

Energy Charter Process: multilateral governance for trade, transit and investments

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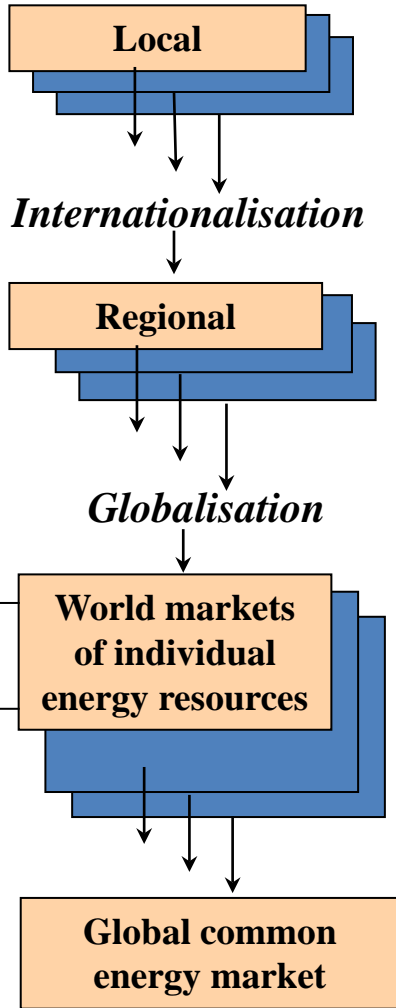
Presentation at the Autumn School "CHANGING POLICIES AND CULTURES IN EUROPE AND RUSSIA: ENVIRONMENT, RESOURCES, ENERGY" jointly conducted by University of Tartu, Euro College; Freie Universität Berlin, Institute for East European Studies; University of Helsinki, Aleksanteri Institute;
September 18 – September 24, 2013, Tartu, Estonia

Table of contents

- **ECT: multilateral dimension**
- ECT: its specific role & legal novelty
- ECT & project financing
- ECT & EU *acquis communautaire*
- Energy Charter & other international organisations
- ECT: way forward

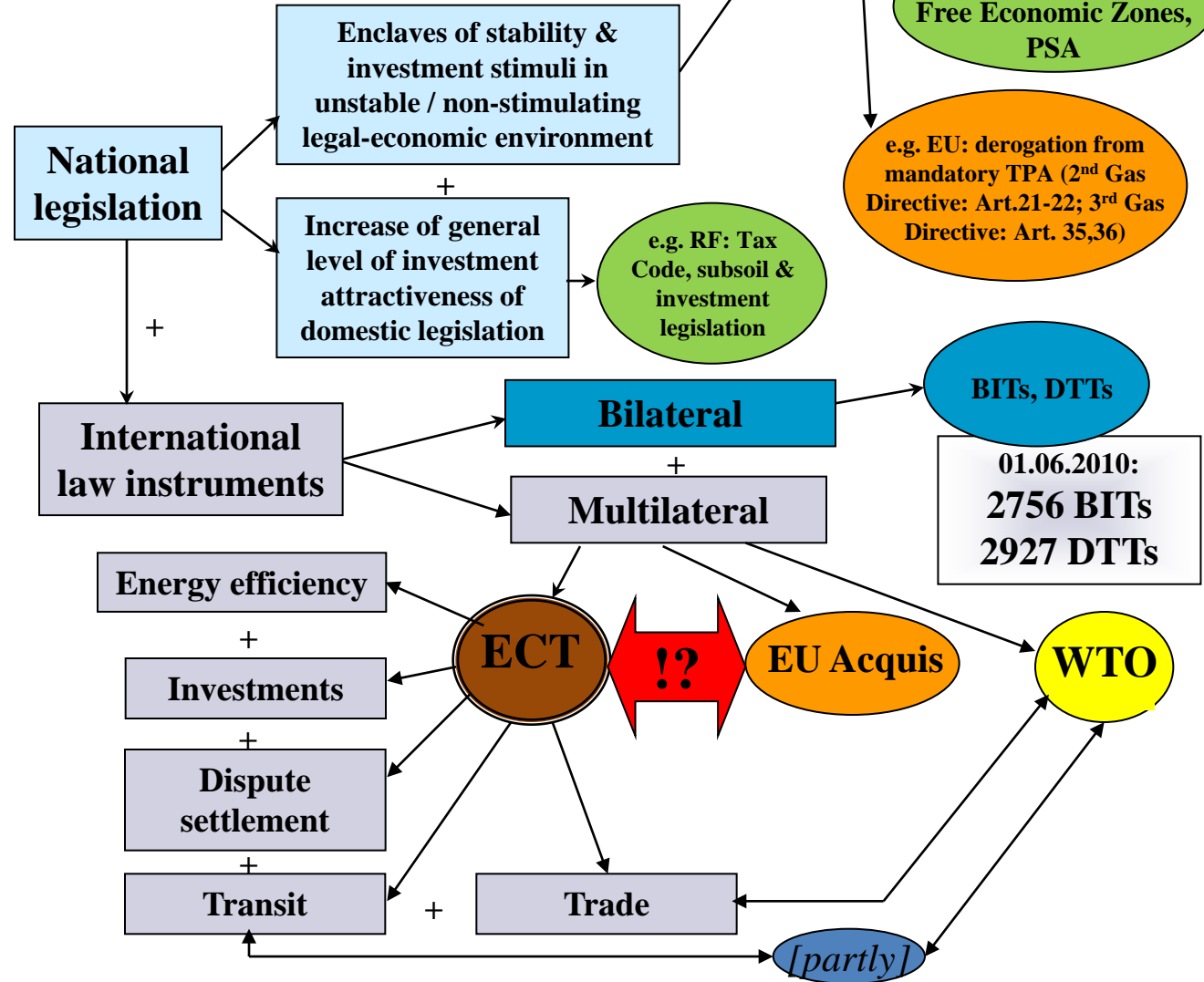
Development of international energy markets and of mechanisms of investment and trade protection and stimulation

Energy markets



ECT (54) = 1431 BITs

Mechanisms of investment protection / stimulation, incl. enforcement mechanisms

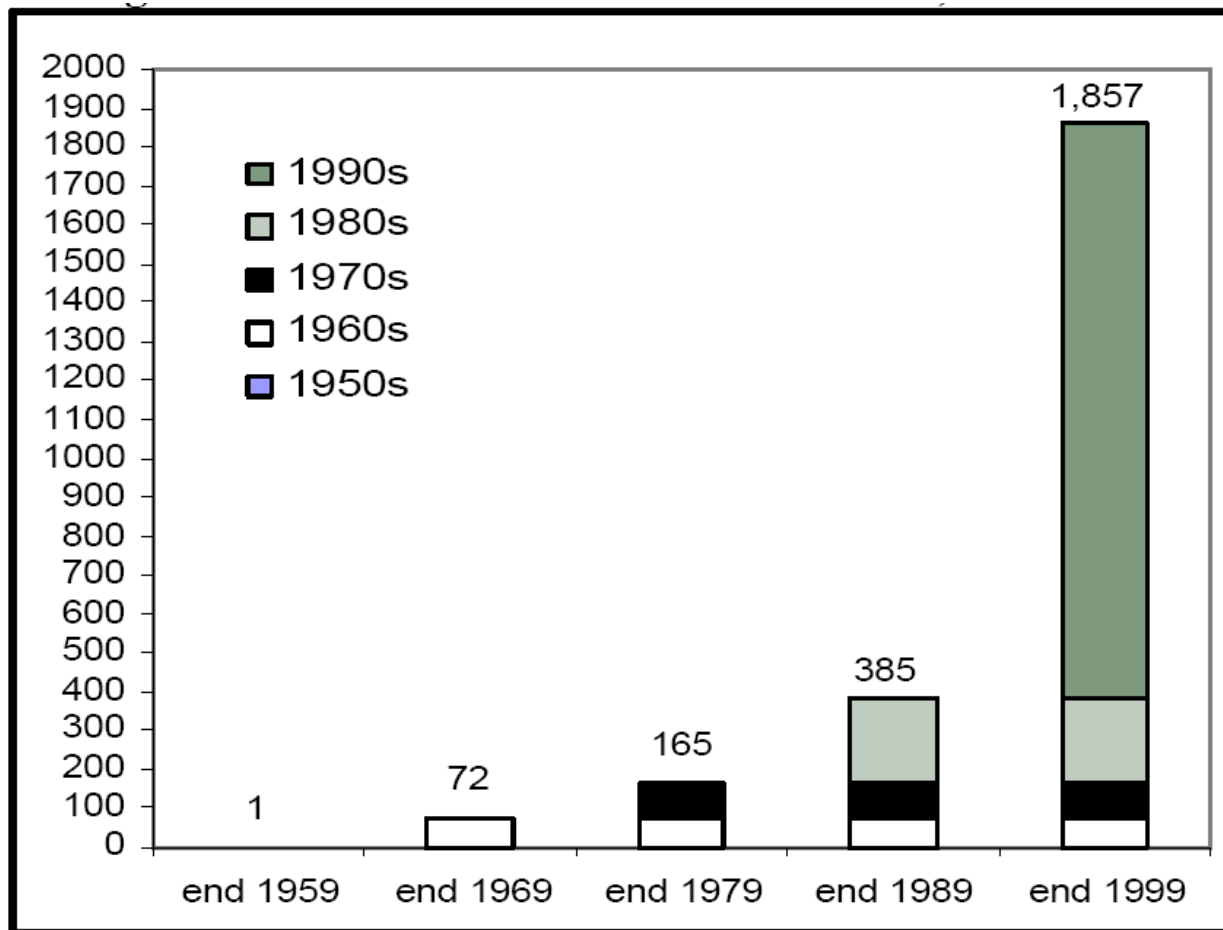


Comparative data on implementation of subsoil use tax/investment regimes worldwide, 2003 & 2009

-	2003		2009	
Number of states in analysis (data available from G.Barrows), incl.:	180		177	
Oil producing states, using:		91		104
- Tax + Royalty	113	45	111	55
- PSA	54	34	55	38
- Both T+R & PSA	13	12	11	11

Based on data, kindly provided to author by Gordon Barrows (Barrows Inc./AIPN)

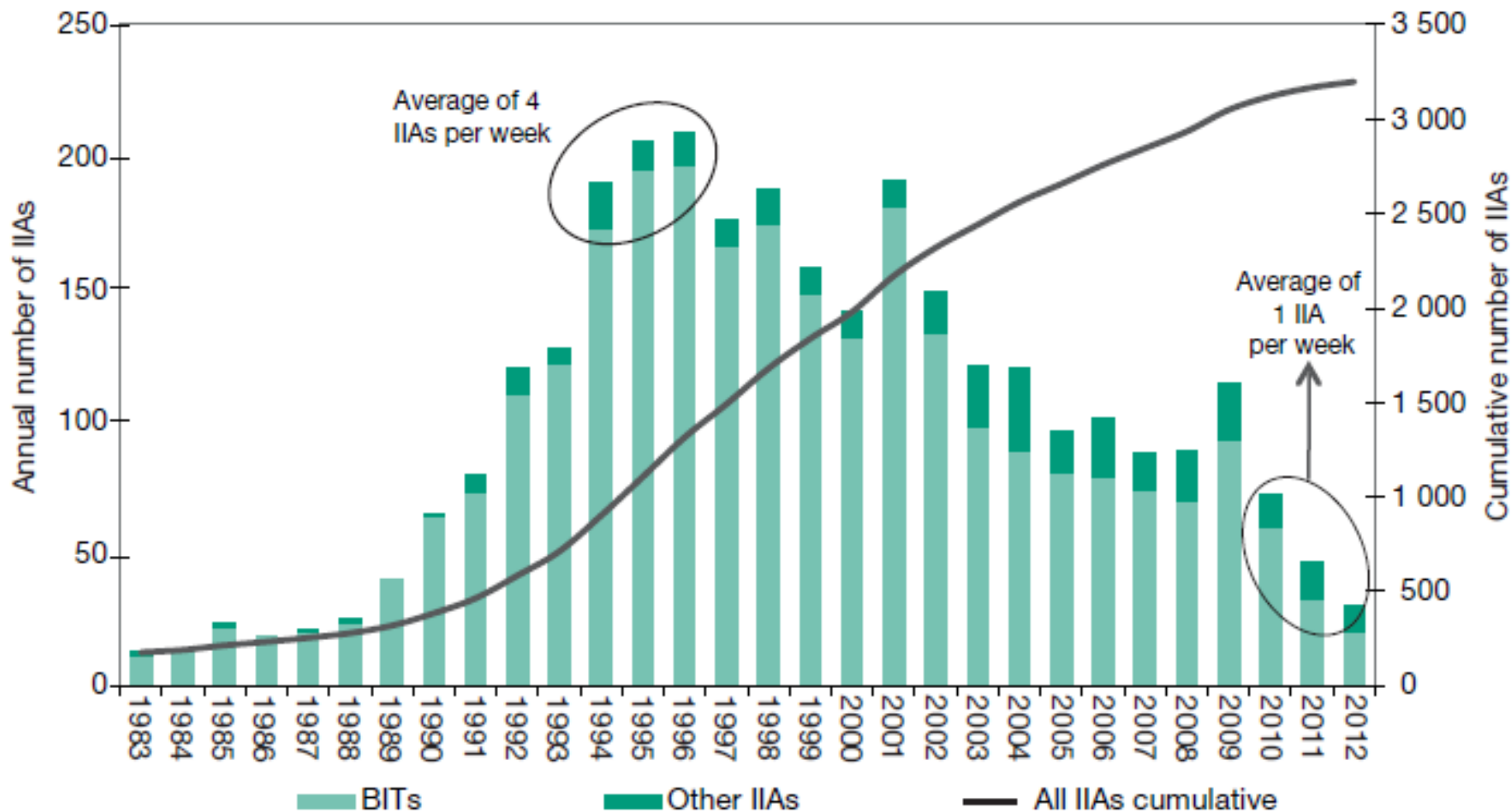
Growth of number of BITs, 1959-1999



Source: UNCTAD database on BITs.

Source: Bilateral Investment Treaties, 1959-1999. UNCTAD/ITE/IIA/2, 2000, p.1

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

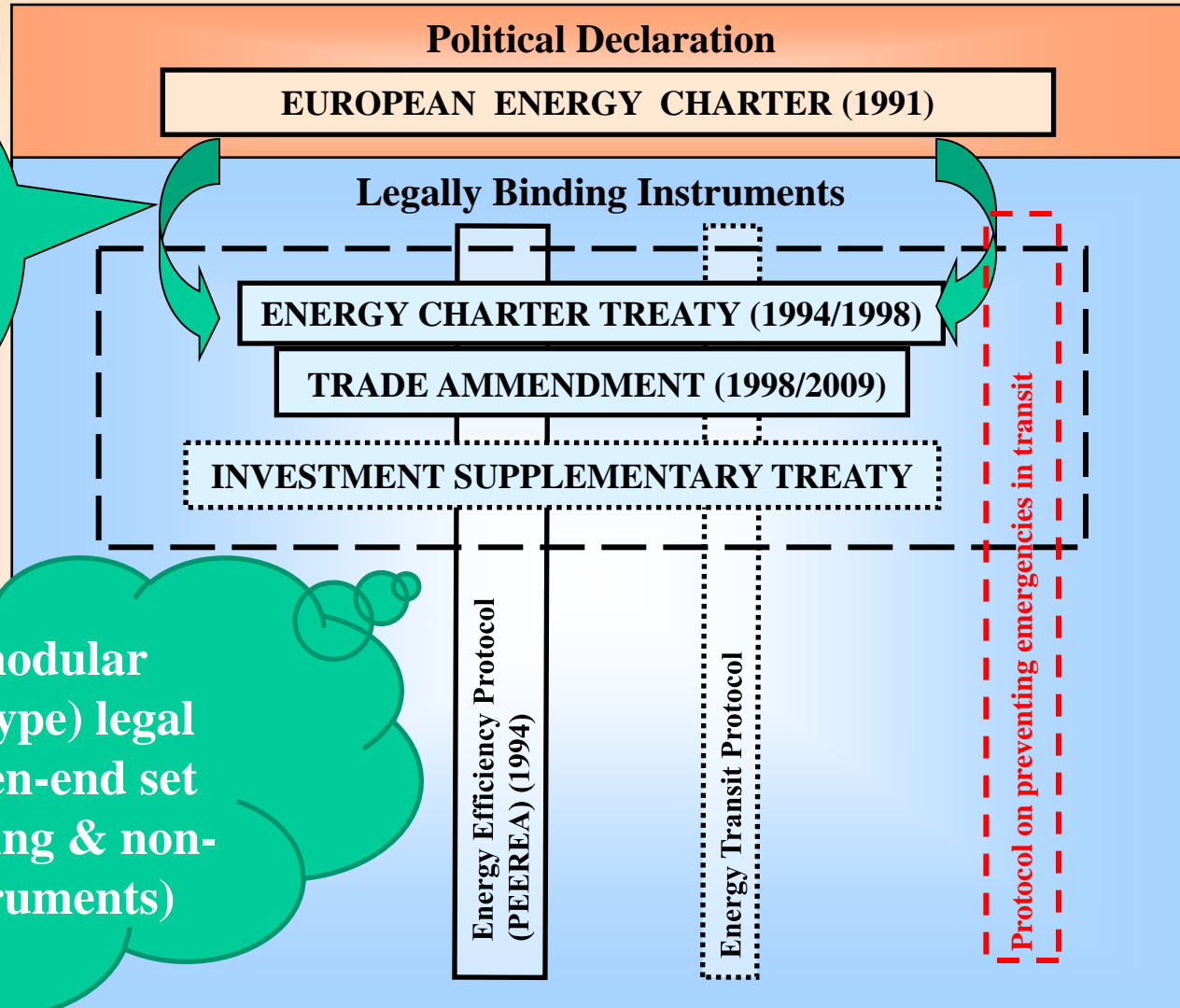


Source: UNCTAD World Investment Report 2013. UNCTAD, NY and Geneva, 2013, p. xx.

Table of contents

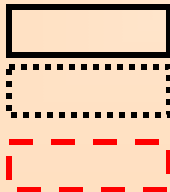
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ENERGY CHARTER AND RELATED DOCUMENTS



Energy Charter political principles incorporated in the legally-binding ECT and related instruments

ECT as a modular design (lego-type) legal structure (open-end set of legally binding & non-binding instruments)



- in force

- negotiations not finished yet

- new Protocol which could have been proposed by Russia

ENERGY CHARTER SPECIFIC ROLE

- **Energy Charter *Treaty*:**

- Unique coverage of different areas for *energy* cooperation:
 - investment, trade, transit, energy efficiency, dispute settlement,
 - energy materials & products + energy-related equipment,
 - 54 members of Energy Charter Conference (5 MS pending ECT ratification) + 9 observer-states which signed 1991 (European) Energy Charter declaration + 16 observer-states by invitation + 10 international organisations with observer status (as of 18.09.2013/www.encharter.org)
- First and only one multilateral investment agreement with high standard of investment protection, incl. dispute settlement

- **Energy Charter *process*:**

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

ECT = THE FIRST MULTILATERAL INVESTMENT AGREEMENT (1)

- Based on:
 - well-established practice of BITs (about 400 BITs at the beginning of the 1990's - around 2600 BITs as of today)
 - investment chapter XI of NAFTA (US, Canada, Mexico)
 - some interaction with then OECD proposed “Multilateral Agreement for Investment” (MAI – aborted in 1998)
- **Within 54 member-states ECT is equivalent to 1431 BITs**
- MFN and National Treatment for investors:
 - *hard-law* obligations (binding guarantee) of non-discriminatory treatment for *post-establishment* phase,
 - *soft-law* obligations for *pre-establishment* phase (stage of making investment)

ECT = THE FIRST MULTILATERAL INVESTMENT AGREEMENT (2)

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

Source: Joachim Karl, UNCTAD

International investment arbitration on the rise

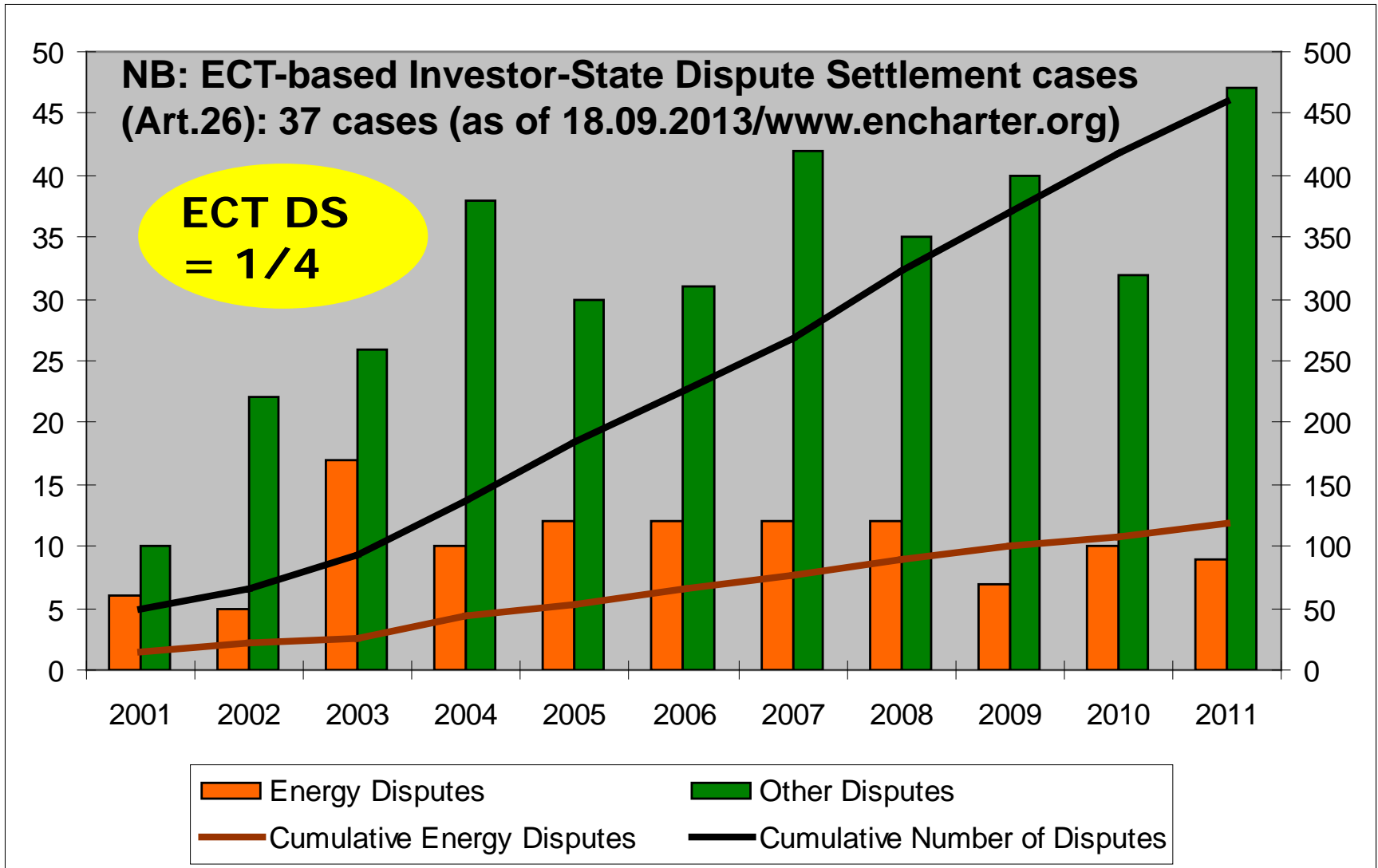
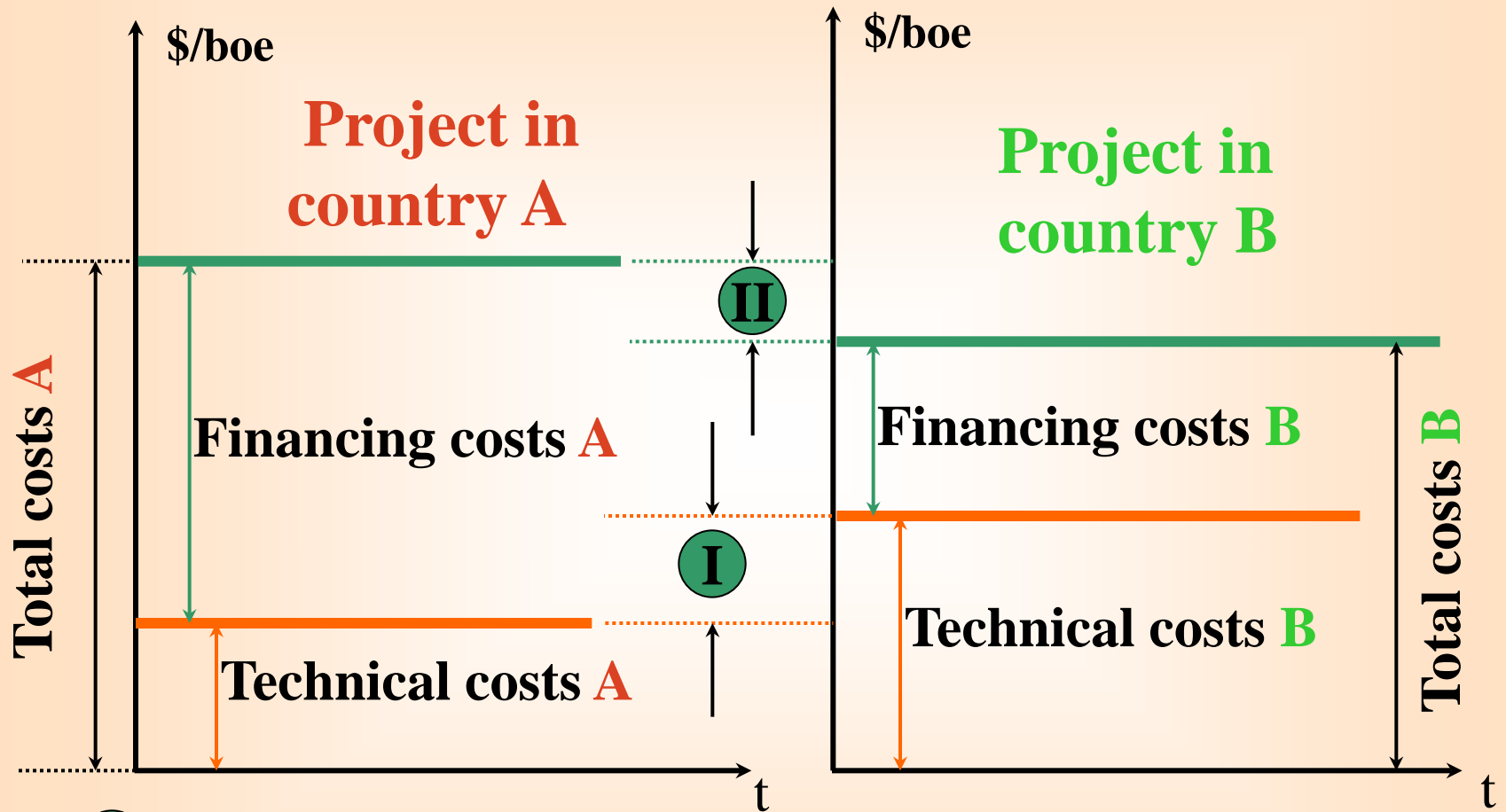


Table of contents

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“NATURAL” VS. “FINAL” COMPETITIVE ADVANTAGES OF ENERGY PROJECTS



- I** “Natural advantage” of project A over project B ($A < B$)
- II** Final competitive *dis*advantage of project A over project B ($A > B$)

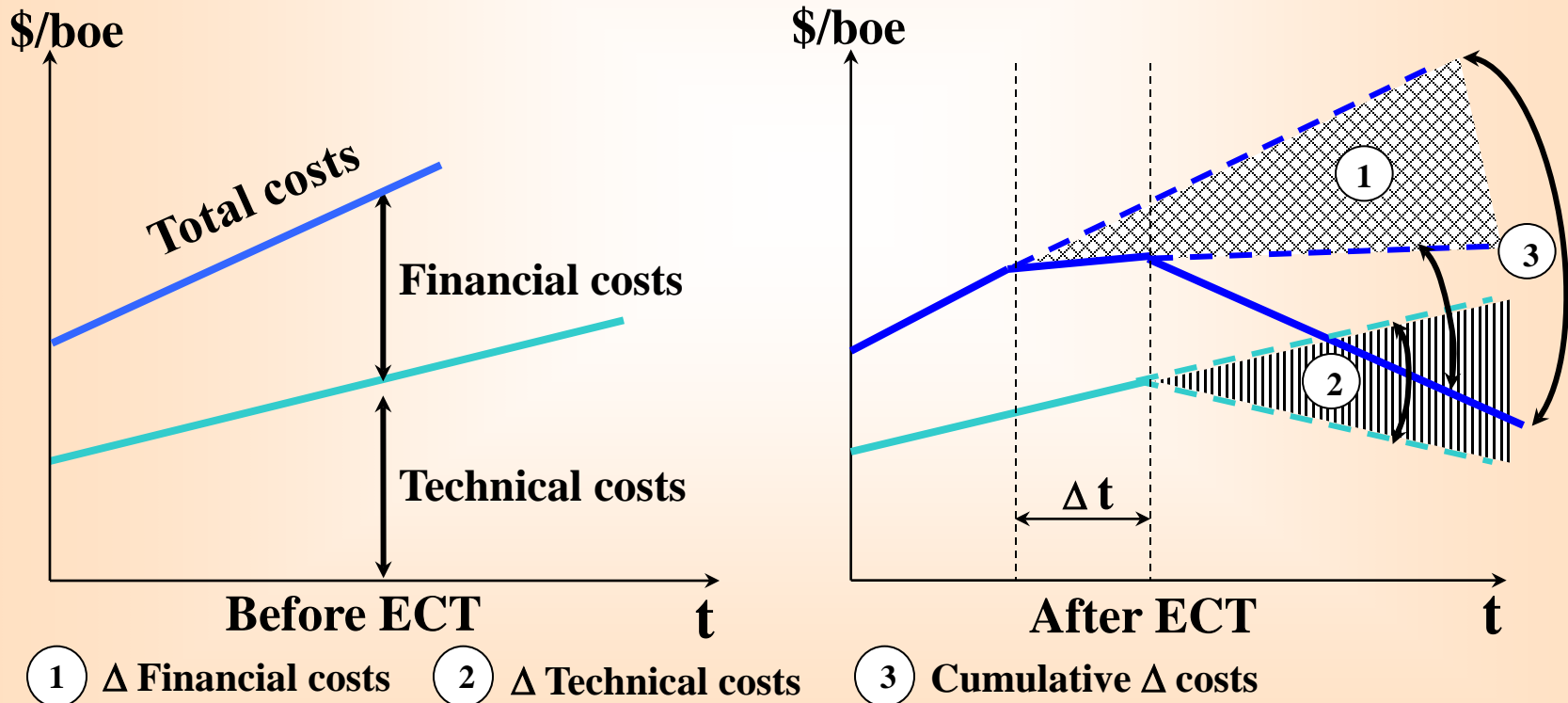
Russia at the scale of major international rating agencies (long-term investment credit ratings in foreign currency)

	Moody's	Standard & Poor's	Fitch IBCA	Short description	LIBOR+	
Investment grades	Aaa	AAA	AAA	Maximum safety level	Up to 4,25%	
	Aa1	AA+	AA+	High level of reliability		
	Aa2	AA	AA			
	Aa3	AA-	AA-			
	A1	A+	A+	Reliability above medium		
	A2	A	A			
	A3	A-	A-			
	Baa1 (RUSSIA: rating awarded 08.10.2008)	BBB+	BBB+	Reliability BELOW MEDIUM		Up to 6%
	Baa2	BBB (RUSSIA: rating confirmed 31.08.2011)	BBB (RUSSIA: rating confirmed 02.09.2011)			
Baa3	BBB-	BBB-				
Speculative grades	Ba1	BB+	BB+	Non-investment, speculative grade	Up to 14%	
	Ba2	BB	BB			
	Ba3	BB-	BB-			
	B1	B+	B+	Highly speculative grade	Up to 19%	
	B2	B	B			
	B3	B-	B-			
	Caa	CCC+	CCC	High risk, emitter is in difficult situation	Up to 19%	
	--	CCC	--			
	--	CCC-	--			
	09.11.2012, LIBOR 1Y: USD=0.86, EUR=0.52, GBP=1.07	Ca	CC	--	Highest speculative rating, default possible	Up to 204%
	C	C	--			
	--	--	DDD			
--	SD	DD	Default	Up to 204%		
--	D	D				
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ROLE OF THE ECT FOR PROJECT FINANCING (ECT IS A BUSINESS-ORIENTED TREATY)

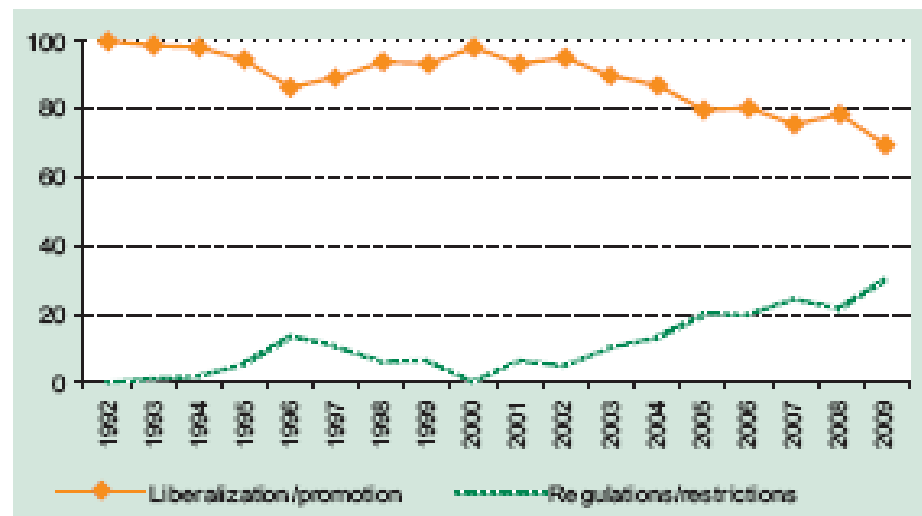
ECT/Legislation \rightarrow \downarrow risks \rightarrow \downarrow financial costs (cost of capital) = ① \rightarrow
 \uparrow inflow of investments (i.e. \uparrow FDI, \downarrow capital flight) \rightarrow \uparrow CAPEX \rightarrow \downarrow technical costs = ② \rightarrow
 ① + ② = ③ \rightarrow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

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



National regulatory changes for DFI, 1992-2009: correlation between liberalization/promotion (more favourable) & regulations/restrictions (less favourable) changes, %

Figure III.1. National regulatory changes, 1992–2009 (Per cent)



Source: UNCTAD database on national laws and regulations.

Table III.1. National regulatory changes, 1992–2009^a

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of countries that introduced changes	43	56	49	63	66	76	60	65	70	71	72	82	103	92	91	58	54	50
Number of regulatory changes	77	100	110	112	114	150	145	139	150	207	246	242	270	203	177	98	106	102
Liberalization/promotion	77	99	108	106	98	134	136	130	147	193	234	218	234	162	142	74	83	71
Regulations/restrictions	-	1	2	6	16	16	9	9	3	14	12	24	36	41	35	24	23	31

Source: UNCTAD database on national laws and regulations.

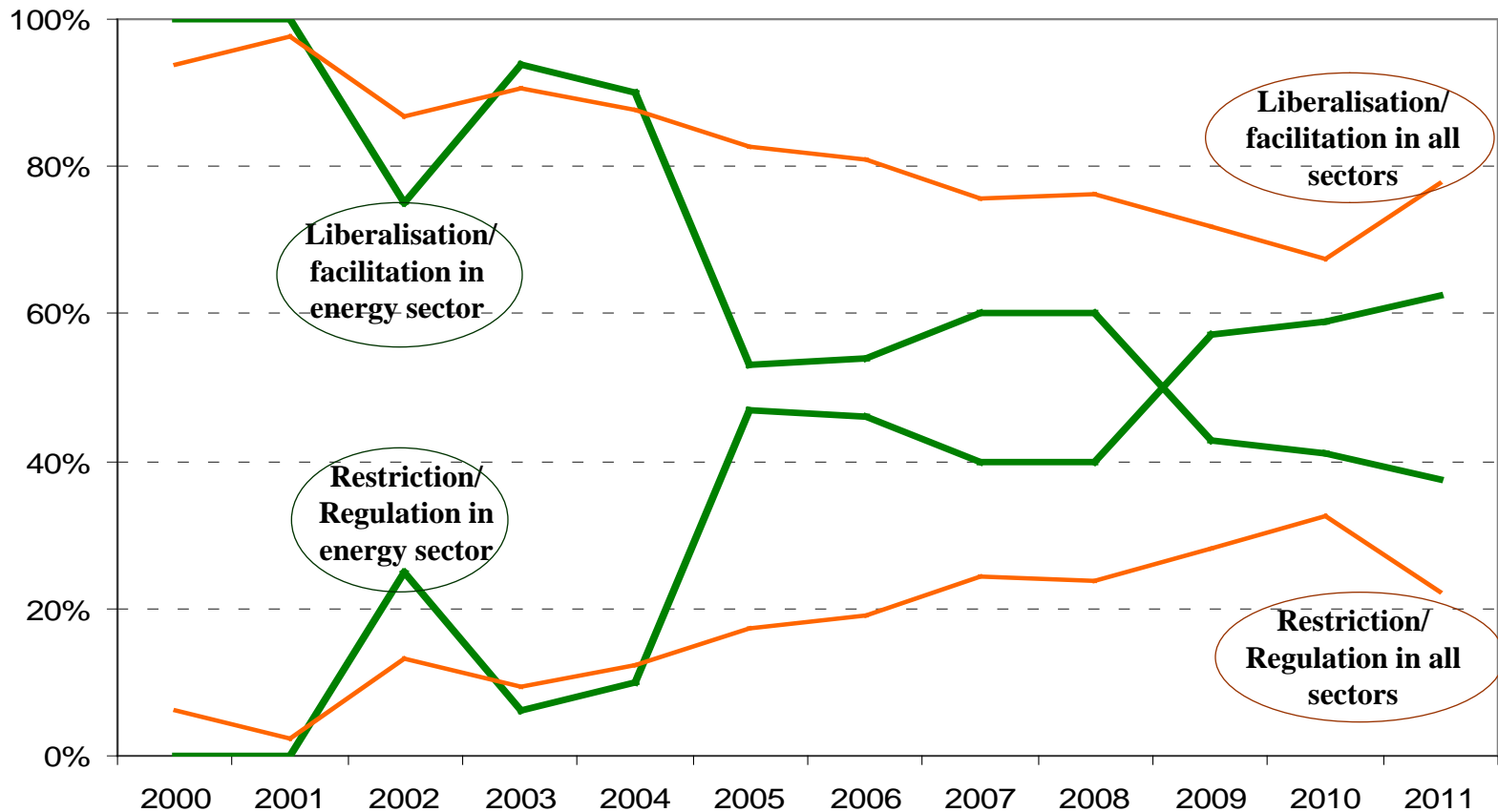
^a Compared with reporting on these numbers in previous WIRs, the wording in the table has changed from "more favourable" to "liberalization/promotion" and from "less favourable" to "regulations/restrictions".

Источник: World Development Report 2010. UNCTAD, 2010, p.76-77.

Policies with regard to FDI in energy

- ❑ The energy sector is more prone to State intervention than most other economic activities

Source: Joachim Karl, UNCTAD



ECT INVESTMENT REGIME: STANDSTILL & ROLLBACK PROVISIONS (ARTICLE 10(5))

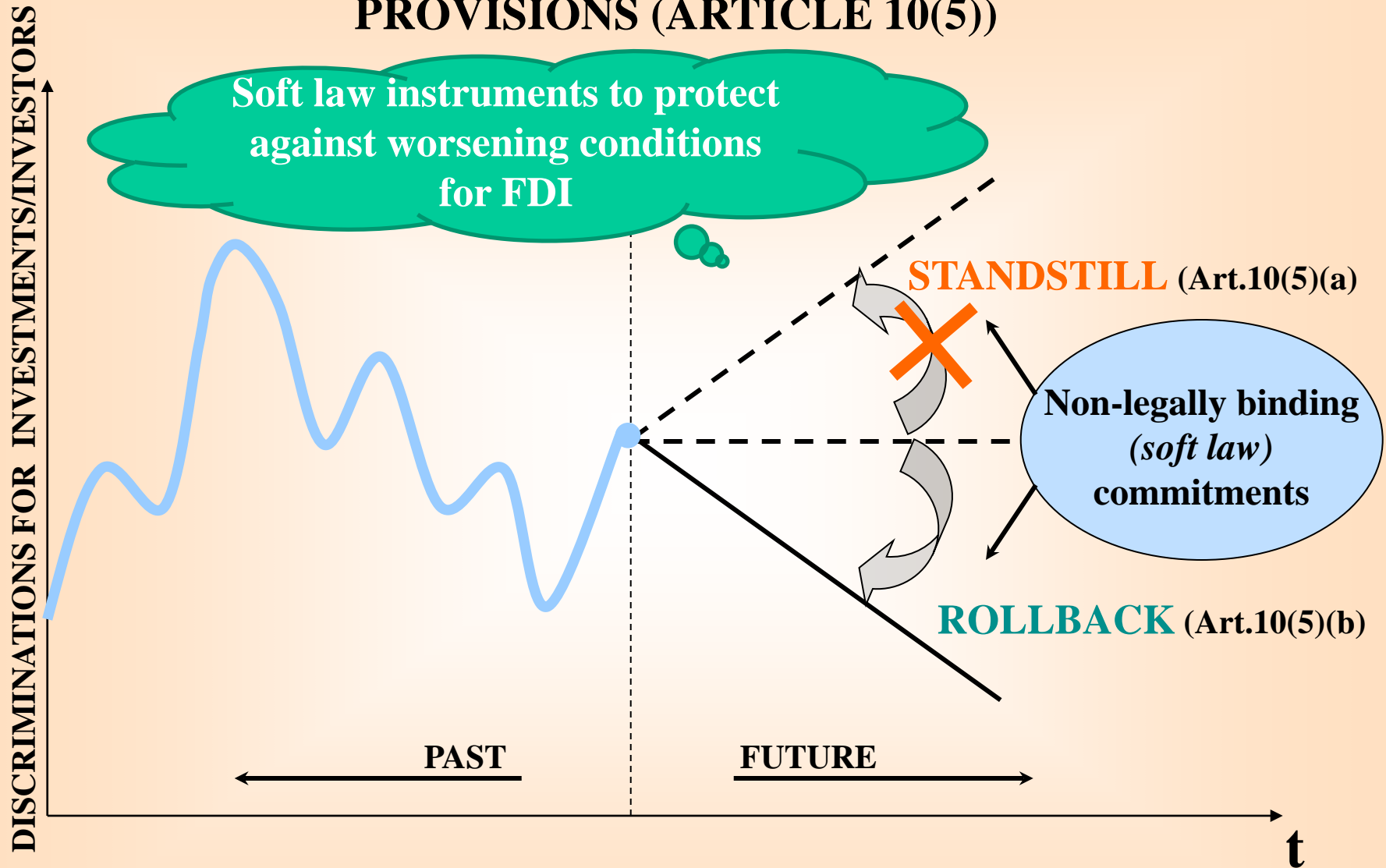


Table of contents

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ECT & EU acquis: “minimum standard” within evolving Eurasian common energy space vs. more liberal “general standard” within evolving common European energy space

Legal norms (key examples)	ECT	EU Acquis (1-st Gas Directives)	EU Acquis (2-nd & 3-rd Gas Directives)
Mandatory TPA	No	No	Yes
Unbundling	No	No	Yes

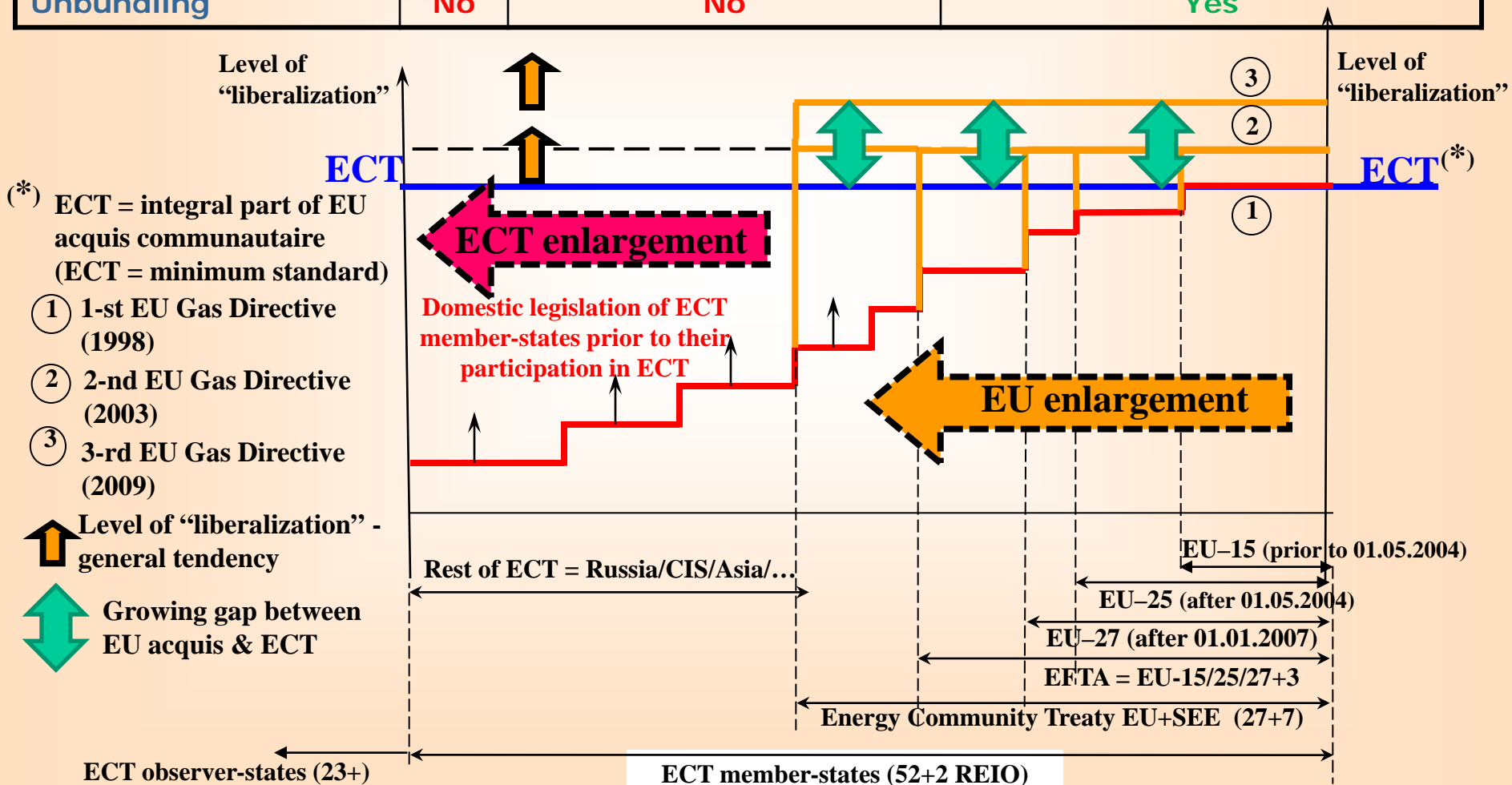


Table of contents

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SELECTED INTERNATIONAL INVESTMENT-RELATED AGREEMENTS

Organisation (member- states/CPs)	Legal Status	Scope	Investment	Trade	Transit	Energy Efficiency	Dispute Settlement
ECT (54/52)	LB	Energy	Yes	Yes	Yes	Yes	Yes
WTO (149)	LB	General	(Yes?) (Services)	Yes	<i>Yes/No*</i>	<i>No</i>	Yes
NAFTA (3)	LB	General	Yes	Yes	<i>No</i>	<i>No</i>	Yes
MERCOSUR (4)	LB	General	Yes	Yes	<i>No</i>	<i>No</i>	Yes
OECD (30)	LB	General	Yes	<i>No</i>	<i>No</i>	<i>No</i>	<i>No</i>
APEC (21)	<i>Non- LB</i>	General	Yes	Yes	<i>No</i>	<i>No</i>	<i>No</i>

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

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

Energy investment protection: complementarity of energy-related international organizations

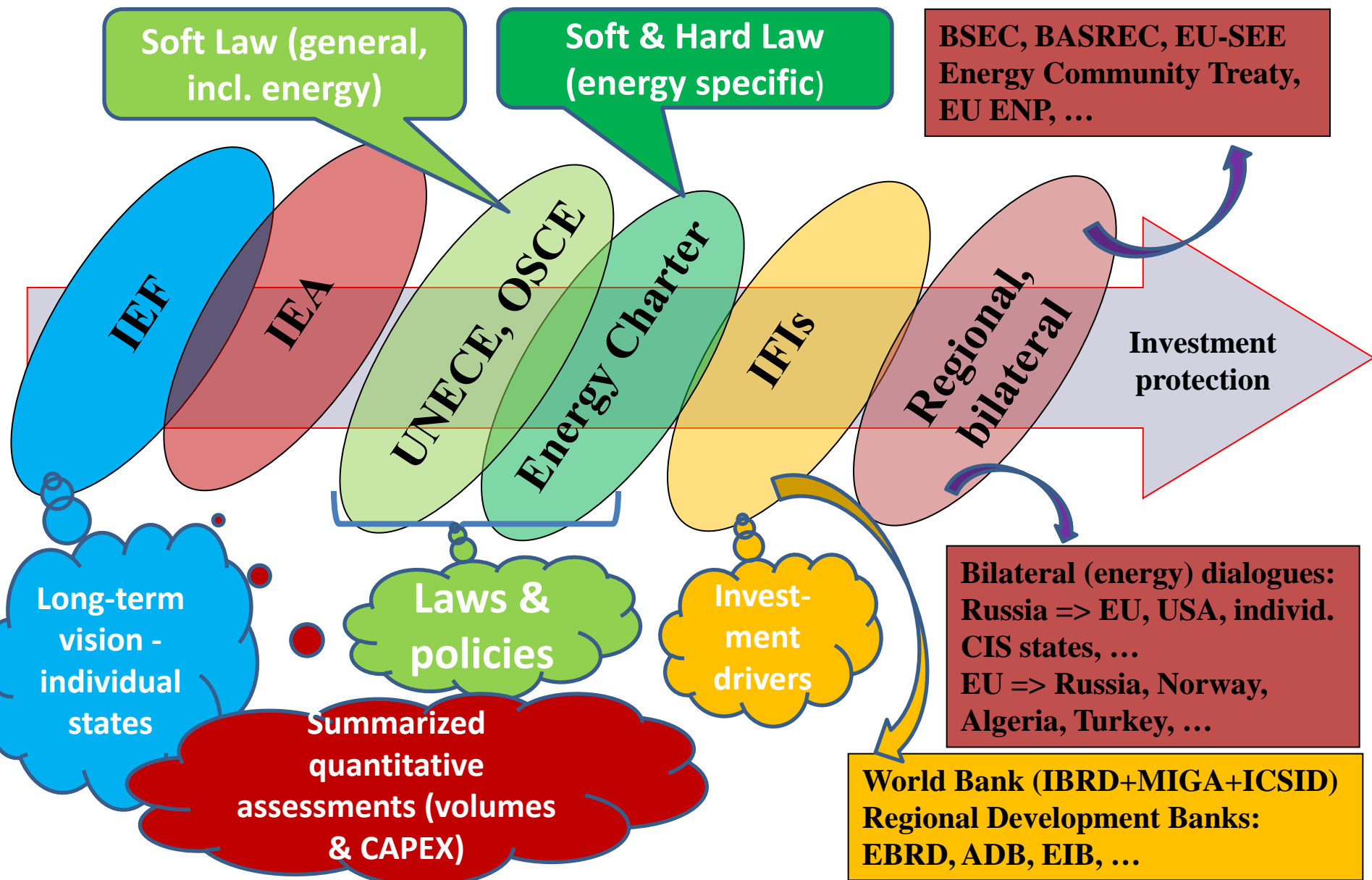
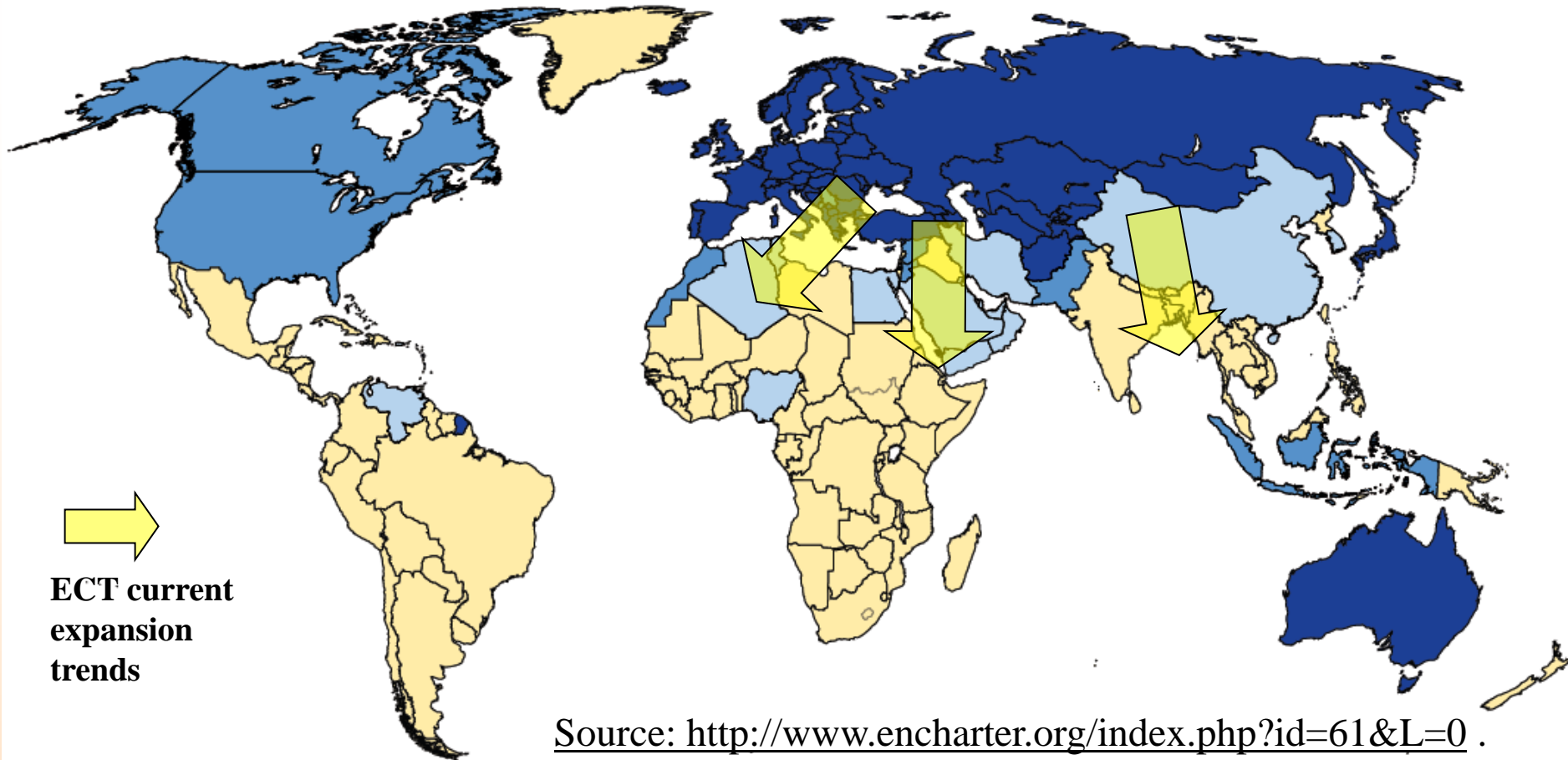


Table of contents

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ENERGY CHARTER PROCESS: GEOGRAPHICAL DEVELOPMENT



Dark blue: signatories to the 1994 Energy Charter Treaty, and members of the Energy Charter Conference

Blue: signatories to the 1991 Energy Charter, and observers to the Energy Charter Conference

Light blue: observers to the Energy Charter Conference by invitation of the Conference (without signing the 1991 Charter)

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

Thank you for your attention!

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