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The Yukos Case under the Energy Charter Treaty and the Provisional Application of International Treaties

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Introduction

This paper analyses the legal concept of "provisional application" of international treaties in relation to the Yukos case, which falls under the Energy Charter Treaty regime.

With the auctioning of Yukos' main oil-producing subsidiary Yuganskneftegas imminent, Yukos management filed for bankruptcy protection under Chapter 11 of the US Bankruptcy Code. Despite this effort to prevent Yukos' legal and economic disintegration, the auction took place in late December 2004, and Yuganskneftegas was sold. Given these facts, the legal strategy for Yukos' investors now seems to focus on financial compensation under international investment protection regimes. Group Menatep, the main shareholder of Yukos, initiated the investment dispute settlement mechanism of Art. 26 Energy Charter Treaty (hereafter ECT) to seek financial compensation. The Russian Federation (hereafter RF) has signed, but not (yet) ratified the ECT. The key question in a claim under Art. 26 ECT by the investors against the RF, therefore, will be the relevance and scope of the binding force of a provisional application of the ECT according to Art. 45 (1) of the Treaty.

Press sources indicated that further legal action concerning investment protection could also be based on Art. 1 of Protocol No. 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms (protection of property), or on one of the Bilateral Investment Treaties. But so far, apparently, no legal steps have been taken in this direction.

The provisional application of the ECT in the Russian Federation

"Provisional application" means that the treaty's substantial provisions are applied even if it has yet to enter into force, either with regard to all signatory states, or only in respect of a certain country which is waiting to ratify the treaty. Thus, a treaty may give rise to obligations for its members despite the fact that the legislature, the constitutionally responsible body, has not yet ratified it. Even if the provisional application of international treaties is not the rule, this concept has long been acknowledged, and was finally codified in Art. 25 (provisional application) of the Vienna Convention on the Law of Treaties 1969 (hereafter VCLT).

In past centuries, the lack of an immediate means of communication was the main reason for provisional treaty application. Nowadays, economic agreements and treaties are applied provisionally because they arise from urgent economic needs which call for a quick response in circumstances that sometimes can-

not wait for the complicated ratification procedure to be completed.

The Energy Charter Treaty is a multilateral international treaty aiming to provide closer cooperation among the contracting states, and to encourage the cross-border integration of national energy markets. The ECT is designed to be a legally binding forum for investment promotion and protection in the energy sector, including an investment dispute settlement mechanism, the promotion of free trade in energy materials, products and related equipment, free transit through pipelines and grids, and the promotion of energy efficiency. The swift economic integration of energy markets in the former East and West was considered vital to the restructuring and reform of the old communist economies, and to safeguard the energy supply to energy-dependent western nations. Therefore, in Art. 45 (1), the ECT prescribes its provisional application, including an opt-out clause for those members not willing to apply the treaty provisionally in Art. 45 (2) ECT. Art. 45 ECT reads in part as follows:

> "(1) Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory (...), to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.
> (2) (a) Notwithstanding paragraph (1) any signatory may, when signing, deliver (...) a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. (...)"

This resulted in the provisional application of the treaty by all signatory states between December 1994 and its entry into force in April 1998, unless a member state expressly declared that it was unable to apply the ECT provisionally. After April 1998, the provisional application was restricted to those signatory states which had not yet ratified the treaty. In the RF, the ratification procedure commenced with the introduction of the project to the Russian State Duma in 1996. Parliamentary hearings began in 1998, but the Duma postponed ratification several times due to ongoing negotiations and disputes about a Transit Protocol to the Energy Charter Treaty. When signing the ECT in 1994, the RF did not register a declaration of non-application according to Art. 45 (2). Therefore the Russian Federation applies the Energy Charter Treaty on a provisional basis in line with Art. 45 (1) ECT.

The Yukos Case under the Energy Charter Treaty?

Even if it is held that the procedural requirements set out in Art. 45 (1) and (2) ECT are met with regard to

the RF, the exact relevance and scope of the ECT's provisional application have to be examined.

The concept of provisional application seems convenient to the negotiating organs of the signatory states, but may cause severe internal legal conflicts. The central conflict arises between the public international law concept of provisional application, and the constitutional law concept of separation of powers, which leaves the final decision on important international commitments to the legislature (ratification), and not to the executive, which negotiated and signed the treaty. This conflict becomes evident when a provisionally applied treaty provides obligations which are inconsistent with the national law of a signatory state.

To clarify the relevance and scope of the legally binding force of the provisionally applied ECT in the Yukos case, one has to take a closer look at the general provisions of the VCLT, Art. 45 ECT, and Russian law.

Art. 25 (1) VCLT itself is not concerned with the weight and scope of the provisional application of treaties. It merely points to the existence of the concept of provisional application, but leaves it to the contracting parties to negotiate its scope, as the very detailed Art. 45 (1) – (7) ECT shows.

Art. 27 (national law and observation of treaties) and Art. 46 (provisions of internal law regarding the capacity to conclude treaties) VCLT expressly deal with the conflict between international treaties and national law:

> Art. 27 VCLT
> "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46."
> Art. 46 VCLT
> "(1) A State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance."

While Art. 27 VCLT deals with the possible conflict between the substantial provisions and obligations of a treaty, and internal law, Art. 46 is designed to determine who has the capacity to enter into a treaty. Both provisions clearly state that treaty law takes precedent over internal law, with the small exception of Art. 46 (1). Accordingly, one could argue that Russian laws which limit the scope of the provisional application of the ECT in the Yukos Case, or contradict it, could not be invoked by the RF. But this conclusion changes on a closer look

at the ECT's rules on provisional application. In contrast to Arts. 27 and 46 VCLT, Art. 45 (1) ECT explicitly states that the Energy Charter Treaty is to be provisionally applied only "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations."

Art. 45 (1) ECT therefore is giving national law priority over the ECT as long as it is applied provisionally. One could argue that the opt-out provision in Art. 45 (2) ECT leads to a different conclusion by saying that a signatory state which does not opt out of the provisional obligation is willing to be bound to such an extent as it would be if the treaty were already in force. But in light of the clear language of Art. 45 (1) ECT, this argument cannot prevail. Thus Art. 45 (1) ECT takes precedent over Arts. 27 and 46 VCLT according to the rule of lex specialis.

Therefore the question of a provisional application of the ECT, and especially its Art. 26, concentrates on the relationship between the ECT and Russian law. Given that Russian law takes precedent over the provisionally applied ECT, one first has to ask whether the provisional application itself is consistent with Russian law. If the concept of provisional application of treaties in general, or the provisional application of the ECT in particular, is inconsistent with Russian law, according to Art. 45 (1) the ECT cannot be applied provisionally. At first sight, this may seem confusing or absurd, but it is the logical consequence of Art. 45 (1) ECT.

The Constitution of the RF (12 December 1993 – CRF) assigns the right to negotiate and conclude international treaties to the President of the RF (Art. 86 (b) CRF), but leaves their ratification to the Federal Assembly (State Duma and Council of the Federation - Arts. 71, 105, and 106 (d) CRF). The concept of "provisional application" is not dealt with in the corresponding provisions of Art. 15 CRF:

> "(4) Generally accepted principles and rules of international law and international treaties of the Russian Federation shall be an integral part of its legal system. If an international treaty of the Russian Federation establishes rules, other than provided for by the law, the rules of the international treaty shall be applied."

The details are regulated by the Federal Law on International Treaties of the RF (16 June 1995 – FL IT). Art. 23 FL IT (provisional application of international treaties in the RF) expressly deals with the provisional application of international treaties in the RF:

> "(1) An international treaty (...) may be applied provisionally in the RF, if the treaty provides so (...).

> (2) The decision about the provisional application (...) is to be taken by the government body, responsible for the (...) signing of the international treaty according to the regime (...) in Art. 11 FL IT.
> If an international treaty, which has to be ratified (...), provides for its provisional application (...), the treaty has to be introduced to the State Duma not later than six month after the provisional application began. With a decision, taken in the form of a federal law according to Art. 17 FT IT (...), the period of provisional application may be prolonged."

Thus Russian law acknowledges the provisional application of treaties, and is therefore consistent with this concept as laid down in Art. 45 (1) ECT. But looking at the drawn-out ratification process in the State Duma, there are doubts whether the actual provisional application of the ECT is consistent with Art. 23 (2) FL IT. As stated above, the ratification process began in 1996, but the State Duma repeatedly postponed its decision, which has yet to be reached. Unfortunately the author so far could not determine whether the procedural arrangements laid down in the second part of Art. 23 (2) FL IT are met regarding ECT ratification. Furthermore, the FL IT gives no indication as to the legal effects of non-compliance with these procedural rules on the provisional application of a treaty. Given that the RF so far has not invoked Art. 23 (2) FL IT, but publicly confirmed the provisional application of the ECT, it shall be assumed for the purpose of this paper that the ongoing ratification process, so far, complies with the rules laid down in the FL IT. Therefore, the provisional application itself, as provided for by Art. 45 (1) ECT, is consistent with Russian law.

Finally there remains the central question of a provisional application of Art. 26 ECT in the Yukos case. Art. 26 ECT contains detailed provisions for an investment dispute settlement mechanism between the investor and the signatory state in which the investment has been made. The provisional application of Art. 26 ECT in general is, of course, covered by Art. 45 (1) ECT. But once again the problem lies with the broad and vague exception in Art. 45 (1) ECT, which would prevent the provisional application of Art. 26 ECT, should a Russian norm be inconsistent with Art. 26 ECT. This conclusion may change if the broad exception in Art. 45 (1) ECT is modified in Art. 45 (3) ECT with regard to Art. 26 ECT. Art. 45 (3) ECT itself deals explicitly with termination of provisional application (Art. 45 (3) (a) ECT), and its effects on the treaties' investment protection and investment dispute settlement provisions (Art. 45 (3) (b) and (c) ECT), including Art. 26 ECT:

> "(3) (a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository.
> (b) In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination, except as otherwise provided in subparagraph (c).
> (c) Subparagraph (b) shall not apply to any signatory listed in Annex PA. A signatory shall be removed from the list in Annex PA effective upon delivery to the Depository of its request therefor."

Following Art. 45 (3) (a) ECT, the RF could cease the provisional application of the ECT at any time. In this case, foreign investments in Russia made between 1994 and today, according to Art. 45 (3) (b), would still benefit from the investment protection regime of the ECT, as Russia did not opt out according to Art. 45 (3) (c).

Perhaps the high standard of investment protection envisaged by Art. 45 (3) (b) changes the regime of according precedence to national law, as set out in Art. 45 (1) ECT. But, as in the case of Art. 45 (2) ECT, Art. 45 (3) ECT cannot reverse the priority of national law over ECT rules in the course provisional application. This may be unsatisfactory regarding the intentions of the treaty, namely to guarantee a stable investment climate even during the phase of provisional application, but facing the clear language of Art. 45 (1) ECT, one can hardly argue otherwise.

In the end, this means that Art. 26 ECT, too, must be consistent with Russian law in order to be applied provisionally. In the author's opinion, there is no provision or principle of Russian law which would deny state-investor settlement under a provisionally applied treaty. But to verify this would go far beyond the scope of this paper, and is therefore left open for further discussion.

Conclusion

In conclusion one can say that the regime of provisional application of the Energy Charter Treaty is not governed by the general provisions of Arts. 25, 27, and 46 VCLT, but

by the special provisions of Art. 45 (1) ECT. Accordingly, this leads to the priority of national law over the provisionally applied ECT. Therefore the Energy Charter Treaty may not be applicable in the Russian Federation as far as the provisional application itself, or provisionally applied substantial provisions, are inconsistent with Russian law. As stated above, the concept of provisional application, and thus the provisional application of the ECT, is consistent with Russian law. Art. 26 ECT, as part of the ECT, is applied provisionally in the RF. Despite the intentions of the treaty regarding investment security, Art. 26 ECT, too, is governed by the provisional application regime of Art. 45 (1) ECT. This means that the investment dispute settlement mechanism will only be applied if there is no Russian law or regulation inconsistent with it. An investment compensation claim of Group Menatep under Art. 26 ECT, apart from the political and economic difficulties it faces, is therefore left with many legal uncertainties. Concerning the concept of provisional application, as set out in Art. 45 (1) ECT, one must conclude that it does not provide a high level of security for investors in countries where the ECT is applied on a provisional basis.

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