Croatian International Relations Review
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CIRR
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XXIV (83) 2018, 52-83
—
DOI 10.2478/cirr-2018-0014
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UDC 620.31:341.1

Energy Charter Treaty — Standards of Investment Protection

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Abstract

The Energy Charter Treaty (ECT) in its Part III which regulates standards of protection guaranteed to foreign investors by the ECT States members, together with the Article 24 of the ECT, constitutes a kind of autonomous investment treatment within the ECT. The ECT provides for a very broad spectrum of standards of protection: fair and equitable treatment; most constant protection and security; prohibition of unreasonable or discriminatory measures; „umbrella clause"; national treatment; most favoured-nation standard and effective means to assert the claims. It can be said that at the time of its drafting the ECT enclosed all standards of protection as recognized in BITs and NAFTA. There have been more than 100 publicly known investment arbitration cases where the ECT was invoked, more than 30 of which concluded by arbitral awards. This comprehensive arbitral practice strongly influences the practice applying other IIAs and vice versa.

Key words:
Energy Charter Treaty; standards of protectio;, investment; arbitration

Croatian International Relations Review
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CIRR
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XXIV (83) 2018, 52-83

Introduction

All international investment agreements (IIAs) contain provisions regarding the treatment of foreign investors. The function of these provisions is to define measures host states are required to take to protect foreign investors from political risk that is the consequence of undertaking investment and putting foreign investor's assets under the jurisdiction of the host state. Measures undertaken by the host country which fail to meet the defined standard constitute a breach of promise given by the host state via IIAs and thus "constitute treaty violations that engage the offending state's international responsibility and render it potentially liable to pay compensation for the injury it has caused" (Salacuse 2015: 228).

In principle, IIAs do not define standards of protection but only refer to them. Consequently, this means that defining the scope of standards of protection is left mainly to the practice of international investment arbitral tribunals. It could be said that IIAs define the scope of investment protection while its content is found in the customary international law and the practice of international investment arbitral tribunals.

The Energy Charter Treaty (ECT) provides for especially broad protection of foreign investors (FI) and their investments. It contains all standards of protection developed at the time of its drafting and signing (1994). It entered into force in 1998 and the first case based on the ECT was initiated in 2001 (*Nykomb v. Latvia*) with the Award rendered in 2003. Since then and considering a rather slow start at the beginning, by 2017 the ECT has become the most frequently invoked IIA before the international investment arbitration (UNCTAD 2017:3). Part III of the ECT is in effect an investment treaty which in its Article 10(1) provides for the following standards of protection of foreign investments:

a) fair and equitable treatment;
b) most constant protection and security;
c) prohibition of unreasonable or discriminatory measures;
d) „umbrella clause". Besides these standards, by its Article 10(7), the ECT also defines
e) national treatment and most favoured-nation standard, and in its Article 10(12) the standard of
f) effective means to assert the claims.

Fair and equitable treatment

The standard of fair and equitable treatment (FET) is the most common standard of investment protection that can be found in virtually all IIAs, so it has a prominent place in the ECT as well. At the same time, the FET is the most frequently used standard of investment protection in international investor-state disputes "present in almost every single claim brought by foreign investors against host State" (Yannaca-Small 2012:111). The purpose of this standard, as it has been applied in IIAs and arbitral practice, is described by Dolzer and Schreuer (2012: 132) as a tool intended to "fill gaps which may be left by the more specific standards, in order to obtain the level of investor protection intended by treaties".

As IIAs like the ECT do not contain the definition of the FET, establishing its scope and content is left to arbitral tribunals.[1] It is a frequently invoked standard of utmost importance, as Babić (2012:397) said, "The most important standard of protection in international investment law", and yet it has no clear and defined content and there is no normative definition of the substance of this standard.[2] According to Schill (2009:263), the FET is a standard which

> *does not have a consolidated and conventional core meaning as such nor is there a definition of the standard that can be applied easily. So far it is only settled that fair and equitable treatment constitutes a standard that is independent from national legal order and is not limited to restricting bad faith conduct of host States. Apart from this very minimal concept, however, its exact normative content is contested, hardly*

1 First IIA which provides definition of FET is CETA Art 8.10(2): „2. A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 if a measure or series of measures constitutes:
(a) denial of justice in criminal, civil or administrative proceedings;
(b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings,
(c) manifest arbitrariness;
(d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
(e) abusive treatment of investors, such as coercion, duress and harassment; or
(f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.

2 According to Hober (2010:157), FET has been derived from "international law, and has, through its frequent applications by tribunals in BIT [bilateral investment treaties] and NAFTA [North American Free Trade Agreement] arbitrations, become an important principle of investment protection".

substantiated by State practice, and impossible to narrow down by traditional means of interpretative syllogism.

One of the frequent issues faced by tribunals applying the ECT in dealing with the FET is whether it is an independent standard or a standard that encompasses other standards of investment protection from Article 10 of the ECT. Only one Tribunal, in the case of *Petrobart v. Kyrgyzstan* (Award, p. 82), concluded that FET standard is not an independent one but that the whole Article 10(1) of the ECT "in its entirety is intended to ensure a fair and equitable treatment of investments" and consequently all above mentioned standards, according to this Tribunal, are rather the elements of the FET.

Contrary to this approach, all other tribunals applying the ECT concluded that the FET is an independent and autonomous standard. The same conclusion was reached by Scheuer (2008: 65): "there is no doubt that it is an autonomous standard of protection that has given rise to numerous successful claims".

Since the FET is frequently used by claimants and there is no definition of its content in the ECT, in their reasoning tribunals often rely on decisions by other tribunals applying not only the ECT, but other IIAs as well. As stated in the case of *Plama v. Bulgaria* (Award, para.164): "the Arbitral Tribunal will therefore attempt to provide a relevant definition of standards considering practice under the ECT and practice of tribunals under other investment treaties".[3]

One of the characteristic of the FET in the ECT context is that it is "case specific" and it can be applied only if all factual circumstances of each specific case are taken in account. It should be applied in a way that firstly enables the determination of its scope and definition, considering the practice of other arbitral tribunals. Then, as explained by the Arbitral Tribunal in *Stati v. Kazakhstan* (Award para. 944), it should be considered *vis-à-vis* the specific factual circumstances of the case, and finally these must be evaluated in the in the legal context of the ECT.

3 Similar in *Stati v. Kazakhstan* (Award, para. 943.): „FET standard has been interpreted and applied under international law by many international investment tribunals, thereby creating a considerable body of case law that has added specific meaning and content to the standard."

There are various types of improper and discreditable conduct of the host state that could be considered as a violation of the FET and these are the elements of the content of standard developed through the arbitral practice. UNCTAD Study on FET (2012: 62) describes the following elements as relevant:

a) defeating investors' legitimate expectations (in balance with the host State's right to regulate in public interest);
b) denial of justice and due process;
c) manifest arbitrariness in decision-making;
d) discrimination;
e) outright abusive treatment.

According to Dolzer and Scheuer (2012: 145), international legal scholars have identified, from the practice of arbitral tribunals, similar elements that are embraced by the FET like: "stability, transparency and investor's legitimate expectations, due process, acting in good faith and freedom from coercion and harassment". Jacob and Schill (2015: 719) offer similar elements that, according to them, can render the FET operable in practice: (a) principle of legality; (b) administrative due process and denial of justice; (c) protection of legitimate expectations; (d) requirement of stability, predictability and consistency regarding the legal framework; (e) non-discrimination; (f) transparency; and (g) principles of reasonableness and proportionality.[4]

Applying the ECT, the Tribunal in the case of *Electrabel v. Hungary* (Decision on Jurisdiction, Applicable Law and Liability 2012 para. 7.74) followed this line of reasoning and established that the obligation to provide the FET comprises of several elements:

> *An obligation to act transparently and with due process; to refrain from taking arbitrary or discriminatory measures or from frustrating the investor's reasonable expectations with respect to the legal framework adversely affecting its investment.*

4 Similar: Babić (2012: 406): (a) protection of legitimate expectations of investors; (b) transparency in decision making and implementing; (c) protection of procedural rights of investors and (d) prohibition of harassment; Salacuse (2015:253) enumerated that tribunals in order to establish whether the FET was breached checked whether the host state has: (1) failed to protect the investor's legitimate expectations; (2) failed to act transparently; (3) acted arbitrarily or subjected the investor to discriminatory treatment; (4) denied the investor access to justice or procedural due process or (5) acted in bad faith.

Tribunal in the case of Mamidoil v. Albania (Award 2015) defined four elements of the FET:

1. *The provision of a stable and transparent legal framework* — when appraising whether the principle of stability and transparency of legal framework has been upheld by the host country, overall situation in a host country should be taken in account:

> *An investor may have been entitled to rely on Albania's efforts to live up to its obligations under international treaties, but that investor was not entitled to believe that these effort would generate the same results of stability as in Great Britain, USA or Japan (Award 2015 para. 626).*

At the same time, the investor's conduct is of the same importance as the investor can rely on stability of the legal framework of the host state only if the investor acted with due diligence in estimating the overall situation in a host country. "The obligation of the State does not dispense the obligation of the investor to evaluate the circumstances. Reliance has as its prerequisite diligent inquiry and information" (Award 2015 para. 634).

Based on this premise, the Tribunal adopted the approach by which to establish whether the FET was breached, it must appraise the conduct of both the host state and of the investor and put them in balance by considering the overall situation in the host state.

2. *Legitimate expectations* — Tribunal defined that they can be based either on explicit representation by the host state (Award para. 691) or on the consistent conduct of the host state (Award para. 706). This distinction is of great importance when estimating the balance of interests of the investor and the host state. In earlier phases of the investment, the investor has a greater liberty to give up his investment but later, with more commitment, especially in the realm of funding, that possibility is reduced:

> *The investor's flexibility is reduced the more it commits funds to implementation, and the gradual loss of flexibility increases the legitimate expectation of stability and protection, while the State, although retaining its right and*

duty to pursue public policy objectives, is obliged to respect the legitimate expectations by pursuing the objectives consistently, coherently and predictably (Award para. 707).

3. *The exertion of pressure on the investor by the host state* — this is the element that is not found in the practice of other tribunals or writings of scholars. It has certain similarities with the due process but, in the specific case, the Tribunal concluded that the host state has a legitimate right to request the investor to acquire certain permits and that it cannot be regarded as the coercion of the harassment of the investor (Award para 748).

4. *Denial of justice* — the Tribunal determined that a claim for the denial of justice must not be "confounded with an appeal against decisions of national judiciary" (Award para. 746) and then described the denial of justice not as the prohibition and protection from wrong decisions of national courts but rather as "the incapability of the whole host state's judicial system to provide the foreign investor with fair and equitable treatment" (Award para. 746). In the arbitral practice of the application of the ECT, the following FET elements have been established so far: (a) legitimate expectations; (b) stability of legal framework; (c) prohibition of the discrimination; (d) proportionality and (e) transparency.

Legitimate expectations

The investor's legitimate expectations are those the investor can expect from his investment, but only if he has undertaken all reasonable, expectable and standard steps for checking the situation in the host state together with all circumstances surrounding his investment. Such expectations are based on the "host state's legal framework and on any undertakings and representations made explicitly or implicitly by the host state" (Dolzer and Scheuer 2012: 145).

As Potesta (2013: 88-112) describes, the principle of protecting the investor's legitimate expectations is more and more frequently used in arbitral practice although its content is not defined. This principle is not absolute and it "does not require host state to freeze its legal system for the investor's benefit" (Salacuse 2015: 255) and a breach of investor's legitimate expectations

is "sufficient to establish liability" (Bonnitcha 2014: 162) of the host state.

In the practice of arbitral tribunals applying the ECT, investors have often been invoking breach of their legitimate expectations as a basis of their claim.

Considering the issue of how to determine whether the conduct of the host state breaches the investor's legitimate expectations, in the case of *Al-Bahloul v. Tajikistan* the Tribunal concluded that such decisions had to be based on several established factors like "the nature of the expectation, the reliance on the expectation and the legitimacy of that reliance" (Partial Award on Jurisdiction and Liability 2009 para. 200).

In the case of *Plama v. Bulgaria*, the Tribunal determined the standard of estimation of the "legitimacy" of the investor's expectations, according to which the expectations ought to be reasonable and justifiable to be legitimate. These primarily include "the conditions that were specifically offered by the State to the Investor when making the Investment and that were relied upon by the Investor to make its Investment" (Award 2008 para. 176).

The Tribunal in the case of *Electrabel v. Hungary* established that the ECT protects investors from unjustified changes of the legal framework but at the same time it recognized the right of the host state to retain possibility and flexibility of changing its legal framework to protect public interest in cases of changing circumstances. Consequently, the requirement that the host states respect FET standard "must not be understood as the immutability of the legal framework, but as implying that subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment"(Decision on Jurisdiction, Applicable Law and Liability para. 7.77). Therefore, determination whether the host state breached the legitimate expectations of foreign investors and thus the FET should be based on both, the conduct of the investor and that of the host state: the investor's conduct especially in regard to the information which he had or should have had (ordinary investor would have those information) at the time of deciding to invest; and the host state's in regard to possible promises given to the investors, providing information regarding changes in legal framework etc.

In the case of *Charanne v. Spain* the Tribunal stated that the principle of *bona fide* of customary international law prohibited the host state to attract investments by raising expectations on the side of foreign investors if it did not have a genuine will to fulfil those expectations (Award 2016 para. 486). The Tribunal also accepted the standard from UNCTAD study on the FET (UNCTAD 2012) that

> *an investor may derive legitimate expectations either from (a) specific commitments personally, for example in the form of stabilization clause, or (b) rules that are not specifically addressed to a particular investor, but which are put in place with a specific aim to induce foreign investment and on which the foreign investor relied in making his investment. (Award 2016 para. 489).*

The Tribunal took a stance that a relevant question when deciding about the existence of legitimate expectations was whether the regulatory framework could give rise to the investor's expectations that it would not be modified or altered to the investor's detriment and in "the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified" (Award 2016 para. 499). The Tribunal further concluded that "to convert a regulatory standard into a specific commitment of the state, by the limited character of the persons who may be affected, would constitute an excessive limitation on power of states to regulate the economy in accordance with the public interest" (Award 2016 para 493).

In conclusion, referring to determinations in the cases *Electrabel* (see above) and *El Paso v. Argentine*[5], the Tribunal concluded that the states had right to change their legal framework and to bring specific decisions in regard to investments but only if such norms were not unreasonable, arbitrary, contrary to public interest, disproportionate, unfair, inconsistent or in violation

5 If the often repeated formula to the effect that "the stability of the legal and business framework is an essential element of fair and equitable treatment" were true, legislation could never be changed: the mere enunciation of that proposition shows its irrelevance. Such a standard of behavior, if strictly applied, is not realistic,

nor is it the BITs' purpose that States guarantee that the economic and legal conditions in which investments take place will remain unaltered ad infinitum." [...] "In other words, the Tribunal cannot follow the line of cases in which fair and equitable treatment was viewed as implying the stability of the legal and business framework. Economic and legal life is by nature evolutionary"(El Paso v. Argentina, Award paras. 350, 352).

to the national regulatory and legislative due process (Award 2016 para. 539).

Thus, to apply the principle of legitimate expectations, there should be balancing of the legitimate interests of the host state and of the investor. When deciding about the alleged breaches of FET standard, tribunals should take in account the overall situation in the host state and in that context estimate both a duty of the state to protect public interest and a legitimate expectation of the investor to have a stable and predictable legal framework. Thus, investors must accept that the legal framework could be changed in the interest of public policy, but in that case, they have a right to demand such changes be made *bona fide,* with no discrimination or arbitrability and in public interest. The legitimate expectations are of extraordinary importance in most recent ECT cases relating to renewables. Due to the relevant changes in regulatory regimes in many states, investors are claiming that their legitimate expectations and thus the FET were breached by the host states.

Stability of legal framework

This FET element is like legitimate expectations. There is, however, one important difference: it is more „objective „criterion, „it does not revolve as closely around a particular investor's perspective, but instead subjects the relevant regulatory framework to a broader assessment"(Jacob and Schill 2015: 729). So, the conduct of the state is not considered in relation to a specific foreign investor and its expectations, but in relation to regulatory changes that affect all foreign investors.

The relation between the legitimate expectations and a demand for the stability of a legal framework in the context of ECT is described in the case of *Eiser v. Spain*[6]*:*

> *Taking account of the context and of the ECT's object and purpose, the Tribunal concludes that the obligation of Article 10(1) to accord fair and equitable treatment necessarily embraces an obligation to provide fundamental stability in*

6 The Tribunal in Eiser v Spain (Award para. 362), among others, quoted a decision from the case Micula v. Romania (Award 2013 para. 666): "[T]he fair and equitable treatment standard does not give a right to regulatory stability per se. The state has a right to regulate, and investors must expect that the legislation will change, absent a stabilization clause or other specific assurance giving rise to a legitimate expectation of stability".

> *the essential characteristics of the legal regime relied upon by investors in making long-term investments. This does not mean that regulatory regimes cannot evolve. Surely, they can. "[T]he legitimate expectations of any investor [...] [have] to include the real possibility of reasonable changes and amendments in the legal framework, made by the competent authorities within the limits of the powers conferred on them by the law." However, the obligation of Article 10(1) to accord fair and equitable treatment means that regulatory regimes cannot be radically altered when applied to existing investments in ways that deprive investors investing in reliance on those regimes of their investment's value (Award 2017 para. 382).*

In the case of *AES Summit v. Hungary*, the Tribunal applied the ECT and decided that the request for stability as an element of the FET was different from a stabilization clause often used in commercial investment contracts. The stability clause guarantees that there would be no changes for a specific investor while a request for stabile conditions relates to a legal framework which is "by definition subject to change as it adapts to new circumstances day by day and a state has the sovereign right to exercise its powers which include legislative acts"(Award 2010 para. 9.3.29).

Stability as the element of the FET of the ECT was not often used by claimants as a basis for their claims. It can be concluded that it has its place in those cases when the foreign investors claim that the system of a certain host state changed dramatically in relation to all investors, not only regarding those who can establish that they had legitimate expectations.

Denial of justice

In its treatment of foreign investors, the host state must comply with the basic due process requirements. Non-compliance with these requirements is considered a denial of justice and thus the breach of FET standard. The denial of justice is usually defined as „any gross misadministration of justice by domestic courts resulting from the ill-functioning of the State's judicial system"(Focarelli 2013). UNCTAD study on the FET (2012: 80) classified the following conduct of states likely to be considered the denial of justice:

a) Denial of access to justice and the refusal of courts to

decide;
b) Unreasonable delay in proceedings;
c) Lack of a court's independence from the legislative and the executive branches of the State;
d) Failure to execute final judgments or arbitral awards;
e) Corruption of a judge;
f) Discrimination against a foreign litigant;
g) Breach of fundamental due process guarantees, such as a failure to give notice of the proceedings and failure to provide an opportunity to be heard.

As Sornarajah (2010: 357) defined, the denial of justice occurs if a state organ conducts amounts to an act which shows such prejudice that "would shock the conscience of the outside word".[7]

The denial of justice, as an element of the FET is by looking at the practice of investment tribunals usually accompanied by a requirement for a due process. In the application of the ECT however only the denial of justice has been claimed so far. In the case of *Petrobart v. Kyrgyzstan*, the Tribunal determined that collusion between the executive branch and the judiciary had constituted a breach of the prohibition of denial of justice and thus the breach of the FET standard of the ECT (Award 2005 p. 28).

In the case of *Liman v. Kazakhstan*, the Tribunal took a position that the denial of justice was an element of the FET and that it constituted the breach of the FET under the ECT (Award 2010 para. 268) or, in other words, the FET implied that "there is no denial of justice". At the same time the Tribunal emphasized that it is not an appellate body and "its function is not to correct errors of domestic procedural or substantive law which may have been committed by the national courts" (Award 2010 para. 274). Regarding the scope[8] of the denial of justice standard, the Tribunal concluded the denial of justice could only exist

7 Paulson (2005: 98) defines the scope of denial of justice as: „ Denial of justice is always procedural. There may be extreme cases where the proof of the failed process is that the substance of a decision is so egregiously wrong that no honest or competent court could possibly have given it. Such cases would sanction the state's failure to provide a decent system of justice. They do not constitute an international appellate review of national law".

8 Tribunal (Award 2010, para. 278) quoted Award from Loewen case (para.132) when describing the content of the denial of justice principle: „Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough ...."

should the court system fundamentally fail but that even "a misapplication of domestic procedural or substantive law provision might under certain circumstances be an indication of lack of due process "(Award 2010 para. 285).

There are three important points that can be taken from the application practice of the ECT regarding the denial of justice as an element of the FET. The first one is that arbitral tribunals do not wish to act as appellate instances for the decisions of domestic courts. Secondly, the misapplication of material or procedural law is not enough to constitute the breach of the FET, there must be fundamental flaws in the legal system. Finally, the interference of the executive branch in the judicial process would be considered as a breach of the FET if it damaged the rights of the foreign investors.

Prohibition of discrimination

This standard of protection of foreign investors in the ECT exists simultaneously - as a separate, independent standard and as an element of the FET, so the main issue is how to distinct between these two standards. Often it is hard to make a distinction. Thus, the tribunals, when a discrimination of the foreign investor is claimed, in principle opt to establish a breach of discrimination as a separate standard not as an element of the FET. In the case of *Stati v. Kazakhstan* the Tribunal concluded that although there are two separate standards (the FET and the prohibition of discrimination), their scopes overlap „though it may be arguable to which extent (Award 2013 para. 1282).[9]

In the case of *Electrabel v. Hungary* the Tribunal determines that the prohibition of discrimination on one hand falls within the FET „obligation to provide fair and equitable treatment comprises several elements, including an obligation ...to refrain from taking arbitrary or discriminatory measures"(Award 2012 para. 7.74) but, on the other hand, independent of the FET, there exists the standard of prohibition of discriminatory measures (Award 2012 para. 7.154). Similar conclusion was reached in the case of *AES v. Hungary,* in which the Tribunal made a distinction between the FET and the prohibition of discriminatory

9 Along the same lines in the case of AMTO v. Ukraine, the Tribunal concluded that there is an obvious overlap between the FET and the prohibition of discrimination as contained in Article 10(1) ECT so „the result is that a claimant can plead that the same conduct breaches various obligations in Article 10(1) in circumstances where the content and relationship between these obligations is not clear"(Award 2008 para. 74).

treatment and decided to deal only with the discrimination as a separate standard of protection (Award 2010 para. 10.3.53).

This distinction seems so far the only theoretical since it is hard to imagine how a tribunal would be able to establish distinction in a specific case. It is to be expected that this element of the FET would not be used in the future practice of application of the ECT.

Proportionality

The principle of proportionality encompasses that "public measures must be appropriate for attaining the legitimate objectives pursued in the sense of not going beyond what is necessary to achieve these" (Jacob and Schill 2015: 736-737). When this principle is applied in international investment law "it implies that arbitral tribunals increasingly link fair and equitable treatment to the concepts of reasonableness and proportionality, controlling the extent to which interferences of host states with foreign investments are permitted" (Schill, S.W. and Kingsbury, B. 2011: 97).

While applying the ECT, many tribunals have determined the proportionality as one of the FET elements. The Tribunal in the case *AES v. Kazakhstan* concluded that

> *The claimants' claim for the breach of FET standard under Article 10(1) of the ECT ...is well-founded to the extent that, in view of their drastic character and extended duration, the restrictions...went beyond what could have been considered a proportional and reasonable response...and can therefore not be deemed to have been justified by the underlying policy (Award 2003 para. 433).*

Similarly, in the case *Charrane v. Spain* the Tribunal determined that the investor had the legitimate expectations that the state, when changing the existing legal framework, would not act, among others, unproportionately (Award 2016 para. 514).[10]

In the case of *Electrabel v. Hungary*, the Arbitral Tribunal defined the test which must be satisfied to regard a measure

10 The Tribunal considered that the criterion of proportionality is "satisfied as long as the changes are not capricious or unnecessary and do not amount to suddenly and unpredictably eliminate the essential characteristics of the existing regulatory framework" (Award 2016 para. 517).

as proportionate:

> *The test for proportionality has been developed from certain municipal administrative laws and requires the measure to be suitable to achieve a legitimate policy objective, necessary for that objective, and not excessive considering the relative weight of each interest involved (Award 2015 para. 179).*

The element of proportionality as an element of the FET is being used extensively in the practice of the application of the ECT and, due to the practice of other international tribunals and international courts, especially the ECHR and the ECJ, it is to be expected that its usage will expand further.

Transparency

Transparent information on how governments implement and change their legal framework dealing with foreign investments is one of the most important determinant in the investment decision (OECD 2006: 12). Transparency is closely related to the protection of the investor's legitimate expectations and thus with the FET (Dolzer and Scheuer 2012: 149) The arbitral tribunals gradually started to include transparency of the element of the FET as a part of „ both the definitions of the conditions of the legitimate expectations principle and its application to the particular facts of a specific situation (Yanaca-Small 2012: 122).

The Arbitral Tribunal when applying the ECT in the case of *Eiser v. Spain* determined that the transparency is part of the ECT's obligation to accord the FET (Award 2017 para. 379). Similarly, in the case of *Mamidoil v. Albania* the Tribunal also stated that a lack of transparency „may be considered unfair and unequitable (Award 2015 para. 599). The Tribunal in the case of *Electrabel v. Hungary* also concluded that the transparency was part of the obligation to provide the FET (Award 2015 para. 7.74).

Although tribunals unequivocally determined that the transparency is an element of FET standard of protection as accorded by the ECT, there were no decisions establishing the breach of the FET solely on this basis.

Most constant protection and security

Clauses which guarantee constant protection and security to foreign investors are the most common ones in IIAs (Lorz 2015: 764), but at the same time it is one of the least frequently applied standards of protection in arbitration practice (Cordero Moss 2012: 131). This standard contains two main obligations on the side of host state — a passive one, to absent from the interference with the rights of investor and the active one, to prevent attacks on investors and their property and, in the case those have happened, to punish responsible parties (Zeitler 2011: 183).[11]

The threshold for establishing that this standard has been violated is rather high and there is no strict liability on the part of the state but the obligation to act with due diligence[12] (Cordero Moss 2012: 139). There is also one unresolved issue in arbitral practice regarding the scope of this standard, namely does it relate only to physical security and protection or does it cover legal protection and security as well. It is undisputable that this standard grants physical protection but there are more and more decisions in arbitral practice to the effect that this standard requires legal protection[13] for investors as well (Dolzer and Scheuer 2012: 162-163).

While interpreting the ECT, Wälde (2004: 390) stated that there was the argument to view this standard as "encompassing more than a low-level standard of police protection in a merely physical sense of security and rather to link it to the "economics police"..., now more commonly termed as "economic regulatory powers of the State". A contrary position was taken by the Tribunal in the case *Liman v. Kazakhstan* — according to which the standard as envisioned by the ECT referred only to the

11 In the case of Saluka v. Check Republic, Partial Award, 2006, par. 483), the Tribunal defined that the standard „obliges the host state to adopt all reasonable measures to protect assets and property from threats or attacks which may target particularly foreigners or certain groups of foreigners".

12 Salacuse (2015:232) described the standard of due diligence as the situation when the host state „takes all the reasonable measures of protection that a well-administered government would take in a similar situation".

13 One of the logical reasons for including the legal protection in this standard as well was given by the Tribunal in the case of Siemens v. Argentina (Award 2007, para. 303): As a general matter and based on the definition of investment, which includes tangible and intangible assets, the Tribunal considers that the obligation to provide full protection and security is wider than "physical" protection and security. It is difficult to understand how the physical security of an intangible asset would be achieved.

physical security and protection (Award 2010 para. 289).

However, other tribunals when applying the ECT took the opposite position and, like e.g. the Tribunal in the case of *AES v. Hungary* concluded that this standard encompassed not only physical but also legal security and protection (Award 2010 para. 13.3.2). It also determined that the standard was not one of strict liability and it did not imply that a change in law affecting the investor's rights could take place, for this "would be practically the same as to recognizing the existence of a non-existent stability agreement as a consequence of the full protection and security standard" (Award 2010, para. 13.3.5).

In the case of *Electrabel v. Hungary* the Tribunal determined that the host state by promising full protection and security undertook obligation to "actively to create and maintain measures that promote security. The necessary measures must be capable of protecting the covered investment against adverse action by private persons" (Award 2010 para. 7.145). The Tribunal did not determine the scope of the standard but relied on the determination in the case of *El Paso v. Argentine*.[14]

Most tribunals applying the ECT took the position that this standard required not only a physical but also a legal protection and security. It is logical for the definition of investment in the ECT to be extremely broad and include not only tangible but also intangible property, intellectual rights etc. which cannot be protected physically. The only solution is to interpret this standard as providing not only physical, but also legal protection and security. If not interpreted in this way, many investments would be excluded from the protection of the ECT. The standard is not of strict liability, but it requires due diligence on the part of the host state.

14 El Paso v. Argentine (Award 2011, paras. 522-523): „A well-established aspect of the international standard of treatment is that States must use "due diligence" to prevent wrongful injuries to the person or property of aliens caused by third parties within their territory, and, if they did not succeed, exercise at least "due diligence" to punish such injuries. If a State fails to exercise due diligence to prevent or punish such injuries, it is responsible for this omission and is liable for the ensuing damage. It should be emphasized that the obligation to show "due diligence" does not mean that the State has to prevent each and every injury. Rather, the obligation is generally understood as requiring that the State take reasonable actions within its power to avoid injury when it is, or should be, aware that there is a risk of injury".

Unreasonable or discriminatory measures

Clauses protecting investors from unreasonable or discriminatory measures are part of the international minimum standard to be found in customary international law (Kriebaum 2015: 790-791) but also in many IIAs, including the ECT. Salacuse (2015: 273) describes three elements that must exist to establish the breach of this standard:

1. there must be a "measure";
2. such a measure must impair or negatively affect a protected investment;
3. the measure must possess the specified negative quality required by the treaty, that is, it must be arbitrary, discriminatory or reasonable.

The same position was taken by the Arbitral Tribunal in the case of *AES v. Hungary* which determined that the "Hungary was thus obliged to avoid any impairment of Claimants' investment as a consequence of either: (a) unreasonable or (b) discriminatory measures" (Award 2010 para. 10.3.2).

Unreasonable measures

Since there is usually no definition of „unreasonableness" in IIAs, many arbitral tribunals rely on the approach of the International Court of Justice (ICJ) in the ELSI case (Kriebaum 2015:798) which defined arbitrariness as „a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety" (Judgement 1989 para. 128) .

Scheuer (2009:188) suggested the measure could be considered as arbitrary if it:

- inflicts damage on the investor without serving any apparent legitimate purpose[15];
- is not based on legal standards but on discretion, prejudice, or personal preference;
- is taken for reasons that are different from those put forward by the decision-maker;

15 „The decisive criterion for the determination of the unreasonable or arbitrary nature of measure harming the investor would be whether it can be justified in terms of rational reasons that are related to the facts. Arbitrariness would be absent if the measure is reasonable and proportionate reaction to objectively verifiable circumstances"(Scheuer 2009: 188).

— is taken in wilful disregard of due process and proper procedure.

The ECT uses the term *unreasonable* while in other IIAs terms *arbitrary* and *unjustifiable* are used (Kriebaum 2015: 792-793). The practice of investment arbitral tribunals shows they took those two terms as synonyms. For example, the Arbitral Tribunal in the case of *Plama v. Bulgaria* concluded that "unreasonable or arbitrary measures - as they are sometimes referred to in other investment instruments, are those which are not founded in reason or fact but on caprice, prejudice or personal preference" (Award 2008 para. 184).

In the case of *AES v. Hungary*, the Arbitral Tribunal determined that it was necessary to analyse two elements to establish whether a state's measure had been unreasonable: "the existence of a rational policy[16] and the reasonableness[17] of the act of the state in relation to the policy" (Award 2010 par. 10.3.7). It is interesting that in this specific case the Tribunal concluded that the "so-called excessive profits may well give rise to legitimate reasons for governments to regulate or re-regulate" (Award 2010 10.3.34).

Discriminatory measures

IIA-s usually do not define the term discriminatory (Kriebaum 2015:801). It can occur in various ways, but in the context of foreign investments it is usually based on nationality (Dolzer and Scheuer 2012: 195).[18]

In application of the ECT, the Tribunal in the case of *Plama v. Bulgaria* defined discriminatory measured as those which treated foreign investors in a way opposite to equal treatment. „It entails like persons being treated in different manner

16 A rational policy is the one that is „taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter"(Award 2010 para. 10.3.8).

17 A reasonable policy is the one in which there is „an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented"(Award 2010 10.3.9).

18 The Tribunal in the case of Lemire v. Ukraine (Decision on Jurisdiction and Liability 2010. para. 261) described discrimination as something that „ requires more than different treatment. To amount to discrimination, a case must be treated differently from similar cases without justification; a measure must be "discriminatory and expose[s] the claimant to sectional or racial prejudice or a measure must "target[ed] Claimant's investments specifically as foreign investments".

in similar circumstances without reasonable or justifiable grounds" (Award 2008 para. 184).

According to Kriebaum (2015: 802), to establish whether a specific measure breaches the standard of prohibition of discrimination, the so-called triple test is often used: (1) basis for comparison; (2) specific measures affecting the investor must be established and (3) existence of factors that justify the difference in treatment.

In the case of *Nykomb v. Latvia* (Award 2003 para. 4.3.2) the Arbitral Tribunal determined that:

"In evaluating whether there is a discrimination in the sense of the Treaty one should only "compare like with like". Similar was the determination of the Tribunal in the case of *Electrabel v. Hungary* (Award 2010 para. 175), saying that for discriminatory treatment "comparators must be materially similar; and there must then be no reasonable justification for differential treatment".

In the case of *AES v. Hungary*, the Arbitral Tribunal concluded that "discrimination necessarily implies that the state benefited or harmed someone more in comparison with the generality" (Award 2010 10.3.53).

The arbitral tribunals in principle took position that the existence of discriminatory intent on the part of the state was not necessary for the measure to be discriminatory, e.g. the Tribunal in the case of *Electrabel v. Hungary* took a position that "discriminatory effects of the measures are sufficient to breach the prohibition. There is no need to prove discriminatory intent" (Award 2012 para. 7.152).

Although this standard of protection is often used in the practice of arbitral tribunals applying other IIAs, especially NAFTA, it has been rarely used in the practice of application of the ECT. One of the reasons could be the nature of investment in energy sector and the fact that the ECT is primarily used in cases involving the EU Member States in which there exist many other mechanisms that prevent discrimination of foreign investors.

Umbrella clause

An umbrella clause provides a guarantee that the host state will respect all obligations it has undertaken regarding foreign investors, it "allows investors to bring any claim for the breach of an investment-related promise made by the host State under the jurisdiction of a treaty-based tribunal " (Schill 2009: Abstract). Such a clause is called "umbrella" because it puts contractual rights under the "protective umbrella" of the investment treaties (Hobér 2008: 575). It has also been called a "mirror clause" and *pacta sunt servanda* clause (Wong 2006: 144). As Salacuse stated (2015: 306), the scope of the umbrella clause is to

> *in effect make the respect by host governments of all their commitments to investors a treaty obligation governed by international law and all disputes related to their failure to fulfil those commitments potentially subject to international arbitration.*

As Whitsitt and Bankes (2013: 234) describe, "umbrella clauses are particularly significant in those economic sectors (such as the energy sector) where there might be significant state involvement either as owner of the resource or as owners of significant facilities".

The umbrella clause from Article 10(1) of the ECT is considered one of the most extensive umbrella clauses in IIAs (De Brabandere 2014: 162). A definition of the scope of the umbrella clause in the ECT was given by the Swiss First Civil Law Court in the process of the annulment of arbitral Award in the case of *EDF v. Hungary:*

> *The umbrella clause puts the contract concluded by the investor with the host state directly under the protection of the bilateral or multilateral treaty protecting investments, with that treaty shielding the contract under its 'umbrella', so that any disregard of a contractual obligation will ipso facto also be a breach of an international commitment and the contract claims in connection with this may be invoked in the jurisdictional body foreseen by the treaty (Judgement 2015 para. 3.2.2).*

The Energy Charter Treaty Secretariat provided an opinion that the umbrella clause "covers any contract that a host country has concluded with a subsidiary of the foreign investor in the host country, or a contract between the host country and the parent company of the subsidiary" (ECT Secretariat 2002: 26). It was supported by the determination of the Tribunal in the case of *AMTO v. Ukraine* which defined that the umbrella clause of the ECT created a responsibility of the host state not only in respect of the direct investor but also vis-a-vis its subsidiary company if organized in that state (Award 2008 para.110).

In the case of *Khan v. Mongolia,* the Arbitral Tribunal recognized, through the application of the umbrella clause, the breach of the domestic law as the breach of the ECT. It means that when the host state breaches its own law, it simultaneously breaches the ECT and the investor can seek the protection of the ECT (Award 2015 para. 295).

In the case of *Liman v. Kazakhstan*, the Tribunal determined two elements in relation to the ECT's umbrella clause: (1) that the umbrella clause encompasses an "abstract unilateral promise by the state in its national legislation and particularly in its laws directed to foreign investors" (Award 2015 para. 458); (2) when applying the domestic laws, national courts are free in their decision and the umbrella clause cannot be applied for the court's decisions (Award 2015 para. 450)

The practice of application of the ECT has yet to take position regarding one of the most important issues concerning the umbrella clause, namely whether it encompasses only substantial issues (narrow approach) or jurisdictional as well (broad approach). To put it differently, can a foreign investor apply the umbrella clause from the ECT to get jurisdiction of some forum envisaged by the ECT but not by the commercial contract or other agreement? Although there is no decision regarding this issue, one would expect that the tribunals would take the position that it does cover jurisdictional issues as well, but only provided there is no specific provision saying otherwise in the basic contract. This expectation is based on a very broad content of the umbrella clause in the ECT, the so far practice of the application of the ECT and a tendency to provide investors with a wide spectrum of protection, and finally, on the arbitral practice of arbitral tribunals applying other IIAs.

National treatment

Almost all IIA-s contain national treatment (NT) provisions requiring host states to accord to foreign investors and their investments "treatment no less favourable than that accorded to their own investors and investments" (Reinsch 2015: 847). The rationale behind this standard is to ensure a degree of competitive equality between national and foreign investors (UNCTAD 1999: executive summary). The aim of this standard is to prevent host governments from undertaking various measures resulting in "negative differentiation between foreign and national investors... and thus to promote the position of the foreign investor to the level accorded to nationals (Dolzer and Scheur 2012: 198).

The practice of investment arbitration has developed a three-step test, the same as the one used for establishing whether discrimination occurred. Salacuse (2015: 277) described the test as follows:

> *The first step involves identifying a group of national investors to be compared with the claimant foreign investor. The second step is to compare the relative treatment the two groups have received and evaluate whether the treatment of the claimant is less favourable than that given to the compared group of national investors. The final step is to determine whether the two are...in "like circumstances" or whether factors justifying differential treatment exist.*[19]

The analysis of the practice of the Arbitral Tribunals applying the ECT shows that the standard of NT as defined in Article 10(7) of the ECT is rarely used and there is no award based on this standard. Foreign investors prefer to claim discriminatory treatment (breaches of Article 10(3) of the ECT). Since the same test applies for breaches of both standards, results are the same.

One of the reasons for such an approach is probably the reasoning of the Tribunal in the case of *Nykomb v. Latvia*. The Arbitral Tribunal established that Latvia breached its obligation not to discriminate a claimant, but then had refused to establish whether other standards had also been breached as

19 Similar e.g. in Dolzer and Scheuer (2012: 199), Bjorklund (2012: 37), Reinsch (2015: 856-866).

claimed (including the one of NT) because "in order to establish liability for the Republic it is strictly speaking sufficient to find that one of the relevant provisions has been violated" (Award 2003 para. 4.3.2).20

The Arbitral Tribunal in the case of *AES v. Hungary* applied the same test for establishing whether the prohibition of discrimination had been breached as for the standard of NT (Award 2010 para. 11.3.2) and concluded that breach of those standards "necessarily implies that the state benefited or harmed someone more in comparison with the generality" (Award 2010 para. 10.3.53).

Most favoured nation treatment

IIAs regularly contain a most favoured-nation (MFN) clauses (Reinisch 2015: 808). The purpose of MFN clauses is to "prevent host states from treating investors and investments of its treaty partners [other states members of the specific IIA] less favourably than investors from third countries" (Salacuse 2015: 280). It is important to emphasize that this standard does not require the standard of equal treatment but only the standard of "no less favourable" treatment.

The so far practice of the application of the ECT shows no cases in which this standard had been applied, except in the case of *AES v. Hungary* in which the Tribunal found no breach of the MFN clause. Since the alleged breach of the MFN treatment obligation has been based on the same facts as alleged discriminatory measure and the Tribunal has found no discriminatory measure, there has obviously been no breach of MFN treatment (Award 2010 para. 12.3.2).

The Arbitral Tribunal in the case of *Plama v. Bulgaria* considered the issue whether the MFN treatment applied to dispute settlement provisions or it only related to standards of protection. It concluded it could not apply to dispute settlement provisions because "an MFN provision in a basic treaty does not incorporate

20 It is interesting that prof Wälde as an expert witness (Legal Opinion para. 47) in Nykomb case predicted: "Discrimination ("national treatment") has again been largely dormant in the past, but has recently been revived vigorously as arbitral tribunals (and counsel) have discovered that behind many actions affecting foreign investors is some action of protectionist privilege in favor of domestic competitors capturing the political process".

by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them " (Decision on Jurisdiction 2005 para. 223).

Existence of effective means to assert the claims

The obligation of host states to ensure that their legal frameworks provide effective means for the assertion of claims and the enforcement of rights with respect to investments, investment agreements, and investment authorizations is contained in Article 10(12) of the ECT. This standard appeared in IIAs recently, mainly through BITs concluded with the USA (Haeri and Dağli 2016: 3). In order not to breach this standard, the host state must provide foreign investors not only with an appropriate institution (in principle court) before which they can protect their rights, but also it must provide them with effective means of enforcement of their rights.

This clause was used for the first time in investment arbitration practice in the case of *Petrobart v. Kyrgyzstan*. The Arbitral Tribunal did not define the scope of this standard but decided that direct governmental intervention into a specific court proceeding breached the obligation to provide effective means for the assertion of claims (Award 2005 para. 82).

In the case of *AMTO v. Ukraine*, the Arbitral Tribunal defined that the fundamental criterion for establishing the existence of effective means to assert the claim is an effective system for the protection of investor's rights, there must be "law and rule of the law":

> *An effective means of the assertion of claims and the enforcement of rights also requires secondary rules of procedure so that the principles and objectives of the legislation can be translated by the investor into effective action in the domestic tribunals (Award 2008 para. 87).*

The last publicly available arbitral award dealing with this standard was in the case of *Charanne v. Spain,* also in application of the ECT. The Arbitral Tribunal determined that "the standard of effective mechanisms as foreseen in Article 10(12) of the ECT requires States to provide a legal framework that guarantees

effective remedies to investors for realization and protection of their investments"(Award 2016 para. 470). The Tribunal also made one important conclusion regarding the "quality" of the standard and stated that it did not impose on a state how to organize its judicial system. It only required it had to be adequate and effective (Award 2026 para. 470).

The practice of applying the ECT is rather "revolutionary" in this regard since, according to public information, the very first and the last award based on this standard was in cases of application of the ECT. Thus, investment tribunals applying other IIAs extensively relied on the practice of application of the ECT. There are few important points taken by arbitral tribunals regarding this standard: (a) when deciding about possible breach of the standard. The Tribunals should consider the legal system as a whole, not only one isolated case or court decision; (b) the state must provide such a legal framework that provides investors with effective remedies for protection of their rights and (c) there is no universal standard how the state must organize its legal system, it only must be adequate and effective.

Conclusion

At the time of its signing, the ECT was the most advanced IIA regarding the scope of standards of protection of foreign investors and their investments. Part III of the ECT containing standards of protection, and Article 26 of the ECT containing the ways of protection themselves represent a kind of a separate investment treaty within the ECT. The following conclusions follow from the analysis of the arbitral practice of the application of standards of protection of the ECT. The ECT encompasses the results of the application of various bilateral investment treaties and NAFTA by arbitral tribunals. At the beginning of the application of the ECT, arbitral decisions were influenced by decisions and attitudes of arbitral tribunals applying other IIAs, but arbitral decisions applying the ECT gradually started to exert a greater influence at arbitral tribunals applying other IIAs.

The most frequently used standard of protection in the practice of the application of the ECT is definitely FET standard. So far, the following elements of the FET have been established:

(a) legitimate expectations; (b) stability of legal framework; (c) prohibition of discrimination; (d) proportionality and (e) transparency. The FET was defined by considering the practice under the ECT and the practice of tribunals under other investment treaties and by applying that definition on all the factual circumstances of each specific case. In establishing whether the FET was breached, the tribunals appraised the conduct of both the host state and of the investor and put them in balance by considering the overall situation in the host state. The most frequently used element of the FET in the practice of the application of the ECT are legitimate expectations.

Regarding the standard of most constant protection and security, most tribunals applying the ECT took the position that this standard required not only a physical, but also a legal protection and security. It is not a standard of strict liability, the state must act with due diligence in both prevention, and if that failed, then in repression against responsible persons. Also, the application of the standard of existence of effective means to assert the claims is very important for the ECT because that standard has been developed from the practice of the tribunals applying the ECT, and many tribunals applying other IIAs relied on this practice.

The practice of ECT tribunals regarding the scope and application of standards of protections of foreign investors and their investments became the integral part of the practice of international investment law. The ECT has recently become the most frequently invoked IIA before investment arbitrations. It is thus to be expected that its importance and influence will rise. Likewise, the nature of investments in energy sector with less "strategic" and huge investments and more and more medium and small investments results in the growth of arbitral cases. This is especially case regarding renewables and changes in regulatory framework happening in the EU in recent years.

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