

Provisional Application of the Energy Charter Treaty: The Yukos Arbitration and the Future Place of Provisional Application in International Law

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The provisional application of treaties is a relatively recent development in international treaty law designed to address some of the shortcomings of the traditional practice of concluding treaties. Generally, the process of concluding a treaty has taken place under a three-step process of signature, ratification, and entry into force.¹ Parties to a treaty must express their consent to be bound, a process most commonly achieved through a simple signature that expresses a party's consent to be bound subject to domestic ratification of the treaty. Signatories then must ratify the treaty under their respective domestic procedures. Once the required number of signatories has ratified the treaty, the treaty will definitively enter into force. It is only at this point that positive legal obligations arise under the treaty.²

Prior to entry into force, a treaty does not impose positive legal duties and obligations on signatory parties; and as a result of each state's varying process of ratification, there is often a substantial gap in time between treaty signature and entry into force. By contrast, provisional application imposes duties and obligations on signatories during this gap period and can be best understood as an attempt to solve collective action problems created by this gap. Under the provisional application of a treaty, signatory states undertake to give effect to treaty obligations prior to the completion of the domestic ratification

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¹ For a general discussion, see UN Office of Legal Affairs Treaty Section, *Treaty Handbook*, UN Sales No. E.02.V.2 (2001), available online at <<http://untreaty.un.org/English/TreatyHandbook/hbframeset.htm>> (visited Apr 21, 2007).

² Under the Vienna Convention on the Law of Treaties, a "treaty in force is binding upon the parties to it and must be performed by them in good faith." See Vienna Convention on the Law of Treaties (1969), art 26, 1155 UN Treaty Ser 331, 339 ("VCLT").

procedures, with the intention of acceding to the treaty once domestic ratification has been completed.³ However, the extent to which these obligations are binding, affirmative legal obligations has not been firmly established in international law. This Comment will examine the obligations imposed by the provisional application of treaties through an analysis of the Energy Charter Treaty (“ECT”) in the context of the Yukos Arbitration.

The ECT is an energy-sector specific multilateral treaty designed to promote long-term cooperation in the energy sector. Currently, fifty-one states, including Russia, are signatories to the ECT. One important feature of the ECT is that it provides for the provisional application of the treaty by a signatory pending formal domestic ratification by that signatory. As a signatory that has not expressly indicated an inability to apply the ECT provisionally, Russia is obligated to comply with its terms prior to ratification by the Russian State Duma “to the extent that such provisional application is not inconsistent with its constitution, laws, or regulations.”⁴

Russia’s agreement to apply the ECT provisionally is an important factor in resolving the arbitration Russia is currently engaged in under the dispute resolution provisions of the ECT (“Yukos Arbitration”) with subsidiaries of Group Menatep (“Menatep”)⁵ over Russia’s forced dismantlement of the Yukos Oil Company (“Yukos”). A threshold issue in this arbitration will be whether Russia, in agreeing to apply the ECT provisionally, incurred binding, affirmative legal obligations that could expose it to liability for the actions taken against Yukos.

Furthermore, the extent to which the provisional application of treaties imposes binding, affirmative legal obligations is not an isolated question without future significance. Recently, Russia has again presided over what appears reminiscent of a Yukos-esque forced nationalization of the Sakhalin II liquefied natural gas project.⁶ Russia also continues to indirectly threaten further nationalization and consolidation in the energy sector. It seems probable that the efficacy of the ECT and the obligations imposed by its provisional application will again be put to the test.

Section I discusses the basis, use, and advantages of the provisional application of treaties in international law. Section II will provide a general

³ UN Office of Legal Affairs, *Treaty Handbook* at § 2.4 (§ 3.4 in online version) (cited in note 1).

⁴ See The Energy Charter Treaty (1994), art 45(1), 34 ILM 360, 409 (1995) (“ECT”).

⁵ Menatep is a holding company which held a controlling interest in Yukos before the Russian actions discussed in Section III.

⁶ As discussed in Section V, in December 2006, after months of Russian bullying ostensibly relating to environmental violations by the Sakhalin II project, Gazprom, the state monopoly provider of natural gas, which is 40 percent owned by the Russian government, acquired a 50 percent-plus-one-share stake in the project at below market price. See notes 108–109 and accompanying text.

overview of the ECT, with a specific emphasis on the treaty provisions likely to arise in the Yukos Arbitration; and Section III presents a brief factual background to the Yukos Arbitration. Section IV analyzes the Yukos Arbitration by examining how the characterization of the obligations imposed by provisional application under the ECT should be resolved in light of the purpose behind provisional application of treaties. Section V will discuss how the outcome of the Yukos Arbitration has the potential to impact foreign investment under the ECT. The Comment concludes with a general discussion of the future place of provisional application in international treaty law.

I. PROVISIONAL APPLICATION IN INTERNATIONAL LAW

The process of concluding a treaty can be broken down into three distinct phases: signature, ratification, and entry into force.⁷ Signature of a treaty in and of itself does not impose a legal duty on a signatory to ultimately ratify the treaty.⁸ Nor, as a general principle of international law, do treaties have legal effect before entry into force.⁹ Article 18 of the Vienna Convention on the Law of Treaties (“VCLT”) provides a limited exception to this principle by obliging signatories to a treaty to refrain from acts that would defeat the object and purpose of the treaty.¹⁰ However, this obligation does not impose affirmative duties on a state to carry out specific provisions of the treaty.¹¹

It is in the gap between signature and entry into force, and against the backdrop of the absence of affirmative duties to carry out provisions of a treaty prior to entry into force, that the concept of provisional application has arisen. Article 25 of the VCLT provides that a treaty or parts of a treaty may be applied provisionally pending entry into force if the treaty so provides or the parties have otherwise agreed. Article 25, however, does not define the substance of provisional application or the specific obligations provisional application imposes. Rather, it grants negotiating parties broad discretion to fashion the specific mode by which provisional application of the treaty at issue will operate.¹²

⁷ See Emmanuel Roucouas, *Uncertainties Regarding the Entry into Force of Some Multilateral Treaties*, in Karel Wellens, ed., *International Law: Theory and Practice: Essays in Honour of Eric Suy* 179, 179 (Kluwer 1998).

⁸ Martin A. Rogoff, *The International Legal Obligations of Signatories to an Unratified Treaty*, 32 Me L Rev 263, 267 (1980).

⁹ See VCLT, arts 26, 24(1), 24(2), 28 (cited in note 2).

¹⁰ Id, art 18.

¹¹ Rogoff, *International Legal Obligations of Signatories* at 297 (cited in note 8).

¹² VCLT, art 25 (cited in note 2).

A. USE OF PROVISIONAL APPLICATION IN
INTERNATIONAL LAW

The provisional application of treaties has primarily been utilized in two types of situations. The first involves treaties responding to some form of international crisis. In these situations, where immediate and decisive action may be necessary to avert catastrophe, delays caused by the ratification process have the potential to frustrate effective international response. Examples of such treaties include the 1934 Pacte d'Entente Balkanique; the Organisation for Economic Co-operation and Development's response to the 1973 Arab Oil Embargo; and the International Atomic Energy Agency's response to the Chernobyl nuclear incident.¹³ The second situation involves treaties for which rapid, broad-based participation and implementation is essential to ensure the effectiveness of the treaty regime. Examples within this category include arms control treaties such as the Treaty on Further Reduction and Limitation of Strategic Offensive Arms,¹⁴ the Agreement Relating to the Implementation of Part XI of the United Nations Convention on the Law of the Sea,¹⁵ and, most notably for the purposes of this Comment, the Protocol of Provisional Application ("PPA") of the General Agreements on Tariffs and Trade ("GATT").¹⁶

The GATT was originally developed as a means of providing an accelerated process for reducing tariffs and other trade barriers while negotiation of the broader treaty regime of the International Trade Organization ("ITO") was ongoing.¹⁷ In October 1947, the eight primary negotiating states, including the US, each agreed to provisionally apply the GATT to the extent that the GATT provisions were not inconsistent with their nation's existing legislation.¹⁸ This provisional application was intended to be a stopgap measure until the ITO became established; however, the ITO effectively failed as a viable treaty regime when the US Senate blocked US ratification. With the death of the ITO, provisional application of the GATT regime under the PPA governed

¹³ Rene Lefebvre, *The Provisional Application of Treaties*, in Jan Klabbbers and Rene Lefebvre, eds, *Essays on the Law of Treaties: A Collection of Essays in Honour of Bert Vierdag* 81, 82–83 (Kluwer 1998) (listing examples of treaties including a provisional application term).

¹⁴ See Andrew Michie, *The Provisional Application of Arms Control Treaties*, 10 J Conflict & Sec L 345 (2005).

¹⁵ Agreement Relating to the Implementation of Part XI of the United Nations Convention on the Law of the Sea (1982), 33 ILM 1309 (1994).

¹⁶ Protocol of Provisional Application of the General Agreement on Tariffs and Trade (1947), 61 Stat A2051, 55 UN Treaty Ser 308 (1950).

¹⁷ See David Palmeter and Petros C. Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure* 3 (Kluwer 1999).

¹⁸ Id.

international trade relations for the forty-seven years until the GATT was replaced by the World Trade Organization (“WTO”) in 1994. The success of the PPA illustrates the potential that the provisional application of treaties has in creating stable international trade and investment regimes.

B. ADVANTAGES OF PROVISIONAL APPLICATION

Provisional application can be best understood as an attempt to solve the collective action problem created by the gap between signature and entry into force of an international treaty. Particularly within the context of international trade and investment treaties, the rapid, uniform, and broad-based implementation of treaty protections and obligations is crucial to the efficacy of the treaty regime. However, given the gap between signature and entry into force and the lack of a ratification obligation in international law, the prospect of capturing some of the benefits of the treaty regime at the time of signing without incurring the costs of treaty obligations that come with ratification creates an incentive for a signatory to defect from the treaty regime by delaying or failing to ratify the treaty. Provisional application helps to minimize this defection problem by forcing signatory parties to bear the costs of treaty obligations immediately at the time of signing. Signatories are induced to take on these obligations by gaining the ability to capture the full benefits of the treaty regime rather than only being able to capture the indirect benefits available to parties for whom the treaty has not entered into force.¹⁹

II. THE ENERGY CHARTER TREATY

The ECT, an energy-sector specific multilateral investment treaty, was signed in December 1994 and entered into force in April 1998. The declared purpose of the ECT is to “establish[] a legal framework . . . to promote long-term cooperation in the energy field . . . in accordance with the objectives and principles of the [European Energy] Charter.”²⁰ Aiming to “strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-

¹⁹ In the context of the ECT, an example of such an indirect benefit would be the benefit accruing to a non-ratifying state’s economy from the establishment of a more stable global energy market.

²⁰ ECT, art 2 (cited in note 4). The European Energy Charter is a nonbinding declaration of political intent to promote East-West cooperation in the energy sector following the collapse of the USSR. It was signed by over fifty states in December 1991. See Energy Charter Secretariat, *The Energy Charter Treaty: A Reader’s Guide*, 8 (2002), available online at <http://www.encharter.org/fileadmin/user_upload/document/document1158668628.pdf> (visited Apr 21, 2007) (“*Reader’s Guide*”).

related investments and trade,”²¹ the ECT seeks to unite signatories behind the common goals of establishing open energy markets, securing and diversifying energy supply, and stimulating cross-border investment and trade in the energy sector.²² To this end, the ECT encompasses a broad range of energy-related issues, including, *inter alia*, investment, trade, and transit of energy goods; however, for purposes of this Comment, only a limited number of provisions need be addressed.²³ This Section will provide a general overview of the provisions of primary importance in the Yukos Arbitration—those concerning provisional application, investment promotion and protection, and dispute settlement.

A. PROVISIONAL APPLICATION

Article 45(1) of the ECT expressly provides that “[e]ach signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory . . . to the extent that such provisional application is not inconsistent with [the signatory’s] constitution, laws or regulations.”²⁴ Article 45(2) provides that, notwithstanding Article 45(1), a signatory may declare when signing that it is unable to accept provisional application. By virtue of exercising this opt-out right, a signatory and its investors are barred from claiming the benefits of provisional application of the ECT.²⁵ As of July 2006, five signatories—Australia, Belarus, Iceland, Norway, and the Russian Federation—have not ratified the ECT.²⁶ Of these, Australia, Iceland, and Norway have chosen to formally exercise the opt-out provision.²⁷

Article 45(3) provides that a signatory may at any time terminate its provisional application by written notification of its intention not to become a Contracting Party (“CP”) to the treaty. However, the provisions of Part III of the ECT, concerning investment promotion and protection, and Part V, concerning dispute settlement, continue to apply to investments made during

²¹ Energy Charter Secretariat, *Energy Charter: About the Charter*, available online at <<http://www.encharter.org/index.php?id=7>> (visited Apr 21, 2007).

²² Energy Charter Secretariat, *Reader’s Guide* at 9 (cited in note 20).

²³ For a general discussion of the ECT as a whole, see Craig S. Bamberger, *An Overview of the Energy Charter Treaty*, in Thomas W. Wälde, ed., *The Energy Charter Treaty: An East-West Gateway for Investment & Trade* 1, 1–34 (Kluwer 1996).

²⁴ ECT, art 45(1) (cited in note 4).

²⁵ *Id.*, art 45(2).

²⁶ Energy Charter Secretariat, *Energy Charter: FAQ*, available online at <<http://www.encharter.org/index.php?id=18>> (visited Apr 21, 2007).

²⁷ *Id.*

the period of provisional application for twenty years from the date of termination.²⁸

B. INVESTMENT PROMOTION AND PROTECTION

The scope of investment protection under the ECT is broad. Article 1(6) defines “investment” to mean “every kind of asset, owned or controlled directly or indirectly by an [i]nvestor” that is associated with an “Economic Activity in the Energy Sector.”²⁹ Within this broad scope, the ECT aims to “reduc[e] to a minimum the non-commercial risks associated with energy-sector investments,”³⁰ by requiring CPs to “encourage and create stable, equitable, favourable and transparent conditions” for investors.³¹ These conditions include a commitment to provide the existing investments of investors from other CPs fair and equitable treatment.³² The ECT also provides that such investments shall “enjoy the most constant protection and security,” and that “no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal.”³³ Furthermore, Article 10(7) provides that CPs shall accord investments and related activities the better of national treatment or most-favored nation treatment.

Article 13 of the ECT addresses the issue of expropriation, providing that “investments . . . shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation” except where the expropriation or measure equivalent is “(a) for a purpose which is in the public interest; (b) not discriminatory; (c) carried out under due process of law; and (d) accompanied by the payment of prompt, adequate and effective compensation.”³⁴

²⁸ ECT, art 45(3)(b) (cited in note 4).

²⁹ Id, art 1(6).

³⁰ Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents* 14 (2004), available online at <http://www.encharter.org/fileadmin/user_upload/document/EN.pdf> (visited Apr 21, 2007) (“ECT & Related Documents”).

³¹ ECT, art 10(1) (cited in note 4).

³² Id. Article 10 expressly distinguishes between existing investments, which are protected by the ECT, and activities in the pre-investment or making of investment phase, which are not protected and are to be governed by a supplemental agreement that has not yet been negotiated. See *Chairman’s Statement at Adoption Session on 17 December 1994, ECT & Related Documents* at 157 (cited in note 30).

³³ ECT, art 10(1) (cited in note 4).

³⁴ Id, art 13(1).

C. DISPUTE SETTLEMENT

Part V of the ECT adopts a bifurcated approach to dispute settlement. Article 26 provides for investor-state arbitration for investment disputes “between a Contracting Party and an Investor of another Contracting Party relating to . . . an alleged breach of an obligation of the former under Part III” of the ECT.³⁵ Article 27 provides that all other disputes, except for those relating to competition under Article 6 and environmental aspects under Article 19, shall be settled in state-state arbitration. However, for purposes of this Comment, only the investor-state arbitration provisions of Article 26 are relevant.

Under the investor-state arbitration provisions, parties are first encouraged to settle any disputes amicably.³⁶ If a dispute cannot be settled within a period of three months, the investor party has the option to submit the dispute to the courts of the host state,³⁷ to any previously-agreed-upon dispute settlement procedure, or to an international arbitral tribunal.³⁸ The ECT requires that both the host state and the investor give their unconditional consent to the submission of a dispute to international arbitration.³⁹ Investors choosing to submit the dispute to an international arbitral tribunal may submit the dispute to the International Centre for Settlement of Investment Disputes,⁴⁰ an ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”), or an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.⁴¹

III. THE YUKOS DISPUTE

Yukos is a publicly-traded joint stock corporation organized under the laws of the Russian Federation in 1993 as part of the privatization and consolidation

³⁵ Id, art 26(1).

³⁶ Id.

³⁷ It should be noted that the use of the term “Contracting Party” in Article 26(1) would appear to exclude disputes between investors and signatories who have agreed to apply the ECT provisionally. As discussed in Section IV.A, this reading does not comport with the purpose of the ECT nor with other provisions of the ECT. Accordingly, for the purposes of clarity within this Section, I shall use the term “host state” rather than “Contracting Party.”

³⁸ ECT, arts 26(2), (3) (cited in note 4).

³⁹ Article 26(3) provides that each host state gives its unconditional consent to the submission of disputes, and Article 26(4) provides that an investor seeking to submit a dispute for resolution under Article 26(2)(c) must provide written consent to submission. Id, arts 26(3)(a), (4).

⁴⁰ This option is only available to disputes in which both the Host State and the state of the investor are parties to the Washington Convention. See Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965), 17 UST 1270.

⁴¹ ECT, art 26(4) (cited in note 4).

of state-owned energy assets following the collapse of the Union of Soviet Socialist Republics.⁴² The Russian government initially retained all shares in the privatized Yukos; however, in response to lackluster performance and mounting debt, it sold off its stake in the company through a series of auctions in 1995 and 1996.⁴³ The principal purchaser was a group of investors led by Mikhail Khodorkovsky and Platon Lebedev through their Gibraltar-based holding company, Menatep.⁴⁴ Prior to the Russian actions discussed in the remainder of this section, Menatep and its subsidiaries held approximately 51 percent of Yukos' equity capital.⁴⁵

In July 2003, Mr. Lebedev, the president of Menatep, was arrested by Russian police on charges of having illegally acquired a stake in a state-owned fertilizer company, Apatia, in 1994.⁴⁶ Over the next month, Russian authorities arrested a number of former and current employees of Menatep, Yukos, and other related companies. On October 25, 2003, Mr. Khodorkovsky was arrested on charges of fraud and tax evasion, charges widely believed to have been motivated by Mr. Khodorkovsky's support of Russian President Vladimir Putin's political opponents and the Russian government's fear that Menatep was going to sell a significant share of its Yukos holding to Exxon Mobil.⁴⁷

Beginning in December 2003, the Russian Ministry of Finance began making a series of tax assessments against Yukos, ultimately totaling \$27.5 billion, for allegedly substantial tax underpayments for the years 2000–2004.⁴⁸ Concomitantly, in response to a request from the Russian Tax Ministry, a

⁴² See *Yukos: About Us*, available online at <http://www.yukos.com/About_us/History.asp> (visited Apr 21, 2007).

⁴³ *Id.*

⁴⁴ *Taming the Robber Barons*, *Economist* 5 (May 22, 2004) (indicating that in exchange for supporting Boris Yeltsin, Mr. Khodorkovsky was permitted to purchase control of Yukos in 1995).

⁴⁵ *Democracy on the Retreat in Russia: Testimony before the Senate Foreign Relations Committee*, 109th Cong, 1st Sess 2 (2005) (statement of Mr. Tim Osborne, Member Of The Board Of Directors Group Menatep), available online at <<http://www.senate.gov/~foreign/testimony/2005/OsborneTestimony050217.pdf>> (visited Apr 21, 2007) (“Osborne Statement”).

⁴⁶ Ed Caesar, *The Visit: Mikhail Khodorkovsky's Life Inside*, *The Independent* (London) 1 (Sept 15, 2006).

⁴⁷ Catherine Belton, *The Arrest That Proved a Turning Point*, *Moscow Times* 1 (Oct 25, 2006) (indicating that “Khodorkovsky's arrest came three weeks after he signed a protocol of understanding with ExxonMobil [sic] to sell a significant chunk of his shares in Yukos”). See also Timothy L. O'Brien, *The Capitalist in the Cage*, *NY Times* C1 (June 20, 2004) (indicating that “Mr. Khodorkovsky tried to sell a large stake in Yukos to an American company, Exxon Mobil, without consulting the Kremlin”).

⁴⁸ *In re Yukos Oil Co*, 321 Bankr 396, 401 (Bankr SD Tex 2005) (“*Yukos IP*”). To understand the scope of these assessments, the 2001 and 2002 assessments exceeded 100 percent of Yukos' annual consolidated gross revenue for those years, and the 2003 assessment was in excess of 80 percent. See Plaintiff's Original Complaint for Injunctive Relief, 2004 WL 3219796, *6 (from *In re Yukos Oil Co*, 320 Bankr 130 (Bankr SD Tex 2004)) (“Plaintiff's Original Complaint”).

Moscow arbitration court implemented a ban on the sale and transfer of Yukos' assets.⁴⁹ As a result of the asset freeze, and despite the fact that half of Yukos' revenues were being applied to tax assessments, Yukos proved unable to satisfy the assessments.⁵⁰ Accordingly, in November 2004, the Russian tax authorities announced that 76.79 percent of Yuganskneftegas ("YNG"), the wholly-owned primary production arm of Yukos,⁵¹ would be auctioned on December 19, 2004 to help satisfy the back-tax liability.⁵² It was widely expected that Gazprom, the state monopoly provider of natural gas, which is 40 percent owned by the Russian government,⁵³ would acquire YNG.

In response to this announcement, Yukos filed a voluntary bankruptcy petition in the Southern District of Texas on December 14, declaring debts of \$30 billion, including the \$27.5 billion tax assessments, against total assets of \$12 billion, and seeking a temporary restraining order ("TRO") against the forced sale.⁵⁴ On December 16, the bankruptcy court issued a TRO enjoining all named defendants—including Gazprom, Deutsche Bank, BNP Paribas, and JP Morgan—with the exception of the Russian government, from participating in the auction.⁵⁵ While the bankruptcy petition was eventually dismissed in February 2005 on jurisdictional grounds,⁵⁶ the TRO did have the immediate effect of frightening Gazprom's Western financial backers into withdrawing financing,⁵⁷ thereby preventing Gazprom from directly participating in the auction.⁵⁸

A day after the issuance of the TRO, the Baikal Finans Group ("Baikal"), a previously unknown entity, applied to participate in the auction.⁵⁹ The auction took place as planned on December 19 with only two participants—Baikal and Rosneft, a Russian state-owned oil company. After a brief ten minute auction in which Rosneft failed to make any bid, Baikal acquired 76.79 percent of YNG for

⁴⁹ Plaintiff's Original Complaint at *6 (cited in note 48).

⁵⁰ See *Yukos II*, 321 Bankr at 401.

⁵¹ YNG was responsible for approximately 60 percent of Yukos' crude oil production. See Erin E. Arvedlund, *Russia to Sell Big Yukos Unit at Low-End Price*, NY Times W1 (Oct 13, 2004).

⁵² Erin E. Arvedlund, *Russia Moves to Auction Crucial Unit of Yukos*, NY Times C1 (Nov 20, 2004).

⁵³ *In re Yukos Oil Co.*, 320 Bankr 130, 136 (Bankr SD Tex 2004) ("*Yukos P*").

⁵⁴ See Bankruptcy Creditors' Service, *Yukos Bankruptcy News*, Issue 1 (Dec 16, 2004), available online at <<http://bankrupt.com/yukos.txt>> (visited Apr 21, 2007).

⁵⁵ *Yukos I*, 320 Bankr at 138.

⁵⁶ See *Yukos II*, 321 Bankr at 411.

⁵⁷ See Erin E. Arvedlund, *Banks Drop Support of Bid for Russian Oil Giant's Unit*, NY Times A10 (Dec 18, 2004).

⁵⁸ Erin E. Arvedlund and Jad Mouawad, *Yukos Sale Deepens Investor Doubts*, NY Times C8 (Dec 21, 2004).

⁵⁹ *Id.*

\$9.35 billion.⁶⁰ YNG, as a whole, had recently been valued by the investment banks of Dresdner Kleinwort Wasserstein and JP Morgan as having a fair range of equity value between \$14.7 billion and \$21.1 billion.⁶¹ Three days after acquiring YNG, Baikal was in turn acquired by Rosneft for an undisclosed sum.⁶²

At the time of the auction, it was widely expected that Rosneft was to be merged with Gazprom.⁶³ While the merger was ultimately cancelled in May 2005,⁶⁴ in its stead the Russian government created a complex transaction between Rosneft and Gazprom that ultimately resulted in giving the Russian government direct majority control over both Gazprom and YNG.⁶⁵ Since having been acquired by Rosneft, YNG has benefited from the substantial reduction of at least \$3.9 billion of the tax claims against it.⁶⁶ These events strengthen the perception that the actions against Yukos were not an issue of legitimate tax liability, but rather part of a plan by the Russian government to consolidate control over the energy sector.

IV. YUKOS ARBITRATION

On November 2, 2004, two subsidiaries of Menatep—Hulley Enterprises Ltd and Yukos Universal Ltd (collectively “Menatep Subsidiaries”)—sent notice to Russia, beginning the three-month conciliation period required by Article 26(3) of the ECT.⁶⁷ On February 3, 2005, after the expiration of the conciliation period, the Menatep Subsidiaries filed notice of arbitration with Russia, seeking

⁶⁰ Erin E. Arvedlund and Steven Lee Meyers, *An All-but-Unknown Company Wins a Rich Russian Oil Stake*, NY Times A1 (Dec 20, 2004).

⁶¹ *Yukos I*, 320 Bankr at 136.

⁶² See Erin E. Arvedlund and Simon Romero, *State Company Buys Winner in Yukos Deal*, NY Times C1 (Dec 23, 2004).

⁶³ Bloomberg News, *Rosneft Takes Control of Yukos Oil Unit*, NY Times C2 (Jan 1, 2005).

⁶⁴ *Russia Cancels Gazprom, Rosneft Merger*, 103 Oil & Gas J 20, 36 (May 23, 2005).

⁶⁵ In a simplified form, the transaction worked as follows. First, Rosneft borrowed \$7.5 billion from Western banks to increase its stake in Gazprom. This increased stake functioned to give the Russian government direct majority control of Gazprom. Then in July 2005, Rosneft raised \$10.4 billion in an initial public offering, the proceeds of which were used to repay the \$7.5 billion loan. See Andrew E. Kramer, *Russian Oil Giant Raises \$10.4 Billion in Offering*, NY Times C4 (July 15, 2006); Andrew E. Kramer, *Russia Fattens Up a State Oil Company*, NY Times C7 (June 8, 2006).

⁶⁶ *Going Twice*, Economist 57 (May 27, 2006).

⁶⁷ Andrew Jack and Pavi Munter, *Investors Bring in the Lawyers as Tax Debts Floor Yukos*, Fin Times 21 (Nov 4, 2004). See also *Group Menatep Seeks 28.3 BLN Compensation from Russia*, Eurasian Bus Rep (Feb 14, 2005); Michael D. Goldhaber, *Global Lawyer: Strategic Arbitration*, Am Lawyer (June 1, 2005), available online at <<http://www.law.com/jsp/tal/PubArticleFriendlyTAL.jsp?id=1117098312615>> (visited Apr 21, 2007).

\$28.3 billion in compensation for the actions against Yukos.⁶⁸ The arbitration is currently proceeding under UNCITRAL Arbitration Rules under supervision of the Permanent Court of Arbitration in the Hague.⁶⁹ The arbitral tribunal consists of the Russian appointee Stephen Schwebel, the Menatep Subsidiaries' appointee Daniel Price, and the presiding arbitrator L. Yves Fortier, jointly chosen by the parties in accordance with Article 7 of the UNCITRAL Rules.⁷⁰ It has been reported that hearings on jurisdiction and admissibility have been set for June 2007.⁷¹

The primary claim of the Menatep Subsidiaries is that Russia's actions against Yukos, particularly the forced sale of YNG, amounted to an expropriation for which the Menatep Subsidiaries must be adequately compensated.⁷² Despite Russia's attempts to characterize the actions behind the veil of the satisfaction of tax liability, given the manner in which the auction of YNG occurred, the Menatep Subsidiaries would appear to have a strong argument that the actions amounted to a "measure[] having effect equivalent to nationalization or expropriation," in violation of Article 13 of the ECT.⁷³ However, before reaching the merits of this claim, the tribunal must first address two threshold jurisdictional issues.

A. PROVISIONAL APPLICATION AND DISPUTE RESOLUTION UNDER ARTICLE 26

The initial jurisdictional issue relates to an apparent inconsistency in the wording of the investor-state arbitration provisions of Article 26 of the ECT. Article 26(1) states that it applies to "[d]isputes between a *Contracting Party* and an Investor of another *Contracting Party*."⁷⁴ Article 1(2) defines "*Contracting Party*" as a "state . . . which has consented to be bound by [the] Treaty and for

⁶⁸ International Institute for Sustainable Development, *Investment Treaty News* 4 (Feb 22, 2005), available online at <http://www.iisd.org/pdf/2005/investment_investsd_feb22_2005.pdf> (visited Apr 21, 2007).

⁶⁹ International Institute for Sustainable Development, *Investment Treaty News* 3 (July 19, 2006), available online at <http://www.iisd.org/pdf/2006/itn_july19_2006.pdf> (visited Apr 21, 2007).

⁷⁰ Id. See also Goldhaber, *Global Lawyer: Strategic Arbitration*, Am Lawyer (cited in note 67); *United Nations Commission on International Trade Law Arbitration Rules*, General Assembly Res No 31/98, UN Doc A/RES/31/98 (1976), available online at <<http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf>> (visited Apr 21, 2007) ("*UNCITRAL Arbitration Rules*").

⁷¹ Energy Charter Secretariat, *Investor-State Dispute Settlement Cases*, available online at <<http://www.encharter.org/index.php?id=213>> (visited Apr 21, 2007).

⁷² See Osborne Statement at 19 (cited in note 45).

⁷³ ECT, art 13(1) (cited in note 4).

⁷⁴ Id, art 26(1) (emphasis added).

which the Treaty is in force.”⁷⁵ Provisional application by a signatory, as provided in Article 45, expressly applies in the period before the ECT has entered into force pursuant to the provisions of Article 44.⁷⁶ Accordingly, such a signatory would not fall within the definition of a “Contracting Party.” Therefore, solely on the basis of a literal reading, Article 26(1) would appear not to apply to disputes between an investor and a signatory who has agreed to apply the ECT provisionally.

Article 31 of the VCLT provides that a treaty is to be interpreted by the ordinary meaning of its terms in context and in light of the treaty’s object and purpose.⁷⁷ Looking to the context, such a reading conflicts with the language of Article 45(3)(b). Article 45(3)(b) indicates that if a signatory who has agreed to apply the ECT provisionally decides to terminate the provisional application, the obligations of that signatory under Part III, concerning investment protection, and Part V, concerning dispute settlement, continue to apply for a period of twenty years. If Article 26, an article under Part V, was not intended to apply to signatories who have agreed to apply the ECT provisionally, the inclusion of the language regarding the continuation of obligations under Part V would seem to be superfluous.

Moreover, looking to the purpose of the ECT suggests that the term “Contracting Party” in the context of Article 26(1) should be interpreted to include signatories who have agreed to provisionally apply the ECT but for whom the treaty has not entered into force. As discussed previously, one of the primary goals of the ECT is to mitigate the risk associated with energy-related investments. Without the obligations imposed by the dispute settlement procedures, investors have limited recourse against states violating the treaty guarantees of investment promotion and protection under Part III. The twenty-year continuation period provided by Article 45(3)(b) works to mitigate the risk of this limited legal recourse by ensuring the availability of appropriate fora for dispute resolution. Failing this protection, signatories who have agreed to provisionally apply the ECT would generally be able to escape their treaty obligations by failing to ratify the ECT, while at the same time retaining the benefits of the ECT accrued in the period of provisional application. Such a result would be inconsistent with the principles of reciprocity embodied in the ECT.

Hence, a proper reading of the scope of the investor-state arbitration provision of Article 26 should include disputes between investors and signatories who have agreed to apply the ECT provisionally. Such a reading has

⁷⁵ Id, art 1(2).

⁷⁶ Id, art 45(1).

⁷⁷ VCLT, art 31(1) (cited in note 2).

been supported by the decision on jurisdiction in the case of *Plama Consortium Limited v Republic of Bulgaria*, to date one of the few ECT arbitrations to have issued an award.⁷⁸ In *Plama*, the tribunal found that Article 26 of the ECT provisionally applied from the date of a state's signature unless that state had declared itself unable to accept provisional application under Article 45(2)(a).⁷⁹ Under this proper reading, the dispute between Russia and the Menatep Subsidiaries is within the scope of the investor-state arbitration provisions of the ECT.

B. THE OBLIGATIONS IMPOSED BY PROVISIONAL APPLICATION

The more significant jurisdictional issue relates to the extent to which Russia's obligations under provisional application of the ECT are binding, affirmative, and meaningful, and therefore implicated in the present arbitration. Article 45(1) of the ECT provides that each signatory agrees to apply the ECT provisionally pending its ratification "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations."⁸⁰ There is a measure of ambiguity in the language of Article 45(1) in that it is not clear whether the inconsistency requirement refers to the specific obligations imposed by the ECT or to the entire concept of provisional application. Under the first reading, the effect of Article 45(1) would be to subject each ECT provision to a comparison against the signatory's constitution, laws, and regulations, adjudging enforceable only those specific provisions which are not in direct conflict. Under the second reading, the effect of Article 45(1) would be to determine if the concept of provisional application—the ability of the executive to incur legal obligations without legislative ratification—is inconsistent with a signatory's constitution, laws, or regulations.

As discussed previously, Article 31 of the VCLT provides that a treaty is to be interpreted by the ordinary meaning of its terms in context and in light of the treaty's object and purpose.⁸¹ Thus, having determined that the ordinary meaning of the terms of Article 45(1) is ambiguous, the next step is an examination of the context of Article 45(1). Article 45(2) provides that at the time of signing, a signatory may make "a declaration that it is not able to accept provisional application." Article 45(2) does not allow a signatory to declare

⁷⁸ *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No ARB/03/24, Decision on Jurisdiction (Feb 8, 2005), available online at <<http://www.worldbank.org/icsid/cases/plama-decision.pdf>> (visited Apr 21, 2007).

⁷⁹ *Id.* ¶ 140.

⁸⁰ ECT, art 45(1) (cited in note 4).

⁸¹ VCLT, art 31(1) (cited in note 2).

specific provisions that it is unable to accept. Rather it treats provisional application as a singular concept, a take-it-or-leave-it approach suggested by the second reading as opposed to the pick-and-choose approach suggested by the first reading. An examination of Article 45(1) in the context of Article 45(2) strongly suggests that the second reading of Article 45(1) is correct. Accordingly, the tribunal must determine if the concept of provisional application is inconsistent with Russia's constitution, laws, or regulations.

1. Constitutional Inconsistency with Provisional Application

One commentator has argued that in countries lacking a specific constitutional provision explicitly providing that provisional application is permitted, an attempt to provisionally apply a treaty would only be valid if the constitutional procedures actually required to ratify a treaty had been satisfied with respect to the treaty being provisionally applied.⁸² However, such an interpretation stands at odds with the object and purpose of including a provisional application term in the ECT, reducing it to a mere formality included specifically to apply to those limited number of states that have specific constitutional provisions providing for provisional application.⁸³ Therefore, the correct analysis should not focus on whether Russia's constitution explicitly permits provisional application, but rather on whether the concept of provisional application is in direct conflict with Russia's constitution.

While a thorough analysis of Russian constitutional law is beyond the scope of this Comment, a basic presentation of some of the issues likely to be addressed in determining if there is a direct conflict is appropriate. Article 46(1) of the VCLT provides that a state may not "invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance."⁸⁴ It can be assumed that any question relating to the separation of powers as established by the Russian constitution qualifies as an internal law of fundamental importance. Therefore, the primary question is whether the concept of provisional application amounts to a manifest violation of the Russian constitution.

Under the 1993 Constitution of the Russian Federation ("1993 Constitution"), the power to negotiate and conclude treaties rests with the

⁸² Gerhard Loibl, *The Energy Charter Treaty: Implementation and Compliance Issues*, in Wälde, ed, *The Energy Charter Treaty* 565, 580–81 (cited in note 23).

⁸³ For example, the Netherlands is one such state having a specific provision providing that provisional application does not conflict with their constitution. Lefeber, *Provisional Application* at 90 n 43 (cited in note 13).

⁸⁴ VCLT, art 46(1) (cited in note 2).

executive.⁸⁵ This power is, however, limited by certain legislative and judicial oversight.⁸⁶ Importantly, Article 15(4) of the 1993 Constitution provides that “[i]f other rules have been established by an international treaty of the Russian Federation than provided for by a law [of the Russian Federation], the rules of the international treaty shall apply.”⁸⁷ This would suggest that provisional application established by the ECT would prevail over inconsistent Russian law. This position is further reinforced by the Chairman’s Statement at the Adoptive Session of the Energy Charter Treaty, in which the representative of Norway, supported by other representatives including the Russian Federation, declared that “a party may not invoke the provisions of its internal law as a justification for its failure to perform a treaty.”⁸⁸ Taken together, this would seem to suggest that the concept of provisional application does not amount to a manifest violation of the Russian constitution; therefore, under Article 46(1) of the VCLT, Russia would be unable to escape the ECT obligations.

2. Obligations by Estoppel

Even if a more thorough analysis of Russian constitutional law suggests that the concept of provisional application amounts to a manifest violation of the Russian constitution, Russia should still not be permitted to escape its ECT obligations. As one commentator has aptly stated, “domestic limitations to the provisional application . . . mean first and foremost that the competent organ should abstain from expressing its consent to be bound to an agreement on provisional application,” and that “[i]f it does not, it will either have to comply with the treaty or have to face its liability for an internationally wrongful act.”⁸⁹ Russia, by becoming a signatory and failing to declare that it was unable to accept provisional application, indicated a desire to capture the benefits of the ECT in the period before ratification. Russia was intimately involved with all stages of negotiation of the ECT and, as late as 2002, declared that it “views the Energy Charter as an important instrument of international energy co-operation and reiterates its resolve to continue its participation in the discussions within

⁸⁵ W.E. Butler, *National Treaty Law and Practice: Russia*, in Duncan B. Hollis, Merritt R. Blakeslee, and L. Benjamin Ederington, eds, *National Treaty Law and Practice* 537, 542 (Brill 2005).

⁸⁶ See *id.* at 544–48.

⁸⁷ *Id.* at 562 (translation of Article 15 of the 1993 Constitution).

⁸⁸ Chairman’s Statement at Adoption Session on 17 Dec 1994, *ECT & Related Documents* at 158 (cited in note 30).

⁸⁹ Lefeber, *Provisional Application* at 91 (cited in note 13).

the framework of the Energy Charter process of a wide range of issues related to energy transit, trade, investments and energy efficiency.”⁹⁰

It is only recently that Russia has begun to forcefully reject international pressure to ratify the ECT, a position reiterated by Russian President Putin at a September 2006 meeting of the G-8 summit.⁹¹ However, at the same time, Gazprom—and by extension the Russian government—continues to push for greater access to Western European markets and distribution networks.⁹² The International Court of Justice has held that “[o]ne of the fundamental principles governing [an] international relationship [established by treaty] is that a party which disowns or does not fulfill its own obligations cannot be recognized as retaining the rights which it claims to derive from the relationship.”⁹³ Russia should not be permitted both to have its cake and eat it too, and the Yukos tribunal should accordingly find that the ECT imposes positive legal obligations on Russia during its period of provisional application.

C. MERITS OF THE MENATEP SUBSIDIARIES’ CLAIMS

The information necessary to fully examine the merits of the Menatep Subsidiaries’ claims is not publicly available, and an actual analysis of the merits of the specific claims is beyond the scope of this Comment. However, it seems relatively clear that provisional application is not inconsistent with the Russian constitution; nor should Russia be permitted to claim constitutional issues as a jurisdictional barrier to avoid a hearing on the merits in the Yukos Arbitration. Accordingly, the tribunal should find that Russia incurred affirmative, binding pre-ratification obligations in agreeing to accept provisional application of the ECT, and the arbitration should proceed on the merits. The importance of such a holding is further reinforced by the potential future implications of the Yukos Arbitration as discussed in the following section.

V. FUTURE IMPLICATIONS OF THE YUKOS ARBITRATION ON THE ECT

In theory, an award or decision in the Yukos Arbitration would not hold precedential value. The Statute of the International Court of Justice does not

⁹⁰ Energy Charter Secretariat, *Russian Federation: Review of the Investment Climate and Market Structure in the Energy Sector* 5 (2004), available online at <http://www.encharter.org/fileadmin/user_upload/document/Investment_-_Russia_-_2004_-_ENG.pdf> (visited Apr 21, 2007).

⁹¹ Martin Arnold, *Putin Calms EADS Nerves*, *Fin Times* E6 (Sept 25, 2006).

⁹² Steven R. Weisman, *Russia Bargains for Bigger Stake in West's Energy*, *NY Times* A1 (June 12, 2006).

⁹³ Advisory Opinion, *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South-West Africa) Notwithstanding Security Council Resolution 276 (1970)*, 1971 ICJ 16, ¶ 91 (June 21, 1971).

expressly enumerate private arbitral decisions as a recognized source of international law.⁹⁴ Furthermore, Article 32(2) of the UNCITRAL Arbitration Rules expressly denies an award precedential value by only providing that an award is “binding on the parties.”⁹⁵ Other international arbitral and treaty regimes include similar non-precedential provisions.⁹⁶ However, in practice, arbitral awards tend to be regarded as a form of soft precedent.⁹⁷ Thus, the outcome of the Yukos Arbitration has the potential to directly impact not only future arbitration under the ECT but, more broadly, the status, characterization, and obligations imposed by provisional application in international law.

Russia continues to consolidate its hold over the energy sector.⁹⁸ This was recently forcefully reiterated by the events surrounding the Sakhalin II project. The Sakhalin II project involves the development of gas fields off of Sakhalin Island and the construction of a liquefied natural gas plant and associated export facilities. Up until December 21, 2006, the project was managed by Sakhalin Energy Investment Company Ltd (“Sakhalin Energy”), a consortium of Royal Dutch Shell (“Shell”), Mitsui & Co, and Mitsubishi Corporation.⁹⁹ Under the Sakhalin II Production Sharing Agreement, Sakhalin Energy was only required to pay minimal royalties on revenues until it recovered its costs. Original cost estimates for the project were \$9.9 billion.¹⁰⁰

In 2005, under Russian government pressure, Shell agreed to exchange a 25 percent-plus-one-share in Sakhalin Energy to Gazprom for a 50 percent stake in another Siberian oilfield.¹⁰¹ However, almost immediately after agreeing to the exchange with Gazprom, Shell announced an increase in the project budget to \$21.9 billion.¹⁰² This in turn set off an investigation by the Russian Ministry of Natural Resources into the project’s documentation and environmental issues,¹⁰³ and resulted in the Gazprom deal stalling.

On September 26, 2006, Yury Trutnev, Russia’s Minister of Natural Resources, announced that Sakhalin Energy had one month to address

⁹⁴ Statute of the International Court of Justice (1945), art 38(1), 59 Stat 1055, 1060.

⁹⁵ *UNCITRAL Arbitration Rules*, art 32(2) (cited in note 70).

⁹⁶ See, for example, North-American Free Trade Agreement (1992), art 1136(1), 32 ILM 605, 646 (1993) (Stating that NAFTA awards are binding only on the parties).

⁹⁷ See Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 *Fordham L Rev* 1521, 1611–12 (2005).

⁹⁸ For a general discussion, see *Don’t Mess with Russia*, *Economist* 11 (Dec 16, 2006).

⁹⁹ Stanley Reed, *Journey to Extreme Oil*, *Bus Wk* 74, 74–76 (May 15, 2006).

¹⁰⁰ *Putin Confident Sakhalin-2 Problems Will be Resolved*, *Interfax: Russia & CIS Presidential Bulletin* (Oct 23, 2006).

¹⁰¹ *Id.*

¹⁰² Reed, *Journey to Extreme Oil*, *Bus Wk* at 75 (cited in note 99).

¹⁰³ *Id.*

environmental violations before Russian authorities would halt the work on the Sakhalin II project.¹⁰⁴ Mr. Trutnev subsequently backpedaled from this assertion, stating that this merely indicated that an investigation into environmental compliance had begun, not that Russia intended to revoke the operating license of the Sakhalin II project.¹⁰⁵ On October 26, the Natural Resources Ministry announced it had extended the environmental review by another month and threatened to bring criminal charges for damaging the country's forests.¹⁰⁶ Despite avowed statements by President Putin that these changes did not amount to a change in the rules of foreign investment in Russia,¹⁰⁷ when viewed in the context of Russia's desire to consolidate control of the energy sector, this seems to be a harbinger of another Yukos-esque expropriation.

As widely expected, on December 21, under an increasingly ominous cloud of investigative delays, Shell and its partners agreed to sell Gazprom a 50 percent plus 1 share of the project for \$7.45 billion,¹⁰⁸ a price viewed by some analysts as below market value.¹⁰⁹ The same evening as the deal was announced, President Putin stated that the "project's 'fundamental problems'—cost overruns and environmental violations—can be considered resolved."¹¹⁰ Further underscoring the non-market character of the transaction, on December 28 the Russian government announced that Shell and its partners had given up the right to recoup \$3.6 billion in capital expenses on a priority basis, money that they were to receive before the Russian government began collecting substantial royalties.¹¹¹

As a specific term of the sale, it is highly probable that Shell and its partners have waived any claims under the ECT. However, similar bullying continues to develop with regard to other energy projects controlled by foreign investors, notably the Arctic Kharyaga oil and gas field being developed by France's Total and Norway's Hydro. The Russian government is currently in the process of reviewing the license to the field, and has indicated that it is seeking a Russian investor for the project.¹¹² A similar process is occurring with respect to

¹⁰⁴ *Trutnev Gives Sakhalin Energy One Month to Fix Sakhalin-2*, Russia & CIS Oil and Gas Weekly (Sept 28, 2006).

¹⁰⁵ Arkady Ostrovsky, *Moscow Reassures Shell over Sakhalin*, Fin Times 11 (Sept 26, 2006).

¹⁰⁶ Arkady Ostrovsky, *Probe into Shell's Sakhalin-2 is Extended*, Fin Times 20 (Oct 26, 2006).

¹⁰⁷ *Putin Confident*, Interfax (cited in note 100).

¹⁰⁸ Chip Cummins and Guy Chazan, *Shell Cedes Control of Pivotal Russian Oil Project*, Wall St J A3 (Dec 22, 2006).

¹⁰⁹ Andrew E. Kramer, *Gas Investors Bow to Pressure on Recovering Expenses*, NY Times C7 (Dec 29, 2006).

¹¹⁰ Cummins and Chazan, *Shell Cedes Control*, Wall St J at A3 (cited in note 108).

¹¹¹ Kramer, *Gas Investors Bow to Pressure*, NY Times at C7 (cited in note 109).

¹¹² See Anatoly Medetsky, *Rosneft and LUKoil in Running for Kharyaga*, Moscow Times 5 (Feb 21, 2007).

the Kovykta gas development in East Siberia being developed by the TNK-BP joint venture.¹¹³

If these developments play out as suggested by the outcome of the Yukos and Sakhalin II affairs, and if any of the foreign investors do bring claims under the ECT, arbitration would once again hinge on the status of Russia's provisional application of the ECT. Given the soft precedential value of arbitral decisions, there is a need to send a clear message in the Yukos Arbitration that Russia's provisional application imposes meaningful binding and affirmative obligations that will expose Russia to liability for any expropriatory actions in violation of the ECT.

VI. CONCLUSION

As discussed in Section I.B, provisional application helps to minimize the collective action problem caused by the gap between signature and entry into force of a treaty by forcing signatory parties to bear the costs of treaty obligations from the moment of signature. However, as illustrated by the Yukos dispute, there is a danger that in certain circumstances, provisional application may actually increase the defection risk. This can only result if the obligations imposed by provisional application are not characterized as binding and affirmative, or are held to be limited in scope. Under these conditions, a signatory agreeing to provisional application would be able to capture the full benefits of the treaty regime up until the point that the signatory determines that the costs of complying in a particular case are less than the benefits to be gained from defection, escaping liability on the grounds that provisional application did not impose binding obligations.

Alternatively, it could be argued that the vagueness of the obligations imposed by provisional application is the primary strength of the concept of provisional application. This vagueness may allow a state to join a treaty regime without initially encountering constitutional or political problems at the national level and without suffering negative reputational effects in the international community arising from refusal to become a signatory. Thus, assuming that the costs to a state's international reputation from failing to follow through with obligations imposed by the treaty it is provisionally applying are sufficiently high, the outcome in the vast majority of cases will be for a state to follow through with its obligations. As a result, the overall effect may be efficient. However, this argument is susceptible to two primary weaknesses. First, in practice, the costs of choosing to violate obligations imposed by a treaty that is being provisionally applied may not be sufficiently high so as to prevent the majority of defects. The

¹¹³ *TNK-BP Not Alone in Moscow's Firing Line*, *Petroleum Intelligence Wkly* (Jan 29, 2007).

case of Russia following its actions against Yukos is illustrative of this point. Even in the face of increasing doubts about the commitment of the Russian government to protect foreign investment, such investment nonetheless increased by 42 percent in the first half of 2006.¹¹⁴ It seems that some markets are so large that foreign investors cannot afford to ignore them despite the risks attendant to such foreign investment. The second weakness relates to the fact that awards by international tribunals are in practice treated as a form of soft precedent. Hence, ex ante, before an international tribunal has directly addressed the extent to which provisional application imposes obligations, the argument regarding the benefits of vagueness may hold true. However, an award in Yukos Arbitration directly assessing the issue of provisional application would in practice be treated as the default rule, thereby eliminating any benefits vagueness may have previously provided.

Regardless of the ultimate outcome on the merits of the Yukos Arbitration, a holding by the tribunal in the Yukos Arbitration establishing affirmative, meaningful, and legally binding obligations arising from the provisional application of treaties has the potential to strengthen the future role of provisional application in international treaty law. Provisional application has the potential to be particularly useful in the context of a global multilateral investment treaty. Even as the WTO was coming into being in 1995, OECD began negotiations on the Multilateral Agreement on Investment, a global treaty on foreign investment. While this effort ultimately failed by 1998, largely as a result of claims that OECD was not the proper forum for negotiating a global treaty on foreign investment,¹¹⁵ it does highlight the perceived need to develop such a broad-based treaty. In November 2001, the WTO agreed to include the subject of foreign investment in the next round of trade talks, though this is unlikely to result in any immediate action.¹¹⁶ Thus, while the prospects for a global multilateral investment treaty in the near future remain dim, it seems clear that the importance of multilateral cooperation in investment will only continue to increase as developing countries seek out foreign investment and foreign investors search for new markets in which their investments are adequately protected. Given the large number of participating states, any attempt to establish a global multilateral treaty on investment would inherently create substantial collective action problems. Providing for the provisional application of such a treaty has the potential to minimize the collective action problems that

¹¹⁴ Neil Buckley, *Bright Prospects Eclipse Concerns: Contradictory Signals from Moscow Have Failed to Keep Foreign Investors Away*, Fin Times FT Report: Investing in Russia 1 (Oct 10, 2006).

¹¹⁵ Jeswald W. Salacuse, *Towards a Global Treaty of Foreign Investment: The Search for a Grand Bargain*, in Norbert Horn, ed., *Arbitrating Foreign Investment Disputes* 51, 82–84 (Kluwer 2004).

¹¹⁶ Id at 85.

result from the gap between signature and entry into force by forcing states to internalize the costs of defection from a treaty that they are provisionally applying. However, as illustrated by the Yukos Arbitration, these beneficial effects will only arise if provisional application creates binding, affirmative legal obligations during the period of provisional application.