLUSIONS

25. In light of the above brief analysis of Article 18 of the ECT, the following observations maybe offered.

a. First, Article 18 is declaratory of a well-established principle of international law, namely, permanent sovereignty over natural resources.

b. Second, a Contracting Party to the ECT cannot successfully rely upon any provisions of Article 18 in order to justify any act or measure, which is in breach of its ECT obligations. In other words, Article 18 does not provide an exception nor was it drafted to serve as a reservation. However, some normative provisions of Article 18 might be invoked as a defence in the sense that the measure or measures in question are taken in the exercise of the Contracting Party's right(s) under Article 18; but the crucial question would always be whether or not the measure in question has breached a substantive obligation of the ECT (particularly those set out in Part III).

c. Third, it is to be made clear that there is nothing in Article 18, which can be used successfully to challenge the jurisdiction of an arbitral tribunal seized under Article 26 of the ECT.

d. Finally, and broadly speaking, it is suggested that a *good faith* approach to the ECT application and interpretation would be better served in the context of two fundamental concepts of international law, which have endured the passage of time. The first is that "[a]ll international

[20] Document available in file.

law of today is made up of the limitations of sovereignty, limitations created by sovereignty itself."[21] The second concept is the dictum first espoused by the Permanent Court of International Justice in the *S.S. Wimbledon* case. The Court observed:

> The Court declines to see in the conclusion of any Treaty by which a State undertakes to perform or refrain from performing a particular act an abandonment of its sovereignty. No doubt any convention creating an obligation of this kind places a restriction upon the exercise of sovereign rights of the State, in the sense that it requires them to be exercised in a certain way. But *the right of entering into international engagements is an attribute of State Sovereignty*.[22]

26. It is therefore imperative to keep all of the above in mind when one is faced with the application and interpretation of the "sovereignty article" of the Energy Charter Treaty. No more or less should be read into it.

[21] *Some Aspects of Sovereignty in International Law*, Marek Stanislaw Korowicz, 102 *Recueil des Cours*, (1961), p. 111.
[22] *The S.S. Wimbledon* case, Judgment of 17 August 1923, PCIJ Rep. 1923, Series A. No.1, at p. 25. Emphasis added.