

Toward an Enhanced Energy Policy Dialogue: The Energy Charter Treaty Experience, and the Road Ahead

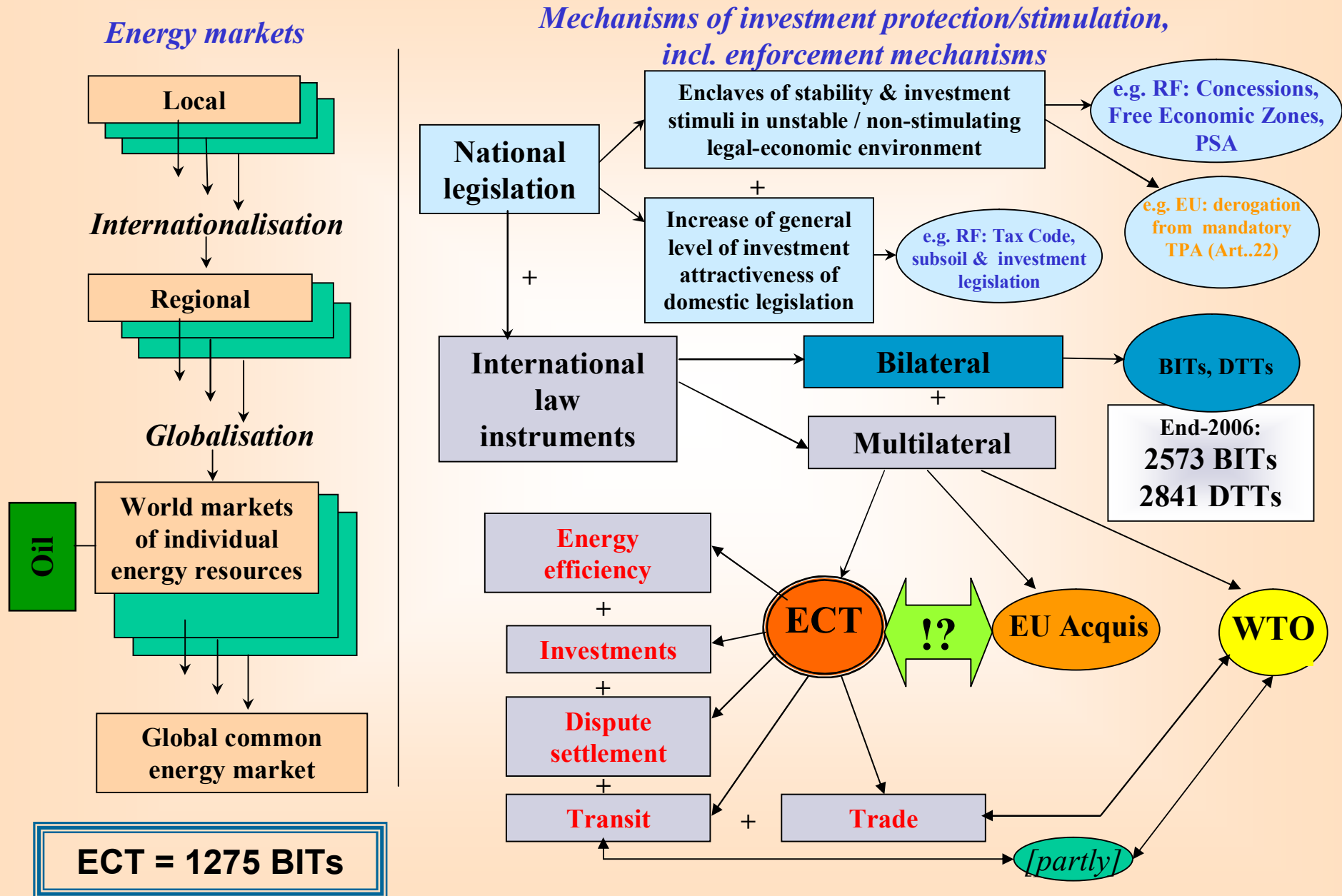
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Natural Resource Investment Relations,**” organized jointly by the
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- New Russian initiative on new international energy order and Energy Charter

DEVELOPMENT OF INTERNATIONAL ENERGY MARKETS & MECHANISMS OF INVESTMENT PROTECTION/STIMULATION



ENERGY ECONOMY: DEMAND FOR QUALITY OF REGULATORY FRAMEWORK

Energy projects (compared to other industries):

- **Highest capital intensity (absolute & unit CAPEX per project),**
- **Longest project life-cycles,**
- **Longest pay-back periods,**
- **Geology risks (+ immobile infrastructure, etc.),**
- **Highest demand for legal & tax stability,**
- **Role of risk management**

=> Higher demand for “quality” of legal and regulatory framework compared to other industries

SELECTED INTERNATIONAL INVESTMENT-RELATED AGREEMENTS

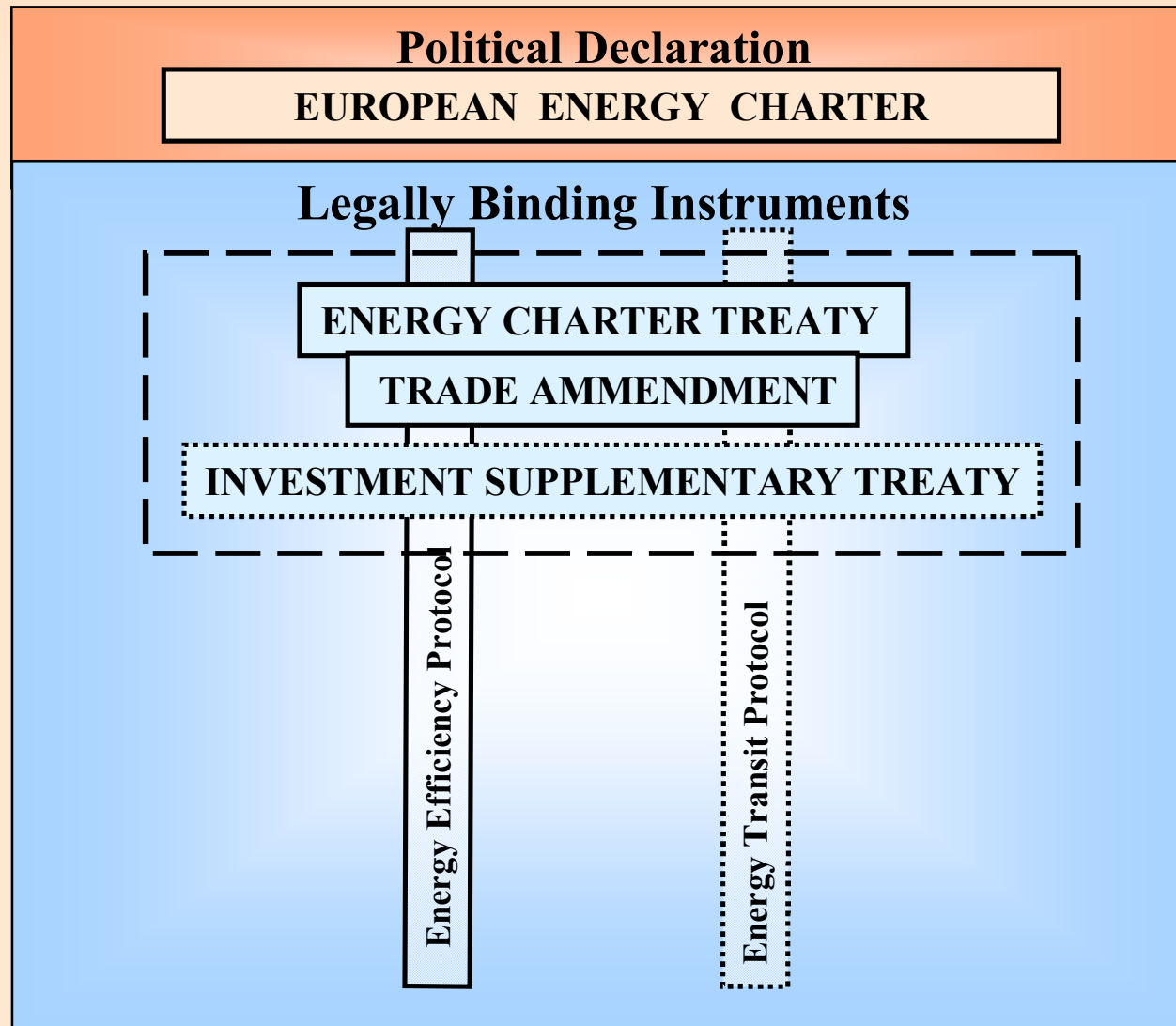
Organisation (member-states/CPs)	Legal Status	Scope	Investment	Trade	Transit	Energy Efficiency	Dispute Settlement
ECT (51/52)	LB	Energy	Yes	Yes	Yes	Yes	Yes
WTO (149)	LB	General	(Yes?) (Services)	Yes	Yes/No*	No	Yes
NAFTA (3)	LB	General	Yes	Yes	No	No	Yes
MERCOSUR (4)	LB	General	Yes	Yes	No	No	Yes
OECD (30)	LB	General	Yes	No	No	No	No
APEC (21)	<i>Non-LB</i>	General	Yes	Yes	No	No	No



* application of GATT Art.V to grid-bound transportation systems is under debate

Plus specialised energy-related organisations: OPEC, IEA, IEF, UN ECE (partly), IAEA, ...

Plus specialised “regional” organisations: BSEC, BASREC, ...

ENERGY CHARTER AND RELATED DOCUMENTS



-  - in force
-  - negotiations not finished yet

ENERGY CHARTER SPECIFIC ROLE

- **Energy Charter *Treaty***

- Unique coverage of different areas for *energy* cooperation:
 - investment, trade, transit, energy efficiency, dispute settlement,
 - energy materials & products + energy-related equipment,
 - 51 member-states (52 CPs) + 20 observer-states + 10 observer international organisations
- First and only one multilateral investment agreement with high standard of investment protection, incl. dispute settlement

- **Energy Charter *process***

- *Implementation* of ECT,
- Specialized forum for “*advanced*” *discussion* of the issues of energy markets evolution that *might create new risks* for development of energy projects in ECT member-states,
- Platform for *preparation of new legally binding instruments* to diminish such risks within ECT member-states (e.g. broadening & deepening of ECT & upgrading its “*minimum standard*” of protection)

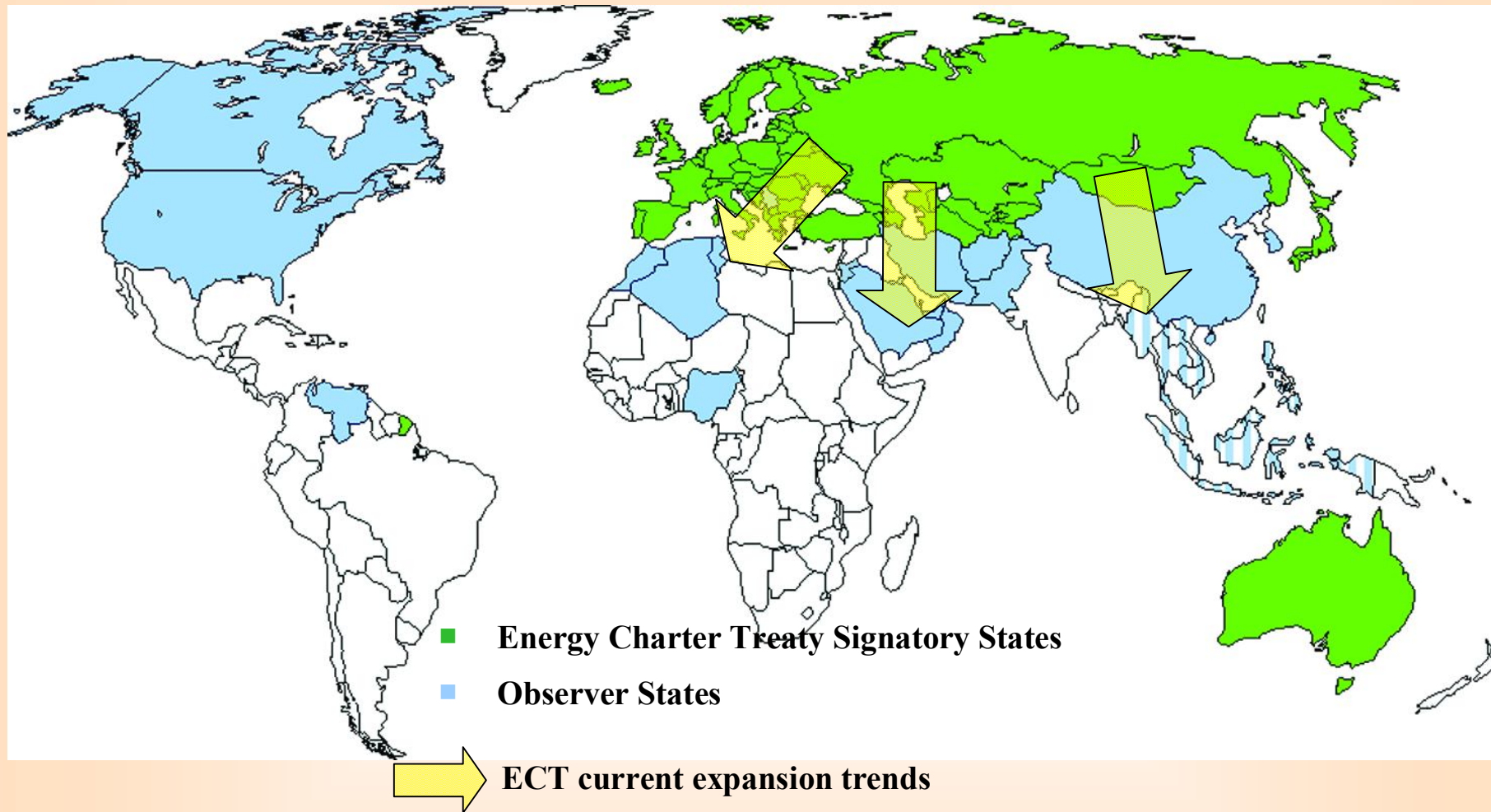
ECT = THE FIRST MULTILATERAL INVESTMENT AGREEMENT (1)

- Based on:
 - well-established practice of BITs (about 400 BITs at the beginning of the 1990's - around 2600 BITs as of today)
 - investment chapter XI of NAFTA (US, Canada, Mexico)
 - some interaction with then OECD proposed “Multilateral Agreement for Investment” (MAI – aborted in 1998)
- **Within 51 member-states ECT is equal to 1275 BITs**
- MFN and National Treatment for investors:
 - *hard-law* obligations (binding guarantee) of non-discriminatory treatment for *post-establishment* phase,
 - *soft-law* obligations for *pre-establishment* phase (stage of making investment)

ECT = THE FIRST MULTILATERAL INVESTMENT AGREEMENT (2)

- Protection against key political/regulatory risk:
 - expropriation and nationalisation,
 - breach of individual investment contracts,
 - unjustified restrictions on transfer of funds
- Reinforced by access to binding international arbitration in case of dispute:
 - State-to-state, and **(NOVELTY!) investor-to-state** => direct dispute settlement at investor's choice at ICSID, UNCITRAL or ICC Stockholm (*competence: appr.50% of new ICSID submissions & appr.20% of ICC cases relates to energy*),
 - Awards:
 - ✓ final and enforceable under New York convention,
 - ✓ usually as entitlement to payment (no risk of vicious circle for retaliating measures),
 - ✓ retroactive to start of dispute, may include interest (no incentive to delay process)

ENERGY CHARTER PROCESS: GEOGRAPHICAL DEVELOPMENT



1. From trans-Atlantic political declaration to broader Eurasian single energy market
2. ECT expansion - objective and logical process based on clear economic and financial reasoning

ENERGY INVESTMENT PROTECTION: COMPLIMENTARITY OF ENERGY-RELATED INTERNATIONAL ORGANISATIONS

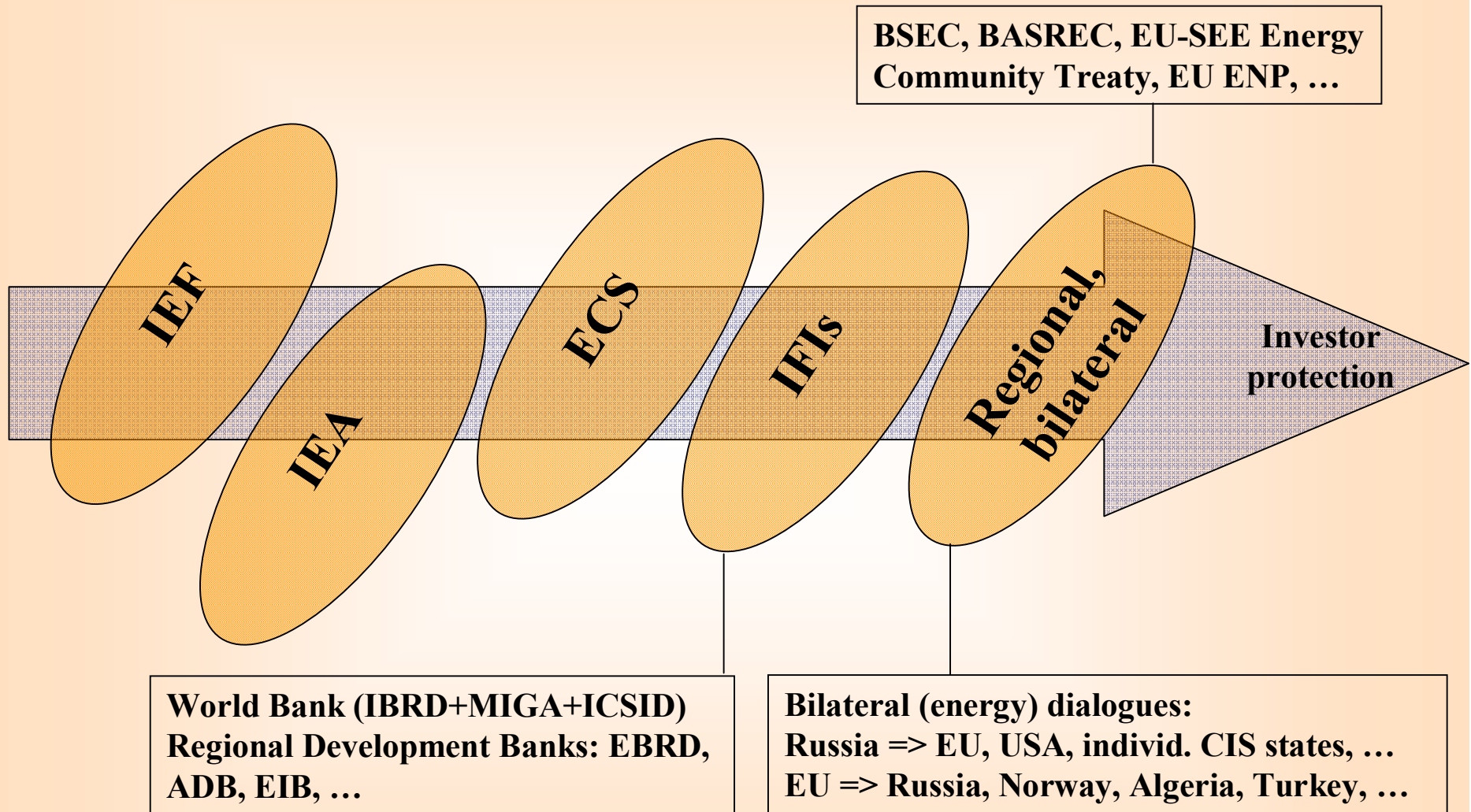
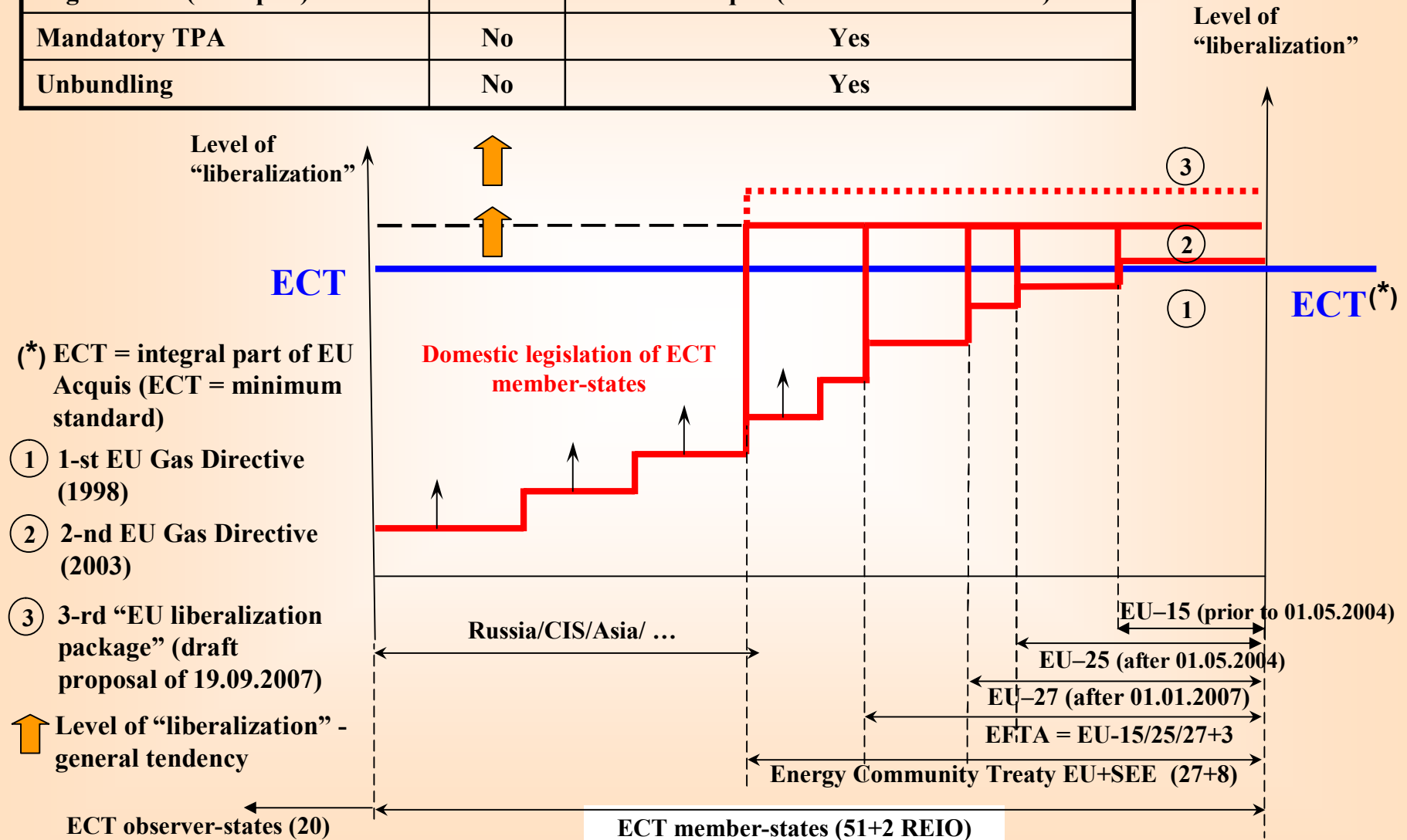


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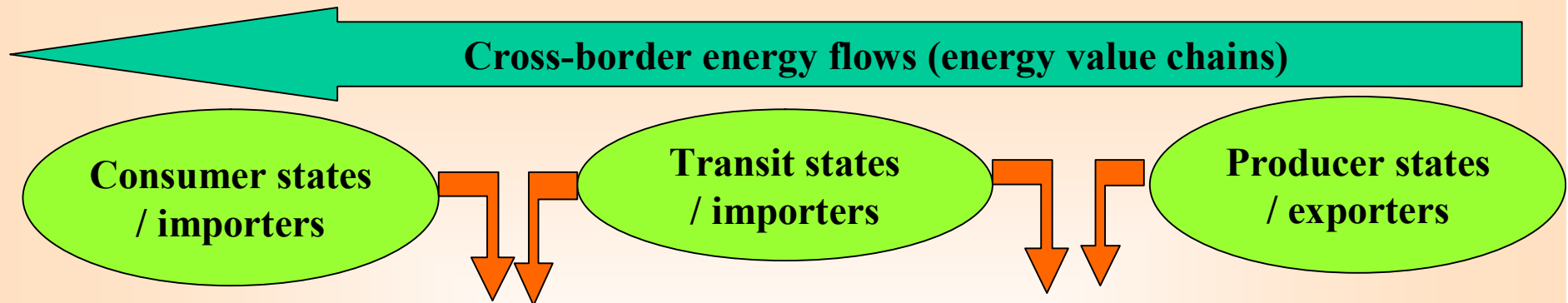
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ECT & EU acquis: "minimum standard" within evolving Eurasian common energy space vs. more "liberalized" model

Legal norms (examples)	ECT	EU Acquis (2-nd EU Gas Directive)
Mandatory TPA	No	Yes
Unbundling	No	Yes



INTERNATIONAL ENERGY: COMPETITION & INVESTMENTS



Aim of importers = increase import supplies of EMP => to **decrease** energy **prices** for end-users => competition is **not** the end in itself, but the **mean** to achieve major aim => competition between exporters (!?) => diversification of supply routes from existing exporters (multiple pipelines) + new exporters & supply routes (multiple supplies) => **CAPEX + time** => competition (cooperation? coordination?) between few major producers;
But: competition increases energy prices for end-users if organised as increase of number of **traders** (especially of small re-sellers) at the consumer/importer market under **limited supply** (restricted, *inter alia*, by liberalization risks for exporters) => investment stimuli (growing markets) dominates over demands for competition (mature markets)

Non-renewable energy resources: limited number of producers / exporters + national sovereignty on energy resources (UNGA Res.N1803 / 1962 + ECT Art.18);
Aim of exporters = resource rent maximization (Hotelling rent + Ricardian rent);
 Competition (for exporters) = diversification of supply routes to existing markets & access to new markets => **CAPEX + time**

Competition = f (CAPEX + time + ...) !!! => investment rules !!!

MATURE & GROWING ENERGY MARKETS ARE DIFFERENT => TO DISTINGUISH THEM

GROWING MARKETS:

- Aim: to develop markets to mature stage = to tie together different segments of energy value chain = to create new energy infrastructure => investment stimuli for domestic & foreign investors regarding creation basic infrastructure
- Basic (most costly/risky) infrastructure is being/to be developed and pay-back periods are still ahead
- Creation of basic infrastructure => aimed to develop access to resources and markets = most costly/risky (pioneering) projects with longest pay-back periods (+ macroeconomic costs usually imputed to these projects)

MATURE MARKETS:

- Aim: to improve their operational efficiency within existing infrastructure/established energy value chains => open & competitive markets, multiple choice & access to diversified infrastructure (both for producers/suppliers & consumers)
- Basic (most costly/risky) infrastructure has been already developed & pay-back periods are over
- Expansion (diversification) of existing basic infrastructure => aimed to provide multiple choice for market participants = less costly/risky projects with shorter pay-back periods

=> Demand for different legal instruments at different stages of market development? Or possible to settle this problem within universal set of rules for broad international community? ECT?

INTERNATIONAL ENERGY LAW: WHOM TO PROTECT FIRST - TRADERS/SPECULATORS *OR* INVESTORS/PRODUCERS/HEDGERS?

Competition rules – most important for **mature** markets (?), since aimed mostly on suppliers-traders (speculators) who:

- work at “**paper** energy” markets
- interested in **liquid & volatile** market (**short-term**)
- make money from providing **financial services**, not energies (money=>money)
- create bubbles & financial crises (when “paper” value exceed too much “physical” value of the market)

Investment rules – most important for **growing** markets (?), since aimed mostly on suppliers-producers (hedgers) who:

- work at “**physical** energy” markets
- interested in **stable & predictable** market (**longer-term**)
- make money from providing **goods & non-financial services** to energy consumers (money=>goods=>money)

Whom international law is aimed to protect first/more: financial speculators *or* suppliers of goods & services ?

THEN AND NOW: CHANGING ROLE OF FDI?

To develop its natural resources (projects) resource-owning state needs:

- **money/finance:** *then* – VIOC/FDI, *now* – NOC (both equity & debt + sovereign budget financing)
- **capital (technologies/innovations):** *then* – VIOC/FDI, *now* – NOC via OECD service companies
- **skilled labour:** *then* VIOC/FDI, *now* – NOC (domestic blue-collars)
- **managerial skills:** *then* VIOC/FDI, *now* – NOC (OECD-originated & domestic white-collars)
- Changing role of FDI !?

New challenges?: Diminishing role of traditional FDI in energy (OECD to non-OECD)? New FDI in energy are developing (non-OECD to OECD & to non-OECD)?

How best to reflect this changes in adapting Energy Charter?

IAP => political debate => Policy Review Conclusions => ...

INTERNATIONAL ENERGY LAW: CHANGING PRIORITIES OVER TIME (1)?

Then:

- **Aim:** to continue develop fossil fuel energy economy =>
- access to resources of fossil fuels outside of OECD by FDI/IOC from OECD (“security of supplies”/SoS concept) =>
- Liberal rules of international energy law reflects SoS concepts developed in OECD to protect FDI/VIIOC from OECD in non-OECD => dominated by “Western” priorities, *but* =>

Now (1):

- whether these FDI-supportive “Western”/OECD concepts incorporated in international law still acceptable for OECD states when they face capital-exporting intentions of non-OECD “Eastern” energy producers (NOC) to invest in OECD? =>
- protectionist measures in “open & competitive” OECD markets against FDI (NOC) from “Eastern” (non-OECD) energy producers?

Changing role of FDI? => move away from open investment rules within open & liquid markets? Away from Anglo-Saxon model to...?

INTERNATIONAL ENERGY LAW: CHANGING PRIORITIES OVER TIME (2)?

Now (2):

- **Aim:** to shift to non-fossil fuel energy economy =>
- Energy Efficiency & Climate Change =>
- new challenges & models for international energy law to reflect further transition *from* specific country/regional energy markets, united by cross-border flows of energy & investment, *to* global energy markets/market =>
- emphasis shifts from protection of individual companies of consumer states in international trade & investment (FDI) to creation of global instruments common & acceptable for all states & companies within cross-border energy value chains?

Changing role of FDI? => changing priorities for international legal instruments? => international rule-making towards supra-national governance (global energy markets) vs. sovereign prerogative (state sovereignty on natural resources)?

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Russian President D.Medvedev on new Russian initiative and Energy Charter (1)

- 20 January 2009: D.Medvedev during meeting with A.Miller, Gazprom:
 - criticised Energy Charter that it did not manage to prevent Russia-Ukraine gas crisis of Jan.2009,
 - “new international mechanisms needed”,
 - “to think either on changing the current version of Energy Charter (if member-states would agree to this) or on creating a new multilateral document...”,
 - Suggested that Government and Gazprom would “think on what mechanism in this sense would be appropriate to prepare and to propose to all members of international community”,
 - promised to propose some ideas during G-20 meeting in London early-April.

Russian President D.Medvedev on new Russian initiative and Energy Charter (2)

- 1 March 2009 during interview to Spanish media D.Medvedev proposed to “prepare a new Energy Charter or a new version of the Energy Charter”
- 20 April 2009 in Helsinki D.Medvedev stated:
 - “Russia has intention to change legal basis of relations with consumer- and transit states”,
 - about “Energy Charter and related documents” that “we have not ratified these documents and do not consider ourselves to be bound by these decisions”,
 - “he will disseminate ... basic document which defines the issues of international cooperation in energy”.

New Russian initiative and Energy Charter (2)

- 21 April 2009 “Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)” published at Russian President’s official website (www.kremlin.ru), total 5 pages, incl.:
 - 2,5 pages – “Main principles of the new legal framework for global energy cooperation”,
 - 1 page – Annex 1: Elements of the Transit Agreement, and
 - 1,5 pages – Annex 2: List of Energy Materials and Products
- Presidential Aide Arkady Dvorkovich (www.kremlin.ru):
 - “These documents are basically being suggested as a substitute for the Energy Charter”, “we probably need a new document” (within broader group of states)
 - “we are not satisfied with the Energy Charter and the related documents as they currently exist, and ... we feel a new legal base is needed”
 - “Russia signed the Energy Charter, but did not ratify it. This means that we do not consider ourselves bound by obligations under the Energy Charter. As for the Energy Charter Treaty, we also do not feel that we are bound by obligations under it... in fact, these documents never applied to us.”

Russia: provisional application of ECT

- Under ECT Art.45 (“Provisional application”) Russia (plus Belarus), applies ECT provisionally, that is “to the extent that such provisional application is not inconsistent with its constitution, laws or regulations”.
- *The worst scenario of immediate future developments:* if Russia, based on results of internal debate, and under ECT Art. 45(3)(b), would decide to declare its termination of the provisional application of ECT (its intention not to become a Contracting Party to the Treaty)
- Visual signs of such internal debate:
 - 21 April, Helsinki, question to A.Dvorkovich: “Russia did not join in on the Energy Charter, so it cannot talk about leaving it”,
 - 29 April, Sofia, V.Putin: “Russia does not see sense in keeping its signature under Energy Charter”.

Russia: Consequences of termination of provisional application of ECT

- will play into hands of anti-Russian political forces (they will repeatedly label Russia as not respecting the rule of law),
- Should Russia ratify ECT, it will in the course of time increasingly protect Russian investments abroad, firstly, from “liberalization risks” within the EU market,
- Since 1998 ECT is an integral part of international law. Russia’s non-participation in the Treaty will not lead to its termination. It’s only that other countries will enjoy its advantages,
- Russia’s repudiation from ECT does not mean that Russia will succeed in creating an alternative and more effective instrument in the foreseeable future. The window of political opportunities is much more narrow today than at the beginning of the 1990s,
- The EU has been exporting its legislation through its system of international treaties. Repudiation of the ECT under these circumstances will deny the possibility for non-EU and non-ECT states to negotiate a “new global energy order” with EU member-states on the terms different from those provided for in the EU legislation.

Common fallacy for quit Energy Charter

- **Two provisions ECT Art.7 “Transit” (interpretations):**
 - Art.7(3) – correlation of domestic transportation and transit tariffs,
 - Art.7(6)-7(7) – conciliatory procedure (correlation of temporary and final transit tariffs)
- **Central Asian gas - transit, tariffs, prices:**
 - As if under direct contracts between CA exporters and EU/CIS importers ECT would bound Russia to provide transit capacities at low domestic transportation tariffs, and thus cheap CA gas would compete with Russian gas at EU market, but
 - ECT, vice versa, presents 5 levels of internationally-accepted mechanisms of justified non-access to the national GTS for potential (new) transit,
 - CA gas is no more “cheap”: since 2009 its export price is based not on cost-plus, but on net-back EU-based replacement value pricing – the highest possible price
- **“YUKOS case”:** (to “quit ECT” to exclude repetition of similar cases):
 - in the event that a signatory terminates provisional application, acc. to ECT Art.45(3)(b), the obligation to apply Part III “Investment Promotion and Protection” and Part V “Dispute Settlement” of the ECT “with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination”.
 - Thus, if, supposedly, Russia would like to withdraw from the ECT in 2009:
 - its obligations on investment protection will remain in force for the next 20 years (till 2029),
 - as well as the possibility of arbitration proceedings against Russia arising out of a breach of ECT investment provisions.

Russian initiative of 21 April 2009: instead of ECT – or to improve multi-facet Energy Charter ?

- **“Energy Charter” is multi-facet meaning:**
 - International organization with open and expanding membership - Energy Charter Conference,
 - Long-term process with its repeating life-cycle (legal negotiations – monitoring of implementation – political debate on adaptation – new legal negotiations - etc.)
 - Expanding package of documents
 - Executive body – Energy Charter Secretariat
- **“Conceptual Approach...”** can not be seriously treated as an alternative to Energy Charter/ECT, but it can be accepted by international community as a set of proposals on how to further improve and adapt existing Energy Charter multi-facet process:
 - Energy Charter Policy Review (ECT Art.34(7)) – once in 5 years: 1999, 2004, 2009,
 - Adaptation of Energy Charter process, with all its components, incorporated in Conclusion of 2004 Policy Review,
 - **“Mail principles...”**: bullet points of Russia’s broad interest to different facets of Energy Charter => to discuss within Ad Hoc Strategy Group & Policy Review 2009
 - **Annex 1 “Elements of the Transit Agreement”**: In draft Transit Agreement – a novelty: Ad Hoc international commissions authorized to settle and prevent transit-related emergencies in case of risk of their occurrences; this novelty was prepared as complimentary to ECT mechanisms and not instead of them; it can be easily incorporated into ECT dispute settlement procedures as second pre-arbitration mechanism in parallel with conciliation.
 - **Annex 2 “List of EMP”**: equal to Annex EM to ECT 1994 and is more narrow than Annex EM1 to Trade Amendment 1998 (energy-related equipment)

Thank you for your attention !

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