

International Conference on
**“The Role of Governments and International Organisations in
Promoting Energy Security”**



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“Energy Security: The Role of International Legal Framework”

Ladies and Gentlemen,

The discussions on energy security, being intensified during the 2006 Russian G-8 Presidency, have once more underlined that investment is a key to international energy security.

Demand for energy has been and would be continuously growing in absolute terms. The bulk of this demand in the foreseeable future (within the duration of at least one-two investment cycles) will be covered by hydrocarbons. New fields are to be developed to cover incremental demand and to compensate depletion of the fields currently in production. Due to asymmetry between energy production and consumption areas (Markets/Resources Mismatch) major energy consumers will face growing import demand. That leads to continued growth in international

energy trade with its increasing cross-border character and to a shift to more use of infrastructure-bound energy.

Figure 1: Global energy trends – why non-OECD important

Major part of new energy demand and supply will come from the “new” (non-OECD) markets, where the need for creation of energy infrastructure is much higher than within existing “old” markets. According to IEA, during 2001-2030 70% of incremental demand, 95% of supply and 60% of energy investments would be originated in non-OECD area. Emerging economies have been developing their legal systems for less time, compared to OECD states, and thus are associated with higher risks.

Linking together consumers and producers by common (usually immobile) infrastructure increase their mutual interdependency. Internationalization and globalization of the energy markets put an end to the earlier existing concepts of “energy independency”. We are leaving in the interdependent energy world nowadays.

As long ago as in 1911, at the time when Winston Churchill switched the Navy from coal to oil, it was recognized that “safety and certainty in oil lie in variety and variety alone”. Since then diversification is the synonym of energy security. This is only true though when the term ‘diversification’ is interpreted in the broad sense and reflects the balance of interests of players representing all units of the energy value chain.

Figure 2: Energy security and diversification

That involves not only diversification of energy supply routes from today’s suppliers to historically developed markets (the concept of ‘multiple pipelines’) and not only diversification of sources of energy supply for existing consumers

(the concept of ‘multiple suppliers’). It also involves diversification of markets and routes to access them for suppliers.

Demand for energy and diversification in the energy area requires creating new infrastructure, hence is related to investments, mostly the large-scale ones. Any - and especially large-scale - investments are aimed at establishing stable long-term relations to the mutual benefit of suppliers and consumers, investor and host-state - relations, which are balanced and are based on clear, predictable and enforceable rules.

Such rules are needed to mitigate risks, and it means stimulating not only investments as such in all parts of the cross-border energy value chain – from exploration and development to final consumption of energy. They are needed to mitigate risks of cross-border energy flows from suppliers to consumers. As well as to mitigate the reverse risks – related to flow of income going from consumers to suppliers for the energy delivered.

Figure 3: Economic “circle of life” regarding energy projects

Only in case of reduced risks and ensuring transparency, predictability and reliability of all three types of flows related to the energy business (or: to the full investment cycle in energy) – investment flows, energy flows and revenue flows – one can talk about a balanced approach to the issue of ensuring energy security. It is in this context that we in the Energy Charter interpret the concept of ‘energy security’ as a triad consisting of security of supplies, security of infrastructure, security of demand, including, thereafter, the issues of access to the resources, infrastructure and markets. But it is investment that is the “starting point” of the economic “circle of life” regarding energy projects.

Thus, to pursue cross-border investments and trade one needs reliable, consistent and transparent legal frameworks irrespective of which companies in which states and under which level of current energy prices would undertake energy projects in any parts of cross-border energy value chains.

Figure 4: Energy Economy: demand for quality of regulatory framework

In energy economy demands for the “quality” of such legal and regulatory framework are among the highest compared to other industries - due to longest lead-times, highest unit capital value of energy projects, together with broadest nomenclature of risks and immobile character of energy infrastructure.

With the evolutionary development of energy markets from national to international and global level there is a parallel development of the spectrum of legal instruments of investment protection and stimulation, aimed to diminish investment risks. Such development took place between the business actors, as well as between the states and business actors, as well as within and between the states. But each one next instrument is generally not to substitute or to cancel the previously existing ones, but to add to their sum-total, thus providing both to states and investors broader spectrum of competitive choices on how to reach their aims.

On business level, evolution of contractual structures can be taken as an example.

Figure 5: Energy markets: evolution of contractual structures

At initial stages of energy markets development long-term contracts dominated absolutely. They were a trade-arm of concessions and PSAs and had no alternatives. Later on, due to diversification and development of infrastructure which provided competitive choices both for producers and consumers in selecting their counterparts, the new contractual structures have appeared first on

“physical energy” markets: short-term contracts, then spot and forward deals. Later-on “paper energy” markets have been evolved with forward deals, futures, options. But within their diversity each type of contractual structures, including LTCs, has its “competitive niche” (even within commodities markets) dependent on the particular economic conditions and particular energy markets. For instance, as of today, LTCs has an absolute dominance in gas supplies both to and within Europe, reflecting current stage of development of that energy market. And thus LTCs will continue to play their role, especially as generally accepted by financial and energy community instrument to develop capital-intensive and long-life-cycle investment projects in energy, especially Greenfields in upstream.

The states as resource-owners started to develop investment protection mechanisms at the national level first within project-oriented legal structures.

***Figure 6: Development of Energy Markets and
Mechanisms of Investor Protection/Stimulation***

They created “enclaves of stability” (such as PSAs, concessions) in unstable or in the absence of adequate legal environment. Next steps were aimed to create and to improve the general “quality level” of national legislation (by implementing not only project-oriented legal structures, but also general principles of investment treatment). Within the globalizing energy world with growing interdependence of the players, their challenges soon become common, and common challenges require common approaches and rules. That is why later-on the above-mentioned legal development is expanded to international level: through development of network of bilateral undertakings (BITs, DTTs – now about 2400 and 2600 worldwide respectfully) to creation of a number of multilateral agreements. Energy Charter is one of those.

There is an increasing need for a common framework – agreed by all states along

the energy value chain – to provide a necessary degree of legal security for investment and reliable cross-border flows and to promote the efficient production and use of energy. There is also a continuous need for a dialogue with partners all along this chain. The balance of interest provides the basis for stable international cooperation. And this is the philosophy that lies at the heart of the Energy Charter process based on the shared belief of its member-states that long-term international energy security can best be served by a binding multilateral framework for energy cooperation. That is the substance of the legally-binding Energy Charter Treaty (ECT) which establishes common obligations to which all member countries subscribe in the areas of energy investment, trade, transit, energy efficiency and dispute settlement.

Of course, in the course of multilateral negotiations on the Treaty on some issues the countries has managed to agree with the higher level of mutually-binding and enforceable obligations (“hard law” language like “the parties should”), on some provisions – with the less binding level of mutual obligations (“soft law” language like “the parties shall endeavor”). But as was stated by the Russian Foreign Ministry in their note on ECT placed at the Ministry’s web-site (at least yesterday it was still there): “the ECT and related documents represent the result of mutual compromises and ‘gives and takes’ reflecting negotiating parties endeavour to find a balance of their interests”¹.

The Energy Charter Treaty (ECT) does provide and promote an environment of legal security that facilitates investment in the energy sector of its member-states. This is particularly important for large-scale oil and gas infrastructure projects that cross multiple national boundaries.

Figures 7: Selected international investment-related agreements

¹ Договор к Энергетической Хартии (справочная информация), 25.11.2005, from www.mid.ru / Международные отраслевые и межведомственные связи

Today the Energy Charter Treaty is the only multilateral investment treaty, which is energy-specific (covering the group of sub-sectors where investment risks are especially high) and provides broadest geographical coverage.

Short description of the ECT characteristic features that makes it unique among other treaties and investment protection measures is presented at the next 3 slides that are self explanatory.

Figure 8: Energy Charter specific role

Figure 9: ECT = first multilateral investment agreement (1)

Figure 10: ECT = first multilateral investment agreement (2)

ECT includes today 51 member-states and 19 observer states. The country with the most recent observer status is Afganistan (since August 2006).

Figure 11: ECT expansion process: Asian dimension dominates

We expect Pakistan, who became an observer in December 2005, to become full member of the ECT on 20 November at the 17th session of the Energy Charter Conference. 10 international organisations are observers to ECT. As international energy investment and trade increases across Eurasia, the strategic value of the Charter framework will increase both for consumers and for producers seeking long-term access to the main international markets.

Figure 12: Energy Charter process: geographical development

Starting with political declaration for Trans-Atlantic Europe (in post-Helsinki OSCE terms), today Energy Charter process has been developing to cover evolving Eurasian energy market. Energy Charter represents objective and logical process based on clear economic and financial reasoning for its member-states. Our role - as an instrument of international law setting a reliable framework with effective dispute settlement procedures - is to protect long-term capital-intensive cross-border investment decisions.

Energy Charter (both in its political and legal dimensions) support and help to develop policies that remove barriers to the flow of international energy investment and promote fair access to the markets. ECT and its instruments provide a legal framework for investments, reducing risk by lowering technical and financing costs and maximizing the economic potential of projects. And energy projects, through their direct and multiplier effects, bring economic development into corresponding areas and add to economic growth – which is especially important for developing nations and economies in transition.

The major benefit of the ECT is that this single multilateral treaty provides common “rules of the game” within its constituency. In the given ECT composition comprising of 51 member-states it substitutes 1275 bilateral investment treaties (BITs) which would be needed to provide the same level of protection among the whole ECT community. Until nowadays only twice as much BITs have been agreed worldwide (2392 at end-2004) as ECT “substitutes”. To conclude these another 1275 (equal to the role of ECT), at least few decades will be needed. In this respect ECT streamlines the way to mutually beneficial international order.

Energy Charter unites both energy producers, consumers and transit states representing developed, developing and transition economies. Moreover, Energy Charter political declaration is the only document establishing common approaches to providing energy security that was signed (in December 1991) by all member-states of the G-8. So common denominator to promote international energy security was established already 15 years ago – and we are glad that at this July’s Summit G-8 member-states has reconfirmed their support to Energy Charter principles.

Moreover, the G-8 Summit went even further in implementing within its documents the ECT principles, though without direct mentioning ECT as such. If one would undertake a comparative reading of both ECT and G-8 documents he will see with evidence that G-8 Action Plan and Chairman's Statement, Final Document of G8 Summit, not only refer to the spirit of the Charter, but also use the same approaches and even same wording, as in the Energy Charter Treaty, on a number of key institutional issues such as development of open and competitive energy markets, investment protection, energy efficiency, transparency, etc.

Finding an international consensus on issues of energy is not always an easy task, especially when the objective is to conclude a binding instrument of international law. And the task became much more difficult when this binding instrument need to be a multilateral one. The Energy Charter Treaty is therefore a unique achievement in international cooperation. But Energy Charter is not the only one energy-related multilateral international organization in the current world.

Figure 13: Some energy-related international organisations

These organizations present different composition of energy producers, consumers and transit states, energy exporters and importers, some of them are more policy-oriented, others have more legally-binding character. However, none is comparable with the Energy Charter in terms of legally binding nature of its provisions.

In the sphere of investment protection, the Energy Charter process forms part of a chain of energy-related international organizations, whose activities are mutually complimentary and which can and already collaborate to improve international energy security:

***Figure 14: Complimentarity of energy-related international organizations
(in protecting energy investments)***

- **International Energy Forum** – the logical starting point - provides the Energy Ministers of both energy-producing and consuming states with twice-a-year opportunity to outline their long-term vision of national and international energy developments and prospects;
- **International Energy Agency** – the second element in this chain - most effectively quantifies those visions in terms of global energy demand and supply projections and investments needed to implement these projections;
- **Energy Charter** – the third element in this chain – provides a forum for discussion of common approaches within its multilateral community to risks involved in future energy-markets development. Energy Charter develops corresponding multilateral legal instruments that will mitigate risks related to international energy investments (as quantified by IEA and/or by member-states), ultimately promoting cross-border energy flows within Eurasia;
- **International financial institutions** (the World Bank and regional development banks such as EBRD, ADB) – the fourth element in the chain – assist in attracting private capital to finance capital-intensive energy projects in the economies in transition and Greenfield areas;
- **Bilateral** organizations (including “energy dialogues”, such as Russia-EU, Russia-USA) and organizations for **regional** economic cooperation (such as BSEC or BASREC) provide additional support, including political and financial support, to the projects of mutual interest to their members.

A structured approach to the international energy cooperation along these lines, reducing international energy-related investment risks, would create positive multiplier effects for all the states within the energy value chain. Without international energy cooperation it is not possible to improve international energy security.

Thank you for your attention.