

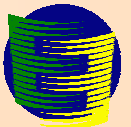
**THE ENERGY CHARTER PROCESS:
ITS LONG-TERM HISTORIC ROLE
AND COMPETITIVE NICHE
WITHIN THE GLOBAL ENERGY ENVIRONMENT**

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The Energy Charter Secretariat**

CEPMLP, University of Dundee - 4 May 2005

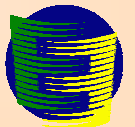
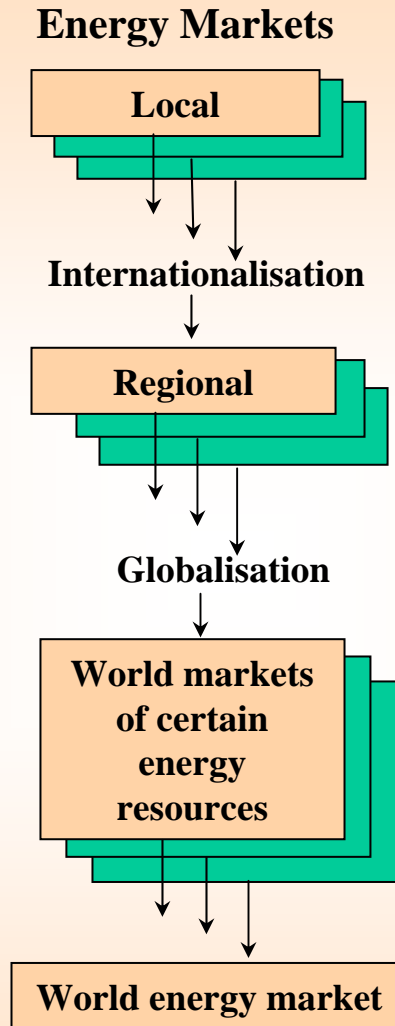
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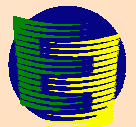
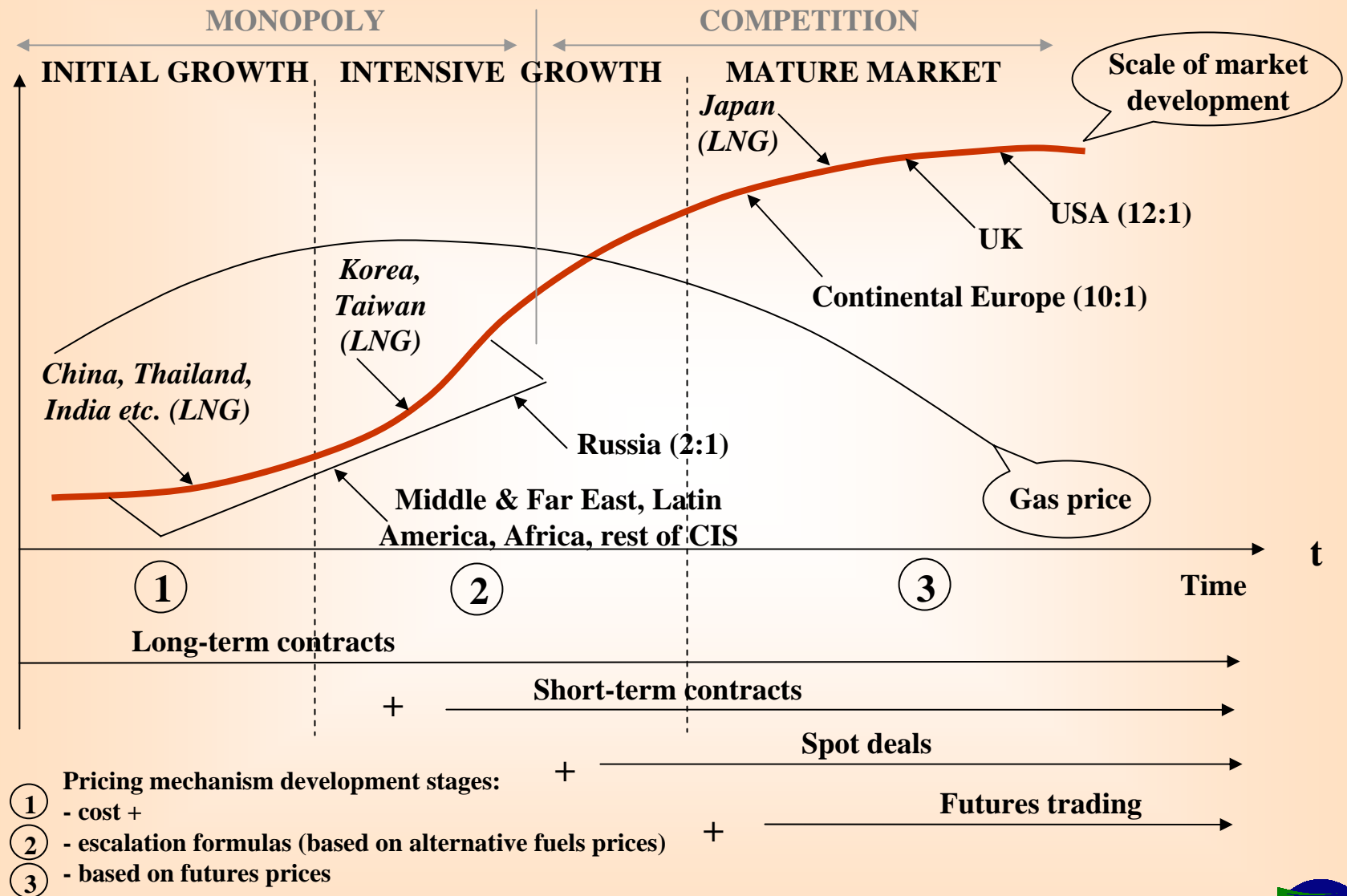


1. Development of energy markets and mechanisms of investor's protection & stimulation

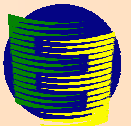
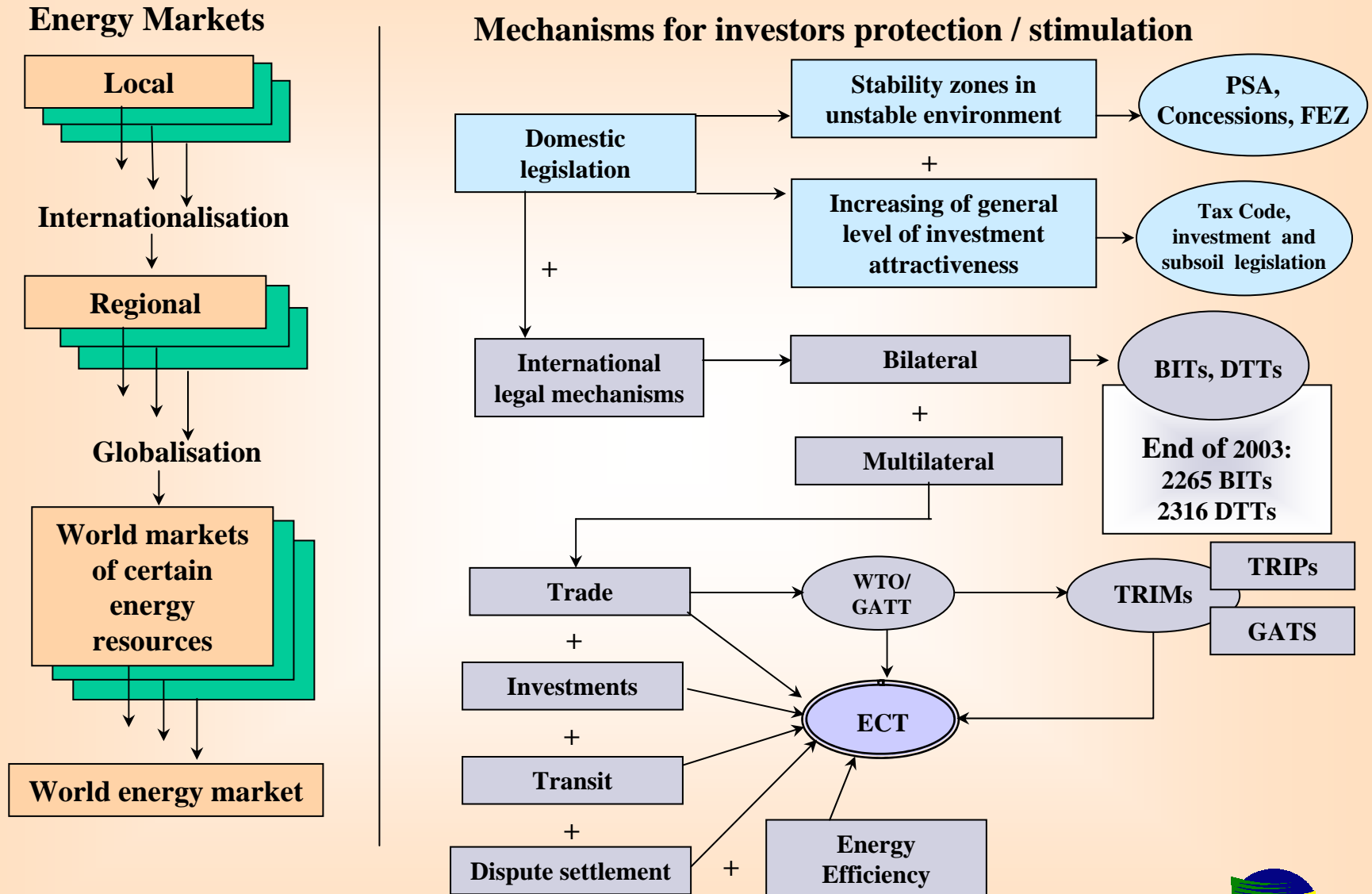
DEVELOPMENT OF ENERGY MARKETS



“EVOLUTION CURVE” OF GAS MARKETS DEVELOPMENT AND CURRENT POSITION OF DIFFERENT COUNTRIES AT THAT CURVE



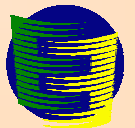
DEVELOPMENT OF ENERGY MARKETS AND MECHANISMS FOR INVESTORS PROTECTION / STIMULATION



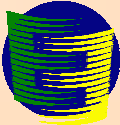
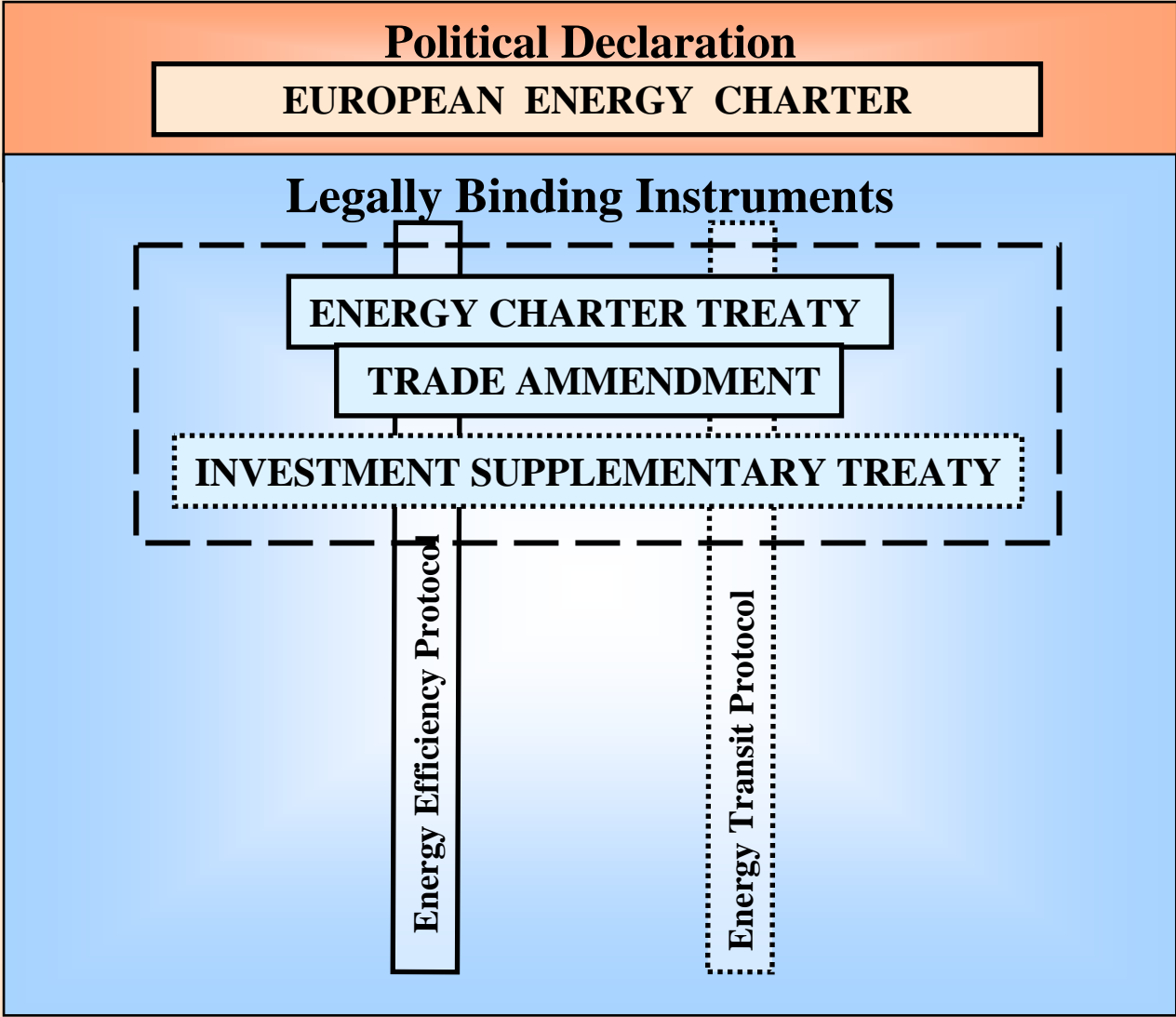
2. General characteristics of the Energy Charter Process

ENERGY CHARTER HISTORY

June 25, 1990	Lubbers' initiative on common broader European energy space presented to the European Council
December 17, 1991	European Energy Charter signed
December 17, 1994	Energy Charter Treaty (ECT) and Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) signed
16 April, 1998	ECT enters into force and became an integral part of international law
As of today	<ul style="list-style-type: none">• ECT signed by 51 states + European Communities = 52 ECT signatories• ECT ratified by 46 states + EC (excl. 5 countries: Russia, Belarus, Iceland, Australia, Norway)• Russia and Belarus : provisional application of ECT



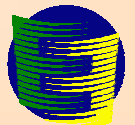
ENERGY CHARTER AND RELATED DOCUMENTS



**THE ENERGY CHARTER TREATY –
A BALANCE OF INTERESTS BETWEEN PRODUCERS
AND CONSUMERS OF ENERGY**

ECT Article 2

**“This Treaty establishes a legal framework
in order to promote long-term cooperation
in the energy field, based on
complementarities and mutual benefits”**

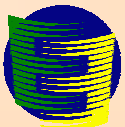


MAIN CONTENT OF SELECTED INTERNATIONAL INVESTMENT-RELATED AGREEMENTS

Organisation	Legal Status	Scope	Investment	Trade	Transit	Energy Efficiency	Dispute Settlement
ECT	LB	Energy	Yes	Yes	Yes	Yes	Yes
WTO	LB	General	(Yes) Services	Yes	Yes/No*	No	Yes
NAFTA	LB	General	Yes	Yes	No	No	Yes
MERCOSUR	LB	General	Yes	Yes	No	No	Yes
OECD	LB	General	Yes	No	No	No	No
APEC	Non-LB	General	Yes	Yes	No	No	No

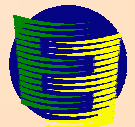
Source: J.Karl, Senior Expert, DEI, Energy Charter Secretariat

* - application of GATT Art.V to grid-bound transportation systems is under debate
 Plus specialised energy-related organisations: OPEC, IEA, IEF, UN ECE
 Plus specialised “regional” organisations: BSEC, BASREC, ...



ECT: THE FIRST MULTILATERAL INVESTMENT AGREEMENT

- **Binding guarantee of non-discriminatory treatment for post-establishment phase**
- **Protection against key political/regulatory risks:**
 - **expropriation and nationalisation,**
 - **breach of individual investment contracts,**
 - **unjustified restrictions on the transfer of funds**
- **Reinforced by access to binding international arbitration in case of dispute**



3. Business role of the Energy Charter process

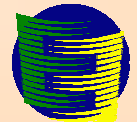
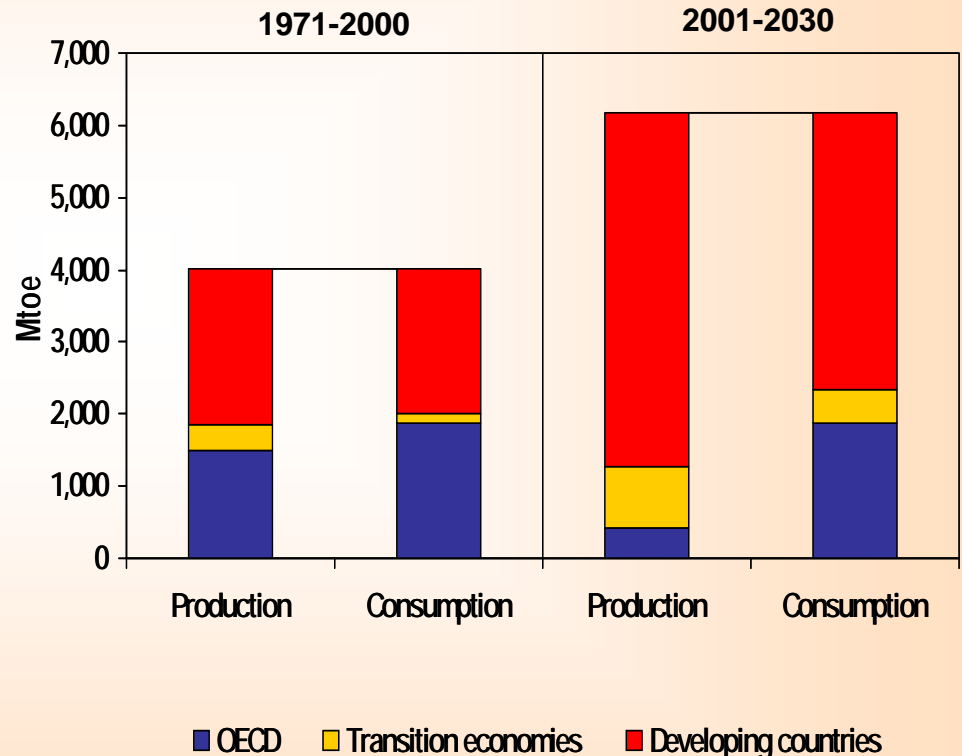
GLOBAL ENERGY TRENDS

2001-2030:

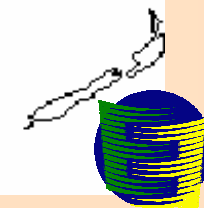
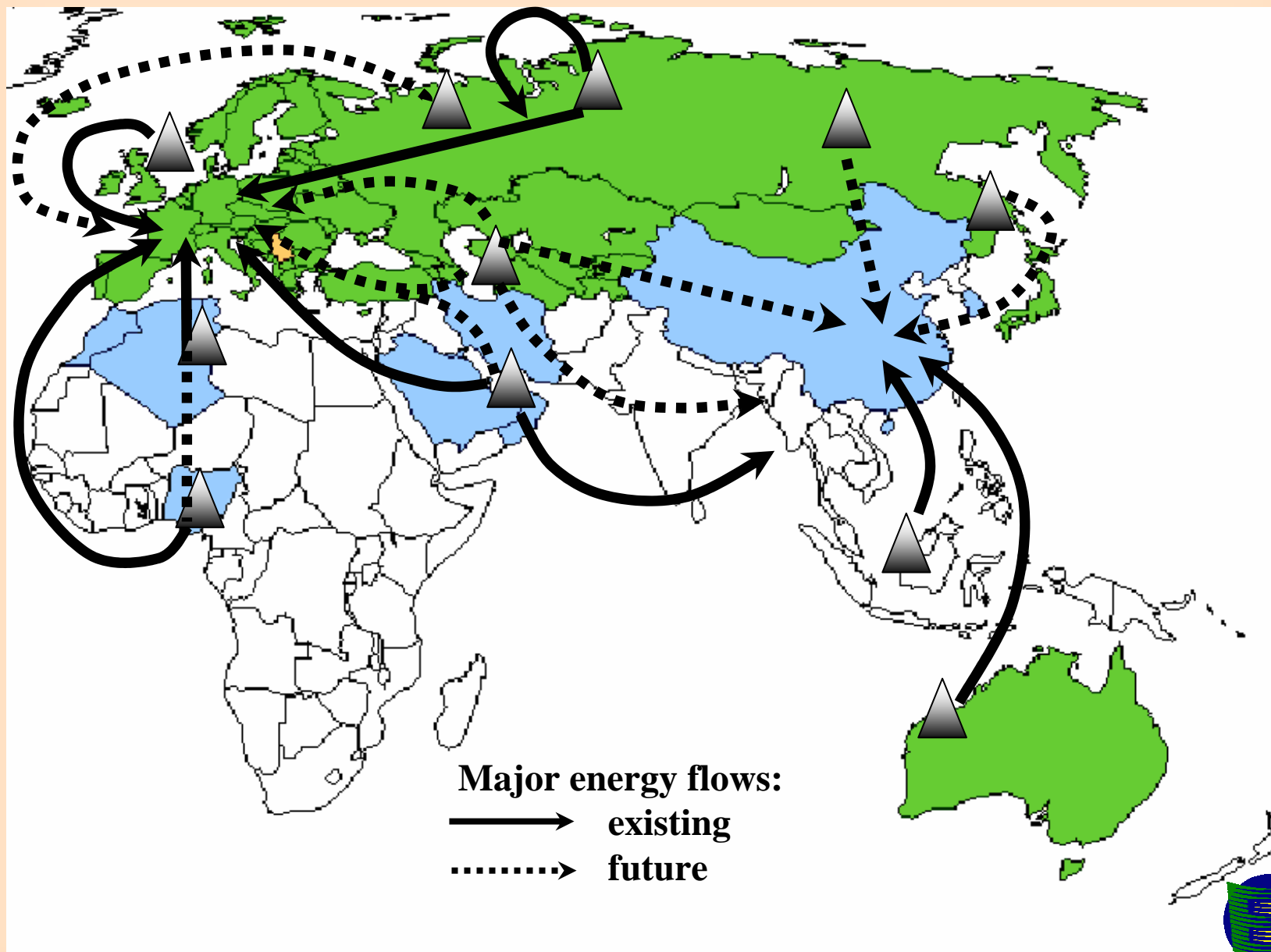
- **Increase in energy production:**
95% outside of OECD
- **Increase in energy consumption:**
70% outside of OECD
- **Cumulative energy investment:**
 - **50% from non-OECD to non-OECD markets, and**
 - **10% from non-OECD to OECD markets**

Increase in World Energy Production and Consumption

(Source: IEA WEIO 2003)



ENERGY CHARTER WORLD AND MAJOR ENERGY FLOWS IN THE EASTERN HEMISPHERE



FINANCING ENERGY PROJECTS: FROM EQUITY TO DEBT FINANCING

Equity/debt financing ratio:

Pre-1970's = ~ 100 / ~ 0

Nowadays = ~ 20-40 / ~ 60-80,

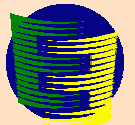
f.i. most recent:

BTC pipeline = 30 / 70

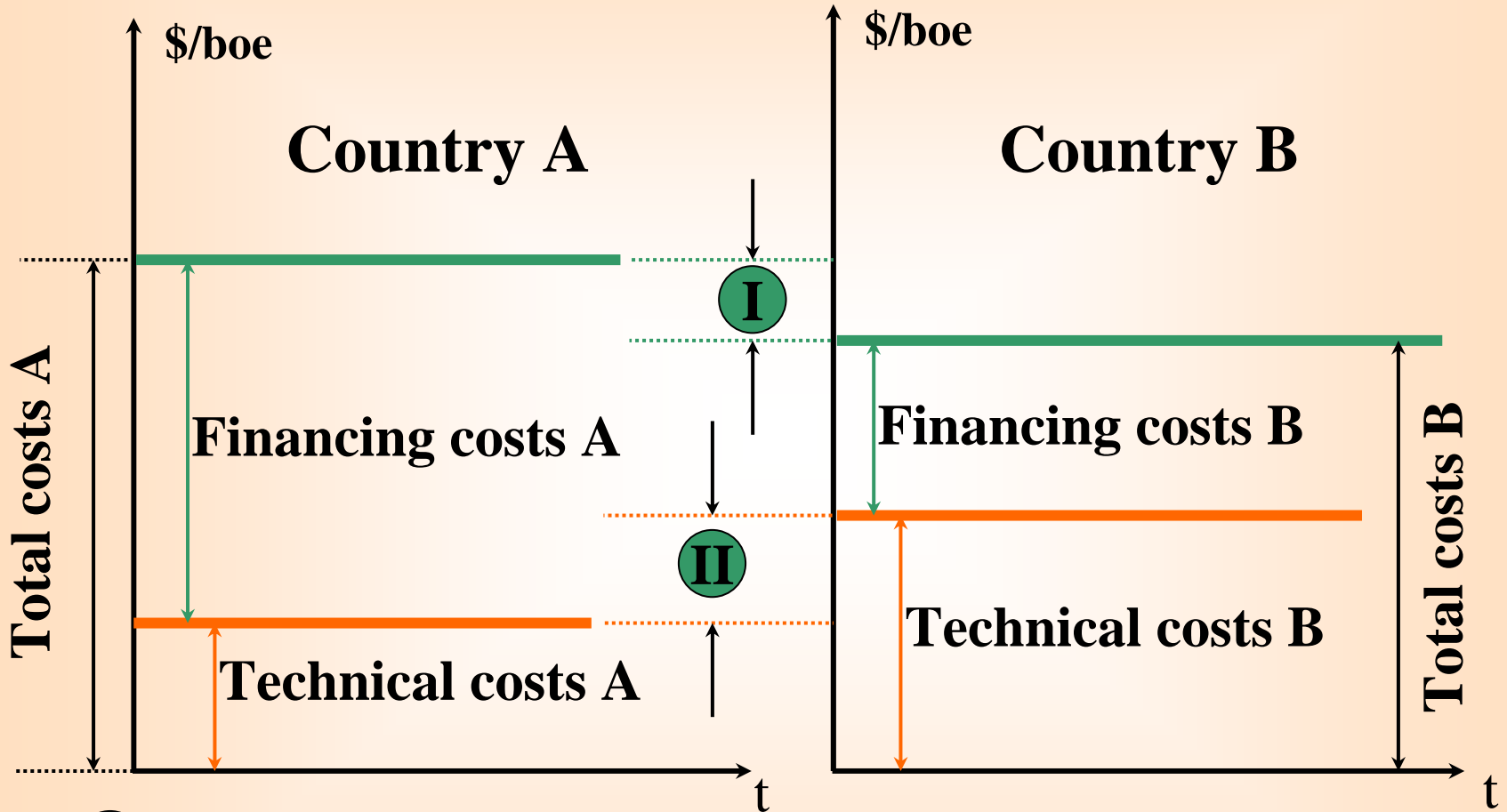
Sakhalin-2 (PSA) = 20 / 80

(2 fields+pipeline+LNG plant)

- ➔ Increased role of financial costs (cost of financing) of the energy projects
- ➔ Availability and cost of raising capital = one of major factors of competitiveness with growing importance in time

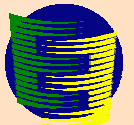


“NATURAL” VS. FINAL COMPETITIVE ADVANTAGES OF ENERGY PROJECTS



I “Natural advantage” of country A over country B

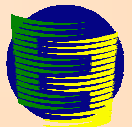
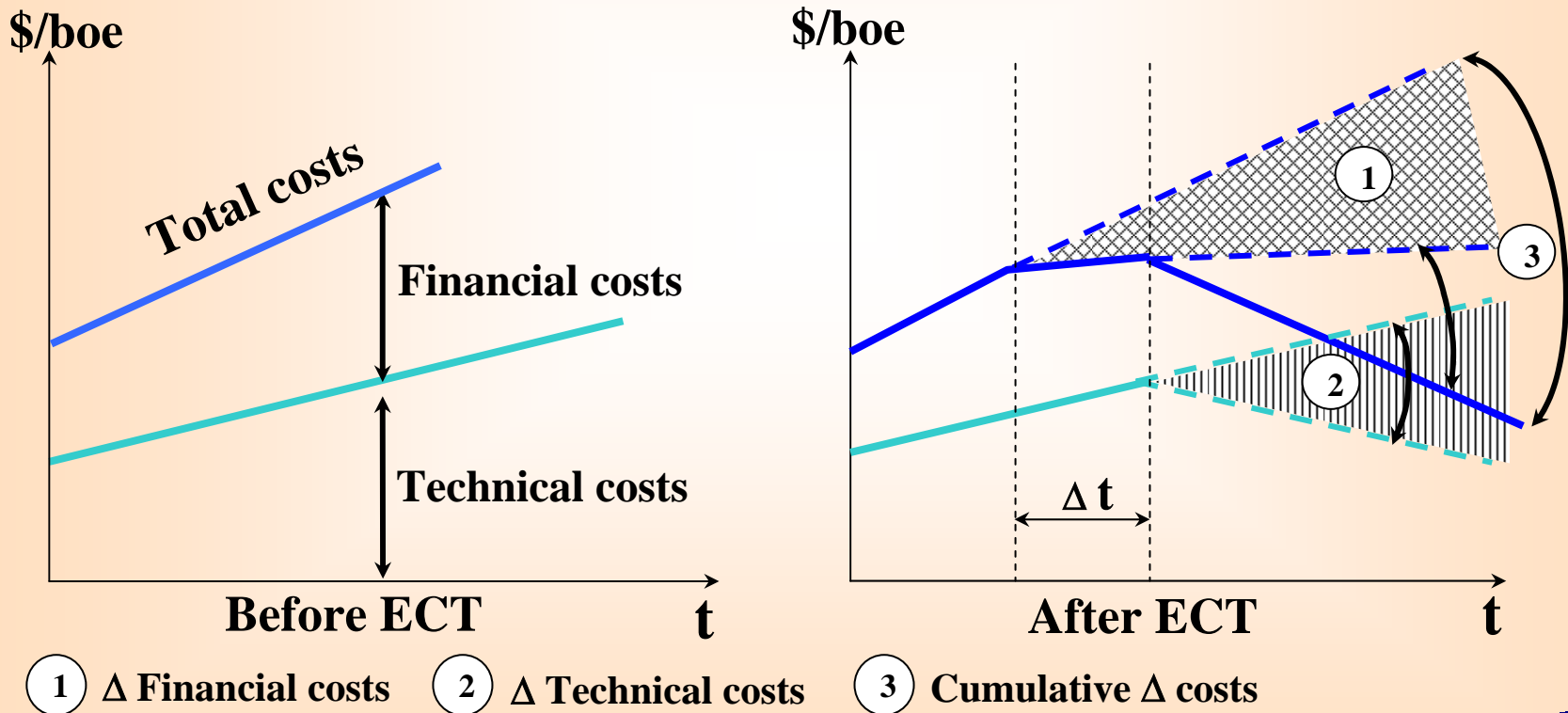
II Final competitive *disadvantage* of country A over country B



ECT IS BUSINESS-ORIENTED TREATY (how it works)

ECT/Legislation → ↓ risks → ↓ financial costs (cost of capital) = ① →
 ↑ inflow of investments (i.e. ↑ FDI, ↓ capital flight) → ↑ CAPEX → ↓ technical costs = ② →
 ① + ② = ③ → ↑ pre-tax profit → ↑ IRR (if adequate tax system) → ↑ competitiveness →
 ↑ market share → ↑ sales volumes → ↑ revenue volumes

ECT provides multiplier legal effect in diminishing risks with consequential economic results in cost reduction and increase of revenues and profits



NON-RATIFICATION OF ECT BY RUSSIA = ITS COMPETITIVE DISADVANTAGE

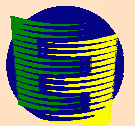
Russia's objective competitive disadvantages: longest distances to markets + falling production at major fields + more complex geology (from Senoman gas of W.Siberia to Valanzhin, Achimov, offshore and Yamal gas) + harsh natural conditions of producing areas

Russia: Highest stimuli to diminish technical and financial costs of production and transportation:

(a) technical costs ← investments ← legal environment in host and transit countries

(b) financial costs ← cost of capital ← credit ratings (sovereign, corporate, project) ← legal environment in host and transit countries

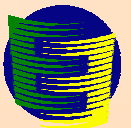
ECT and related documents (when ratified) = common legal environment minimizing risks and technical & financial costs



**4. Energy Charter competitive
niche among other
international organisations**

ENERGY CHARTER PROCESS IN A GLOBAL FRAMEWORK

- General vs. specific risks,
- Global vs. regional scope



ENERGY CHARTER PROCESS IN A GLOBAL FRAMEWORK: GENERAL VS. SPECIFIC RISKS

Q.: Are there any specific risks in energy to be addressed in a special forum / documents?

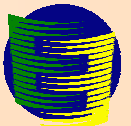
A.: Yes. Energy projects (compared to other industries):

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

So, a competitive niche exists for energy-related multilateral international organisations – at least to address specific character of energy risks.

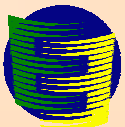
Are these organisations complimentary or competitive to each other?

What is their optimal correlation?



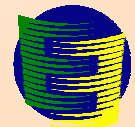
ENERGY CHARTER PROCESS IN A GLOBAL FRAMEWORK: GLOBAL VS. REGIONAL SCOPE

- Investment = global (BITs, DTTs, [MAI?])
- Energy Efficiency = global (partly IEA and UNECE)
- Trade = global (WTO)
- Dispute settlement = global (ECT covers all available DS types/procedures):
 - State-to-State
 - Investor-to-State
- Transit = regional (no other international organization deals with transit except ECT)

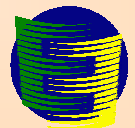
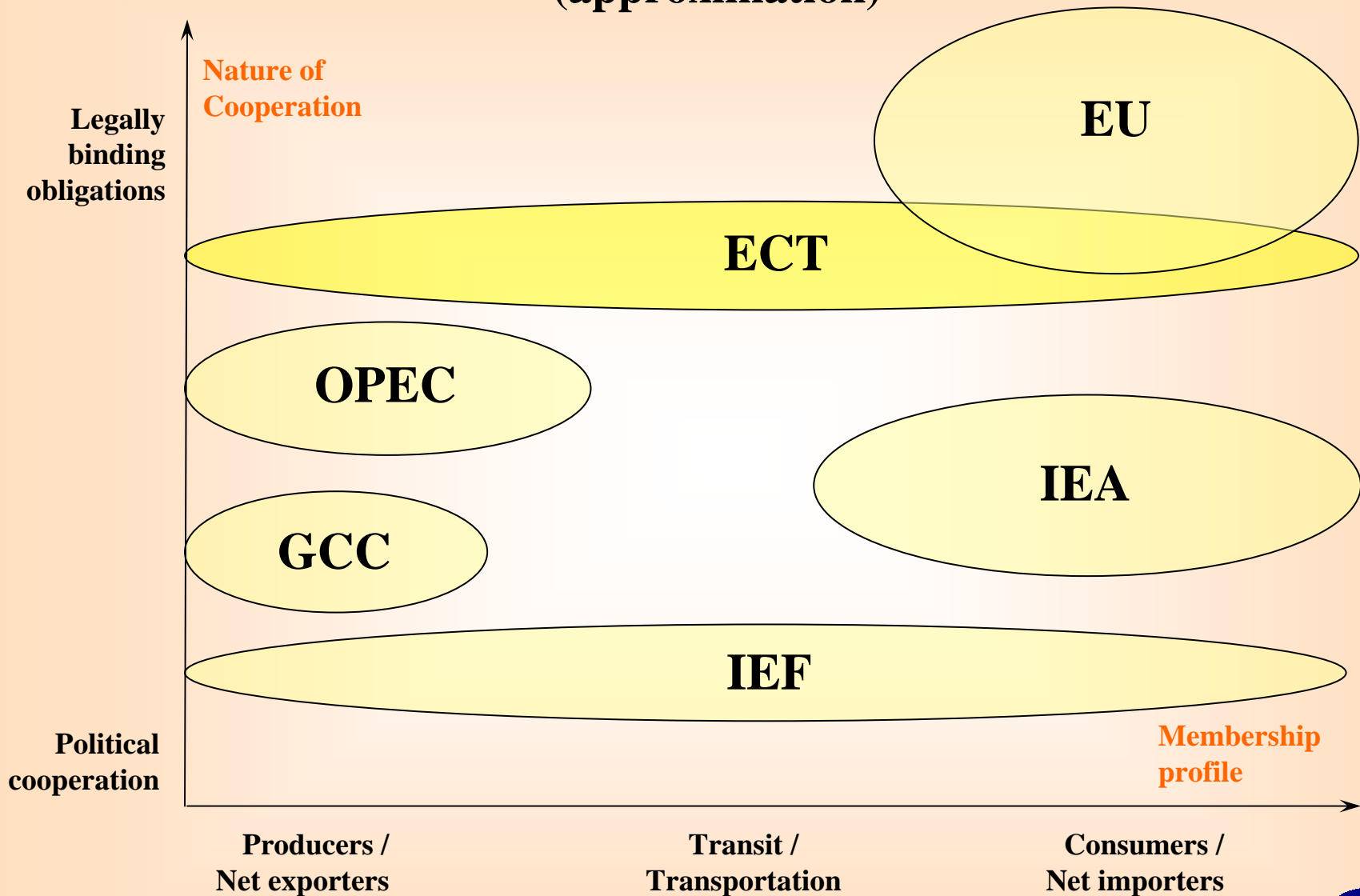


MULTILATERAL ENERGY-RELATED ORGANISATIONS: OPEC, IEF, IEA, UN ECE, ENERGY CHARTER

- **Organisation of Petroleum Exporting Countries (Vienna):**
 - Formal (government oil export policies), but deals only with one – oil – market,
 - Crude oil export quotas mechanism,
 - Oil market research & analysis, etc.
- **International Energy Forum (Er-Ryadh):**
 - Purely informal minister-to-minister dialogue (?),
 - No legal consequences (?),
 - Strong intention of IEF leadership to prevent potential bureaucratisation, etc.
- **International Energy Agency (Paris):**
 - Partly formal – related to oil market (common IEA governments oil stocks policy),
 - Mostly informal (energy markets research & analysis, energy policy recommendations),
 - Quantitative assessments of future energy markets, etc.
- **United Nations Economic Commission for Europe (UN ECE) (Geneva):**
 - Policy debate, technical issues, coordinated policies (?),
 - The only “transatlantic” organisation that historically has been uniting both OECD and former USSR/COMECON states.
- **Energy Charter (Brussels):**
 - Formal (negotiations on legally-binding documents + their implementation),
 - Expanding and deepening the scope of international law in energy-related sphere
 - Add. Policy debate

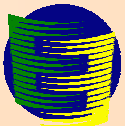


FOCUS OF INTERNATIONAL ORGANISATIONS (approximation)

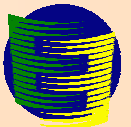
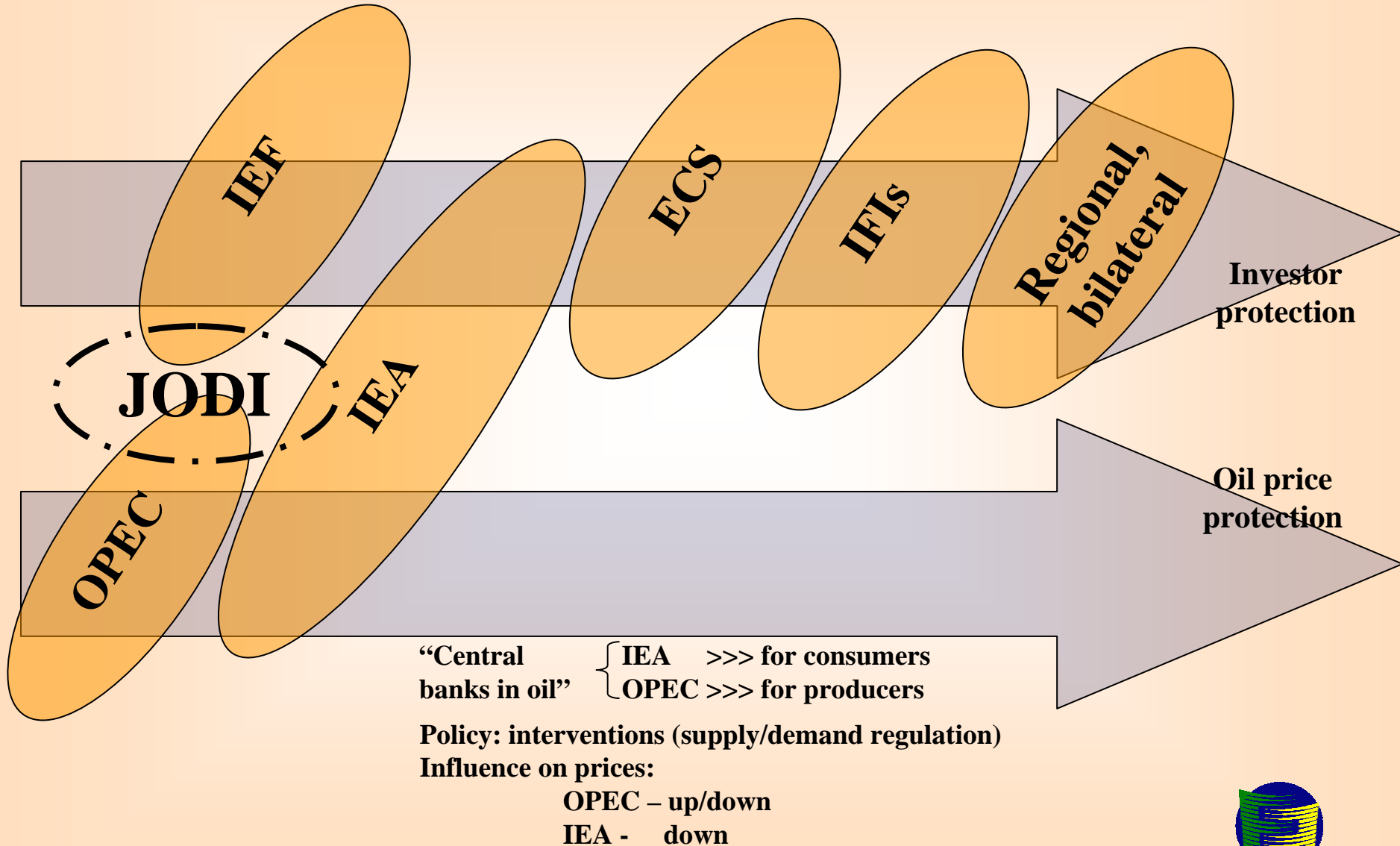


CHAIN OF ACTIVITIES SUPPORTIVE TO ENERGY MARKETS DEVELOPMENT PROCESS AND PROSPECTIVE ROLE/PLACE IN IT OF DIFFERENT INTERNATIONAL ENERGY-RELATED ORGANISATIONS

- **International Energy Forum (IEF):**
 - Indication of issues of interest/concern, “raising the questions”
- **International Energy Agency (IEA):**
 - In-depth analysis, quantitative assessments, scenarios-forecasts
- **Energy Charter:**
 - *Policy debate* – development of common approach to identified challenges and risks of future energy markets development,
 - *Negotiations & implementation* – establishing new legal instruments that would address newly identified risks, and/or amendments to (revisions of) existing legal instruments to update them (when/if necessary) to the new state of the energy markets developments
- **International Financial Institutions (IFIs = EBRD, ADB, ...):**
 - Lead-financiers in FDI inflows in transition economies (pilot actors), lower cost of capital (debt financing),
 - Possibility (?): ECT based policy chapters in IFIs energy loans structure
- **Regional organisations (BSEC, BASREC), bilateral processes (RF-EU energy dialogue):**
 - Incremental political, economic (?), financial (?) support to the “projects of common interest”

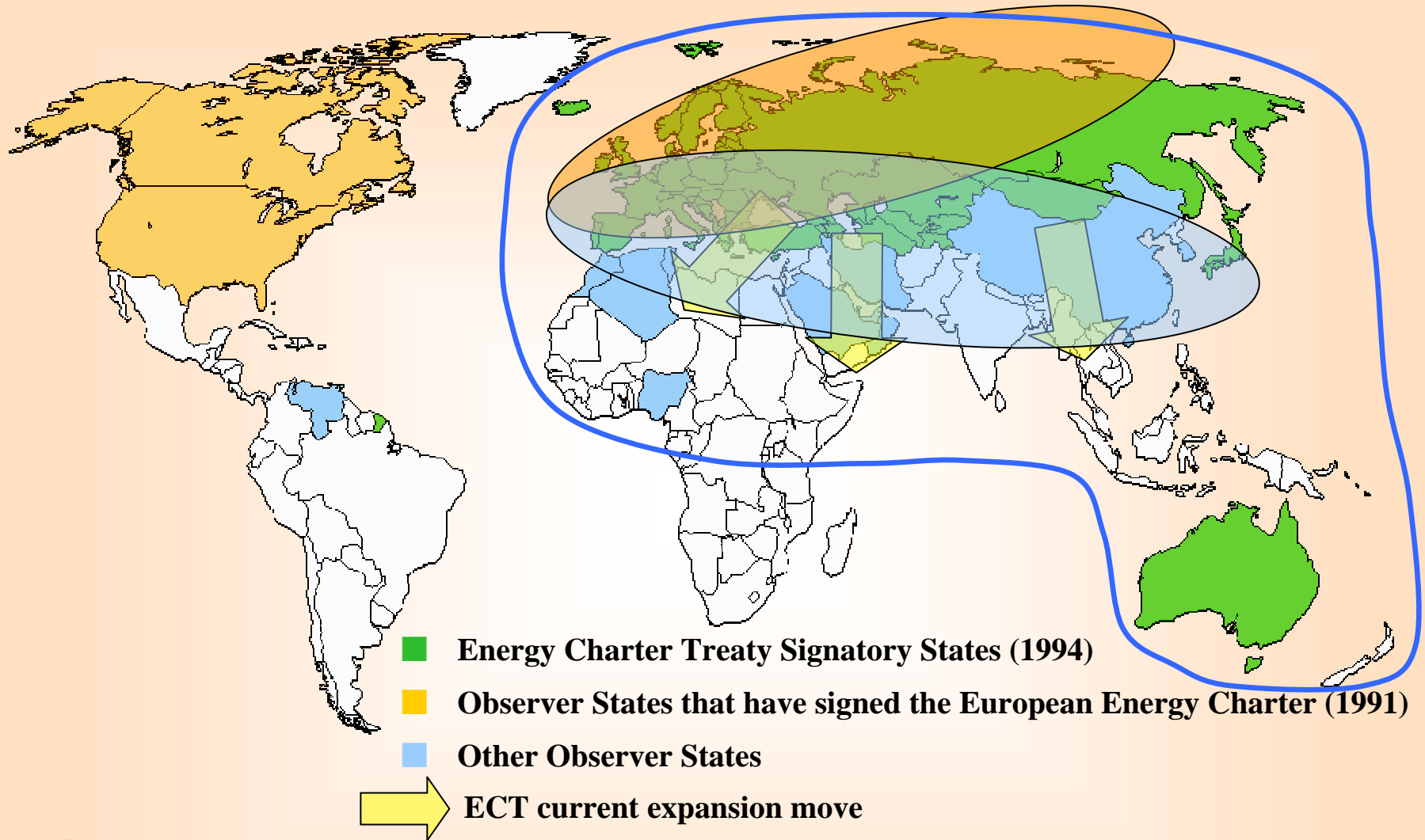


CHAIN OF ACTIVITIES SUPPORTIVE TO ENERGY MARKETS DEVELOPMENT PROCESS AND PROSPECTIVE ROLE/PLACE IN IT OF DIFFERENT INTERNATIONAL ENERGY-RELATED ORGANISATIONS (II)



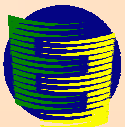
5. Energy Charter emerging geography and expansion policy

ENERGY CHARTER PROCESS: GEOGRAPHICAL DEVELOPMENT

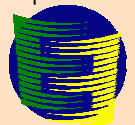
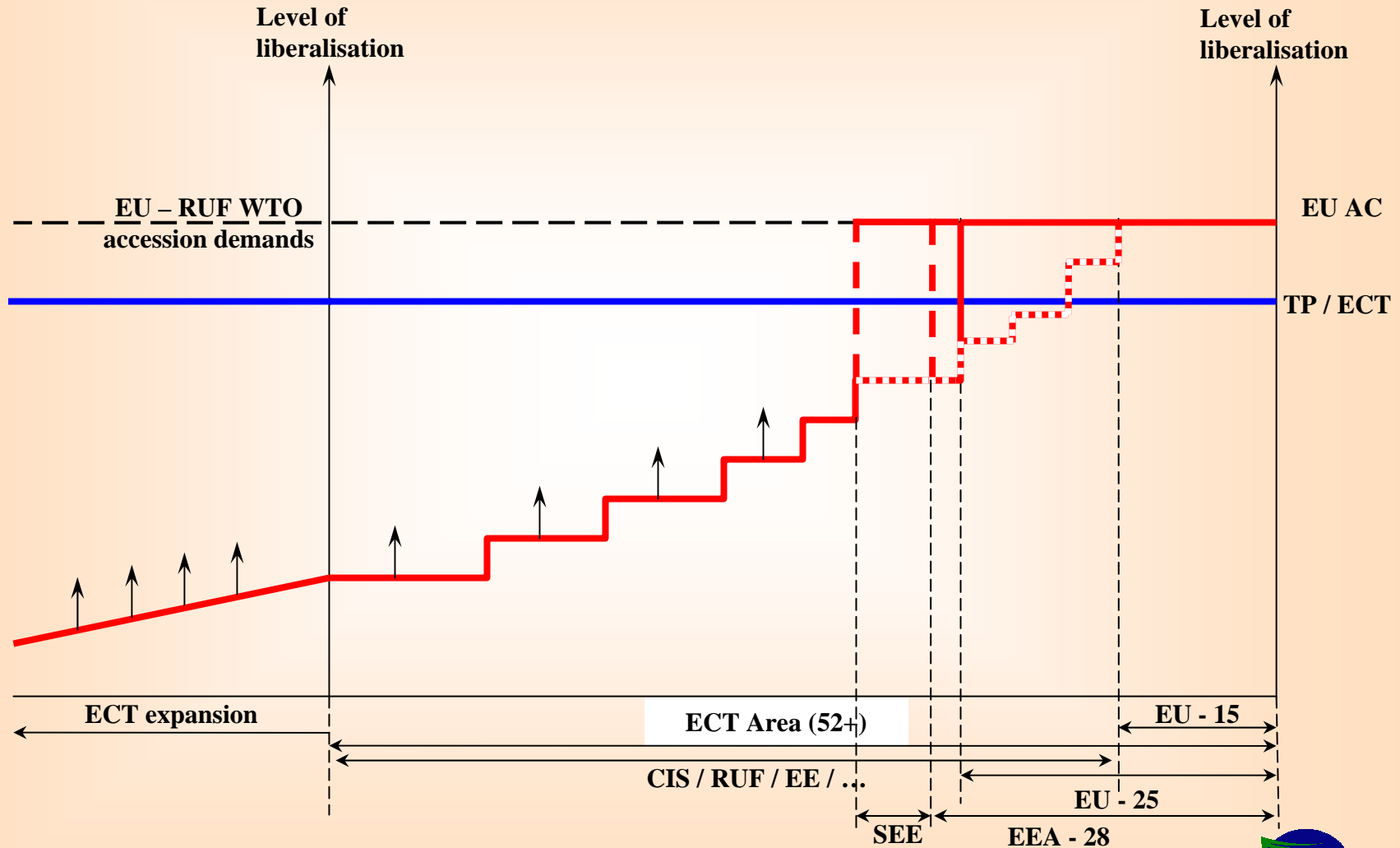


Ⓛ A prospective area of broader Eurasian single energy market

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



CORRELATION BETWEEN EU AND ECT EXPANSION PROCESSES



6. Conclusions: Energy Charter process then and now

ENERGY CHARTER PROCESS: THEN & NOW

	INITIALLY	CURRENTLY
Driving force	Motivated & dominated by interests of consumers	Consumer-producer balance of interests
Policy vs. economy dominance	Politically initiated	Economically driven
Approach to energy security	Physical security of supplies from economies in transition	Security of supplies + security of demand by economic and legal (business supportive legislation) and not administrative means
Geography	<p>(1) “Trans-Atlantic” Europe (i.e. in political / OSCE terms)</p> <p>(2) OECD+CIS+EE</p>	<p>(1) Broader Eurasia, incl. North Africa, Australasia (i.e. in energy & economic terms)</p> <p>(2) OECD+CIS+EE+others</p>
Competitiveness	To decrease final energy prices to consumers even by diminishing producer’s ROR	To decrease full investment-cycle risks → to diminish both technical & financial costs → to increase competitiveness and protect adequate ROR at each step of energy & investment cycle

