THE INTERNATIONAL ENERGY CHARTER: A GLOBAL INVESTMENT FRAMEWORK FOR THE NATURAL GAS INDUSTRY

During the 2015-2018 triennium, the Study Group on Best Practices in Governance and Regulation in IGU's Strategy Committee has cooperated with the Energy Charter Secretariat to look at natural gas market reforms, develop case studies on technical, commercial and regulatory changes, and review best practices to mitigate commercial and regulatory risks. Prior to a full presentation of the findings at WGC 2018, this article highlights international trends in investment protection. **By Dr Ernesto Bonafé and Dr Urban Rusnák**

The IEA 2017 World Energy Outlook (WEO) forecasts a growth of natural gas consumption of 45% by 2040 with most of the projected growth in demand taking place in Asian developing economies led by China and India. Also, there is a shift towards a more flexible, liquid, global market in LNG. According to the IEA 2017 Global Gas Security Review, however, security of natural gas cannot be taken for granted, as shown by the disruptions due to harsh winter temperatures in Southern Europe, the diplomatic tensions in the Gulf and the hurricanes in the United States.

IGU praised the 2017 WEO for recognising the great versatility of gas and reiterated IEA's findings that natural gas "can play multiple roles across the energy system in a way that no other fuel or technology can match, generating power, heat and mobility with fewer CO2 and pollutant emissions than other fossil fuels". IGU was also present at the G20 Natural Gas Day held in June 2016 in Beijing, and co-hosted by the National Energy Administration of China. The panel discussions stressed "the pivotal role of natural gas in the world energy transformation […] far beyond its position as a bridge fuel [in] the world's energy future", since its economic advantages make it a source that is "available, affordable, economical, clean and sustainable". The need to reduce methane emissions and to distinguish natural gas from other fossil fuels was also stressed.



Dr Urban Rusnák, Energy Charter Secretary General (left) with Francisco de la Flor, Leader of the Study Group on Best Practices in Governance and Regulation in IGU's Strategy Committee.

In the G20 Beijing meeting of 2016, energy ministers confirmed that "natural gas can be a less emission intensive fossil fuel, and can play an important and effective role in moving towards a low GHG emission energy future". G20 ministers also noted that natural gas is an integral part of the global energy supply and, as such, there is a need to ensure well-functioning, transparent and competitive gas markets, including LNG at the global level. Many countries are expected to use more natural gas in transportation, distributed energy and power generation, which in turn requires more gas extraction, transportation and processing in a sustain-

able manner. The same key role of natural gas in moving towards a low-carbon energy future with competitive global gas markets was recognised by the 2016 Tokyo and 2017 Ashgabat Energy Charter Declarations.

In terms of total energy investment worldwide, there was a fall of 12% in 2016 amounting to $1.7 trillion. The increased spending on energy efficiency and electricity networks was offset by a drop in investment in upstream oil and gas (25% down) and in power generation. IEA's Executive Director, Fatih Birol concluded that "[a]s the oil and gas industry refocuses on shorter-cycle projects, the need for policymakers to keep an eye on the long-term adequacy of supply is more important. Even with ambitious climate-mitigation goals, current investment activity in oil and gas will have to rise from its current slump."



IGU President David Carroll at the G20 Energy Ministerial Meeting in Beijing.

A new order for global investment policy

At the Word Economic Forum at Davos in January 2018, US President Donald Trump's keynote speech clarifying that "America First does not mean America alone" was interpreted as a bid to re-build bridges with the international community, after the 2017 G20 summit in Hamburg failed to agree to fight protectionism in all its forms and secure free trade. Despite the tendency of governments to raise barriers to trade and investment flows, concerted efforts to create a level playing field should be pursued. Here we review international best practices on investment policymaking that are of relevance to the natural gas industry.

The G20 trade ministers meeting in Shanghai in July 2016 endorsed the G20 Guiding Principles for Global Investment Policymaking with the objective of fostering an open, transparent and conducive global policy environment for investment. The agreed principles aim to achieve coherence in national and international policymaking and promote inclusive economic growth and sustainable development. These non-binding principles can serve as a reference point for national and international investment policymakers and help provide greater predictability and certainty to investors. They include:

- Avoiding protectionism in relation to cross-border investment.
- Establishing open, non-discriminatory, transparent and predictable conditions for investment.
- Providing legal certainty and strong protection to investors and investments.
- Allowing stakeholders' participation in the development of investment-related regulation.
- Ensuring consistency with the objectives of sustainable development and inclusive growth.
- Preserving the states' right to regulate investment for legitimate public policy purposes.
- Facilitating investors' efforts for investors to establish, conduct and expand their businesses.
- Promoting best practices on responsible business conduct and corporate governance.
- Maintaining an open policy environment for investment.

Focusing on established foreign investors/investments, the UN Conference on Trade and Development (UNCTAD) 2015 Investment Policy Framework for Sustainable Development sets out a series of standards of treatment and protection that host states are required to guarantee:

- *National treatment:* It protects foreign investors/investments against discrimination vis-à-vis domestic investors.
- *Most-favoured nation (MFN)*

treatment: It protects foreign investors/investments against discrimination vis-à-vis other foreign investors.

- *Fair and equitable treatment (FET):* It protects foreign investors/investments against, e.g. denial of justice, arbitrary and abusive treatment. The FET clause does not preclude states from adopting good faith regulatory or other measures that pursue legitimate policy objectives.
- *Full protection and security:* It requires host states to exercise due diligence in protecting foreign investments.
- *Expropriation:* It protects foreign investors in case of dispossession of their investments by the host country. Expropriation must comply with four conditions: public purpose, non-discrimination, due process and payment of compensation.
- *Protection from strife:* It grants non-discriminatory treatment with respect to restitution or compensation in case of armed conflict or civil strife.
- *Transfer of funds:* It grants the right to free movement of investment-related financial flows in and out of the host country.
- *Transparency:* It fosters access to information which may affect investment, e.g. laws and regulations, general procedures, administrative rulings and international investment agreements.
- *Performance requirements:* It regulates the extent to which host states can impose certain operation conditions on foreign investors/ investments (e.g. local content requirements).
- *"Umbrella" clause:* It establishes a commitment on the part of the host state to observe any obligation (e.g. contractual) which it has assumed vis-a-vis an investment.
- *Personnel and staffing:* It facilitates the entry, sojourn and employment of foreign personnel (e.g. issuing of work permits).

The OECD 2016 *Investment Policies Related National Security – A Survey of Country Practices* reviews the policies implemented in 54 countries to address national security concerns stemming from foreign investment. Over the past decades, strategic industries, including energy, were under state control. Hence governments did not have to worry that these sensitive sectors would fall under foreign influence. With the progressive restructuring of former national monopolies, many of these sectors are now open to private and foreign investors. This has stirred a debate about governments' need to remain open to foreign investors and, at the same time, safeguard national security related sectors.

The Survey also assess the implementation of the key principles set out in the *2009 Guidelines to meet the need to safeguard national security while reducing the impact of these polices on international investment*. Those principles are the following:

- *Non-discrimination:* In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion.
- *Transparency/predictability:* While maintaining confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase predictability.
- *Regulatory proportionality:* Restrictions on investment should not be greater than needed to protect national security.
- *Accountability:* It is to be ensured by procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels.

Likewise, the increase of state intervention and involvement in the petroleum sector, by declaring oil and gas as strategic national resources and subjecting them to special laws and regulations, has been noted by the Energy Sector Strategy of the European Bank for Reconstruction and Development (EBRD). The Energy Strategy sets out EBRD's operation tools and approaches throughout the sector for the period 2014-2018 together with the Bank's strategic orientation. EBRD's agenda pursues the primacy of markets, market-supporting structures and cost-reflective pricing.

EBRD notes that private investors

often operate at a disadvantage because of increased taxation, the risk of nationalisation of contracts or projects or state expropriation, and limitations on ownership of strategic assets by foreign companies or governments' pre-emption rights on mineral assets or sub-soil licences. Moreover, incumbent operators have strengthened their positions to the detriment of smaller private operators. Regional and national energy markets do not operate efficiently and trade barriers remain.



Construction of the Trans Adriatic Gas Pipeline from the Greece/Turkey border to southern Italy is underway. The international project is due onstream in 2020.

A rules-based international energy order

From its inception in the early 1990s, the Energy Charter Treaty (ECT) was designed to mobilise foreign, private investment on a major international scale. After the fall of the Berlin Wall, it was clear what industry expected from governments: removal of barriers to trade; stable conditions allowing for investment and finance; open, competitive and liquid markets; transparent, predictable and efficient regulatory frameworks guided by market-based principles; and mechanisms for recourse and enforcement of rights in the event that a government might breach its obligations. Investors still look for these conditions today.

The ECT sets out common standards in the areas of cross-border trade, transit and investment. Foreign investors are protected against the most important political risks, such as discrimination, direct and indirect expropriation and nationalisation, breach of investment contracts, damages due to war and similar events, and unjustified restrictions on the transfer of funds. At the same time, the Treaty respects states' sovereignty over natural resources, national strategies and the energy mix. Adopting the ECT does not mean member countries are obliged to restructure their national energy sectors in a particular way or to privatise energy companies.

The ECT offers a wide range of tailor-made dispute resolution mechanisms, including the famous and increasingly used investment arbitration (but also investment mediation). As of February 2018, the ECT has been the most invoked international agreement with 113 investment arbitration cases, usually involving substantial amounts of money. The Energy Charter Secretariat (ECS) has been compiling summaries of available arbitral awards. The contested measures often concern issues such as revocation of licences and permits, alleged expropriations of direct or indirect nature, or disguised discrimination of foreign investors.

The ECT is a unique, legally-binding multilateral framework. On the other hand, the 2015 International Energy Charter is a political declaration that reinforces the long-term commitment to create a friendly investment climate. This commitment has expanded beyond the traditional boundaries to bring on board new countries and regional organisations from Asia (Bangladesh, Cambodia, China, Korea), Latin America (Chile, Colombia, Guatemala, Panama), the Middle East (Iran, Iraq, Jordan, the United Arab Emirates, Palestine, Yemen) and Africa (Benin, Burkina Faso, Burundi, Chad, Gambia, Kenya, Mauritania, Morocco, Mali, Niger, Nigeria, Rwanda, Senegal, Swaziland, Tanzania, Uganda and the four regional organisations: the East African Community, Economic Community of Central African States, Economic Community of West African States – ECOWAS and G5 Sahel).

The ECT and the International Energy Charter contribute to the creation of a rules-based international

energy order. The ECS assists members and observers to implement the ECT and the International Energy Charter through handbooks, studies, toolboxes, dialogues, conferences, memoranda of understanding, technical assistance and capacity building.

- The *2017 Handbook on General Provisions Applicable to Investment Agreements in the Energy Sector* offers guidance to governments on possible drafting and negotiation approaches that can be considered on a voluntary basis when preparing to enter into complex negotiations in the energy sector. A well-negotiated contract reduces potential conflicts and facilitates its correct implementation for the benefit of both parties, the country and the foreign investor.
- The *2017 Investment Facilitation Toolbox* contains a checklist of policy options for removing non-discriminatory and de facto barriers to the establishment of energy investments, covering the following areas: long-term and predictable energy and investment objectives; efficient institutional governance and policy-making; effective bureaucracy; transparent administrative and regulatory regimes; favourable investment rules and conditions; and effective national judiciary.
- The *2017 Best practices in regulatory reform: Minimising potential conflicts with foreign investors* takes stock of recent investment policy practices. In that respect, arbitral tribunals constituted under the ECT have confirmed that the host state is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest though subsequent changes should be made fairly, non-retroactively, consistently and predictably, taking into account the circumstances of the investment.
- The *2017 Review on Potential Standardisation of LNG Sale and Purchase Agreements* provides a basis for a discussion on key issues relating to the potential standardisation of LNG contracts. This review is primarily focused on medium-to-long-term LNG contracts, but it may also be applicable to certain spot contracts. Its main conclusion is that the development of a fully standardised LNG contract for universal application is not currently feasible. However, certain key trends and issues could be addressed by standard provisions, which could then form the basis of a model contract.
- The *Energy Charter Industry Advisory Panel (IAP)* aims to strengthen the dialogue with the private sector on the main directions of the Energy Charter Process, with a particular focus on risk mitigation and improvement of the business climate. An IAP meeting in 2017 in Warsaw, Poland, was devoted to "Pathways to Develop a Flexible and Liquid LNG Market: Role of LNG in the global energy future".
- The forthcoming *Energy Investment Risk Assessment (EIRA)* report develops risk profiles for individual countries and assesses performance against a set of indicators. EIRA aims to both inform investors and assist countries in reviewing and adapting their legal and regulatory frameworks so the investment climate can be optimised and the risk of investor-state disputes associated with policy change, discrimination and breach of state obligations can be minimised.
- The ECS participates in several initiatives providing technical assistance, drafting policy recommendations and identifying investment opportunities. Along with IEA and the Energy Community, the ECS is an implementation partner of the EU4Energy Initiative (covering Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine), and has engaged with some African countries in the context of the EU Technical Assistance Facility for the SE4All Initiative. Moreover, the ECS has a special collaboration with China, Iran and Nigeria.

In 2017, the ECS hosted the Brussels International Energy Charter Forum – Mobilising Investments for a Sustainable Energy Future bringing together investment and energy experts. The realisation of the objectives of the ECT and the implementation of its general provisions may benefit from the exper-

tise and experience of regulatory associations. In that respect the ECS has collaborated with the Council of European Energy Regulators, Agency for the Cooperation of Energy Regulators, Association of the Mediterranean Energy Regulators, International Confederation of Energy Regulators and has signed MoUs with the Asociación Iberoamericana de Entidades Reguladoras de la Energía and ECOWAS Regional Electricity Regulatory Authority.

Beyond the importance of ensuring proper implementation of existing international rules, new trends in investment policies focus on re-defining the international standards and the way they are enforced. The UN Commission on International Trade Law was mandated in July 2017 to consider possible reform of investor-state dispute settlement (ISDS), including discussions on a court-based system. The current ISDS system is facing a perceived deficit of legitimacy, transparency, independence, impartiality and accountability. Moreover, UNCTAD has issued guidance on areas of evolution in treaty-making practice. This includes options that clarify or circumscribe key protection standards (e.g. most-favoured nation treatment, fair and equitable treatment or indirect expropriation) and options that strengthen the right to regulate (e.g. exceptions for public policies or national security).

In line with the current international investment trends, the 2017 Ashgabat Energy Charter Conference approved the timeline for discussions on the modernisation of the ECT. Consultations with observer countries and the industry are scheduled during the first semester of 2018 and will be followed with discussions on potential clarifications and/or amendments to some provisions of the ECT, as well as the negotiation of additional legal and/or non-legally binding tools. The ECT was adopted as a package agreement, and therefore the discussions on modernisation envisage the ECT as a whole, and not only the investment protection standards.



Australia's LNG capacity continues to increase. The Wheatstone project made its first shipment from train 1 in October 2017.

Conclusion

This article gives a snapshot of rapidly evolving natural gas markets and international trends in investment protection. It also reflects the contribution of the ECS to the Study Group on Best Practices in Governance and Regulation of IGU's Strategy Committee, confirming the need to maintain a dialogue between the two organisations.

By enhancing the rule of law, the objective of the International Energy Charter and the ECT is to de-politicise the energy sector with fair, transparent and predictable investment conditions. The modernisation of the ECT gives the opportunity to rethink and review the investment protection standards and other relevant provisions for producing, transit and consuming energy countries, developed and developing ones. These legal and regulatory developments at international level are fundamental for the supply of natural gas as a source of energy that is a key part of the equation to achieve the objectives of mitigating climate change and universal energy access.

Dr Ernesto Bonafé is Head of the Expansion Unit at the Energy Charter Secretariat and Dr Urban Rusnák is the Energy Charter Secretary General. Views expressed in this article are those of the authors and not of the Energy Charter Secretariat.