
4. Multilateral and bilateral energy investment treaties: Do we need a global solution? The Energy Charter Treaty as an objective result of the evolution of international energy markets and instruments of investment protection and stimulation

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1. EVOLUTION OF THE ENERGY MARKETS AND THE ENERGY CHARTER TREATY – A SUMMARY

There are two main factors that contributed to the creation of the Energy Charter Treaty (ECT): (i) the development of international energy markets to the stage where demand for transition to multilateral instruments of investment protection reached its ‘critical mass’, and (ii) the opening of the window of political opportunities for such multilateral cooperative efforts. So it was fortunate for the broader energy Europe that the economic and political developments coincided for the first time when and where they did.¹

The events in the early 1990s, with the dissolution of the USSR and the COMECON system, the breakdown of the Berlin wall and the related events, provided a window of opportunity for East-West cooperation and the possibility to create an international law instrument to facilitate this type of transnational cooperation between the former ideological opposites in the major segment of their major economic relations.² This

¹ By the ‘broader energy Europe’ the author has been considering the whole geographic area covered by fixed immobile energy infrastructure (such as grids and pipelines) destined for the EU. This means that the broader energy Europe, which includes cross-border energy value chains destined for the EU, factually covers not only the whole geographical area of Europe, but also parts of Asia (incl. Western Siberia, Central Asia, Caucasus, etc.), Northern Africa and will be further expanding.

² See in more details: A. Konoplyanik, ‘The Energy Charter Treaty: A Russian Perspective’, in Thomas Wälde (ed.), *Centre for Petroleum & Mineral*

should have stipulated the inflow of foreign direct investments (FDI) into the ex-Soviet energy sector based on commonly accepted Western-type rule of law. This was expected to help former socialist states to move more effectively towards a market-based economy by using, for this purpose, government takes from additional resource rent generated by development of energy resources and direct, indirect and multiplier effects of energy investments.³ However, this is not to say that the ECT would not have seen the light of the day without these events.

The increasingly international nature of energy markets has originated from an objective asymmetry between the geographical locations of centres and volumes of energy production and centres and volumes of energy consumption (a mismatch between locations of conventional, at the given moment, energy resources/reserves and the key energy-consuming economic areas). This has led to the growth of international energy trade which also called, and still calls, for growth in international energy investments. The growth in international energy trade and investments has been quite naturally complemented by new international instruments and international institutions that support this internationalization development and minimize the risks of international trade and investment flows. This means that the type of international institution such as the ECT was to be created at a time when the demand for its appearance and the opportunities/possibilities for its creation simultaneously coexisted. This happened in the early 1990s.

Energy markets have developed in stages and through a particular logic. The first step was local markets with one producer and a few customers and within a specific territory or specific state. The initial investments that had to be made at this stage of the oil market were not as large as they would be in the later stages or in the gas sector. This is why at the very initial stage, development of the gas sector usually started with vertically

Law & Policy (University of Dundee), 156–178. European Energy Charter Treaty, ‘An East-West Gateway for Investment & Trade’, in *International Energy and Resources Law & Policy Series* (Kluwer Law International, London 1996), 700.

³ A. Konoplyanik, ‘Lubbers Memorandum: An Energy Marshall Plan for the USSR?’, *Interfax – Business Weekly*, March 29, 1991, 9–10; A. Konoplyanik, ‘Lubbers plan: Soviet Energy Export Base Expansion and Creation of Efficient Economic and Legal Environment in the USSR’ – *‘Europäische Energiepolitik und die Sowjetunion’*. Beiträge zu einer Konferenz des Instituts für Europa, Moskau, und der Stiftung Wissenschaft und Politik vom 3. bis 5. Juli 1991. – Stiftung Wissenschaft und Politik. Forschungsinstitut für Internationale politik und Sicherheit. SWP – S 369, September 1991, 203–23; A. Konoplyanik. ‘Lubbers Plan: Soviet Energy as a Standpoint for Improving Economic Reforms in the USSR’, 13(3) *The Energy Journal* (1992), 281–94.

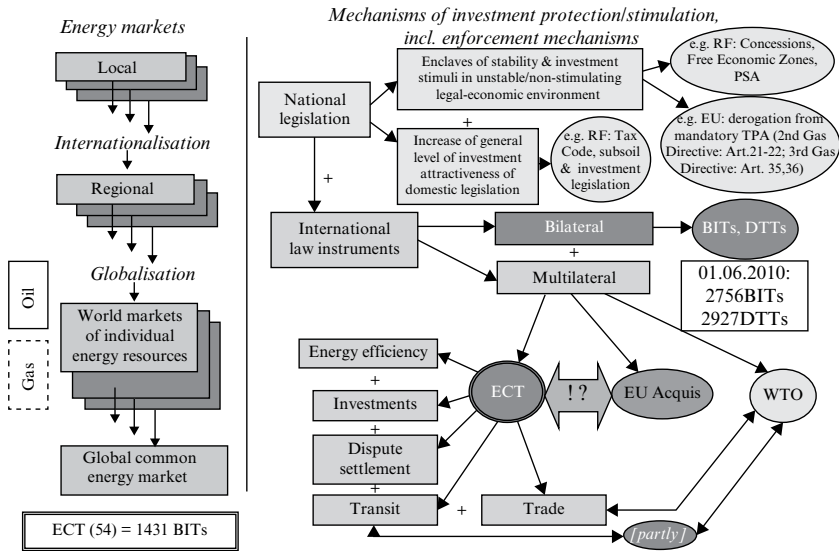


Figure 4.1 Development of international energy markets and of mechanisms of investment and trade protection and stimulation

integrated local companies, which provided limited supplies to the nearby located consumers. This initial stage was then followed by the process of internationalization where the geographical markets expanded and the trade (and then related investment) became international, or regional. Here, markets evolved to include more complex commercial institutions. This process first leads to regional markets. The final stage is the stage of future internationalization or even globalization of energy trade and then investment. The globalization trend then leads to globalization of the markets for energy materials and products as has been the case of oil, and coal to certain extent. In relation to gas, there is no international market but only regional markets – yet. However, we can see a trend towards a similar type of development (as in oil) in the case of LNG which has been uniting regional gas pipeline markets into a global integrated pipeline and LNG based gas market.⁴ This however, requires future developments and investments (Figure 4.1).

⁴ For more details see: А.Конопляник. Ратификация ДЭХ Россией: прежде всего, необходимо развеять добросовестные заблуждения оппонентов (chapter 22). – in А.Конопляник, Т.Вальде (ред.) Договор к Энергетической Хартии – путь к инвестициям и торговле для Востока и Запада (под ред Т.Вальде – англ. изд. и А.Конопляника – рус.изд). – М.: Международные отношения, 2002, 632

It is against this background that the ECT will be now examined. As an investment protection and stimulation mechanism the ECT represents the limits of the political process in the international arena. At the time of its negotiations, and today, it is the leading multilateral framework in this area which presents the best effective mutually accessible consensus of the parties involved at the time of negotiations, e.g. in the early 1990s. The ECT introduces several innovations and pushes the international law in this area into new levels.

2. INVESTMENT PROTECTION INSTRUMENTS IN ENERGY BEFORE INTERNATIONAL LAW

In the first stage of energy markets development, local or national markets, we can distinguish two separate options for investment protection, the choice depending largely on the maturity of the legal and socio-economic situation in the country. In developing or transitioning economies, there is a need for stabilization (a stable economic environment) to attract investments and thus to create for them a transparent and clear legal environment and the possibility and predictability of a reasonable rate of return (RROR). Given the state of national legislation or political and/or legal institutions there is a need to create a mechanism which increases stability for large and capital intensive investments.

Taking into consideration the specificity of energy resources' natural conditions and thus the specificity of risks of upstream energy projects, this type of risk usually requires a project specific response as the first option. This can be included in the investment agreement with the state (concession, production sharing agreement (PSA), host government agreement on pipelines and so on). That was the way the current petroleum arrangements developed in the developing countries starting from the first successful international concessions such as the D'Arcy concession of 1901 in Persia.⁵ The host countries of that time (mostly the monarchies of the

crp.; A. Konoplyanik, 'Energy Security and the Development of International Energy Markets', in B. Barton, C. Redgwell, A. Ronne, and D.N. Zillman (eds), *Energy security: Managing Risk in a Dynamic Legal and Regulatory Environment* (International Bar Association/Oxford University Press, 2004), 47–84; Energy Charter Secretariat, *Putting a Price on ENERGY: International Pricing Mechanisms for Oil and Gas* (Brussels 2007), 236.

⁵ The predecessors of concessions were colonies. The latter were mainly used as a mechanism of providing non-energy natural-resources security for the metropolitan countries. Principal distinction between the two are:– colonies did not

Middle East) did not possess the legal systems, in the traditional Western meaning of that term, which would have provided comfort for the concessionaire doing business (long term stability and predictability of the terms of cooperation between the state and the investor). Established at the edge of the nineteenth-twentieth centuries these petroleum arrangements – traditional concessions – were the early investment-protecting instruments between host state and international investor. They have faced a few stages in their development: in 1948 Venezuela introduced taxation of the concessionaire's profit (which previously did not exist in traditional concessions) – and that's how 'modernized' concessions appeared. In 1963 Indonesia introduced a new type of petroleum arrangement where the investor's net profit was not the result of the deductions from the gross revenue of all the costs, royalties and taxes and thus a residual product, but, instead, it was a result of splitting the gross pre-tax profit of the investor (gross revenues less costs and royalties, where the latter existed) between the host state and the investor based on a previously negotiated formula. That's how 'production-sharing agreements' appeared.⁶

The system of petroleum arrangements has been evolving and updating

possess sovereignty over their territory and their natural resources; these rights belonged to the metropolitan state and natural resources in their colonies were developed as if their own, – under the concessions system, sovereignty over the territory and its natural resources remained with the host state which transmitted resource rights to the concessionaire for a limited (though initially rather long) period of time and on a chargeable basis. Initially the duration of such concessions was very long-term (many would endure today if not nationalized) and the charges rather modest. Thus, approximate expiry dates of former concessions in some OPEC countries would have been (if not nationalized in the 1970s): 1989–99 in Nigeria, 1994 in Iran, 1999–2000 in Saudi Arabia, 2000–13 in Iraq, 2003–26 in Kuwait, 2010–27 in Qatar, 2011–16 in Libya, 2014–18 in Abu-Dhabi. 'When do the concessions end?' in *Petroleum Press Service*, December 1971, 449–50.

⁶ On the history of petroleum arrangement worldwide see numerous publications by the Association of International Petroleum Negotiators (AIPN) and by Gordon Barrows, the former AIPN Vice-President and the Chairman of Barrows Company Inc. (for instance: Claude Duval, Honore Le Leuch, André Pertuzio, Jacqueline Lang Weaver, International Petroleum Exploration and Exploitation Agreements – Legal, Economic, and Policy Aspects. Barrows Company, New York, NY, 2009), Daniel Johnston (Джонстон Д. Международный нефтяной бизнес. Налоговые системы и СПП. – М., 2000; Джонстон Д. Анализ экономики геологоразведки, рисков и соглашений в международной нефтегазовой отрасли. – М., 2005.). The author has also contributed to this list of publications by presenting (at that time the first in the USSR of this kind) a generalized description/summary of the petroleum arrangements worldwide based on data from Barrows Inc. (А.Конопляник. Основные виды и условия соглашений, действующих в нефтяной промышленности капиталистических государств между ТНК и принимающими

Table 4.1 Comparative data on implementation of different types of petroleum arrangements worldwide, 2003 and 2009

	2003		2009	
Number of states in analysis including:	180		177	
Oil producing states, using:		91		104
– Tax plus Royalty (T + R)(*)	113	45	111	55
– PSA	54	32	55	38
– Both T + R & PSA	13	12	11	11

Note: (*) concessions and/or licensing regime.

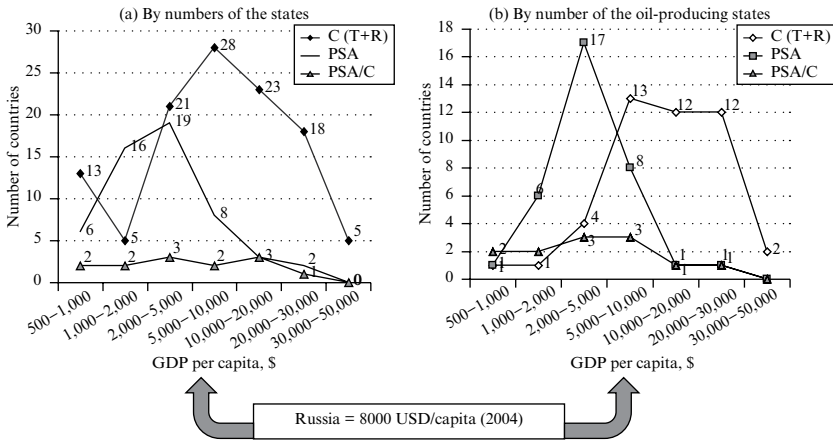
Source: А.Конопляник. Средство от ‘правового вакуума’. Уровень экономического и правового развития государства определяет выбор инвестиционных режимов в недропользовании. ‘Нефть России’, 2012, No. 8, с. 20–24; No 9, с. 26–29; No 10, с. 16–23. Based on data, kindly provided to the author personally by Gordon Barrows (Barrows Company/AIPN)

to the new state of the economy and market developments and nowadays presents one of the important segments of the system of investment protection instruments in energy worldwide.

According to Gordon Barrows (Barrows Company database), there are about 180 states with existing petroleum legislation worldwide nowadays. About half of them are oil producing states. Among those 11–12 are states which possess at least two types of petroleum arrangements if the tax component of petroleum investment regime is taken into consideration: ‘tax plus royalty’ scheme (which means licensing and/or concessionary regime) and PSA. This means that about ten per cent of oil producing states apply domestically more than one investment regime in the subsoil. Others prefer a single investment regime system – either licensing/concessionary or with PSAs. Sixty three per cent of the states (both producing and non-producing) prefer a concessionary/licensing regime, 30 per cent prefer PSAs. Within the group of oil-producing states the share of those preferring concessionary/licensing system is lower – down to 50 per cent, and those with PSAs – is slightly higher – up to 37 per cent (Table 4.1).

This author’s evaluation of the dissemination of the different petroleum arrangements worldwide (project-based instruments of investment protection in upstream oil sector of the host states) dependent on the state of economic development of the host states has shown, that – as a

странами. – ‘Бюллетень иностранной коммерческой информации’ (БИКИ), 1989, Приложение # 10, с. 3–23).



Note: Calculated by M.Belova (ENIP&PF) with involvement of data kindly provided by Barrows Inc. (special personal thanks for this to Mr. Gordon Barrows)

Source: A.Konoplyanik, 'Alternative Investment Regimes for Direct Foreign and Domestic Investments in Russian Subsoil' – Harriman Institute Occasional Paper 2013, 'The Harriman Review Occasional Paper Jan 2013', vol. 19, no. 1 (2013), slide 19

Figure 4.2 'Tax plus royalty' (concessions and/or licences) and PSA worldwide: Distribution curves vs. level of economic development of host state (2003)

general rule – PSAs are immanent for the countries with lower per capita GDP level, while the concessionary/licensing system is immanent for the countries with the higher per capita GDP level and for the non-producing states with the lowest per capita GDP (Figure 4.2). The latter seems to be a surprise at first glance, though quite explainable in the end by the nature and origins of technical assistance programmes for least developed countries (LDCs).⁷

At the time of the dissolution of the USSR, a lack of transparency and stability of investment rules characterized the Russian legal and political

⁷ А.Конопляник. Средство от «правового вакуума». Уровень экономического и правового развития государства определяет выбор инвестиционных режимов в недропользовании. – «Нефть России», 2012, No 8, с. 20–24; No 9, с. 26–29, No 10, с. 16–23; to be published soon in English by Barrows Company; A. Konoplyanik, 'Alternative Investment Regimes for Direct Foreign and Domestic Investments in Russian Subsoil', 19(1) *The Harriman Review Occasional Paper* (2013), 57, 32.

system as well⁸ but for different reasons compared to developing states at the initial stage of their economic development. In the former USSR/ COMECON states this happened due to the radical change from the political and economic model of their previous development, when all the previously existing Soviet mechanisms of managing the economy would no longer have worked but the new post-Soviet mechanisms were not yet created. This movement from a socialist system towards a market based economy created significant transition risks in all post-Soviet and post-COMECON states who decided (voluntarily or by development of the events) to change their economic and political system.

However, it must be noted that this type of transition risk is not absent from the more developed market economies. Just consider the progress in the EU energy markets from the First (1996/1998), to the Second (2003) and to, currently, the Third energy package (2009). These constant legislative changes also create legal uncertainty about the future regulation and the impact of these changes to future and – especially – to prior investments.⁹ For instance, the introduction of obligatory unbundling of vertically integrated companies (VIC) and/or mandatory third party access (MTPA), considered as the major values for energy trade, are quite detrimental for the – especially past – investments.¹⁰ This is only one

⁸ This was one of the reasons why I have proposed in early 1990s to develop PSA legislation in Russia as the most investor-friendly choice, the most effective in the then given circumstances, and has acted as the head of the drafters of Russian PSA legislation. In cooperation with and strong support from major liberal political factions in the State Duma of mid-1990s (such as ‘Yabloko’ (Apple) of Grigory Yavlinsky, ‘Vybor Rossii’ (Choice of Russia) of Egor Gaidar, ‘Regiony Rossii’ (Russian regions) of Vladimir Medvedev), we had managed to successfully pass the PSA law through the lower chamber of the Russian Parliament. Unfortunately, afterwards PSA law was significantly worsened by the upper chamber (Federation Council) and finally its implementation was almost blocked by the law on amendments of Chapter 26 of the Tax Code, developed and sponsored by the Yukos/ Mikhail Khodorkovsky and signed in June 2003 by Vladimir Putin (see corresponding publications and presentations referring to the ‘PSA period’ of my professional activities, mostly 1990–2003, at www.konopyanik.ru).

⁹ This risk has been emphasized in Kim Talus, *Vertical natural gas transportation capacity, upstream commodity contracts and EU competition law* (Kluwer Law International 2011).

¹⁰ See, for instance, an Interview with A. Konopyanik, ‘The 3rd Energy Package and the concerns of non-EU gas producers’, *Eurasia Energy Observer*, 12 February 2011; A. Konopyanik, ‘Russia and the Third EU Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Including Non-EU Suppliers) and Consumers’, 8 *International Energy Law Review* (2011), 24–40; A. Конопляник. Уменьшить риски и неопределенности Третьего Энергопакета ЕС. – «Нефтегазовая Вертикаль»,

example of changes undermining investment stability for long-term energy investments.¹¹ The EU legislators have responded to such risks by the creation of temporary ‘enclaves of stability’ for investors in new capacity by the means of individual project-related derogations from the general rules of the EU energy legislation (Arts 21–22 in the Second EU Gas Directive and Arts 35–36 in the Third EU Gas Directive) (see Figure 4.1).

Thus the appearance of incremental investment risks due to a change of the rules of the game in national economies is not only a characteristic feature of developing countries and/or economies in transition. It is an objective characteristic feature of any emerging economy, including developed market economies, which move further on through the liberalization path (like the EU today) within the general evolutionary trend of energy markets development towards more competitive energy markets. So it is an immanent risk for any development, for any economy in transition, in adapting to new realities which can be considered as ‘permanent soft reforming’. ‘When the Moon went full, it began to diminish’, says the Holy Bible. This means that by changing the rules of the game, even with the aim to further improve some economic condition within the domestic legislative area, any host state, by definition, adds some investment risk for business actors by deviating from the type of economic behaviour known to them to a currently unknown one. This increases transaction costs for any investor, especially in such a capital-intensive, long-term and high-risky area as energy, and firstly in its upstream segments (due to the existence of geological risks which are not present in any other area of economic activity).

Two examples from current EU practice showing the type of new risks appearing with new developments in the regulatory sphere of the developed market economies (what can be called ‘above-the-ground’ risks) are as follows:

The introduction of the unbundling philosophy has led to the situation where commodities and capacities markets are separated nowadays. This has objectively led to the risk of appearance of ‘contractual mismatches’¹²

2012, No 7, c. 79–88; A. Konoplyanik, ‘Reducing risks and uncertainty of EU Third Energy Package’, 3 *Energy Dialogue. Review of International Energy Policy and Security* (2012), 12–14.

¹¹ Also the case-by-case antitrust treatment of long-term contracts in the EU increases significantly business risks for the market actors. See Kim Talus, ‘Just what is the scope of the essential facilities doctrine in the energy sector: Third Party Access – friendly interpretation in the EU v. contractual freedom in the US’, 485(5) *Common Market Law Review* (2011).

¹² Which means that duration and volume of the long-term supply (delivery) contract does not correspond to (exceeds) the duration and the volume of the transit (transportation) contract, the latter being an integral part to fulfil this

(including multiple mismatches within cross-border supplies) since the parties to the supply contract (producer/supplier and its customer) and transportation contract (or a number of contracts within cross-border supply) which enables the implementation of this particular supply contract (producer/supplier and corresponding TSO) now differ and thus multi-facet coordination between all parties involved is needed. This was not the case in earlier days when both supply and transportation contracts were not separated as they were coordinated within the same VIC, which owned and managed both the pipe (which it had usually financed and developed earlier) and the gas in this pipe;¹³

The Third EU energy package in gas (approved in 2009) radically changed the whole architecture of the internal EU gas market, changing it from 'point-to-point' physical deliveries to the 'pool' concept, which meant the introduction of 'entry-exit' zones with virtual trading point (hubs) in each zone.¹⁴

The second option in stipulating/protecting investments by the appropriate means at the national level is the creation of a predictable and stable domestic general legal framework for energy investments (in addition to project-specific instruments) (Figure 4.1). The specific investment laws as well as other related laws, on taxation and/or for subsoil use for example, are to be designed to provide investment stability. Here, the protection does not cover a specific agreement or project but is wider, covering all types of investment activities in the whole economy or in the specific sphere such as subsoil. This tool might work well in the case of similarity of natural conditions of the country-wide resource base or in the case of intelligent construction of the flexible and adaptable energy taxation in the

delivery contract. This creates a risk of non-renewal of transit (transportation) contract which creates risk for supplier of fulfilment of his delivery contract. Core issue: to guarantee access to (creation of) adequate transportation capacity for the duration of long term supply contracts.

¹³ For more details see, for instance: A. Konoplyanik, 'Russian Gas to Europe: From Long-Term Contracts, On-Border Trade, Destination Clauses and Major Role of Transit to . . .?', 23(3) *Journal of Energy and Natural Resources Law* (2005), 282–307; A. Konoplyanik, 'Gas Transit in Eurasia: transit issues between Russia and the European Union and the role of the Energy Charter', 27(3) *Journal of Energy and Natural Resources Law* (2009), 445–86.

¹⁴ For more details see, for instance: A. Konoplyanik, 'Third EU Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Incl. Non-EU Suppliers) and Consumers', OGE 3 (2011), www.ogel.org/article.asp?key=3130; А.Конопляник. Уменьшить риски и неопределенности Третьего Энергопакета ЕС. – «Нефтегазовая Вертикаль», 2012, No 7, с. 79–88.

host country by its government which can differentiate by law (and not in a handy manner) and tax burden (resource rent collection) between and within the different upstream projects¹⁵ located in different natural conditions.¹⁶ An alternative way of creation of investor-friendly investment climate in the subsoil in the host-state, especially with such broad geographical dimensions and such complexity in geological conditions of its multiple oil provinces, as in Russia, is to develop not a single unified legal and tax regime for very different upstream projects, but to create a multiple investment regime (sort of investment menu) established by law in such a host state.¹⁷ The above-mentioned illustration that about a dozen host states worldwide implement more than one type of petroleum arrangements within their territory, proves that the implementation of multiple investment regimes within one state is possible.

These two above-mentioned options are available and typical when the projects are national in scope and energy markets are local or national.

3. INVESTMENT PROTECTION IN ENERGY WITHIN THE INTERNATIONAL LAW PERIOD – BILATERAL INSTRUMENTS

The next stage in the market development, brought about by the internationalization of energy markets, first in trade, then in investments, creates a need for an international response to international projects and markets. Here, international law instruments come into play. Again, there are two consequential options at this stage which came one at a time, not

¹⁵ Thus taking into consideration both the difference (different portion of resource rent in the price) between the upstream projects as well as between different development stages within a single project.

¹⁶ See, for instance: А.Конопляник. Реформы в нефтяной отрасли России (налоги, СПП, концессии) и их последствия для инвесторов. – М.: «Олита», 2002, 217 с. A detailed analysis of the evolving oil tax regime in Russia through more than a 20 year-long period and its fluctuations between partially differentiated, on the one hand, such as in the early 1990s, and non-differentiated oil taxation, on the other hand, such as in the period 2003–06, and back towards partial differentiation again in the most recent years, is presented in: Е.А.Дьячкова. Экономическое регулирование нефтегазовой отрасли в постсоветской России. Москва: ООО «Геоинформмарк», 2011.

¹⁷ A more detailed and most recent description of this proposal in regard to Russian subsoil is presented in: А. Konoplyanik, 'Alternative Investment Regimes for Direct Foreign and Domestic Investments in Russian Subsoil', 19(1) *Harriman Institute Occasional Paper* (2013), 57, 32.

simultaneously. Firstly, it is possible to adopt bilateral agreements with the main commercial partners: bilateral investment treaties ('BIT') and/or double taxation treaties ('DTT'). Such instruments have a rather long history though not as long as the history of concessions as 'enclaves of investment stability' for individual projects, whose commercially successful story started, as was mentioned above, in 1901.

DTTs appeared in the 1920s and the first BIT is dated 1959 – this is because the expansion of the international energy trade beyond the group of major oil VIC started just after WWII, followed by an expansion in foreign direct investments (FDI). By mid-2010 both BITs and DTTs were approaching 3000 each group: 2756 BITs and 2923 DTTs¹⁸ (see Figure 4.1). However, one issue with this approach is that the relevant instruments date back to different decades and, as such, are the product of different trends in international law and international relations. This is also reflected in the content which is different in each case (though strong similarities also exist now due to model bilateral agreements existing in a number of states). So the integral composition of bilateral investment and trade protecting international instruments (BITs and DTTs) is not quite homogenous by objective reasons.

It is the commonly accepted view of UNCTAD that BITs were initially concluded between a developed and a developing country, usually at the initiative at the developed state. The developed country – typically a capital exporting state – entered into a BIT with a developing country – typically a capital importing state in order to secure additional and higher standards of legal protection and guarantees for the investments of its firms than those offered under national laws. The developing country, on the other hand, would sign a BIT as one of the elements of a favourable climate to attract foreign investors. This pattern has changed since the late 1980s and especially in the 1990s, as developing countries and economies in transition began to sign BITs between themselves in great numbers. Starting with the first BIT signed in 1959, 71 BITs were signed worldwide in the 1960s, 93 in the 1970s, 220 in the 1980s, 1472 in the 1990s and about 900 in the 2000s.¹⁹ I will address this peak (saturation) issue later on.

As a result, the dividing line for BIT partners between capital exporting and capital importing countries no longer holds true and, in many instances, countries approach BITs with the dual purpose of protecting their outward investments with, while attracting inward investments from,

¹⁸ Since 2011 UNCTAD World Investment Report has stopped publishing DTT data. By the end of 2011 the overall number of BITs reached 2833.

¹⁹ Based on Bilateral Investment Treaties, 1959–1999. UNCTAD/ITE/IIA/2, 2000, 1-2; UNCTAD World Investment Report 2010. UNCTAD, NY and Geneva, 2010, 81–2.

the other BIT partner. Of course, the degree of emphasis that countries place on each of these objectives varies considerably from BIT to BIT.²⁰

By 1 June 2010 the international investment agreements (IIA) universe consisted of a total of 5985 agreements, including 2756 BITs, 2927 DTTs and 302 other IIAs. As a result, Germany and United Kingdom were parties to 292 IIAs each, followed by France (275 IIAs), the Netherlands (252), Belgium (243), Italy (236), Switzerland (231) and China (230). Germany and China have concluded the most BITs, with 135 and 125 treaties respectively; the United Kingdom and France were signatories to the most DTTs, with 124 and 109 treaties respectively. Members of the EU are parties to most of the other IIAs.²¹

In my view, the slowdown in signing new IIAs does not reflect just a temporary effect. According to UNCTAD, with which I concur, the regime of IIAs is at a crossroads. With close to 6100 treaties in 2011, many ongoing negotiations and multiple dispute-settlement mechanisms, it has come close to a point where it is too big and complex to handle for governments and investors alike, yet remains inadequate to cover all possible bilateral investment relationships (which would require a further 14000 bilateral treaties). The policy discourse about the future orientation of the IIA regime and its development impact is intensifying.²²

The increasing diversity of the whole aggregate totality of bilateral treaties stipulated the search for (at least some) standardization of investment protection rules and instruments within the international law area. A similar search for standardization of the rules happened in the 1980s when liberalization tendencies in the international markets speeded up thus paving the way for further globalization trends. In energy markets this was reflected by their commoditization which demanded the standardization of contractual arrangements in energy trade. As a result the paper energy markets have emerged (firstly in oil in the second half of the 1980s) with futures contracts and financial derivatives in addition to the previous solely existing markets of physical energies.²³ Nowadays we

²⁰ Bilateral Investment Treaties, 1959–1999. UNCTAD/ITE/IIA/2, 2000, 1–2.

²¹ UNCTAD World Investment Report 2010. UNCTAD, NY and Geneva, 2010, 81–82.

²² UNCTAD World Investment Report 2011. UNCTAD, NY and Geneva, 2011, 93.

²³ On the issue of energy markets transformation from one-segment (physical) market to two segments (physical and paper) market, see, for instance: A. Konoplyanik, 'Global Oil market developments and Their Consequences for Russia', in Andreas Goldthau (ed.), *The Handbook of Global Energy Policy*, (Handbooks of Global Policy Series 2013), 477–500; Бушуев В.В., Конопляник

face their regional developments in gas, further to the expansion of spot trading schemes in gas markets.

Thus the creation of some multilateral cut-off minimum standard rules became justified at that stage of economic development when the community of BITs/DTTs became quite big, on the one hand, and on the other hand, it became rather heterogeneous. At this time multilateral instruments and multilateral treaties has come to an existence and had become a regular practice. They began to play an increasingly important – and from my view shall continue to play – primary role as an international instrument of non-commercial risk mitigation in energy.

The UNCTAD World Investment Report (WIR) 2012 stated that

with a total of 47 IIAs signed in 2011 (33 BITs and 14 other IIAs), compared with 69 in 2010, traditional investment treaty making continued to lose momentum. This may have several causes, including (i) a gradual shift towards regional treaty making, and (ii) the fact that IIAs are becoming increasingly controversial and politically sensitive.²⁴

The latter is evidently true within a historical retrospective since it would have been an illusionary perception to expect equality of the provisions of the BIT/DTT between a pair of economically non-equal partners (for example, between the USA and some less developed economy), especially if based on the model IIA developed by the stronger party in the pair.

WIR 2013 provides further evidence in proving the slowdown in the growth of accumulated BITs. Figure 4.3 clearly shows a saturation-type curve in BITs historical development, whose annual number peaked in the mid/late-1990s and has been steadily declining since then. The 20 BITs signed in 2012 represent the lowest annual number of concluded treaties in a quarter of a century.²⁵

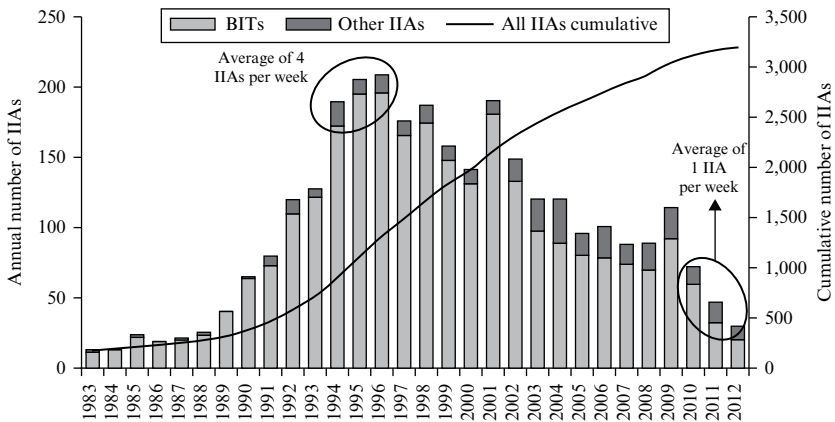
This type of curve reflecting the development of bilateral IIAs is similar to the evolutionary curve of energy markets growth (Figure 4.4) which, in my view, can be explained by the economic interpretation of the left-wing part of the ‘Hubbert’s curve’.²⁶ Within the movement through the

A.A., Миркин Я.М. и др. *Цены на нефть: анализ, тенденции, прогноз*. – М.: ИД «Энергия», 2013, 344 стр.

²⁴ UNCTAD World Investment Report 2012. UNCTAD, NY and Geneva, 2012, p.xx.

²⁵ UNCTAD World Investment Report 2013. UNCTAD, NY and Geneva, 2013, p.xix.

²⁶ Chapter 2.2 in Energy Charter Secretariat, *Putting a Price on ENERGY: International Pricing Mechanisms for Oil and Gas* (Brussels, 2007), 236; A. Konoplyanik, ‘Global Oil market developments and Their Consequences



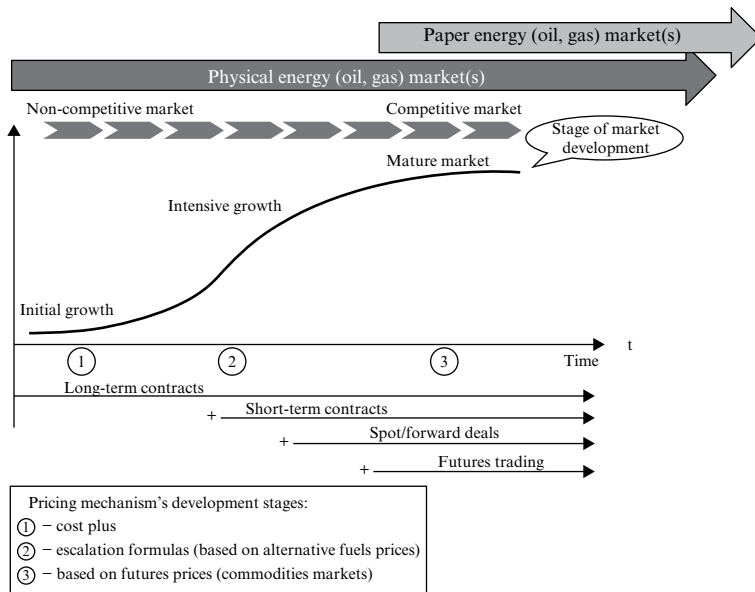
Source: UNCTAD World Investment Report 2013. UNCTAD, NY and Geneva, 2013, p. xx

Figure 4.3 Trends in IIAs: 1983–2012, according to UNCTAD WIR 2013

evolutionary curve of energy markets development, at first institutional instruments of physical market were evolving, which were at some later stage complemented by the institutional instruments of the paper energy markets. Within the physical markets development, contractual structures and pricing mechanisms have evolved starting with long-term contracts and cost-plus pricing, then they were complemented by shorter term contracts with indexation formulas within replacement-value-based pricing, then spot contract and spot pricing has appeared as additional choice for market players within physical supplies. This development makes physical supplies more competitive since it provides multiple choices for market participants. Afterwards, on top of the physical market, paper energy markets began to evolve with corresponding instruments (such as futures contracts, options and different energy-based financial derivatives) which have expanded the number of market players much more by adding to their totality not only participants within the physical energy value chain, but also financial players, e.g. financial investors/speculators.²⁷ Finally (at

for Russia', in Andreas Goldthau (ed.), *The Handbook of Global Energy Policy* (Handbooks of Global Policy Series 2013), 477–500; А.Конопляник. Эволюция энергетических рынков и кривые Хабберта (с.83–90). – в кн.: Бушуев В.В., Конопляник А.А., Миркин Я.М. и др. Цены на нефть: анализ, тенденции, прогноз. – М.: ИД «Энергия», 2013, 344 стр.

²⁷ Ibid.; see also: А. Konoplyanik, 'Long-term investments in the gas



Source: Based on Andrei Konoplyanik, 'Putting a Price on ENERGY: International Pricing Mechanisms for Oil and Gas'. Energy Charter Secretariat, Brussels, 2007, p. 60

Figure 4.4 *Evolution of energy markets and their institutional and contractual structure*

the current stage) the value of the paper oil market exceeds the value of physical oil market by two orders and the first one nowadays dominates, for example, in oil pricing.

This above-mentioned similarity (saturation-type or wave-type) in development curves predetermined, from my view, a door-opening period for the appearance and expansion of new forms of investment

industry: the role of oil indexation (background to the debate)', Presentation at the Workshop on contractual issues related to energy trade, organized jointly by the Energy Charter Secretariat & Hungarian Ministry of National Development, 20 March 2013, Budapest, Hungary; А.Коноплиник. «Эволюция рынков нефти и газа: закономерности движения от рынков физической к рынкам бумажной энергии. Должен ли быть конечным пунктом эволюции энергетических рынков биржевой рынок с единой мировой ценой, как сегодня в нефти?» – Выступление на VII Мелентьевских чтениях «Прогнозирование развития мировой и российской энергетики: подходы, проблемы, решения», Звенигород, 18-19 апреля 2013 г.

protection/stimulation mechanisms in addition to bilateral ones. In my opinion, we have entered into a period of expansion of different multilateral forms of investment protection/stimulation. Something similar to the comparative development of the paper and physical oil markets might happen in the comparative development of bilateral and multilateral instruments of investment protection/stimulation: they will further evolve thus creating competitive choices for the host states to use one or both mechanisms.

4. INVESTMENT PROTECTION IN ENERGY WITHIN THE INTERNATIONAL LAW PERIOD – GROWING IMPORTANCE OF MULTILATERAL INSTRUMENTS

Multilateral treaties present the most recent phenomenon among the available set of tools of investment protection/stimulation in energy. Unlike the BITs/DTTs, a multilateral framework applies to all those countries that have opted to join the framework in the same manner and its application is therefore more predictable within the broader area covered by its contracting parties.

WIR 2012 notes that in quantitative terms bilateral agreements still dominate; however, in terms of economic significance, regionalism becomes more important.²⁸ This should be interpreted as the general trend based on pure economic sense: just as energy markets have been internationalized and have been evolving from regional to global markets, in the same manner but with a different pace, the IIAs can internationalize from regionalization to globalization. However deviations from this rule can happen, if/when/where the market demand and windows of opportunities co-exist, bringing corresponding IIAs immediately to multi-regional level. In my view, this was the case with the ECT.

The major comparative benefit of multilateral instruments against bilateral ones is that one multilateral instrument has a consolidated strength/power of a number of bilateral ones, thus saving time, money and negotiating efforts for their preparation. On the other hand, multilateral instruments provide a common denominator – a minimum standard (if agreed as such) of applicable rules which is quite difficult to achieve through a multitude of bilateral instruments.

Thus, for example, the ECT as a multilateral tool within the current 54

²⁸ Ibid.

member-states has a consolidated power of 1431 BITs (see Figure 4.1) and it only took three years to negotiate and sign the ECT. On the contrary, it took almost 55 years to reach today's amount of BITs (2833 by the end of 2011).²⁹ This means that preparation of half of that quantity (which amounts to the consolidated power of BITs the ECT is equal to) might have taken at least also the half of the time, i.e. more than 25 years or eight times longer than it took to prepare and sign the ECT. So, the immediate economic and logistical benefits of the multilateral instruments are quite evident.

UNCTAD has noted that in most cases, regional treaties are free trade agreements (FTAs) in which the trade and investment elements of international economic activities are increasingly interconnected, and that despite a step towards multilateralism, the new treaties do not entail the phase-out of the old ones.³⁰ This, again, corresponds to the general evolutionary trend in energy markets development: new institutional characteristics of the markets (like contractual structures, pricing mechanisms, energy mixes, etc.) are being developed by adding new elements to their previously existing composition and thus creating a new broader dynamic competitive environment, and not by direct substitutions of the preceding mechanisms by the new ones.³¹

WIR 2013 signalizes that investment regionalism is gaining ground. At least 110 countries (57 per cent of the UN community) are involved in 22 regional negotiations.³² According to UNCTAD, regionalism can provide an opportunity for rationalization of the IIAs. The dominant avenue for rationalization is to be chosen soon since between 2014–18 the window of opportunities will be open for termination and/or renegotiation of almost half of all existing BITs: by the end of 2013, 1325 BITs will be at the stage where they could be terminated or renegotiated at any time, and by the end of 2018 – 1598 BITs, 'creating a window of opportunity to address inconsistencies and overlaps in the multi-faceted and multi-layered IIA regime'.³³ The choice is: whether the states would prefer to continue adap-

²⁹ Ibid.

³⁰ Ibid.

³¹ A. Konoplyanik, 'Global Oil market developments and Their Consequences for Russia', in Andreas Goldthau (ed.), *The Handbook of Global Energy Policy* (Handbooks of Global Policy Series 2013), 480–481; Бушуев В.В., Конопляник А.А., Миркин Я.М. и др. *Цены на нефть: анализ, тенденции, прогноз.* – М.: ИД «Энергия», 2013, с.94

³² UNCTAD World Investment Report 2013. UNCTAD, NY and Geneva, 2013, p.xx.

³³ Ibid., pp.xx–xxi.

tation within the bilateral line of action, or whether they would prefer multilateral options, both regional and/or global ones.

And once again, in my view, multilateralism will, most probably, continue to increase in importance during the years to come, thus step-by-step becoming a dominant trend.

Well-known multilateral legal instruments, international treaties, include, inter alia, the WTO and the ECT, but the EU legal system can also be considered to be a multilateral legal framework (Figure 4.1).

The latter is still the issue of a not yet finalized (and maybe not even started) international debate on the correlation and subordination of the EU *acquis communautaire* and international treaties, such as, for instance, the ECT. For a number of years, starting with my tenure in the Energy Charter Secretariat (ECS) in 2002–08, this has been an issue. In 2004–07 when we organized the process of bilateral informal consultations between experts of Russia and the EU (with participation of the ECS staff-members) on the outstanding issues of the draft Energy Charter Protocol on Transit,³⁴ this was one particular issue which was not discussed in substance³⁵ since our colleagues from the Commission were not in a position to accept the invitation nor one from the ECS (within the multilateral Energy Charter process), nor one from Russian experts (within different bilateral formats) to organize a debate on how internal EU law (*acquis communautaire*) corresponds with international law provisions (ECT, Russia-EU Partnership & Cooperative Agreement, etc.), especially regarding their investment protection clauses. One of the key points for the proposed discussion has been the following: for the EU as a whole its *acquis communautaire* is an internal domestic legislation. This means that the international treaties, to which the EU as a whole is a party, dominate over EU domestic legislation in cases of conflict of their respective provisions. The EU as a whole is a Contracting Party to the ECT (as well as its individual Member-States). This means that in case of legal conflict/collision ECT provisions should dominate over provisions of

³⁴ See a series of this author's publications, especially through the period 2002–08, on this at www.konoplyanik.ru and, in particular, on results achieved during this consultations, in A. Konoplyanik, 'Gas Transit in Eurasia: transit issues between Russia and the European Union and the role of the Energy Charter', 27(3) *Journal of Energy and Natural Resources Law* (2009), 445–86.

³⁵ This open issue resulted from the different views of the EU and Russian delegations on the Art. 20 of the draft Energy Charter Protocol on Transit, the so-called 'REIO clause' (for more details, see this author's publications mentioned under previous footnote).

the Second and/or Third EU Directives.³⁶ It seems, nevertheless, that our EU colleagues consider differently.³⁷

If key selected international investment-related agreements are compared (see Table 4.2), one will notice that the ECT is, firstly, the only ‘sectorial’ (namely, energy-specific) international investment-related agreement. Secondly, it covers the broader/broadest range of legally-binding areas within its scope.

The further focus in this chapter will be on the ECT.³⁸

5. THE ENERGY CHARTER TREATY AND ITS ORIGINS

The ECT is an energy-specific multilateral instrument³⁹ covering issues such as free trade in energy-related materials and products (based on GATT/WTO rules), and also since 1998, when the so-called ‘Trade Amendment’ was signed (which came into force in 2009) – energy-related equipment, freedom⁴⁰ of

³⁶ A. Konoplyanik, ‘Third EU Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Incl. Non-EU Suppliers) and Consumers’, Provisional issue *Oil, Gas and Energy Law (OGEL)* (2011), 37.

³⁷ The invitation is still open for our European colleagues to discuss these legal issues in details in order to reach clarity and mutual understanding on them, to diminish the ‘grey zone’ of potential misunderstanding and of different interpretations on the correlation between internal EU legislation (which influence justified economic interests of the non-EU energy-exporters to the EU) and the international treaties to which both the EU and such non-EU energy-exporters to the EU are the parties. The most recent informal invitation to the Commission to discuss these issues on the non-politicized expert level with the aim to create better understanding between the experts or at least to narrow the gap in understanding was made in 2011 during informal expert consultations between group of Russian experts and representatives of national energy regulators (NRAs) and transmission system operators (TSOs) of the EU member-states with participation of representatives of the Commission. The agreement from the Commission for such expert debate has not been received yet.

³⁸ The following paragraphs are based on (present mostly short summaries of) the author’s publications and presentations on Energy Charter related issues since his first involvement in this topic in 1990 until now, and especially through his tenure as Deputy Secretary General of the Energy Charter Secretariat from 2002–08. They all are available at www.konoplyanik.ru.

³⁹ All relevant information on the ECT and related issues can be found at www.encharter.org.

⁴⁰ Of course, the terms ‘free’ and ‘freedom’ here do not mean an absolute one(s) in referring to trade and/or transit, but within economically justified limits.

Table 4.2 Selected international investment-related agreements (*)

Organization (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)	Non-LB	General	Yes	Yes	No	No	No

Notes:

(*) Other multilateral energy-specific (OPEC, IEA, IEF, IAEA, . . .) and/or energy-inclusive (UN ECE, . . .) and/or 'sub-regional' (BSEC, BASREC, . . .) organisations can be mentioned; though most of them are non-LB and/or do not address investment-protection issue.
 (**) LB = legally-binding.
 (***) Application of GATT Art. V to grid-bound transportation systems is under debate.

Source: Compiled by Dr Joachim Karl, former Senior Expert of the Energy Charter Secretariat, Brussels, and currently Legal Affairs Officer, UNCTAD, Geneva, and has been updated and presented with his kind permission since then by the author

transit,⁴¹ protection and promotion of foreign investment (national treatment/most favoured nation treatment) and dispute settlement (both State-to-State and investor-to-State), as well as energy efficiency issues (Figure 4.1). The objective of the ECT is to ‘establish a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.’⁴² These principles include, inter alia, secure energy supply⁴³ and sustainable economic development.⁴⁴

Given the nature of energy investments – highly capital intensive with long lead times and pay-back periods, and the internationalization of the energy trade, it is no surprise that this industry-specific investment protection scheme appeared in the 1990s.

The process leading towards this legally binding document dates back to the early 1990s and was from the beginning geared towards securing EU energy supplies.⁴⁵ As is well known, on 25 June 1990 the then Prime-Minister of the Netherlands Ruud Lubbers (the country held the Presidency of the EU at that time) proposed the creation of the European energy space. This initiative further developed first with the signing of the political declaration – the European Energy Charter – on 17 December 1991, and, after three years of further negotiations, in the signing on 17 December 1994

⁴¹ Transit issues are further specified in the draft Energy Charter Protocol on Transit. Certain parallels to WTO (Article 5 ‘Freedom of Transit’) can be seen in the ECT (Article 7 ‘Transit’), though the latter takes the transit issues much further, especially since it specially takes into consideration operational aspects of immobile fixed energy infrastructure, such as pipelines and electricity grids, which development at the time of negotiating and signing of GATT in 1947 was in its infancy.

⁴² Article 2 of the Energy Charter Treaty.

⁴³ For me this means justified economic considerations of all parties in the supply chain.

⁴⁴ Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents – A Legal Framework for International Energy Cooperation*, 13.

⁴⁵ S.S. Haghighi, *Energy Security: The External Legal Relations of the European Union with Major Oil and Gas Supplying Countries* (Hart Publishing, 2007), 188. The process was initiated in June 1990 when the European Council gave the Commission the task of finding the best way to implement the cooperation between ex-Soviet countries and the EU. Further to this request, the Commission proposed that a European Energy Charter be created. This has been seen as the first formal step in the ECT process. (C. Bamberger & T. Wälde, ‘The Energy Charter Treaty’, in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford University Press, 2008), 145–94; A. Konoplyanik, ‘The Energy Charter Treaty: A Russian Perspective’, in Thomas Wälde (ed.), *Centre for Petroleum & Mineral Law & Policy* (University of Dundee), 156–78; T. Wälde (ed.), *The Energy Charter Treaty, An East-West Gateway for Investment & Trade* (International Energy and Resources Law & Policy Series, (Kluwer Law International, London 1996), 700).

of the ECT and Protocol on energy efficiency and related environmental issues (PEEREA). The ECT entered into force on 16 April 1998 after the 30th signature was ratified. The initial focus of the ECT process was East-West energy cooperation⁴⁶ within Transatlantic Europe. In essence the political need for this international law framework came from the uncertainty created by the dissolution of the USSR. This is also reflected in the motivation of the parties to the ECT process in the early days.

The major stakeholders in the early 1990s were the European Union and its member states, the Russian Federation and the Energy Charter Secretariat itself. The USA and Canada have refused in the end to sign the ECT,⁴⁷ though they had earlier signed Energy Charter political declaration.

For the EU, the major driver behind the ECT was the need to protect through international law (complementary to and/or non-conflicting with the being developed at that time First EU energy package/Directives) both the existing East-West energy flows and the to-be-expected West-East investment flows. Another motivational factor was the aspiration of the Western participants of the Energy Charter process to export the Western model for Rule of Law to the former USSR and COMECON states and thus to export the EU energy acquis to these countries. By this it was intended to create a 'common legal denominator' as broad as possible – meaning within 'broader energy Europe' – so this predetermined such a wide coverage of areas by the future ECT. The last mentioned driver was obviously based on the First EU energy package, the content of which is strongly reflected in the ECT legal framework (this issue will be further discussed below). The first EU energy package was developed simultaneously with negotiations on the ECT, though this EU package was adopted later than the ECT was signed: in 1996 (electricity) and in 1998 (gas) for the First EU Directives compared to 1994 for the ECT.

For the Russian Federation, the main driver was the need to compensate for the lack of an adequate legal framework for energy investments (more generally any investment) which was a result of the early days of transition from the former socialist system to a capitalist system. This compensation was sought through adopting the most advanced international law

⁴⁶ Illustratively put in the heading of one of the most significant publications on the ECT, T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Kluwer Law International 1996).

⁴⁷ On reasoning of such decision see chapter by William Fox in Thomas Waelde (ed). Centre for Petroleum & Mineral Law & Policy, University of Dundee. *European Energy Charter Treaty, An East-West Gateway for Investment & Trade* (International Energy and Resources Law & Policy Series, Kluwer Law International, London 1996), 700.

solutions for energy trade and energy investment protection and stimulation. On top of this, the idea was of course to bring in the much needed foreign capital and foreign investments – not of a speculative character, but a productive (direct) one.⁴⁸

Both sides believed that creation of common rules of the game for energy markets and energy investments would bring the necessary stability and predictability, based on the common rules of the game, level playing field for the cooperation in energy and related spheres between the two partners.

In my view, the third major stakeholder in the negotiations was the working team of the Energy Charter Secretariat (ECS, which was at that time temporary), which is largely behind the successful outcome of the negotiations. Thus I consider it necessary to mention personally three key people who provided strong professional leadership of the negotiating process and the effective use of the political window of opportunity with the strong support of all the parties involved:

- (1) Ambassador Charles Rutten, the Netherlands, first Chairman of the Energy Charter Conference,
- (2) Clive Jones, the UK, first Secretary General of the ECS,
- (3) Leif Ervik, Norway, key negotiator, then first Director for Trade and Transit of the ECS.

Without these three people the positive result of the negotiations might have been quite different if not questionable.

6. THE ENERGY CHARTER TREATY AND THE ENERGY CHARTER PROCESS

As mentioned above, the Energy Charter Treaty provides unique coverage of various areas of energy cooperation, including investment, trade, transit,

⁴⁸ А. Конопляник. Комплексный подход к привлечению иностранных инвестиций в российскую энергетику. – Диссертация в виде научного доклада на соискание ученой степени доктора экономических наук. М.: ГАУ им С.Орджоникидзе, 1995, 103 с.; он же. Российское нефтяное хозяйство: экономико-правовая среда, основные формы и приоритетные направления внешнего финансирования. – Тематическое приложение к журналу ‘Энергетическая политика России’, М.: Минтопэнерго/ВНИИОЭНГ, 1995, 70 с.; он же. А. Konoplyanik, ‘Russlands Energiesektor Zwischen Krise Und Transformation: Der Bedarf An Auslaendischen Investitionen’, *Stiftung Wissenschaft und Politik (SWP)*, Forschungsinstitut fur Internationale Politik und Sicherheit, Ebenhausen/Isartal, SWP – AP 2959, Juni 1996, 93 pp.

energy efficiency and dispute settlement. It applies to energy materials and products (since 1994) and energy related equipment (since 1998). It has a significant group of stakeholders including, as of 20 June 2013, 54 members of the Energy Charter Conference, nine observer states that have signed the Energy Charter political declaration of 1991 and 16 observer states by invitation of the Conference, and ten international organizations with observer status.⁴⁹ The ECT is the first and only one multilateral investment agreement with high standard of investment protection, including dispute settlement.

The Energy Charter Process is, firstly, aimed at the implementation of the Energy Charter Treaty. This implementation is based on monitoring procedures with regular reviews aimed at evaluating the implementation of the ECT provisions in the member states. It is also, in essence, a highly specialized forum for advanced discussions (in working groups) on the evolution of energy markets and new risks and uncertainties for energy projects that might arise from such evolutions. Once identified, the Energy Charter as a process attempts to address these risks in cooperation with governments and other stakeholders. As such, it is also a platform for further developments and preparation of new legally binding instruments to reduce the related existing and forthcoming risks. In this sense, the role of the Energy Charter Process is to deepen (in terms of producing further details as, for example, Article 7 on transit has been complemented by the draft Transit Protocol which goes into much more detail in terms of transit) and broaden (both in terms of geographical coverage and product scope) the ECT, as well as to upgrade its commonly accepted 'minimum standard' of investment and trade protection in energy.⁵⁰

Given the recent developments with Russia unfortunately (and in my view – unjustifiably) withdrawing from the ECT provisional application in October 2009,⁵¹ but not from signatories of the

⁴⁹ http://www.encharter.org/fileadmin/user_upload/Publications/AR_2012_ENG.pdf.

⁵⁰ For more details see: A. Konoplyanik and T. Wälde, 'Energy Charter Treaty and its Role in International Energy' 24(4) *Journal of Energy and Natural Resources Law* (2006), 523–58.

⁵¹ After analysing all possible reasons for my country's withdrawal from the ECT provisional application (both publicly mentioned, even if speculatively, as well as based on my clever guesses) I can't see any justified argument for such action. See: A. Konoplyanik, 'Energy charter and the Russian initiative – Future prospects of the legal base of international cooperation', 7(2) *Oil, Gas and Energy Law (OGEL)* (2009); А.Конопляник. Выход России из временного применения ДЭХ и «дело ЮКОСа»: комментарий по итогам процедурного решения арбитражного суда в Гааге. – «Нефть, газ и право», 2010, No 1, с. 42–49; A. Konoplyanik, 'Why Is Russia Opting Out of the Energy Charter?' 56(2)

ECT,⁵² nor from the Energy Charter Process itself, the latter process can be used to improve the Treaty or to discuss/clarify/upgrade its details, including those ECT articles which have been present in the Treaty in the form of ‘sleeping beauties’, for instance, Art. 8 ‘Transfer of Technology’ and/or Art. 9 ‘Access to Capital’.⁵³

In my view, the so-called Warsaw Process – work on modernizing the 1991 Energy Charter, the founding document of the Charter Process,⁵⁴ can be considered as a reasonable practical avenue for updating the 1991 Energy Charter and the overall Charter Process modernization which started officially in November 2010 by the adoption of the ‘Road Map for the Modernisation of the Energy Charter Process’.⁵⁵ The objective of an ongoing modernization process aims at consolidating and strengthening the framework covering the expansion of the Energy Charter Treaty’s geographical scope, transit and cross-border trade, emergency response, investment promotion and protection, energy efficiency, energy security and interdependence, and the effectiveness of the Charter’s institutions.⁵⁶

7. THE ECT AS THE FIRST MULTILATERAL INVESTMENT AGREEMENT

The ECT is based on a well-established practice of BITs, the investment chapter XI of NAFTA and certain interactions can even be traced with

International Affairs (2010), 84–96; А.Конопляник. Россия и Энергетическая хартия: долгий и извилистый путь навстречу друг другу. – «ЭКО: Всероссийский экономический журнал», декабрь 2010, № 12 (438), с. 114–132 (часть 1); А.Конопляник. Энергетическая хартия: отменить нельзя модернизировать. – «ЭКО: Всероссийский экономический журнал», февраль 2011, № 2 (440), с. 118–136 (часть 2).

⁵² А. Konoplyanik, ‘Russia remains a signatory of the Energy Charter Treaty’, *Financial Times (Comments/Letters to the Editor)*, 26 August, 2008, 6. Available at http://www.ft.com/cms/s/0/00b3fd5e-91d8-11de-879d-00144feabdc0.html?ncklick_check=1.

⁵³ А. Konoplyanik, ‘Russia: don’t oppose the Energy Charter, help to adapt it’, *Petroleum Economist*, July 2009, 2–3; А. Konoplyanik, ‘Energy Charter Plus – Russia to Take the Lead Role in Modernizing ECT?’, 7(5) *Oil, Gas and Energy Law (OGEL)* (2009).

⁵⁴ See ‘Mandate for Updating the 1991 European Energy Charter’ at http://www.encharter.org/fileadmin/user_upload/Publications/AR_2012_ENG.pdf, p.11.

⁵⁵ <http://www.encharter.org/index.php?id=7&L=0>.

⁵⁶ http://www.encharter.org/ntc_admin/dev_extranet/files/Warsaw_Min00_1352216586.pdf.

the, now abandoned, OECD project on Multilateral Agreement for Investment as well as the first EU energy package.⁵⁷ Within its current membership of 54 member states (as of 20 June 2013)⁵⁸ the ECT represents the combined effect and legal power of 1431 BITs (see Figure 4.1).

The ECT includes two types of investment protection. It contains binding 'hard-law' obligations for the post-establishment phase of the energy investment (non-discrimination etc) and soft-law obligations for the pre-establishment phase (the stage of making the investment). It provides protection against certain key political and regulatory risks such as expropriation or nationalization, breaches of individual investment contracts or unjustified restrictions on transfer of funds. It provides for most-favoured-nation treatment and national treatment. It also prohibits discrimination, etc.

These, and other, substantive rules on investment protection are reinforced by providing access to binding international dispute resolution mechanisms. It provides for both state-to-state and investor-to-state arbitration. The later mechanism provides – and this is an ECT novelty – for direct access to the investment arbitration forum of investor's choice: ICSID, ICC Stockholm or UNCITRAL (with just two exceptions to unconditional consent to arbitration).⁵⁹ These institutions are quite competent in energy-related disputes since about 50 per cent of new ICSID submissions and 20 per cent of ICC cases relate to energy. The awards rendered under these mechanisms are final and directly enforceable (under the New York convention), usually act as entitlement to payment (no risk of a vicious circle of retaliating measures), retroactive to start of the dispute and may include interest (no incentive to delay the process).

As of mid-July 2013, there were at least 35 investor-state dispute settlement cases, known to the ECS.⁶⁰ Compared with an accumulated amount of around 120 energy disputes worldwide at the end of 2011 (according

⁵⁷ But also the Directives on Transit and Hydrocarbons Licensing Directives, Articles 101 and 102 TFEU and notions of special responsibility incumbent on State and private enterprises with a publicly privileged but dominant market position. See C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford University Press, 2008).

⁵⁸ http://www.encharter.org/fileadmin/user_upload/Publications/AR_2012_ENG.pdf.

⁵⁹ <http://www.encharter.org/index.php?id=323&L=%2F%5C%5C%5C%5C%5C%5C%27#c992>.

⁶⁰ <http://www.encharter.org/index.php?id=213&L=%2F%5C%5C%5C%5C%5C%5C%27>.

to the UNCTAD database),⁶¹ this means that ECT-based energy disputes equal already to about 30 per cent of this total quantity and reflect the growing importance of the ECT tested by the arbitration practice within the legal energy world.

From a development point of view, Article 10 on the promotion, protection and treatment of investments provides for two interesting and important – though non-legally binding – principles: those of *standstill* (Art.10(5)(a): Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to limit to the minimum the exceptions to the Treatment described in paragraph (3) [national treatment and MFN]) and *rollback* (Art.10(5)(b): Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to: progressively remove existing restrictions affecting Investors of other Contracting Parties) (Figure 4.5).

The standstill provision requires the state not to introduce new

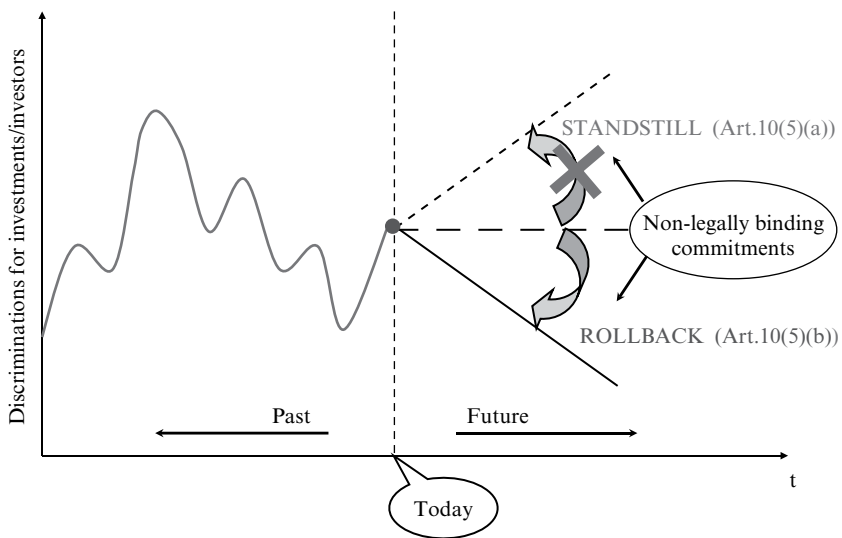


Figure 4.5 *ECT investment regime: 'Standstill' and 'rollback' provisions (Art. 10(5))*

⁶¹ Dr. Joachim Karl (Chief, Policy Research Section, Division on Investment and Enterprise, UNCTAD Geneva), 'FDI in the energy sector – recent trends and policy issues', Presentation at the 2nd Leiden-VU Expert Seminar on Investment Law 'Foreign investment in the energy sector: Balancing private and public interests', Leiden Law School, 1–2 October 2012.

restrictions for investments. The rollback provision requires the reduction of all investment restrictions. These are not legally binding obligations, as the wording 'endeavour' suggests. However, they do reflect the general objective of the Treaty provisions on investment protection.

8. THE ENERGY CHARTER, THE ECT AND THEIR GEOGRAPHICAL SCOPE

The initial focus of the ECT process was East-West energy cooperation within Transatlantic Europe. Despite the fact that it was initiated by the EU (which means that it was born in Europe), from the very beginning the Western side was represented in the Energy Charter by the whole OECD community as potential FDI donors in the expected initial complementarity of the Energy Charter process as 'energy resources for investments'. So it was a natural consequence of the widening geographical scope of energy markets, the internationalization of European energy markets and the developments in the internal arena more generally. While certain OECD countries like the US and Canada participated in the negotiations, they did eventually not sign the ECT.⁶² On the other hand, initial Transatlantic Europe in the Charter process was a follow-up of the composition of the 1975 Helsinki Conference on Security and Cooperation in Europe.⁶³

The geographical focus of the Energy Charter process has now been widened significantly. Three major dimensions of the Energy Charter expansion can be noted – two in Eurasia and one in the Mediterranean. The Far Eastern vector includes major energy consuming emerging economies such as China and Korea; the South Eastern vector – India, Pakistan, Afghanistan; the Mediterranean – countries in Northern Africa and the Middle East.⁶⁴ This expansion was initiated by the 2004 Policy Review⁶⁵

⁶² See footnote 47

⁶³ See A. Konoplyanik, 'The Energy Charter Treaty: A Russian Perspective', in T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Kluwer Law International 1996), 156–78.

⁶⁴ See the map of the Energy Charter constituency at page 8 in the Energy Charter Annual Report 2012 at http://www.encharter.org/fileadmin/user_upload/Publications/AR_2012_ENG.pdf.

⁶⁵ CC 298 and Summary Record of the Fifteenth Meeting of the Energy Charter Conference (CC 294). Key philosophy of the Energy Charter development, including expansion activities is presented in A. Konoplyanik, 'The future of the Energy Charter Process: to find a competitive niche', Presentation at the internal ECS Seminar, Brussels, 28 May 2004.

which directed the attention to these geographical areas. These regions and developments reflect the internationalization of the energy markets and the increasing cross-border character of the energy value chains, especially in Eurasia.

However, despite the continuing discussions, none of the main EU gas suppliers, Russia and Norway, have ratified the ECT,⁶⁶ Algeria is just an observer in the ECT process as well as are the major energy producers of the Middle East. More generally, it is rather obvious from the list of Member States that those countries that are keen to adopt the ECT are the consuming or transit countries, not the producing states.⁶⁷ This is without the doubt the major shortcoming of the ECT from a global perspective. And this is despite the fact that since the UN General Assembly Resolution 1803 (XVII) 'Permanent Sovereignty over Natural Resources' of 14 December 1962, it is only ECT Art.18 'Sovereignty over Energy Resources' which reconfirmed this principle within the international law and its multilateral treaties.

9. EVOLVING EMPHASIS OF THE ENERGY CHARTER ACTIVITIES OVER TIME

Article 34.7 of the ECT determined Policy Reviews of the Energy Charter process to be conducted at least once every five years. It is helpful thus to have a look at the evolving dominant trends during the periods between the Reviews, e.g. what types of activities the Energy Charter community has been concentrating on. Since the beginning of the Energy Charter process the periods between Reviews were characterized by the changing dominance of the policy debate versus legal negotiations and implementation activities.

The period 1990–94 was marked initially by policy level debates and then negotiations on the political declaration – the (European)

⁶⁶ Although Russia did apply the ECT provisionally until October 2009, which meant that Russia applied the ECT 'to the extent that such provisional application is not inconsistent with its constitution, law or regulations', according to Art. 45 of the ECT. For the provisional application, see K. Hobér, 'The Energy Charter Treaty – Recent Developments', 5(2) *OGEL* (2007) or C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford University Press, 2008).

⁶⁷ D. Doeh, A. Popov and S. Nappert, 'Russia and the Energy Charter Treaty: Common Interests or Irreconcilable Differences?', 5(2) *OGEL* (2007); and C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford University Press, 2008).

Energy Charter signed on 17 December 1991. Then the legal negotiations related to the ECT and the PEEREA came to the forefront of the Energy Charter Process from 1992 and ended with their signing on 17 December 1994. Negotiations for different proposed Protocols were also debated but subsequently abandoned at different stages except for the PEEREA.⁶⁸ No implementation, and hence, no monitoring took place during that period.

During 1994–99, the ECT came into force on 16 April 1998. The policy debate was quasi-absent and the legal negotiations were focused on the Trade Amendment (signed in 1998, came into force in 2009) and the Supplementary Treaty thought the latter was terminated. The implementation phase began in relation to the ECT and PEEREA.

During 1999–2004, the policy debate was more focused than before. This was a result of the 1999 ECT Policy Review (the first review under Article 34 (7) taken place) that established these policy debates as an integral part of the Charter process. Legal negotiations were focused on the draft Transit Protocol. Monitoring of ECT and PEEREA implementation continued.

Between 2004–09, there were active policy debates on the results of the 2004 ECT Policy Review (second Policy Review though de facto it was the first Review for the period that ECT was in force) and reaction to the new challenges and risks of energy markets developments that appeared in the 2000s compared to the 1990s.⁶⁹ This started preparation for the 2009 Review. Legal negotiations were not actively on-going and the focus was on bilateral (and multilateral) discussions on the Transit Protocol (multilateral negotiations on it were suspended in 2002), including the Russia-EU informal expert consultations on three open issues of the draft Protocol between the two parties.⁷⁰ Monitoring of the ECT and PEEREA implementation continued.

Post 2009, Russia decided to withdraw from the provisional application of the ECT. Policy level discussions are focused on this and on the

⁶⁸ See Figure 1 in: А.Конопляник. Ратификация ДЭХ Россией: прежде всего, необходимо развеять добросовестные заблуждения оппонентов. – chapter 22 in: Т.Вальде (ред.англ.изд.), А.Конопляник (ред.рус.изд.). Договор к Энергетической Хартии – путь к инвестициям и торговле для Востока и Запада. – М.: Международные отношения, 2002, 632 с.

⁶⁹ For reasons of radical differences in energy markets development in the 1990s and the 2000s see, inter alia: Бушуев В.В., Конопляник А.А., Миркин Я.М. и др. Цены на нефть: анализ, тенденции, прогноз. – М.: ИД «Энергия», 2013, 344 стр.

⁷⁰ For more details see corresponding publications and presentations of 2002–08 at www.konoplyanik.ru.

proposals from Russia to profoundly modify the ECT. (This period is discussed below under the heading ‘current issues.’)

10. DEVELOPMENT OF ACTIVITIES OF THE ECT AND THE ENERGY CHARTER PROCESS IN TERMS OF FOCUS

Looking at the activities and priorities of the ECT and the Energy Charter Process, it is also possible to see development and movement along the cross-border energy value chain. The activities and priorities of the Energy Charter in the early 1990s were largely focused on production and upstream supply of energy. The driving idea was factually about the swap ‘energy for investment’.

Towards the end of 1990s and the early 2000s, the focus moved to include the whole value chain, with special attention to transit due to the increasingly cross-border character of the energy flows. Energy security emerged as a major theme during this period, especially in advance of the G-8 2006 Summit in Saint Petersburg in which agenda it was announced as one of the three major topics. The ECS has added value to this debate by developing risk mitigation along the entire supply chain as a facet of ‘international energy security’. The ECS has pointed out – the first in the row – that, bearing in mind the highest capital intensity of the energy projects, especially in the upstream, and the nature of risks in energy industries, the major economic threat to international energy security is the threat of wrong investment decisions. Addressing the issue of the so-called ‘resource nationalism’, which tended to grow in the 2000s with the increase of the oil prices, the ECS started a debate on rent allocation.⁷¹ This ended with publication in 2007 of the ECS pricing

⁷¹ Instead of using the term ‘resource nationalism’ which from the very beginning provides negative perceptions, I would prefer to use another terminology, reflecting the changing economic realities of the 2000s compared to the 1990s. The economic environment of the 2000s with growing oil prices (up to historical maximum of 147 USD/bbl in July 2008) differs significantly from that of the previous decade when the prices were fluctuating within 15–25 USD/bbl interval. Today’s prices stay at around 100 USD/bbl level which also differs quite significantly from the 1990s. So I see justified economic considerations of the host states for reallocation of the resource rent from their non-renewable energy resources when the oil prices began their steady growth which has stipulated the increase in the windfall profits of the oil companies developing these resources. What is called ‘resource nationalism’ for me is a request for redistribution of the resource rent in order to find its new balanced split between the host state and the investor in the new economic environment.

study,⁷² well received by the whole Energy Charter and broader professional international community.

Current Energy Charter activities are mostly aimed at its strategy development and on finding the most effective way to modernize the Energy Charter process. This, to a large extent, reflects the Energy Charter response to Russian claims on its lack of balance in favour of energy consumers.

11. INVESTMENT-PROTECTION IN ENERGY: THE ENERGY CHARTER ROLE WITHIN ENERGY-RELATED INTERNATIONAL ORGANIZATIONS

A key objective of the Energy Charter Policy Review (based on ECT Art. 34.7) is to ensure the efficiency of the Energy Charter process by concentrating its activities in areas where the Energy Charter's legal basis and broad constituency provide it with clear advantages. Already the 2004 Review (the first Review for the five year period after ECT came into force) has called, inter alia, for continued – and where appropriate, strengthened – cooperation with other relevant international organizations.⁷³ In preparation for the 23rd Meeting of the Energy Charter Conference in Warsaw, on 27 November 2012, the ECS prepared a Discussion note with an overview of the landscape of existing international energy-related organizations, which listed about 30 of those directly and indirectly dealing with energy issues.⁷⁴ My vision of the competitive niche of the Charter process in the investment protection area is based on the natural ECT synergy with some other international energy-related organizations⁷⁵ (possible scenario, not yet implemented) (Figure 4.6):

- The International Energy Forum (IEF) – the first element in this chain – provides opportunities for the Energy Ministers of its member states (both energy producers and consumers) to indicate

⁷² Energy Charter Secretariat, *Putting a Price on ENERGY: International Pricing Mechanisms for Oil and Gas* (Brussels 2007), 236.

⁷³ The complete conclusions of the review of the Energy Charter process, as adopted by the Energy Charter Conference in December 2004, are presented in Energy Charter, *Annual Report 2004* and are available at www.encharter.org.

⁷⁴ On the overview of landscape of existing international energy-related organizations see http://www.encharter.org/ntc_admin/dev_extranet/files/Warsaw_Min00_1352216586.pdf.

⁷⁵ 'The future of the Energy Charter Process: to find a competitive niche', presentation at the internal ECS Seminar, Brussels, 28 May 2004.

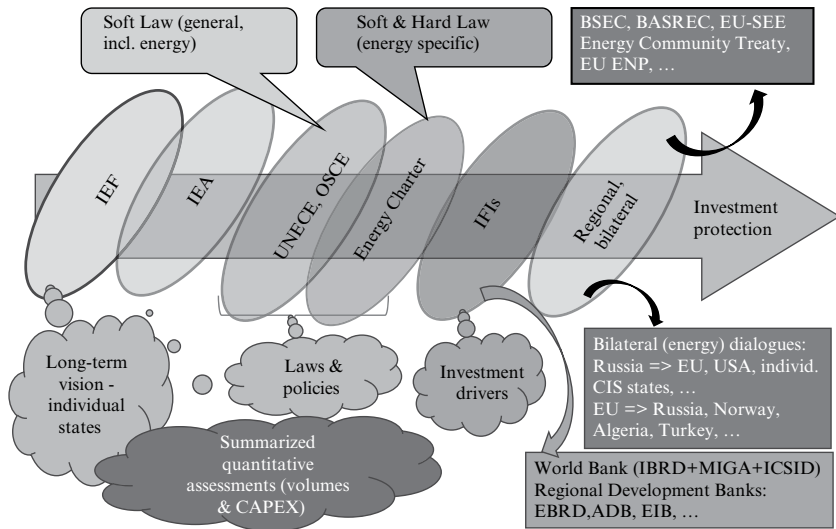


Figure 4.6 Energy investment protection: Complementarity of energy-related international organizations

their vision of the long-term prospects and problems of energy developments at IEF biannual meetings.

- The International Energy Agency (IEA) – the second element – would most effectively quantify those visions in terms both of energy demand and supply projections (biannual IEA World Energy Outlooks) and investments needed to implement these projections (the first IEA World Energy Investment Outlook was published in 2003).
- The UNECE and OSCE – possibly, but not necessarily the third element in this chain – non-energy specific ‘soft law’ organizations that can soften understanding for necessary changes and adaptation within their broad constituency and broader economic debate.
- The Energy Charter – the fourth element – energy-specific both ‘soft law’ and, which is most important, ‘hard law’ international institution, which would develop corresponding multilateral legal instruments and would promote their implementation aimed at minimizing the risks related to such investments.
- International financial institutions – the fifth element – would play their role of investment drivers/triggers, being catalysts for bringing private capital to co-financing capital-intensive energy projects. This group will include, firstly, World Bank institutions (IBRD,

MIGA, ICSID) and regional development banks (such as EBRD, ADB, EIB, etc.) as well as national development banks in the countries where they exist (like VEB in Russia).

- Bilateral institutions (for example different Energy Dialogues, such as between Russia and the EU, and their analogies) and/or regional organizations (like BSEC, BASREC, etc.) – the sixth element in this chain – would provide incremental support (including political and/or direct financial support) to the projects of their mutual interest.⁷⁶

Such an approach presents, on the one hand, an opportunity for the Energy Charter to improve its competitive niche among other energy-related international organizations based on their mutual complementarity, and, on the other hand, to support a balanced and objectively determined life-cycle for the Energy Charter process.

For me, the Energy Charter life-cycle presents a revolving-type changing dominance at the given time-periods of the policy debates, which will pave the way to the negotiations on legal instruments (on efficiency of the existing ones and on necessity to develop new ones), which will again bring the Charter community to the new policy debate on a new level.

Within the Energy Charter activities, targeted policy debate would continue to be aimed at discussing commonly understood challenges and risks related to energy markets developments, based on IEF and IEA activities at the previous steps of the ‘investment protection’ chain of institutions. Such risks include both still existing and not yet effectively mitigated ‘old’ risks (the issue for continuous monitoring of ECT implementation) and ‘new’ ones that have appeared or might appear at new stages of the development of energy markets. This debate should define the amount of incremental investment protection that would be needed in line with the expected market developments (‘demand’ for investment protection). On the other hand, such debate should lead to understanding of what amount of investment protection can be achieved (‘supply’ of investment protection) by improving ECT implementation and what will be left, further to increased efficiency of existing instruments, for new instruments to be developed. Negotiations of new instruments will demand their posterior

⁷⁶ See A. Konoplyanik, ‘Energy and Security: The Role of the Institutional Structures Within the OSCE Region (with particular emphasis on the Energy Charter Process)’, presentation at the OSCE Economic and Environmental Sub-Committee Meeting, Vienna, 26 November 2004; *ibid*, ‘Energy Charter, The Key to International Energy Security’, *Petroleum Economist*, February 2006, 19–20.

implementation and monitoring, and the Energy Charter cycle will continue at the new level.⁷⁷

12. RUSSIA'S CONCERNS REGARDING THE ENERGY CHARTER

As was discussed above, the ratification of the ECT by Russia never took place. There are various reasons for this. I intend to identify three groups of those.

The first group, political concerns, presents a natural reaction to external political pressure on Russia to ratify ECT without considering Russia's concerns, such as requests that 'Russia *must* ratify ECT' (such requests if not demands were repeated by Mr. Barroso et al prior to the 2006 G-8 St.Petersburg Summit). This group of concerns is based on misinterpretations of the ECT from both sides. Some Russian politicians, opposing the ECT, just did not read it (which is proven by, for example, long-repeated concerns of Mr. Yazev et al that the ECT requests MTPA despite clear indication in the ECT that it does not, etc.).⁷⁸ For this reason many Russian politicians reacted mostly not to the ECT provisions per se, but to (mostly questionable or incorrect) interpretations by the EU officials echoed by the international press (such as 'ECT opens access to Gazprom transportation system at low domestic tariffs', etc.), which were mostly also not based on the legal provisions of the ECT.

The second group can be called 'concerns as negotiating tool', reflecting the basic diplomatic approach in the negotiations: first to possess something to be given up later in search of compromise. I include also in this group all general concerns regarding what is *not* present in the ECT (such as the 'ECT does not address problems of Turkish & Danish straits', etc.). Russia also considers that, from a producer perspective, the balance of the ECT is too consumer friendly, not containing the necessary balance between the consumer and producer countries.

The third group in my classification represents valid and substantiated economic concerns. During January 2001 Parliamentary Hearings, Russian State Duma stated that Russia will return to the ECT ratification issue

⁷⁷ See A. Konoplyanik and T. Wälde, 'Energy Charter Treaty and its Role in International Energy', 24(4) *Journal of Energy and Natural Resources Law* (2006), 523–58.

⁷⁸ А.Конопляник. Борьба с мифами. О мнимых выгодах и угрозах Договора к Энергетической Хартии. – «*Политический журнал*», 13 июня 2006 г., No 21 (116), с. 32–36.

after all her valid concerns are adequately addressed. Since that time I have identified only two such issues – both in regard to transit (ECT Art.7) which should have been addressed in the draft Transit Protocol. The then Russian Energy and Industry Minister V. Khristenko has repeatedly been saying that there will be thus no ECT ratification without a Transit Protocol. Three open issues in the draft Transit Protocol itself prevented its finalization.

The negotiations on the Transit Protocol were initiated in 1998, negotiations on the text started in 2000 and were provisionally suspended in 2002 after it became clear that the text that had been produced could not be unanimously adopted.

A natural question then arose: how to most effectively proceed with Russia's ECT ratification and finalization of the draft Transit Protocol? Option one would have been that Russia first ratify ECT and afterwards the Energy Charter community finalize and ratify the Transit Protocol. This was the proposal of the EU which was impossible for Russia. Option two was to first finalize and ratify the Transit Protocol with full consideration of Russia's valid concerns, and afterwards Russia returns to the ECT ratification issue. This would be the preferred option for Russia but it is impossible by ECT rules since no state can join the Energy Charter Protocol if they have not first ratified the ECT. So option three was thus the only workable compromise. It meant that Russia would ratify the ECT and Transit Protocol simultaneously. The ECT community thus needed to concentrate on practical ways of solving this problem and to address all substantiated Russia's concerns regarding the ECT and draft TP. This I saw as my major task during my tenure as Deputy Secretary General of the ECS in 2002–08.

In sum total I saw then only five open issues preventing Russia from ratifying the ECT. All of them related to transit. Two of those referred to the ECT, and three – to the draft Transit Protocol.

Two open issues for Russia in the ECT related to different interpretations by Russia and the EU of two provisions of Art. 7 'Transit'. The first issue was regarding correlation between transit vs. domestic tariffs – whether they shall be equal or not necessarily (ECT Art. 7.3). The EU delegation considered that these tariffs shall be equal – as if based on WTO rules and EU *acquis* they interpreted in the same way as ECT Art. 7.3. Russia disagreed. Finally, Russian and EU experts, with ECS as moderator of their bilateral informal consultations, have managed to reach a consensus after the ECS published a study⁷⁹ where we have proved

⁷⁹ Gas Transit Tariffs in selected Energy Charter Treaty Countries. ECS, January 2006, 86. Available at http://www.encharter.org/fileadmin/user_upload/document/Gas_Transit_Tariffs_-_2006_-_ENG.pdf.

(Table 6.2, p.67) that in at least five EU member states out of six analysed, transit tariffs were not equal to domestic ones. After that the EU delegation stopped claiming that through the ECT constituency both domestic and transit tariffs shall be equal.

The second issue was regarding the conciliatory procedure for transit disputes (ECT Art. 7.6–7.7) and referred to the method of recalculation of interim tariffs (established by conciliator during transit dispute) and final transit tariffs after a dispute is settled. During informal Russia-EU expert consultations which took place in 2004–07, the wording of two corresponding draft Understandings within Draft Transit Protocol were agreed by experts of Russia and the EU on these two open ECT issues.

Three open issues in the draft Transit Protocol were left open between Russia and the EU after multilateral phase of its negotiations was suspended in 2002. The first one referred to implementation of auctions and cost-reflectiveness of transit tariffs (draft TP Art. 10). A draft solution was found during consultations and a new article on congestion management was proposed for the draft Transit Protocol (draft TP Art. 10bis). The second issue referred to the problem of contractual mismatch (long-term access to transportation capacities for long-term supply contracts within unbundled energy systems where/when available transportation capacity is in deficit) and the ways to solve it (draft TP Art. 8). The initial proposal of the Russian side as a draft solution when contractual mismatch is already in place (so-called ‘right of first refusal’) was rejected by the EU. The consensus between Russian and EU experts was found in 2007 based on the proposal for using ‘open season’ procedure as a means of excluding deficit of available capacity to appear (draft TP Art. 8.4).

The third issue referred to the implementation of the Transit Protocol within the EU. The EU proposal in the draft Transit Protocol Art. 20 (so-called ‘REIO clause’) was that within the EU, cross-border gas transportation can be considered as transit only when energy flow crosses the whole EU territory and not only territories of its individual member-states. This was definitely the key issue of disagreements between Russia & the EU since such proposal de facto excludes EU territory as a whole from the application of the Transit Protocol. This issue is a pure internal EU issue since it refers to the correlation between the ECT and *acquis* within the EU (which is an unfinished or not yet started discussion, as was mentioned above). But this means that a key to ECT ratification by Russia was/is/had been in the EU hands!!!

To summarize on justified Russian concerns regarding the ECT and the draft Transit Protocol: technical experts solutions to all issues (except the ‘REIO clause’) reached at a bilateral Russia-EU level were afterwards agreed in principle informally at multilateral level. A draft solution on TP

Art. 20 was discussed informally as part of the package on the 'Energy Charter Plus' scenario.⁸⁰

13. RUSSIA'S WITHDRAWAL FROM THE ECT PROVISIONAL APPLICATION: PROS & CONS

Despite this progress and the possibility for trade-off regarding the 'REIO clause' under the informal 'Energy Charter Plus' scenario, after the unfortunate Russia-Ukraine gas dispute/crisis of January 2009, Russia first began to strongly criticize the Energy Charter for its incapability to prevent/solve this dispute (though no one country involved never applied to the ECS with a formal request) and finally notified the Depository of the Treaty in August 2009 that it would not ratify the ECT and would cease to apply the ECT provisionally (which came into effect on the 60th day afterwards, e.g. on October 19, 2009).⁸¹ It has also suggested that a new treaty should be negotiated instead of the ECT or ECT should be updated.⁸²

Two other issues began to be repeated in Russia as possible explanations of such withdrawal. One related to Central Asian gas (transit, tariffs, prices) – as if under direct contracts between Central Asian exporters and EU/CIS importers the ECT would bind Russia to provide transit capacities in its territory at low domestic transportation tariffs. Cheap Central Asian gas would compete then with Russian gas on EU market to the detriment of Russia. But as was already shown long ago,⁸³ the ECT, on

⁸⁰ A. Konoplyanik, 'Energy Charter Plus – Russia to Take the Lead Role in Modernizing ECT?' 7(5) *Oil, Gas and Energy Law (OGEL)* (2009); А.Конопляник. Выход России из временного применения ДЭХ: мифические угрозы оказались сильнее реальных выгод? – «Нефть и газ», ноябрь 2009, № 9, с. 32–35; А. Конопляник, 'Why Is Russia Opting Out of the Energy Charter?', 56(2) *International Affairs* (2010), 84–96; А.Конопляник. Энергетическая хартия: отменить нельзя модернизировать. – «ЭКО: Всероссийский экономический журнал», февраль 2011, № 2 (440), с. 118-136 (часть 2).

⁸¹ For this, see A. Konoplyanik, 'A Common Russia EU Energy Space (The New EU Russia Partnership Agreement, Acquis Communautaire, The Energy Charter and the New Russian Initiative)', in K. Talus and P. Fratini, *EU-Russia Energy Relations* (Euroconfidential, 2010).

⁸² Before the notification to the contrary, Russia had agreed to apply the ECT provisionally. This meant, according to Article 45 of the ECT, that it applied the ECT 'to the extent that such provisional application is not inconsistent with its constitution, law or regulations.' For an analysis of the proposal and the background see: OGEL Special on EU-Russia relations, 2 *OGEL* (2009). Available at www.ogel.org.

⁸³ А.Конопляник. Договор к Энергетической Хартии: «Ратифицировать надо, но не сегодня. . .». – «Промышленный мир», 2001, № 2, с. 44–48; А.Конопляник.

the contrary, presents five levels of internationally-accepted mechanisms of justified non-access to national gas transportation system (GTS) of the country in question for potential (new) transit. Moreover, Central Asian gas is no longer ‘cheap’: since January 2009 its export price is based not on ‘cost-plus’, but on ‘net-back EU-end-use replacement value’ pricing principle. This is the highest possible price for Central Asian producers which makes it preferable for them to sell gas at their external border and not to seek reaching the EU market.⁸⁴

Another possible argument was the so-called ‘YUKOS case’,⁸⁵ as if Russia’s decision to quit the ECT was taken to escape arbitration/repetition of similar cases. But this is not helpful, since according to ECT Art. 45(3)(b), after the termination of the ECT’s provisional application its obligations on investment protection will remain in force for the next 20 years (for Russia – until 2029), as well as the possibility of arbitration proceedings against Russia arising out of a breach of ECT investment provisions.⁸⁶

This is why I see no positive consequences for my country of the termination of ECT provisional application. At the same time, I see a number of negative consequences of such action.

It plays into the hands of anti-Russian political forces – they will repeatedly label Russia as not respecting the rule of law. Should Russia ratify the ECT, it will in course of time increasingly protect Russian investments abroad, firstly, from ‘liberalization risks’ within the EU market since the ECT provides a minimum standard and its non-EU contracting parties are protected by its ‘softer’ than the EU’s *acquis* request for market liberalization. Russia’s non-participation in the ECT will not lead to its termination,

Есть только один путь к ратификации ДЭХ. Чтобы договориться, надо понять возражения противной стороны. – «Нефть и капитал», 2001, No 3, с.8–10; А. Конопляник. ‘We must ratify Energy Charter Treaty – but not yet’ – *Oil & Capital. Russia & CIS Energy Magazine*, April 2001, pp. 6–8.

⁸⁴ А.Конопляник, Н.Никитин. Туркменский газ в Европе? – «Нефтегазовая Вертикаль», 2010 г., No 18, с. 66–68; А.Конопляник. На развилке трех дорог. Центральноазиатский газ будет в ближайшей перспективе поставляться только в Китай и Россию, а не в ЕС. – «Нефть России», 2011, No 2, с. 46–51; А. Конопляник, ‘Gas Export Pricing & Alternative Gas Export Routes (Central Asia case)’, Provisional Issue *Oil, Gas and Energy Law (OGEL)* (2011), 16.

⁸⁵ Available information on the case at <http://www.encharter.org/index.php?id=213&L=0#Yukos>, also at www.globalarbitrationreview.com.

⁸⁶ See also: А. Конопляник, ‘Energy Charter Treaty – and “Yukos case”’, 8 *Petroleum Economist* (2005), 35–6; А.Конопляник. ДЭХ и «дело ЮКОСа». – «Нефть России», август 2005, No 8, с. 83–6; А.Конопляник. Выход России из временного применения ДЭХ и «дело ЮКОСа»: комментарий по итогам процедурного решения арбитражного суда в Гааге. – «Нефть, газ и право», 2010, No 1, с. 42–49.

only that other countries will enjoy its advantages. Russia's repudiation from the ECT does not mean that Russia will succeed in creating an alternative and more effective instrument in the foreseeable future since the window of political opportunities is much narrower today than at the beginning of the 1990s, and any bilateral treaty with the EU would be de facto a multilateral one (28 EU member-states plus Russia). The EU has been exporting its legislation through its system of international treaties. So repudiation of the ECT will deny the possibility for non-EU and non-ECT states to negotiate a 'new global energy order' (which Russia has proposed) with EU member-states on terms different from those provided for in the current EU legislation (which is based on the Third EU Energy Package which is much more liberalized and different from the First EU Energy Package which corresponded to and correlated with the provisions of the ECT).

14. THE GROWING GAP BETWEEN THE ECT AND THE EU ENERGY ACQUIS

When the ECT was negotiated in the early 1990s it was largely based on the approach of the First EU Energy Directives (adopted in 1996/1998). There was a clear correlation between the two processes: development of EU energy legislation and of the ECT. Then the Second EU Energy Package emerged in 2003 and the level of liberalization between the ECT and the EU energy acquis started to diverge. The new unbundling and mandatory third party access (MTPA) moved the EU energy regulation to a deeper and more intrusive level. An example of this is the third party access (TPA) provisions under various Directives. MTPA is not required by the ECT. Nor was it required under the First EU Energy Directives, which included a choice between regulated (MTPA) and negotiated third party access. This freedom of choice was eliminated from the subsequent Second and Third Directives (2003 and 2009). This growing gap in the levels of liberalization between the ECT and the EU acquis is the first dimension of the problem (Figure 4.7).

At the same time, the enlargement of the EU towards the East took place moving the EU from 15 to 25, then to 27, and now to 28 Member States. Here it must also be noted that the EFTA countries also implement most of the EU energy acquis bringing the number of countries applying the EU energy laws now to 31. In addition, Energy Community Treaty Member States also apply the First and the Second EU Energy Packages and have agreed that they would apply the Third one as well. The potential for a conflict between the more liberalized EU energy acquis and the ECT as the minimum standard for its Member States (those not members of the

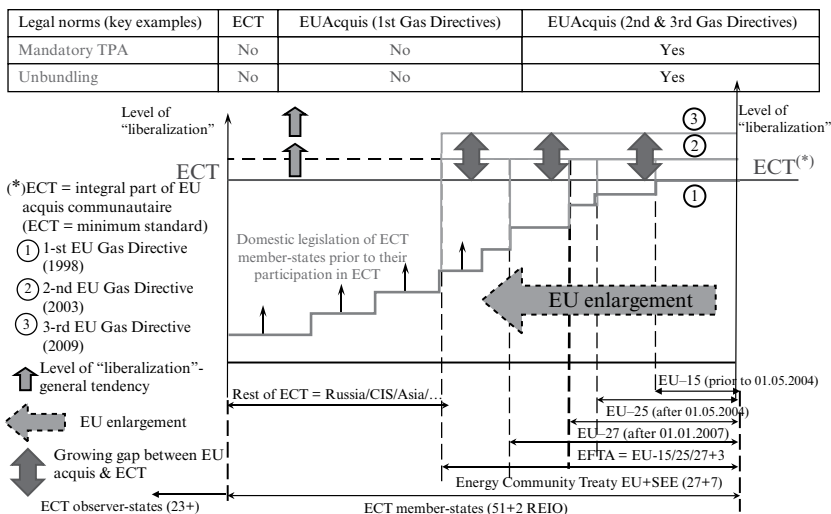


Figure 4.7 ECT and EU acquis: 'Minimum standard' within evolving Eurasian common energy space vs. more liberal 'general standard' within evolving common European energy space

EU or the Energy Community Treaty) grows in tandem with the number of Member States in each of the legal systems.

The approach of the European Commission seems to be that the EU energy acquis is the dominant legal framework and international law will have to be adopted to correlate with the EU energy laws. In line with this, it seems that in the mind of the Commission, any and all conflicts fall under the competence of the Court of Justice of the European Union (and not international arbitration). An interesting situation could have occurred had the proposal for mandatory ownership unbundling as a part of the Third EU Energy Package in 2009 been accepted by the European Parliament and the Council. In this situation, companies could have initiated arbitral proceedings against the EU under the ECT (claiming expropriation under ECT Article 13). Here, the increasing gap between the two legal systems creates a situation where the ECT can provide for international law protection against excessive liberalization in the EU.

Clearly, for the EU the preferential modus operandi is the exportation of EU energy legislation to third countries. The EU attempts to expand the geographical area of implementation of the energy acquis in different ways and through different methods (formal legal methods and softer methods). Harder and more formal methods include the enlargement process and integration of new countries into the EU, the creation

of the Energy Community Treaty bringing South East Europe under the umbrella of the EU energy acquis and moving the membership of this organization further east (Ukraine, Moldova and so on). The softer methods include EU neighbourhood policies with North African or CIS countries and various memorandums of understanding with the CIS and Caspian countries. There was an attempt to adopt a similar approach with Russia (by unilaterally including this country initially into the Eastern Partnership project) but this was abandoned both for political reasons and by substance (Russia has been stating that it does not endeavour to accept and to implement domestically energy acquis rules). Similarly various partnerships are a softer method of gradually expanding the geographical scope of the EU acquis, including in energy.

15. ATTITUDES OF THE KEY PARTIES: EU AND RUSSIA

Acting as an agent provocateur, I argue that even if it is the Russian Federation that has withdrawn from the provisional application of the ECT, it is in many ways the EU that is the party blocking the Russian access and/or further progress within the Energy Charter. There are several issues on the EU side that makes the negotiations rather problematic. These issues include:

1. Long-time monopolization of participation in Energy Charter Process by DG ENERGY (formerly DG TREN) at low level with no and/or with lack of adequate coordination with and/or within the EU Member States.
2. Absolutization of norms of *acquis communautaire* and unwillingness to even discuss the issues relating to the relationship between the EU energy law and the ECT.
3. Unwillingness to solve the issues relating to the intra-EU transit and the REIO clause.
4. Attempts to use ECT as a subordinated instrument of EU external policy.
5. Diminished interest to Energy Charter Treaty in favour of Energy Community Treaty.

However, there is also fault in the Russian side as well. Significant problems from the Russian Federation would include the negative attitude towards the (political leadership of the) Secretariat after the January 2009 Russia-Ukraine gas crisis which was extrapolated towards the whole

Treaty and the Energy Charter Process. Also the long term lack of formal internal organization and coordination between Russian State agencies in relation to participation in the Energy Charter Process has been a problem on the Russian side. The fact that Russia is not a member of the ECT but a signatory only, is not a reason not to participate in the process (or not to send a negotiation team to the meetings (!) which was unfortunately the case sometimes during my tenure at the ECS). Just look at Norway, a signatory of the ECT but not a Contracting Party. Norway is actively pursuing and defending its interests and pushing the Charter process forward in cooperative efforts. This is not always the case with Russia. In a situation where Russia is not present, why would, for instance, the REIO clause be discussed at all.

16. THE WAY FORWARD

It is quite clear that the EU energy acquis would not be accepted by Russia as the common legal framework for the EU-Russia energy space. It is also clear that the EU energy acquis will not cover all segments of the energy value chain.

It is also clear that it is very unlikely that the Russian proposal for a new ECT will lead to a new Treaty. In particular as a separate non-ECT related Treaty that does not build on the existing framework. I agree with the ECS that 'The establishment of a new comprehensive global energy organisation is an unlikely scenario'.⁸⁷

Similarly, there would be a variety of problems with choosing a bilateral treaty between Russia and EU as the method to move forward (among the problems would be the transit states and the relation with the ECT).

One option as the way forward would be to include a short energy chapter to the new Russia-EU partnership agreement essentially stating that it is the ECT that functions as the legal framework of the common EU-Russia energy space. This solution will enable both Russia and the EU to develop their common energy markets without conflicts and allows the further expansion of this common energy space to the east and south. This way the ECT would function as the common denominator for the emerging Eurasian energy market.

Given that the ECT has been in force since the 1990s, this approach is in line with the realities of today. The ECT can already be considered as the

⁸⁷ http://www.encharter.org/ntc_admin/dev_extranet/files/Warsaw_Min00_1352216586.pdf.

common legal framework for EU-Russia and even broader cooperation within the Eurasian energy space.⁸⁸

The remaining issues making Russian ratification difficult are not impossible to solve. Most questions relating to transit have been solved at the technical level and the remaining issue, the intra-EU transit and the REIO clause, are mainly internal EU issues that need to be resolved.

Again acting as an agent provocateur I conclude: it seems that the focus in the public domain is on the Russian attitude against the ECT. In addition to this (not instead), a more balanced approach that reflects the political and practical realities should be adopted. This would include a discussion on the EU attitude towards the ECT. Only if this is done, can we move towards a long lasting solution.

To summarize: the Energy Charter Treaty as an open-ended package of legally binding instruments is an objective result and, moreover, a natural culmination of parallel/synchronized evolution of the international energy markets and instruments of investment protection/stimulation. In this capacity, the ECT cannot stay fixed once and forever in its form and structure as it was signed in 1994. It should be further evolved as a package structure and not rewritten as an existing document. In this evolving package structure new legally binding and non-legally binding documents (best practices, model agreements, specific protocols, etc.) should appear thus expanding and upgrading the benchmark level of investment protection in energy. The aim of investment protection is to mitigate and minimize the risks and uncertainties of energy markets evolutionary development to a tolerable level, preferably in a proactive, rather than in a reactive way.

⁸⁸ A. Konoplyanik, 'A common Russia-EU energy space (The new EU-Russia Partnership Agreement, *acquis communautaire*, the Energy Charter and the new Russian initiative)', 7(2) *Oil, Gas and Energy Law (OGEL)* (2009); А.Конопляник. «Третий путь» для России. Москве предстоит выбрать один из трёх вариантов построения общего энергетического пространства с ЕС. – «Нефть России», 2009, No 6, с. 16–21; No 7, с. 14–19; No 8, с. 11–16; No 9, с. 13–18.