

The speech of the Secretary General Dr. Ria Kemper

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Mr Chairman, distinguished delegates, it is a great honour for me to be addressing this discussion session today. I believe that today's topic - how to meet the challenge of cross-border supply - is one of the most important issues facing the energy community, and I commend the organisers for giving it high prominence at this World Energy Congress.

I will use my presentation to highlight the way in which the organisation that I represent, the Energy Charter, is tackling this issue in Eurasia through a framework of rules for international energy cooperation. In particular, I will focus on the Charter's efforts to develop binding disciplines in the critical area of energy transit.

But first, a few words on the nature of the challenge. It is well known that global energy demand, and demand for natural gas in particular, is likely to grow significantly in the coming years. Taking natural gas as an example, two-thirds of the growth in consumption is expected to be covered by piped gas, with one-third in the form of LNG. It is increasingly the case that these pipelines - or planned pipelines - cross many national borders. The question of energy transit will therefore remain a key strategic issue for global energy security, and a major responsibility for governments.

I would like to illustrate this by concentrating on Eurasia, since this region provides the geographical focus for the work of the Energy Charter. The countries marked in green are those that have signed the 1994 Energy Charter Treaty, those in blue are observers - a topic to which I will return later. The US and Canada have a special status, in that they signed the 1991 political declaration, the European Energy Charter, but not the 1994 Treaty.

Looking at the energy prospects for Eurasia over the next decades, most observers foresee that this region can be more or less self-sufficient in natural gas supplies. Japan, the enlarged European Union, and also China, depend upon imported energy. Yet the Eurasian space as a whole is rich in energy resources. It contains around 38% of global gas reserves, of which three-quarters are in Russia and most of the rest are in Turkmenistan, Uzbekistan and Azerbaijan. This suggests the potential for Eurasia to emerge as a natural single market for energy supply, at least in natural gas.

But the development of this cooperative vision is by no means assured, and I would like to highlight two areas where I believe that governments, and inter-governmental organisations like the Energy Charter, have a crucial role to play.

The first concerns the enormous long-term investments that will be required to develop these reserves and bring them to market. The sums involved are vast, particularly for projects transporting natural gas from remote locations such as

Russia's Yamal Peninsula in northern Siberia. Governments are not in a position to provide capital on this scale, but they have a crucial contribution to make in creating the necessary legal and regulatory conditions for private companies to invest.

The second area is directly related to today's discussion, and concerns the conditions for use of the network infrastructure in Eurasia and problems associated with cross-border energy flows. The experience of the last ten years has shown that this is a critical issue, and that the main points of contention have been a lack of transparency in the conditions for access to export capacity in gas pipelines, a lack of clearly-established criteria for the setting of tariffs for energy flows in transit, and the phenomenon of illegal taking of gas in transit.

What can governments do collectively in order to address these concerns? One particularly striking answer to this question is provided by the European Union, which has taken major steps in recent years to create a fully liberalised and competitive market for gas and for electricity, including mandatory third-party access to networks and market-based tariffs. This model of an integrated energy market already extends beyond the twenty-five member states of the EU to the three countries of the European Economic Area. There is also a firm political commitment to extend it to other non-EU countries in South-East Europe, creating the realistic prospect that the rules of the European internal energy market will apply in full to more than thirty-five countries before the end of this decade.

This blueprint for open and competitive markets, if extended across Eurasia, would certainly tackle the problems associated with cross-border supply. Yet there are presumably limits to the extension of a complex policy framework that is so closely linked to the institutional and decision-making power of the European Union. This impression is reinforced by an examination of the current situation in Russia and in some other parts of the CIS. Although there has been remarkable progress in some areas, it is not difficult to find grounds for uncertainty over the investment climate: supply competition is limited; there is a high concentration of market power in the hands of a few large producers; conditions for access to networks are inexact; and there are significant deviations in the level of energy prices from the cost-based principle on which a true market system must operate. The prospects of rapid progress in these states towards EU levels of liberalisation appear at this stage to be rather remote.

In this light, there is a requirement for a set of rules agreed by a broader constituency. Taking energy transit as an example, this is an activity that by its nature involves a chain of countries, and the result is no stronger than its weakest link. A reliable transit regime in a large geographical area such as Eurasia therefore has to be based on common denominators to which all countries subscribe.

A set of common disciplines is of course available at the global level, in the multilateral rules of the WTO. These rules provide the essential framework for world trade and cover many issues relevant to the international energy business, but they do not address directly the challenges that I mentioned earlier. In the first case, this is because the WTO has few substantive provisions on investment and investment protection. In the case of supply across multiple national borders, the WTO has the

well-established principle of 'freedom of transit', but it is not easy to transpose this principle from goods travelling by road or rail - as it is normally understood - to energy resources requiring access to grids or pipelines. By themselves, the existing WTO rules are not sufficient to minimise the specific risks associated with energy transit.

You may not be surprised to hear that my line of argument is leading to the specific niche occupied by the Energy Charter Treaty. This Treaty, signed by 51 countries across Europe and Asia, is a collective attempt by governments to agree common 'rules of the game' for the energy sector across Eurasia. These rules are fully compatible with the wider multilateral system, and refer to WTO rules directly in many areas. Indeed, one of the main strengths of the ECT is that it applies WTO rules to energy trade among all its member countries, whether or not they have joined the WTO.

But the Treaty is also unique in many respects. It is the only multilateral investment protection treaty in the energy sector, supported by access to binding international arbitration in case of disputes. It is also the only international legal instrument that covers in detail the complex set of issues associated with energy transit.

The Treaty's provisions in this area are built upon the principles of freedom of transit and non-discrimination, as embodied in the WTO. However, they are distinctive in that they are explicit in their coverage of grid-bound energy transport, and also because they are enforceable through a conciliation mechanism in case of transit disputes. In short, these provisions mean that countries applying the existing Treaty rules may not refuse transit, or refuse to agree to the construction of a new pipeline or network capacity, solely on the basis of the origin, destination or ownership of the energy.

These rules came into force in 1998. However, experience showed that the issue of transit across Eurasia remained problematic, particularly for landlocked energy producers in the Caspian and in Central Asia. These countries led the demand to clarify specific operational issues related to energy transit, notably the conditions for access to national energy networks, and the criteria that network operators must observe when setting transit tariffs.

This was the background to the launch of negotiations on an additional Transit Protocol to the Treaty. These began already in 2000, and I regret to say that they have still to reach a positive conclusion, despite the fact that a wide degree of agreement has been achieved on nearly all substantive aspects of the draft text, and that the majority of our constituent member states have been ready since the end of 2002 to proceed with the Protocol's adoption.

The three outstanding issues in the draft Protocol relate to differences between the European Union and Russia, and I do not believe that these issues are insurmountable. However, over the last year the negotiations on the Protocol became intertwined with the separate discussions that were taking place between the EU and Russia over the terms of Russia's accession to the WTO, and this has complicated progress towards its finalisation. I am therefore pleased that, since my

initial paper was submitted earlier this year, two very positive developments have taken place. First of all, the EU and Russia completed in May their bilateral market access discussions on the WTO. Then, at the June meeting of the Energy Charter Conference, the parties agreed to resume their consultations on the draft Transit Protocol. These consultations should now take place in the coming weeks, and I strongly hope that these new circumstances will allow for the Protocol to be completed, paving the way for its final adoption by all our member states.

The benefits of this additional legal instrument in terms of facilitating cross-border supply would, in my view, be extremely significant. I will not go into all the details here: more information, including the draft Protocol text, is available through the Charter's web site for those wishing to examine it in depth. I would, however, emphasise some of the Protocol's key features. In its current form it would clarify, for the first time under international law, such key issues as the definition of "available capacity for transit", and oblige pipeline operators to hold negotiations, in good faith and based on transparent procedures, over access to such capacity. It would also stipulate that transit tariffs be cost-reflective, objective and non-discriminatory, and prohibit the illegal taking of energy resources in transit.

Our experience with these negotiations on transit provides an example of the difficulties involved in agreeing multilateral instruments. But I believe that the need for such rules remains undiminished, and that the demand for them will only grow as the importance of cross-border supply increases. This is the message that I am looking to underline today, and this will also be the focus of a major conference on transit issues, organised by the Charter Secretariat, in Brussels next month with participation from senior government officials and industry representatives from across our constituency.

In this context, it is appropriate to mention that the Charter's work on transit does not begin and end with the Protocol. In recent years, following a request from the Azeri authorities, the Charter has developed model intergovernmental and host-government agreements which provide a balanced template for the negotiation of specific cross-border pipeline agreements. We also engage our member governments in a dynamic process of policy dialogue, aimed at promoting the implementation of existing Treaty commitments.

To summarise the above, Mr Chairman, the Energy Charter process represents a pioneering attempt to manage and reduce the risks associated with cross-border supplies of energy. This work is not complete, but the Energy Charter remains a uniquely appropriate forum within which to develop this agenda in the future. The bottom line is that energy transit, by its nature, is a multilateral activity, which cannot be regulated adequately through bilateral channels alone, and the Energy Charter process is the most developed multilateral mechanism in existence through which governments can cooperate in this area.

Mr Chairman, by way of conclusion, I would like to make one further observation. The Energy Charter process as a whole provides a model for regional cooperation that, while focused in the first instance on Eurasia, can be of wider relevance. As I hope that today's presentation has demonstrated, the challenges facing Eurasia in

terms of securing energy supply are not unique, and so the solutions being developed - for instance in the area of cross-border supply - can likewise be of general interest and of broad potential application.

In saying this, I am greatly encouraged by the interest shown in the Charter process by China, Korea and ASEAN, all of which have become observers in recent years. I think that the Charter merits careful study as a possible mechanism for regional cooperation both in Northeast and in Southeast Asia, particularly given the well-documented need for additional cross-border pipeline projects in these areas. In all of these cases I will be pursuing dialogue with the governments in question over the possibility of their closer involvement in the work of the Energy Charter process in future.

This Asian dimension to the Charter process serves to emphasise that the Charter is far from an exclusively European organisation. It is true that the European Community was the "founding father" of the Energy Charter process, and that our relationship with the EU remains a strong one. Indeed, since May of this year the enlarged Union accounts for nearly half of our constituency. But since the beginning the Energy Charter has included member states from outside Europe: our hosts today, Australia, together with Japan and the states of Central Asia, were also among our founding members, and they were joined more recently by Mongolia, which acceded to the Charter Treaty in 1999.

I hope that my presentation today has highlighted the way that the Energy Charter process is trying to tackle the challenge of cross-border supply, and also that it might provoke some thoughts as to the broader application of our experience. Needless, to say, the Energy Charter Secretariat stands ready to provide any further advice or assistance that might be required in this respect.

Thank you for your attention, and I will of course be pleased to answer any questions that you might have.