

State Responsibility and Antitrust in the Energy Charter Treaty: Socialization vs. Liberalization in Bilateral Investment Relations

THEOCHARIS N. GRIGORIADIS*

This article analyzes state responsibility and antitrust as conflicting forces of investment protection under the Energy Charter Treaty (“ECT”). State responsibility is defined in Articles 22 and 23; it imposes a strict liability rule and reinforces the role of government in the conclusion of energy investment contracts. This phenomenon is what I call the socialization of bilateral investment relations. At the same time, Article 6 proposes antitrust as a normative commitment for all signatory parts; its goal is to advance energy sector liberalization in the ECT region. International arbitration (Article 26) is a much more effective dispute settlement mechanism than diplomatic negotiations (Article 27). Four state-investor disputes in the East European energy sector are used to model the interaction between state responsibility and antitrust (Matrix I). Bilateral investment relations are modeled on the distinction between open and closed markets in the case of German-Russian gas relations (Matrix II). Despite the radically different political environments in Germany and Russia, the calculus of the two governments vis-à-vis energy liberalization is the same: neither really believes in it. Thus, there is no dilemma between liberalization and socialization in energy market development. States have never been able to boost competition when they are part of the domestic market play; international economic agreements can.

Keywords: Energy Charter Treaty, state responsibility, antitrust, investment protection, socialization, liberalization, Germany, Russia, regulation

* Department of Political Science, University of California at Berkeley, 210 Barrows Hall, Berkeley, CA, 94720-1950, email: thgrigoriadis@berkeley.edu. For useful comments and suggestions, I am grateful to Guillermo Aguilar-Alvarez, M. Steven Fish, W. Michael Reisman and David J. Vogel. Responsibility for any errors remains with the author.

SUMMARY

| | | |
|------|--|----|
| I. | INTRODUCTION | 46 |
| II. | MULTIPLE INTERPRETATIONS OF STATE RESPONSIBILITY IN THE ENERGY CHARTER TREATY: FROM STATE TO SOCIETY, FROM PRODUCERS TO CONSUMERS..... | 49 |
| III. | OPEN AND CLOSED MARKETS IN THE GLOBAL ENERGY SECTOR: HORIZONTAL AND VERTICAL CONSTRAINTS IN THE ENERGY CHARTER TREATY | 52 |
| IV. | CONFLICTING HYPOTHESES AND RESEARCH DESIGN | 55 |
| | A. <i>Main Hypotheses</i> | 56 |
| | B. <i>Corollaries</i> | 56 |
| V. | DISCUSSION | 60 |
| VI. | APPENDIX | 63 |

I. INTRODUCTION

The Energy Charter Treaty (ECT) is a unique international investment agreement for many reasons. It is the first binding multilateral agreement covering the promotion and protection of foreign investment.¹ It is also the first to apply transit rules, which oblige its Contracting Parties to facilitate the transit of energy on a non-discriminatory basis consistent with the principle of freedom of transit.² This is a critical issue for the collective energy security of the Charter's Signatory states, because energy resources are increasingly being transported across multiple national boundaries on their way from producer to consumer. In addition, the ECT provides for international dispute settlement as a fundamental provision.³ Compared with the numerous Bilateral Investment Treaties and NAFTA, the ECT, as an industry-specific multilateral investment agreement, is distinct for the following reasons:

1. Extension of state liability to state-controlled enterprises, regulatory agencies, or legal entities, which have been connected with the government either *ex post* or since their establishment;⁴
2. Application of general antitrust principles with respect to either the nature of contracts or the abuse of a firm's dominant position in the market.

1. ENERGY CHARTER SECRETARIAT, THE ENERGY CHARTER TREATY: A READER'S GUIDE 10 (2002) available at http://www.encharter.org/fileadmin/user_upload/document/ECT_Guide_ENG.pdf [hereinafter ENERGY CHARTER READER'S GUIDE].

2. *Id.* at 10, 30.

3. *Id.* at 10.

4. Energy Charter Treaty art. 22, Dec. 17, 1994, 34 I.L.M. 397.

Examples of anticompetitive behavior include fixing purchase or selling prices, limiting production and investment, concluding contracts with irrelevant or unfavorable terms, or imposing a competitive disadvantage;⁵

3. Extension of the ECT investment protection provisions to third parties doing substantial business activities in the energy sector;⁶ and

4. Initiation of a compulsory arbitration mechanism, which can be triggered unilaterally by the investor.⁷

It is important to underscore the two-fold nature of the ECT: it is a multilateral investment agreement in its premises and a global administrative law mechanism in its redistributive effects.⁸ Contrary to other multilateral investment treaties or investment arbitration mechanisms, the ECT is confronted with the politically ambitious task of establishing market coordination criteria in energy and resources, the most heavily monopolized industrial sector.⁹ For that reason, it is unclear whether it will succeed toward both its administrative and multilateral investment ends. The observed clash between competitive and monopolistic structures in the ECT is critical for the evolution of my analysis. In Article 6, the ECT states that energy monopolies should be removed from the ECT markets; the purpose of the ECT is to advance competitive energy markets and reduce transaction costs for investors stemming from market failures and discrimination.¹⁰ In Article 22, the ECT renders the state responsible for contractual misconduct of state-controlled enterprises and regulatory authorities that constitute violations of the ECT.¹¹ Where the government is the major shareholder, the state is held accountable for management decisions of both public enterprises and private firms. This is also the case for the decisions of independent administrative agencies.

International energy law has not yet proved to be an effective instrument for regulatory harmonization across states with different administrative traditions and economic organization.¹² Despite its clear reference to antitrust provisions, the weak enforceability of its antitrust classes reveals that the ECT is not strongly committed to competitive energy markets.¹³ Although amplified government liability is not

5. *Id.* at art. 6.

6. *Id.* at art. 17 para. 1.

7. *Id.* at art. 26.

8. Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L LAW 121, 123–25 (2006). See Justin R. Marles, *Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law*, J. TRANSNAT'L L. & POL'Y 275, 277 (stating that the ECT is an international investment treaty with redistributive effects).

9. Energy Charter Secretariat, Energy Charter FAQ, "Why an Energy Charter?," <http://www.encharter.org/index.php?id=18> (last visited, Jan. 26, 2009). See Richard Bradley, *Over the River and (Around) the Woods to Grandma's House We Go: Long-Term Firm Transmission Rights, Transmission Market Power, & Gaming Strategies in a Deregulated Energy Market—An International Comparison*, 30 HOUS. J. INT'L L. 327, 387 (2008) (describing the monopolization of the European electricity market).

10. Energy Charter Treaty, *supra* note 4, at art. 6.

11. *Id.* at art. 22.

12. See Yinka O. Omorogbe, *Promoting Sustainable Development Through the Use of Renewable Energy: The Role of Law*, in BEYOND THE CARBON ECONOMY: ENERGY LAW IN TRANSITION 47–48 (Donald N. Zillman et al. eds., 2008) (stating that national strategies have only paid lip service to integrating energy policy internationally).

13. Article 27(1) (diplomatic negotiations), as opposed to Article 26 (international arbitration), is the

connected with the development of competitive structures in the domestic energy markets, an alternative analysis is proposed. In the Former Soviet Union (“FSU”) and the majority of the EU, member-states’ energy ownership is regulated directly or indirectly by the government.¹⁴ Thus, in order to increase the level of investment protection, the ECT requires contracting governments to pay compensation to energy investors whose rights were violated by a state or quasi-state agency.¹⁵ I argue that this clause contradicts the antitrust provisions mentioned above. If investors contracting with public enterprises enjoy a higher level of certainty because they can receive government compensation, then there is no reason for a foreign investor to contract with a non-state energy company, if he has the option. As the *Nykomb* case has shown, dispute resolution for the state liability established in Article 22 takes place under Article 26 (international arbitration).¹⁶

This antithetical set of incentives forms one of the two analytical axes in my article Article 22 motivates the governments to privatize the energy sector while incentivizing energy multinationals to support monopoly structures in the countries where they invest. The weak enforceability of antitrust clauses raises the interesting question of whether the ECT is a credible international treaty under which operation can depoliticize the structure of energy markets both in the EU and the FSU without a strong antitrust agency. This last observation lies more on positive rather than normative grounds. If the state owned a small share of the energy market, Article 22 may not necessarily clash with Article 6. The ECT’s primary objective is to consolidate Eurasian energy security and form common grounds for international investment practices that are able to place serious legal delimitations on arbitrary domestic transfers of property rights in the East European and Eurasian energy sectors.¹⁷ Given that the energy sector is not likely to become competitive in the near future,¹⁸ the definition of public energy enterprises contained in Article 22 is significant in predicting the ECT’s impact on domestic energy markets.

The article is organized as follows. In Section II, I propose multiple interpretations of state responsibility under the ECT. In Section III, I discuss open and closed energy markets in the form of vertical and horizontal constraints on the ECT. In Section IV, I model the interaction between state responsibility and antitrust and German-Russian energy investment relations. In Section V, I discuss my findings and conclude that international arbitration and state ownership are the two leading trends in energy market development under the ECT.

exclusive means of resolving any disputes that may arise under Article 6 (competition).

14. HANS BJORNSSON, ROBERT CROW & HILLARD HUNTINGTON, INTERNATIONAL COMPARISONS OF ELECTRICITY RESTRUCTURING: CONSIDERATIONS FOR JAPAN 44–45 (2004); Jason M. Waltrip, Note, *The Russian Oil and Gas Industry After Yuoks: Outlook for Foreign Investment*, 17 TRANSNAT’L L. & CONTEMP. PROBS. 575, 598–600 (2008).

15. Energy Charter Treaty, *supra* note 4, at art. 12.

16. *Nykomb Synergetics Tech. Holding AB v. Latvia*, Award, § 2.1 (Arb. Inst. of the Stockholm Chamber of Com. Dec. 16, 2003), 2003 WL 24045555 (APPAWD), available at http://www.encharter.org/fileadmin/user_upload/document/Nykomb.pdf.

17. ENERGY CHARTER SECRETARIAT, THE ENERGY CHARTER TREATY AND RELATED DOCUMENTS, 13–14 (2004), available at http://www.encharter.org/fileadmin/user_upload/document/EN.pdf. See also Andre Mernier, Secretary General, Energy Charter Secretariat, Speech to Forum Istanbul 2007 (July 5, 2007) (discussing the effect of the ECT on Eurasia), available at http://www.encharter.org/index.php?id=59&id_article=108&L=0.

18. See *Communication From the Commission, Inquiry Pursuant to Article 17 of Regulation (EC) No 1/2003 Into the European Gas and Electricity Sectors*, at 2, COM (2006) 851 final (Oct. 1, 2007) (stating that European gas and electricity markets have yet to open up to competition).

II. MULTIPLE INTERPRETATIONS OF STATE RESPONSIBILITY IN THE ENERGY CHARTER TREATY: FROM STATE TO SOCIETY, FROM PRODUCERS TO CONSUMERS

The two-fold definition of state responsibility suggested by the ECT is both hierarchical and horizontal.¹⁹ The definition covers multiple levels of administrative organizations, and at the same time it is extended to non-state actors (corporations) that are owned or privileged by the government.²⁰ There is certainly substantial cross-jurisdictional variation in the treatment of state responsibility by the ECT signatory states.²¹ Enforcement of national or supranational state liability is contingent upon the intensity of the rule of law and democratic structures in a given state.²² We have been observing a continuous expansion of the state liability doctrine in recent years; the government is not only held accountable vis-à-vis the individual for failing to enforce the law, but also for implementing legislation against a hierarchically superior set of rules (international or European Community law) and failing to enforce a judicial decision.²³ Under the European Community (“EC”) system, article 292, article 228, and article 7 of the European Community Treaty²⁴ as well as the ruling of the European Court of Justice in the *Frankovich* case have formed the legal grounds for the analysis of international responsibility regimes for EC member states.²⁵ Comparing the normative effects of the ECT with the respective institutional constraints imposed by the EC rules, there is no doubt that countries that are both EC member-states and ECT signatories are more likely to be held liable for EC law rather than ECT breaches.

Therefore, that lack of enforcement by a public judicial institution contributes to ECT’s problematic policy effectiveness and political legitimacy.²⁶ It can be argued that ECT establishes a distinct form of strict liability for states that receive foreign energy investment in their territory. A teleological interpretation of Articles 22 and

19. See ENERGY CHARTER READER’S GUIDE, *supra* note 1, at 36, 39–41 (stating that the ECT requires responsibility for actions taken by nations, sub-national groups, and non-state actors (e.g., government controlled corporations)).

20. Thomas W. Waelde & Patricia K. Wouters, *State Responsibility and the Energy Charter Treaty: The Rules Regarding State Enterprises, Entities and Sub-national Authorities*, 2 HOFSTRA L. & POL’Y SYMP. 117, 117–18 (1997).

21. See, Symposium, *The ILC’s State Responsibility Articles*, 96 AM. J. INT’L L. 773, 773 (2002) (stating that state responsibility is a topic of legal confusion and uncertainty).

22. See George W. Downs, David M. Rocke & Peter N. Barsoom, *Is the Good News About Compliance the Good News About Cooperation?*, 50 INT’L ORG. 379, 388 (1996) (stating that violations of international agreements stem from a combination of “ambiguity of treaties, the capacity limitations of states, and uncontrollable social and economic changes”).

23. Daniel J. Meltzer, *Member State Liability in Europe and the United States*, 4 INT’L J. CONST. L. 39, 43 (2006). *But see generally* Andrea Ott, *Case Law: Deutscher Handballbund EV v. Maros Kolpak, Case C-438/00, 2003 E.C.R. I-4135*, 10 COLUM. J. EUR. L. 379 (2004) (stating that the increase in state liability has been uncertain); Pablo Martin Rodriguez, *State Liability for Judicial Acts in European Community Law: The Conceptual Weaknesses of the Functional Approach*, 11 COLUM. J. EUR. L. 605 (2005) (arguing that state liability has been reduced).

24. Gerard Conway, *Breaches of EC Law and the International Responsibility of the Member States*, 13 EUR. J. INT’L L. 679, 686–89, 688 n.38–39 (2002).

25. Joined Cases C-6/90 and C-9/91, *Frankovich v. Italy*, 1991 E.C.R. I-5357.

26. See Luigi Pellizzoni, *Responsibility and Environmental Governance*, 13: 3 ENVTL. POL. 541, 542–44 (2004) (discussing what is meant by political effectiveness and legitimacy, and stating that without accountability, there will be no legitimacy).

23 of the ECT leads to the observation that states and their horizontal or vertical extensions are institutionally interconnected by the principal-agent model. This last analytical framework represents the international legislator's intention when designing these two ECT articles. The four-tier state responsibility, which is proposed in the field of environmental governance, can hardly be applied in the context of global energy governance.²⁷ This occurs because the Energy Charter constitutes an international regime, as opposed to a domestic legal regime, with major enforceability constraints. Furthermore, it is obvious that the ECT suffers from two crucial biases, one normative and the other empirical: (1) fair and free competition principles have to be expanded in the post-socialist world and ECT has to be a first decisive step in that direction; and (2) the state has been, and continues to be, the main source of ownership, and hence institutional distortion, for all potential private investors that want to enter East European and Eurasian energy economies.²⁸

The increased public character of post-communist energy ownership raises considerations about the regulatory role of the state, which has to be held accountable in civil rather than administrative law terms. This is the interesting part in the ECT's innovative state liability rule, a dual nature derived from the premises of both international civil litigation and the regulatory state.²⁹ That may imply that the ECT aims to incentivize energy-rich states to take precautionary restructuring measures *ex ante* rather than pay fines imposed by arbitral awards *ex post*. The double character of *ex post* arbitral regulation—administrative in redistribution of public resources and private in institutional format—shows how fluid the boundaries are between private adjudication and public welfare in state-investor disputes. Although a breach of an energy investment contract by a state authority does not have the social harm consequences of a state violation of greenhouse gas emissions, it can be argued that an extension of stricter provisions into the energy sphere followed by a subsequent *socialization* of energy investment could also be seen as a step toward increasing state responsibility.³⁰

The imposition of this liability norm on such a socially, legally, and economically diverse space poses a critical challenge for ECT drafters and ECT signatories. Comparative evidence from pollution liability and compensation indicates that a country with a leading role in an industrial sector can maintain its own liability system, despite its differentiation from international norms.³¹ Thus, it can be expected that Russia's current persistence not to incorporate the ECT into its domestic law will continue due to its leading position in oil and gas extraction and export. It seems that regulatory competition across jurisdictions and the transnational dimension of the state liability clause determine the observed enduring dichotomy between the advanced capitalist and the post-communist world

27. See *id.* at 549–51 (discussing the four-tier model of state responsibility).

28. See Waelde & Wouters, *supra* note 20, at 127–31 (discussing the ECT's innovations regarding state liability).

29. Edward L. Glaeser & Andrei Shleifer, *The Rise of the Regulatory State*, 41 J. ECON. LITERATURE 401, 402–08, 411–18 (2008).

30. Richard S.J. Tol & Roda Verheyen, *State Responsibility and Compensation for Climate Change Damages—a Legal and Economic Assessment*, 32 ENERGY POL'Y 1109, 1111–16 (2004).

31. See Inho Kim, *A Comparison Between the International and US Regimes Regulating Oil Pollution Liability and Compensation*, 27 MARINE POL'Y 265, 273 (2003) (arguing that the United States is an example of this idea).

comprising the ECT area.³² This is why the *socialization* argument derived from the environmental liability literature can justify the direct effect of an arbitral award on similar energy investment disputes under the ECT. Concluded and projected energy contracts usually entail an EU-based investor and a former Soviet country with a state-regulated sector. Contracts signed between European corporations on the one hand, and Gazprom, Russia's state-controlled gas monopoly, on the other, were negotiated bilaterally between the respective companies and the Russian government.³³ Nevertheless, the ECT liability clause should not be seen as a mere institutional effort by the international community to reduce the Kremlin's control over Russia's strategic resources.³⁴ On the contrary, it rationalizes foreign energy investment in Russia and increases the probability of availability for exportable gas supplies to Western Europe and East Asia.³⁵

It is true that EU member states, with the exception of France and some other smaller European economies, have privatized energy sectors.³⁶ The 2004 inclusion of East Central Europe into the EU rendered the ECT state-liability debate important for the EU, since many East Central European economies have had state-controlled energy sectors.³⁷ Thus, the ECT could internationalize what would otherwise have been an absolutely domestic EU economic dispute likely to be adjudicated by the ECJ. The ECT intends to safeguard the interests of both entrepreneurs and consumers against state arbitrariness, while preventing cartel practices between state-owned companies and foreign investors to the detriment of consumers.³⁸ My analysis of energy investment protection through the state liability clause underscores the crucial social dimension of energy development in the former communist world. At the same time, it provides a conceptual basis for the perpetuation of state dominance in the ownership structures of the East European and Eurasian energy sectors.

32. DANIEL W. DREZNER, ALL POLITICS IS GLOBAL: EXPLAINING INTERNATIONAL REGULATORY REGIMES 75–88 (2007) (explaining the “club standard,” where powerful states rely on club IGOs to create different enforcement mechanisms rather than having a universal membership IGO and thus achieve lower adjustment costs).

33. See Dominique Finon & Catherine Locatelli, *Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?*, 36 ENERGY POL. 423, 430 (2008) (discussing the lopsided contract terms between Russia and E.ON, BASF, and ENI), available at http://www.sciencedirect.com/science?_ob=MIimg&_imagekey=B6V2W-4R2HKV9-1-1&_cdi=5713&_user=108429&_orig=search&_coverDate=01%2F31%2F2008&_sk=999639998&view=c&wchp=dGLbVlb-zSkWb&md5=1626d3afc8dfd7cac4f832e8a93e348f&ie=/sdatarticle.pdf.

34. LANGENOHL & WESTPHAL, COMPARING AND INTER-RELATING THE EUROPEAN UNION AND THE RUSSIAN FEDERATION 67 (2006), available at <http://www.uni-giessen.de/zeu/Papers/DiscPap%20%2330.pdf>.

35. Thomas W. Waelde, *International Energy Investment*, 17 ENERGY L.J. 191, 212–14 (1996).

36. ENERGY INFO. ADMIN, U.S. DEP'T OF ENERGY, PRIVATIZATION AND THE GLOBALIZATION OF ENERGY MARKETS 46 (1996).

37. *Id.* at 28.

38. See Craig Bamberger et al., *The Energy Charter Treaty*, in ENERGY LAW IN EUROPE: NATIONAL, EU AND INTERNATIONAL LAW AND INSTITUTIONS 171, 177, 209 (Martha M. Roggenkamp et al. eds., 2001) (explaining that the ECT extends protection to investors from ‘unreasonable or discriminatory measures’ and also places special responsibilities on states and private enterprises with a dominant market position).

III. OPEN AND CLOSED MARKETS IN THE GLOBAL ENERGY SECTOR: HORIZONTAL AND VERTICAL CONSTRAINTS IN THE ENERGY CHARTER TREATY

The ECT antitrust clause in Article 6 constitutes a verbal commitment of the ECT signatory parties to the principles of free and fair competition.³⁹ Given the critical role of EC competition law in the formation of the Single European market, it is reasonable to hypothesize that global energy markets will be transformed from a fragmented to a coordinated economic space only when competition rules across different jurisdictions are harmonized and defined by comparable monitoring institutions, normalized pricing, and adequate foreign investment laws that adhere both to WTO principles and EC competition law. Russia's partial adoption of ECT requirements through the introduction of the 1999 Law on Foreign Investment and the Federal Amendment to the Law of Subsoil in 2000 signaled the Kremlin's intention to attract foreign investment in the energy sector in order to advance Russia's export potential and innovate its deteriorating industrial infrastructure.⁴⁰ Nevertheless, these legal developments constrained only marginally administrative barriers imposed on potential foreign investors with respect to the conclusion of Production-Sharing Agreements (PSA); since the early 2000s the new semi-authoritarian form of government in Russia has opted for a restrictive set of legal and economic reforms in the exploitation and management of the country's strategic energy resources.⁴¹ This reality in combination with the slow implementation of the Gas and Electricity Directives, particularly in the antitrust field, preserve the monopoly status of incumbent firms in European and post-Soviet markets.⁴² The European Commission's recent legislative initiatives have managed to maintain the dominant market positions of national champions in France, Germany, and Britain (such as Gaz de France, E.ON/Ruhrgas, and British Gas, respectively), independently of their ownership status, public or private.⁴³

The intensity of cross-nationally observed administrative barriers is not the main distortion to the proclaimed principle of antitrust under the auspices of the ECT. Policy discourse on energy antitrust is defined both in terms of state sovereignty (vertical constraint) and domestic energy business competition (horizontal constraint). The role of the state in both dimensions is critical. There is a severe disharmony between what the ECT requires and what the Russian law on Production-Sharing Agreements states; although the latter entails a credible

39. ENERGY CHARTER READER'S GUIDE, *supra* note 1, at 46–47.

40. Arina Shulga, *Foreign Investment in Russia's Oil and Gas: Legal Framework and Lessons for the Future*, 22 U. PA. J. INT'L ECON. L. 1067, 1088–89 (2001). See generally Yuri Grigoryev, *The Russian Gas Industry, Its Legal Structures and Its Influences on World Markets*, 28 ENERGY L.J. 125.

41. *Id.* at 129.

42. See *id.* at 130–31 (explaining that foreign investors argue that the PSAs are simply a mechanism to increase the Russian firms' competitive advantages in the market); Alexander J. Black, *Direct Sales of Gas in the European Community*, 1 TULSA J. INT'L & COMP. L. 119, 128–33 (discussing gas-related directives implemented by the European Commission).

43. See Fabio Domanico, *Concentration in the European Electricity Industry: The Internal Market as Solution?*, 35 ENERGY POL'Y 5064, 5068–69 (2007) (describing recent mergers that illustrate government intervention in creating a dominant "national champion").

provision for international arbitration in case of contract violation,⁴⁴ no multinational with serious intentions of advancing its business activities in Russia in the long-run would ever bring the Russian Ministry of Economy or Energy Resources in front of an international arbitral venue.⁴⁵ Thus, state sovereignty proved to be the main vertical impediment to competitive investment, free entry, and transparent administrative institutions that oversee the market development and expansion process. Despite its profound commitment to the principles of national treatment and most-favored nation, the ECT implies that the state remains the final proprietor of the natural resources located in its territory.⁴⁶ The ECT provides a large variety of exceptions in the fields of privatization, continental shelf exploitation, registration, and screening, as well as land and real estate; the formal percentage limits of foreign participation for RAO UESR (25%) and Gazprom (20%) demonstrate that the state is the common denominator of all energy ownership and investment decisions.⁴⁷ The more strategic an energy market is, the higher the percentage of state ownership in that sector will be. While the Russian government has expressed its willingness to adopt those regulatory standards that will facilitate its integration to global energy markets, it seems that it is inclined to do so without undermining its supremacy vis-à-vis its foreign competitors, both in the interior and the exterior level of its business transactions.⁴⁸

The EU energy sector does not experience the same state sovereignty challenge that Russian energy markets do, because the EU energy sector simply does not account for a substantial component of global oil and gas production.⁴⁹ And unlike Russia, market distortions generated by the state are horizontal rather than vertical.⁵⁰ The energy debate in Western Europe is not focused on the capacity of the state to own energy fields and infrastructure in order to pursue its economic

44. Giuditta Cordero Moss, *Contract or License? Regulation of Petroleum Investment in Russia and Foreign Legal Advice*, 13 *TRANSNAT'L L. & CONTEMP. PROBS.* 519, 528 (2003).

45. See Mark A. Stolson, *Investment at an Impasse: Russia's Production-Sharing Agreement Law and the Continuing Barriers to Petroleum Investment in Russia*, 7 *DUKE J. COMP. & INT'L L.* 671, 686 (1997) (discussing the impotence of arbitration clauses in Russian Production-Sharing Agreements).

46. Energy Charter Treaty, *supra* note 4, art. 18. See also ENERGY CHARTER SECRETARIAT, *THE BLUE BOOK: MAKING INVESTMENTS IN ENERGY CHARTER MEMBER COUNTRIES: EXCEPTIONS TO THE PRINCIPLE OF NON-DISCRIMINATORY TREATMENT 71-72* (2007) (stating that Russian control over gas supply limits foreign ownership to 20%), available at http://www.encharter.org/fileadmin/user_upload/document/Blue_Book_ENG.pdf [hereinafter BLUE BOOK].

47. BLUE BOOK, *supra* note 46, at 5, 57, 72. UNITED STATES TRADE REPRESENTATIVE, 2004 NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS 413 (2004), available at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_National_Trade_Estimate/2004_NTE_Report/asset_upload_file202_4794.pdf.

48. See ENERGY CHARTER SECRETARIAT, *RUSSIAN FEDERATION: REVIEW OF THE INVESTMENT CLIMATE AND MARKET STRUCTURE IN THE ENERGY SECTOR 45-46* (2004) (discussing the maintenance of government supremacy through the use of foreign investment oversight and PSA caps), available at http://www.encharter.org/fileadmin/user_upload/document/Investment_-_Russia_-_2004_-_ENG.pdf.

49. See BRITISH PETROLEUM, *BP STATISTICAL REVIEW OF WORLD ENERGY 2008*, 8, 24 (2008) (listing statistics for the production of oil and natural gas in Europe and Russia), available at http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/downloads/pdf/statistical_review_of_world_energy_full_review_2008.pdf.

50. Vladimir Milov, *The EU-Russia Energy Dialogue: Competition Versus Monopolies*, *RUSSIE.NEI.VISIONS*, No. 13, at 4 (2006), http://www.ifri.org/files/Russie/ifri_milov_energie_sept2006_eng.pdf.

interests against antitrust principles; it is concentrated instead on the indirect and anti-competitive regulatory sponsoring of certain multinationals by their home government.⁵¹ State ownership is not at the epicenter of this debate. The inherent contradictions of the ECT become obvious at this point. In the previous section of this article, I argued that the reinforcement of social purpose in energy investment would justify the increase of state liability levels for public companies failing to fulfill their obligations. In this section, I discuss how state sovereignty over energy resources generates increased state ownership in the energy sector, which is a vertical distortion against the formation of global energy antitrust. Russia, as expected, stands out as the main country of reference in the post-socialist region.⁵²

It is true that the state-sovereignty doctrine allows Russia, and any other country with a state-owned energy sector, to fully or partially reverse the conditions of an investment contract if it considers the conditions to be detrimental (ex post) to its energy security.⁵³ This increases investment risk for foreign—mainly European—investors and facilitates the exclusive implementation of large-scale projects by multinationals that maintain a dominant position in their home markets.⁵⁴ Consequently, national monopolies across the ECT region become even stronger and the entry opportunities of potential contenders are minimized; as empirical information has shown, market participation has been possible for independent producers, but it has been characterized by a limited profit horizon due to the transmission tariffs that they have to pay the state pipeline monopoly.⁵⁵ Thus, the rationalization of East-West energy trade occurs through the reinforcement of monopoly structures across the continent, which is the exact opposite of what the ECT has been aiming to achieve.⁵⁶ Energy regulatory initiatives at the EU level were intended to largely alleviate antitrust distortions originating from corporate actors, not from the state.⁵⁷ The 2003 European Community directives on gas and electricity liberalization strengthened the position of independent regulators, separated transmission from distribution, and introduced regulated third party access.⁵⁸ Despite the proclaimed goal of liberalization, vested energy business interests, instead of regulators, define who enters and who exits any national energy market. The standard rhetoric on the positive welfare effects of price liberalization on consumers does not hold in markets that have no potential of shifting from their

51. Joseph A. Stanislaw, *Energy Competition or Cooperation: Shifting the Paradigm* (discussing the need for cooperation and common regulation in Europe's energy sector), available at <http://usinfo.state.gov/journals/ites/0504/ijee/stanislaw.htm>.

52. Milov, *supra* note 50, at 5–6.

53. Thomas W. Wälde & Martin Friedrich, Introductory Note to *Russian Federation: Law on Production Sharing Agreements*, Dec. 30, 1995, 35 I.L.M. 1251, 1270–71 (1996).

54. For example, European-based multinationals such as Elf, E.ON/Ruhrgas, ENI, OMV, BP.

55. See Berit Tennbakk, *Power Trade and Competition in Northern Europe*, 28 ENERGY POL'Y 857, 859 (2000) (arguing that monopoly pricing and transmission tariffs limit opportunities for independent companies).

56. Kapa Sodupe & Eduardo Benito, *Pan-European Energy Co-Operation: Opportunities, Limitations, and Security of Supply to the EU*, 39 J. COMMON MKT. STUD. 172–74 (2001).

57. See NICHOLAS JABKO, *THE REFORM OF ENERGY REGULATION IN THE EU: THE MARKET AS A NORM* 29–30 (2005) (explaining that the goal of some sub-state organizations that supported the European Commission's liberalization agenda was to find ways to increase bargaining power over the monopolistic utilities).

58. Council Directive, 2003/54, arts. 10, 15, 20, 23, 2003 O.J. (L 176) 37, 45–50 [hereinafter Council, Electricity]; Council Directive 2003/55, arts. 9, 13, 18, 25, 2003 O.J. (L 176) 57, 64–65, 67, 70–71 (EC) [hereinafter Council, Natural Gas].

monopoly or oligopoly status.⁵⁹ The same phenomenon is observed in the elimination of barriers across the EU member states in terms of market entry and investment.⁶⁰ France has only recently started to adjust due to its publicly owned gas and electricity sector, while Germany has already conformed to both directives from a legal standpoint.⁶¹

Nevertheless, Europe has experienced a concentration in its gas and electricity markets; liberalization is a bargaining process among a limited number of monopolists or oligopolists.⁶² This demonstrates that neither the ECT nor EC energy law solve the governance problem that pervades the EU energy sector.⁶³ As Helm points out, and as I analyze below, the German Cartel Office allowed the merger of Ruhrgas with E.ON to maintain a long-term public interest goal: the security of energy supplies.⁶⁴ This is an example of state regulation buying energy resources at the expense of domestic competition.⁶⁵ Energy integration has focused less on advancing competitive structures within the Community market and more on implementing network interconnection among national gas and electricity markets with differentiated sets of infrastructure. Hence, it is reasonable to conclude that what has not occurred at the EC level is very unlikely to be successful at the international level. If the EU itself can not resolve its main energy antitrust problems, how will it use the ECT in order to transplant its legal and policy practices to Russia?⁶⁶ The formation of global energy antitrust structures is likely to be obstructed by powerful business-government coalitions. These coalitions do not want to move from a status quo that allows them to split monopoly rents and to use security of supplies to preserve the managerial and electoral aspects of their positions.

IV. CONFLICTING HYPOTHESES AND RESEARCH DESIGN

The theoretical analysis presented above leads us to the following contradictory set of hypotheses:

59. See Ana-Maria Boromisa, *Energy Trade in Europe: Competition and Regulation in View of the EU Enlargement* 3–7 (Sept. 6, 2002 draft paper prepared for the Fourth Annual Conference of European Trade Study Group, Kiel, Sept. 13–15, 2002) (comparing the implementation and effects of competition and regulation).

60. Council, Electricity, *supra* note 58, at 42–43; Council, Natural Gas, *supra* note 58 at 62.

61. Magdalena A. K. Muir, *European Energy Liberalization and the Integration of Eastern Europe With EU Energy Markets and Environmental Initiatives* 4 (written remarks prepared for the ENERGEX 2002 Conference, Krakow, Poland, May 19–24, 2002).

62. Dieter Helm, *The Assessment: European Networks—Competition, Interconnection, and Regulation*, 17 OXFORD REV. OF ECON. POL'Y 297, 310 (2001).

63. See Aurelia Mane-Estrada, *European Energy Security: Towards the Creation of the Geo-Energy Space*, 34 ENERGY POL'Y 3773, 3781–85 (2006) (arguing that national interests have prevented the development of a pan-European energy market).

64. Helm, *supra* note 62, at 3065–89.

65. *Id.*

66. See Muir, *supra* note 61, at 5 (describing the EU's failure to establish an internal energy taxation system).

A. Main Hypotheses

H1: *State responsibility under the ECT advances the role of the central government and state agencies or enterprises in attracting foreign direct investment in their national energy sector.*

H2: *Antitrust regulation under the ECT intends to constrain state ownership in the energy sector and facilitate market access to new entrants.*

B. Corollaries

C1: *State ownership in the energy sector has the potential to socialize energy investment and link it to broader consumer-welfare objectives.*

C2: *State sovereignty rules and incumbent energy monopolies constitute the two respective sets of vertical and horizontal constraints to the formation of global energy antitrust under the ECT.*

There are a limited number of cases that have been adjudicated based on the ECT⁶⁷ (See Table 1 in the Appendix). To show how the aforementioned set of hypotheses and corollaries interacts with international arbitration developments in the field of foreign energy investment in Eastern Europe, I suggest the following two-by-two matrix where state responsibility forms the first axis of analysis and antitrust regulation forms the second axis. I divide state responsibility into two conceptual categories: (1) state liability due to a direct or indirect action by the central government; and (2) state liability due to a direct or indirect action by a state agency or a state-owned enterprise. I also divide antitrust regulation into two clusters: (1) state sovereignty, which generates vertical constraints on foreign energy investment; and (2) monopoly structures, which create horizontal constraints on foreign energy investment by resisting market liberalization and, therefore, legal reform.

Matrix 1

| Antitrust Regulation → | State Sovereignty → Vertical Constraints (High) | Monopoly Structures → Horizontal Constraints (Low) |
|----------------------------------|---|--|
| State Responsibility ↓ | | |
| Central Government (High) | <i>Petrobart Ltd. v. Kyrgyz Republic</i> | <i>Plama v. Bulgaria</i> |
| State Agency/Enterprise (Low) | <i>Generation Ukraine, Inc. v. Ukraine</i> | <i>Nykomb Synergetics v. Latvia</i> |

67. See Appendix, Table 1.

The choice of the four arbitral awards, which are used to operationalize my theory, is not incidental. Observe that *Petrobart Ltd. v. Kyrgyz Republic* is in the upper left entry (High, High).⁶⁸ The active involvement of the Kyrgyz government in the restructuring of KGM, the country's gas monopoly, made the company unable to pay its debts to Petrobart and therefore liable under Article 22 of the ECT.⁶⁹ It may be argued that Article 22 is used as an ancillary rule in addition to the violations of Article 10, paragraphs 1 and 12.⁷⁰ The Kyrgyz government failed to treat Petrobart's investment in accordance with the principle of MFN treatment and did not provide the investor with an adequate set of domestic remedies for the effective pursuit of its legal claims.⁷¹ It becomes evident why I assigned the value High to state responsibility caused by an action of the central government: when the central government itself breaches its contractual obligations, there is no need for an intermediary principal-agent model to delineate the causal chain of the dispute between the state and the investor. I assign the value High to the principle of state sovereignty as a vertical and thus, more intense constraint of antitrust rules. Hence, I contend that state sovereignty is implied in the economic logic and the restructuring measures undertaken by the Kyrgyz government for KGM. These restructuring measures can be interpreted as a legislative expression of what constitutes the state's final right to intervene and shape the management of its natural resources.

Plama v. Bulgaria is located in the upper right entry (High, Low).⁷² I chose the value Low for monopoly structures that create horizontal constraints to antitrust regulation in the ECT area. The value variation between state sovereignty and monopoly structures is explained by the level of state intervention that they require. In that respect, I assign a higher value to state sovereignty than monopoly structure. In *Plama v. Bulgaria* there was no adjudication based on Articles 22 and 23. The legal argumentation presented by both sides was based on Article 17, paragraphs one and two.⁷³ However, Bulgaria's decision to inflict substantial material damages on the investor's refinery—derived from a textual and retrospective, rather than teleological and prospective interpretation of Article 17, paragraphs one and two—maps the intention of a government to control the number of market players by forcing one of them to exit.⁷⁴ Moreover, there was no indication for the involvement of lower- or medium-level administrative authorities from a hierarchical standpoint.

Nykomb Synergetics v. Latvia is a case located in the lower right entry of our matrix (Low, Low).⁷⁵ Although the Tribunal applied customary international law rather than Article 22 of the ECT to form the basis for Latvia's responsibility,⁷⁶ this

68. *Petrobart Ltd. v. Kyrgyz Republic*, No. 126/2003, Arbitral Award (Arbitration Inst. of the Stockholm Chamber of Commerce, Mar. 29, 2005), available at http://www.encharter.org/fileadmin/user_upload/document/Petrobart.pdf.

69. *Id.* § VII(1)(C)(h).

70. *Id.* § VII(1)(C).

71. *Id.*

72. *Plama Consortium Ltd. v. Republic of Bulgaria (Cyprus v. Bulgaria)*, 2005 ICSID No. ARB/03/24 (Decision on Jurisdiction of Oct. 28 2005).

73. *See id.* at 13–26 (detailing the claims made by both parties).

74. *DISTRIGAS, THE LIBERALISED GAS MARKET (2008)*, available at <http://www.distrigas.eu/content/Germany/de-en/natural-gas-de-en/liberalization-de-en.html>.

75. *Nykomb Synergetics*, *supra* note 16.

76. *Id.* at 38–41.

case is extremely useful both from an antitrust and a state liability perspective. On the one hand, Latvenergo's non-compliance with both the contractual and statutorily defined tariff constitutes a case of state responsibility, where the government is held liable for an action of a state-owned enterprise.⁷⁷ On the other hand, it is obvious that the Latvian government by using procedural rather than substantive arguments in front of the Tribunal breached the contract for the additional reason that the Latvian energy sector is monopolized by Latvenergo.⁷⁸ *Generation Ukraine, Inc. v. Ukraine* is assigned to the lower left entry of the matrix (Low, High).⁷⁹ Unlike the other three cases, *Generation Ukraine* did not involve the implementation of the ECT, but that of the U.S.-Ukrainian Bilateral Investment Treaty (BIT).⁸⁰ The Tribunal decided that the administrative obstruction by the Kiev City State Administration did not constitute an indirect expropriation of the American company.⁸¹ Nevertheless, the case came in front of the Tribunal both as an example of indirect state liability through an administrative agency (municipal administration) and a vertical state deprivation of property rights, which were derived from the BIT.⁸²

I now turn to a hypothetical scenario of state-investor relations between Germany and Russia. In this model, Russia is the host state and German energy multinationals are the investors. To propose an analysis of German-Russian investment energy relations based on the ECT, I suggest the following two-by-two matrix where the set of policy choices for the Russian government is to either ratify the ECT (High) and promote open markets⁸³ or remain in the current status quo (Low) and have its investment relations with Germany defined by their Bilateral Investment Treaty (BIT); in the latter case, the Russian market will remain closed. The choices of German energy multinationals, on the other hand, are defined by the economic policy decisions of the federal government in Berlin. There are two options offered to the German government with respect to structure of its domestic energy markets: either to fully liberalize energy markets by conforming not only to the letter but also the purpose of the 2003 Gas and Electricity Directives (open market), or to maintain the oligopoly character of the German energy sector by allowing limited competition at the distribution level (closed market).

77. *Id.* at 29–31.

78. *Id.* at 33–38.

79. *Generation Ukraine, Inc. v. Ukraine*, ICSID ARB/00/9, Award (Sept. 16 2003), *reprinted in* 44 I.L.M. 404.

80. *Id.* paras. 1.2–1.3.

81. *Id.* para. 20.33.

82. *Id.* paras. 1.2–1.3.

83. See M. STEVEN FISH, *DEMOCRACY DERAILED IN RUSSIA: THE FAILURE OF OPEN POLITICS* 20–23 (2005) (describing how to measure openness on a high-low scale).

Matrix 2

| | | |
|--|---|------------------------------|
| State (Russia) → | ECT Ratification – Open Market (High) | BIT – Closed Market (Low) |
| Investor (Germany) ↓ | | |
| Market Liberalization – Open Market (High) | International Arbitration | Incremental Contracts |
| Oligopoly – Closed Market (Low) | Strategic Bargaining | Political Regulation |

I will now evaluate the four entries of the matrix. If the Russian government ratifies the ECT, this will give more leverage to its investors when they negotiate, and subsequently implement, energy investment contracts within the Russian Federation. At the same time, a potential ECT ratification by the Russian side will increase the supply of potential energy investors, because it substantially reduces capital risk.⁸⁴ With respect to German-Russian investment relations, the increase or decrease in the supply of German investors will depend on the degree of liberalization that the German government chooses to enforce within its domestic energy markets.⁸⁵ The upper left entry (High, High) constitutes the best possible option from a market entrants' perspective. It increases the number of energy multinationals with a potential interest to invest in the Russian energy sector and at the same time provides them with the highest possible level of protection: international arbitration. Because liberalization is inclined to demonopolize German energy markets,⁸⁶ and ECT ratification is likely to depoliticize the function of Russian energy companies,⁸⁷ international arbitration is perceived as the most adequate form of adjudication in terms of both reducing perceived or real political risk and constraining arbitrary state intervention in the fulfillment course of an energy investment contract.⁸⁸

84. See Matteo Winkler, *Arbitration Without Privity and Russian Oil: The Yukos Case Before the Houston Court*, 27 U. PA. J. INT'L ECON. L. 115, 145–46 (2006) (explaining that investors would be entitled to arbitration under the ECT).

85. Thomas Von Danwitz, *Regulation and Liberalization of the European Electricity Market: A German View*, 27 ENERGY L.J. 423, 445–46 (2006).

86. See Asche Frank et al., *European Market/Integration for Gas? Volume Flexibility and Political Risk*. 24 ENERGY ECON. 249, 249–50, 262–64 (2002) (describing the influence of liberalization on Germany's natural gas market).

87. Dylan Cors, *Breaking the Bottleneck: The Future of Russia's Oil Pipelines*, 7 DUKE J. COMP. & INT'L L. 597, 622 (1997).

88. See A.F.M. Maniruzzaman, *Stabilization in Investment Contracts and Change of Rules by Host Countries: Tools for O&G Investors*, 32–34 (2005), (explaining the role of arbitral tribunals in international investment contracts) available at http://lba.legis.state.ak.us/sga/doc_log/2006-03-15_aipn_stabilization-maniruzzaman_first_draft.pdf; FINE-KAPER CONSULTING, FOREIGN POLICY IMPLICATIONS OF THE NORD STREAM PIPELINE, (2006), (reporting that the Germans cannot ignore the political component of the pipeline project) available at <http://classes.maxwell.syr.edu/PSC783/2006/Germany>.

The lower left entry (High, Low) shows that German energy multinationals such as E.ON/RuhrGas and Wintershall would be motivated to enter a bargaining process with the Kremlin in order to trade their right to use an arbitral claim. The limited number of gas multinationals that could compete with them, combined with their financial interdependence linkages to Gazprom, would provide strong incentives to the Russian government and German gas oligopolies to engage in strategic bargaining with the purpose of maximizing their payoffs.⁸⁹ Under the upper right entry (Low, High), the expected volume of energy investment contracts would fall. The Russian side would have a wide array of potential investors with which to negotiate under the German-Russian BIT and would sign incremental contracts of limited size with each of its German partners. The lower right entry (Low, Low) describes the current status quo: German energy investments in Russia have a strong political component.

V. DISCUSSION

My analysis is centered on two axes. The first axis focuses on the interaction between state responsibility and antitrust regulation. The second axis focuses on the interrelation among countries whose multinationals are inclined to be investors in energy-rich countries in the field of upstream energy business and domestic institutional developments between countries, which are likely to host foreign energy investment due to abundant energy resources. Dispute settlement mechanisms are the same for state-investor relations arising both from BITs and the ECT. Nevertheless, as ICSID jurisprudence has clearly shown, the interpretation of the same principles can vary across different international investment treaties; historically, the MFN clause has been one such case.⁹⁰ The increase in international arbitration in Eastern Europe since the fall of the socialist bloc has not had an impact on the quantity of disputes adjudicated based on the ECT; the majority of the cases involved direct or indirect state expropriation.⁹¹ I contend that the interpretation of Articles 22 and 23 of the ECT as the statutory grounds for a strict liability rule and the proposed expansion of environmental state responsibility standards to energy investment disputes increase the normative credibility of the ECT and serve its primary goal:⁹² investment volume increase in the energy economies of Eastern Europe and Eurasia by multinationals originating from advanced capitalist economies.

The economic map of the ECT region is not the same as it used to be when the ECT was signed in 1994. Enhanced growth rates, implementation of partial but consistent reform packages, and gradual elimination of rent-seeking practices at the higher levels of public administration have provided Russia with a new assertive and self-confident set of economic policies and political strategies. Additionally, the role

89. Gert Brunekreeft & Sven Tweleemann, *Regulation, Competition and Investment in the German Electricity Market: RegTP or REGTP*, ENERGY J. 99, 107 (2005).

90. Scott Vessel, *Clearing a Path Through a Tangled Jurisprudence: Most-Favored Nation Clauses and Dispute Settlement Provisions in Bilateral Investment Treaties*, 32 YALE J. INT'L L. 125, 126 (2007).

91. Kaj Hober, *Investment Arbitration in Eastern Europe: Recent Cases on Expropriation*, 14 AM. REV. INT'L ARB. 377, 442 (2003).

92. *Contra* David A. Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation Under NAFTA's Chapter 11*, 33 GEO. WASH. INT'L L. REV. 651, 731 (2001) (arguing that the ECT's environmental standards are weak and may contradict the main purpose of the ECT).

of the MFN clause in investment protection is more clarified and normatively important under the ECT than any BIT between two countries in the ECT region (including Germany and Russia).⁹³ I argue that the two rival hypotheses, which co-exist in the ECT, are inclined to produce drastically divergent policy outcomes. Interestingly enough, the socialization trend, as expressed by Articles 22 and 23 of the ECT, has a much more complete and efficient enforcement mechanism (international arbitration) than the liberalization trend (diplomatic negotiations).⁹⁴ Although the proclaimed goal of state-responsibility clauses in the ECT is to constrain the arbitrariness of public administration against private investors, in practice the ECT consolidates the position of the state and facilitates energy investment contracts with state rather than private corporations in the post-socialist region.

International tribunals have revealed a lack of consistency in defining key terms of investment protection such as state sovereignty, expropriation, investment, and validity of the MFN clause.⁹⁵ Nevertheless, it does not seem sound to contend that there has been an evolving privatization of international investment law. This dichotomy between state responsibility and antitrust clauses, in terms of their level of protection, shows the inherent paradox in the ECT: state ownership is treated as a fixed factor, and antitrust regulation as a variable factor in the calculus of East-West energy cooperation. While trying to provide financial incentives to central governments and agencies to abstain from distortion practices, the ECT encouraged foreign investors to pursue contractual relations with state energy corporations, which undermined private business initiatives in the heavily politicized energy sector of the post-Soviet space.⁹⁶

However, this phenomenal paradox has very rational conceptual extensions. Since the main focus of analysis is on state-investor disputes in the energy sector, it makes sense to include state responsibility as one of the pillars of investment protection. Nevertheless, this approach does not take into account the evolving renationalization of energy ownership in Russia and other former Soviet energy economies by direct or indirect means; this development implies that the institutional connections between the central government and the state agencies or enterprises have already become increasingly intense.⁹⁷ That said, cases such as *Plama vs. Bulgaria* and *Petrobart vs. Kyrgyz Republic*, where state responsibility is derived directly from an action of the central government rather than from an action confined in the administrative boundaries of an agency or a state-controlled business

93. See Gabriel Egli, *Don't Get Bit: Addressing ICSID's Inconsistent Application of Most-Favored Nation Clauses to Dispute Resolution Provisions*, 34 PEPP. L. REV. 1045, 1076-78 (2007) (describing the ICSID's reliance on ECT's arbitration clause instead of BIT's in the *Plama* case).

94. See Alejandro Escobar, *An Overview of the International Legal Framework Governing Investment*, 91 AM. SOC'Y INT'L L. PROC. 485, 488-89 (1997) (explaining the legal trend in international investment moving away from customary international law and diplomatic protection and towards treaty provisions such as binding arbitration clauses).

95. Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1565-69 (2005); Charles H. Brower II, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*, 40 COLUM. J. TRANSNAT'L L. 43, 54-55 (2001).

96. See ENERGY CHARTER READER'S GUIDE, *supra* note 1, at 19-20 (discussing the ECT's encouragement of negotiated contracts).

97. Philip Andrews-Speed, *The Politics of Petroleum and the Energy Charter Treaty as an Effective Investment Regime*, 4 J. ENERGY FIN. & DEV. 117, 126-29 (1999).

organization, are far more likely. Article 27, which discusses diplomatic negotiations, is the main channel of dispute settlement on competition issues, and it confirms the political character of the ECT; however, it lacks normative enforceability.⁹⁸ Varieties of antitrust violations such as these are captured by the interval [state sovereignty, monopoly] are themselves the outcomes of inefficient political decisions that generate energy rents for administrative and business elites.

The German-Russian gas trade model has a multidimensional value in my argument. Its distinction between closed and open markets explains an economic organization problem in purely political terms. ECT ratification is interpreted as the most powerful energy-liberalization signal that the Russian government can give to the international community. At the same time, the degree of Germany's adjustment to the EU Gas and Electricity Directives defines whether its energy markets are open or closed to new entrants able to challenge the predominance of E.ON/Ruhrgas and Wingas. The four policy outcomes presented in Matrix 2 can be placed on a horizontal axis, given their level of political and economic openness: [international arbitration, incremental contracts, strategic bargaining, political regulation]. International arbitration and political regulation are the two extreme points, while incremental contracts and strategic bargaining are the two middle points. ECT ratification by Russia can only ultimately occur if the structure of the gas market is preserved in such a way that Gazprom will never lose its monopoly status. The same observation holds for the German gas sector, where oligopolies secure the flow of supplies. Despite the radically different political environment in Germany and Russia, I conclude that the calculus of the two governments vis-à-vis energy liberalization is the same: neither really believes in it. Thus, there is no dilemma between liberalization and socialization in energy market development. States have never been able to boost competition when they are part of the market play, but international agreements can. That explains why the ECT increases the diversion costs of licensing instead of contracting. In a state-controlled energy economy, contract breaches lead to much higher long-term profit losses for investors than for governments that break the contract, subsequently paying the arbitral award. So far there have not been many alternative non-state energy entities that could substitute state energy enterprises in energy contracting in Eastern Europe and Eurasia.

98. Thomas W. Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation*, 12 ARB. INT'L 429, 439–40 (1996).

VI. APPENDIX

Table 1

Settlement of State-Investor Disputes under the Energy Charter Treaty⁹⁹

| Ref. No. | Claimant | Country of Incorporation | Respondent | Registration | Status of Proceedings |
|----------|--|--------------------------|--------------------|--------------|--|
| 1 | AES Summit Generation Ltd. | United Kingdom | Hungary | 2001 | Settlement Agreed and Proceedings Discontinued |
| 2 | Nykomb Synergetics Technology Holding AB | Sweden | Latvia | 2001 | Award Rendered on 12/16/2003 |
| 3 | Plama Consortium Ltd. | Cyprus | Bulgaria | 2003 | Award Rendered on 02/08/2005 |
| 4 | Petrobart Ltd. | Gibraltar | Kyrgyz Republic | 2003 | Award Rendered on 09/01/2003 |
| 5 | Alston Power Italia SpA | Italy | Mongolia | 2004 | Settlement Agreed and Proceedings Discontinued |
| 6 | Yukos Universal Ltd. | United Kingdom | Russian Federation | 2005 | Pending |
| 7 | Hulley Enterprises Ltd. | Cyprus | Russian Federation | 2005 | Pending |
| 8 | Veteran Petroleum Trust | Cyprus | Russian Federation | 2005 | Pending |
| 9 | Ioannis Kardassopoulos | Greece | Georgia | 2005 | Pending |
| 10 | Amto | Latvia | Ukraine | 2005 | Award Rendered on 03/26/2003 |

99. See Energy Charter Secretariat, *Investor-State Dispute Settlement Cases*, <http://www.encharter.org/index.php?id=213&L=0> (last visited Nov. 6, 2008) (providing more detailed information on the cases summarized in this table).

| | | | | | |
|----|--|-------------------|------------|------|---------|
| 11 | Hrvatska Elektroprivreda d.d (HEP) | Croatia | Slovenia | 2005 | Pending |
| 12 | Libananco Holdings Co. Ltd. | Cyprus | Turkey | 2006 | Pending |
| 13 | Azpetrol International Holdings B.V., Azpetrol Group B.V., And Azpetrol Oil Services Group B.V. | Netherlands | Azerbaijan | 2006 | Pending |
| 14 | Cementownia "Nova Huta" SA | Poland | Turkey | 2006 | Pending |
| 15 | Europe Cement Investment and Trade SA | Poland | Turkey | 2007 | Pending |
| 16 | Liman Caspian Oil BV And NCL Dutch Investment BV | Netherlands | Kazakhstan | 2007 | Pending |
| 17 | Electrabel SA | France | Hungary | 2007 | Pending |
| 18 | AES Summit Generation Ltd. And AES-Tisza Eromu Kft. | United Kingdom | Hungary | 2007 | Pending |
| 19 | Mercuria Energy Group Ltd. | Switzerland | Poland | 2008 | Pending |
| 20 | Alapli Elektrik B.V. | Netherlands | Turkey | 2008 | Pending |