International Arbitration in the Energy Sector 2024

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International Arbitration

A) State – State Arbitration

B) Commercial Arbitration

C) Investor – State Arbitration

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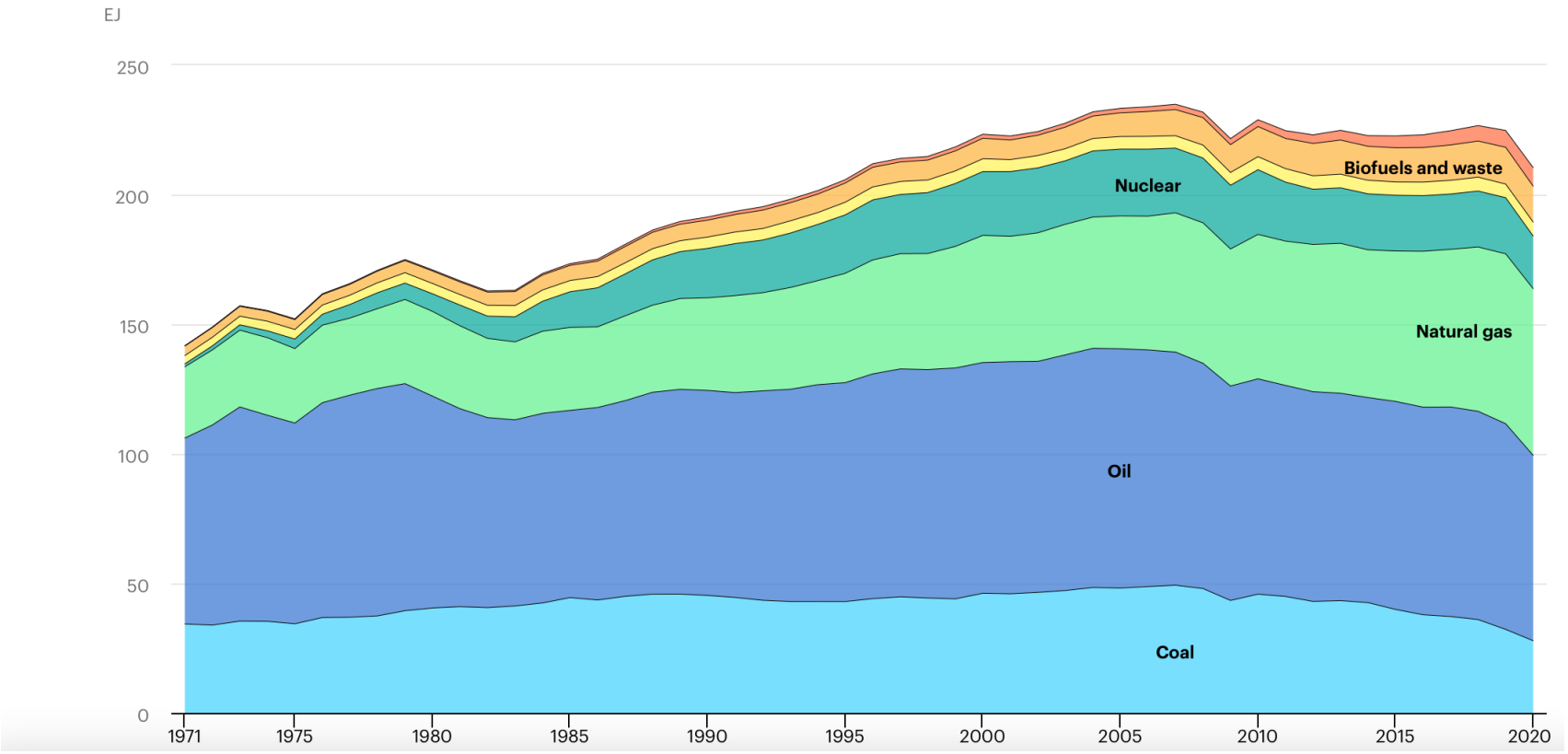
Fuels

OECD total energy supply by source, 1971-2020



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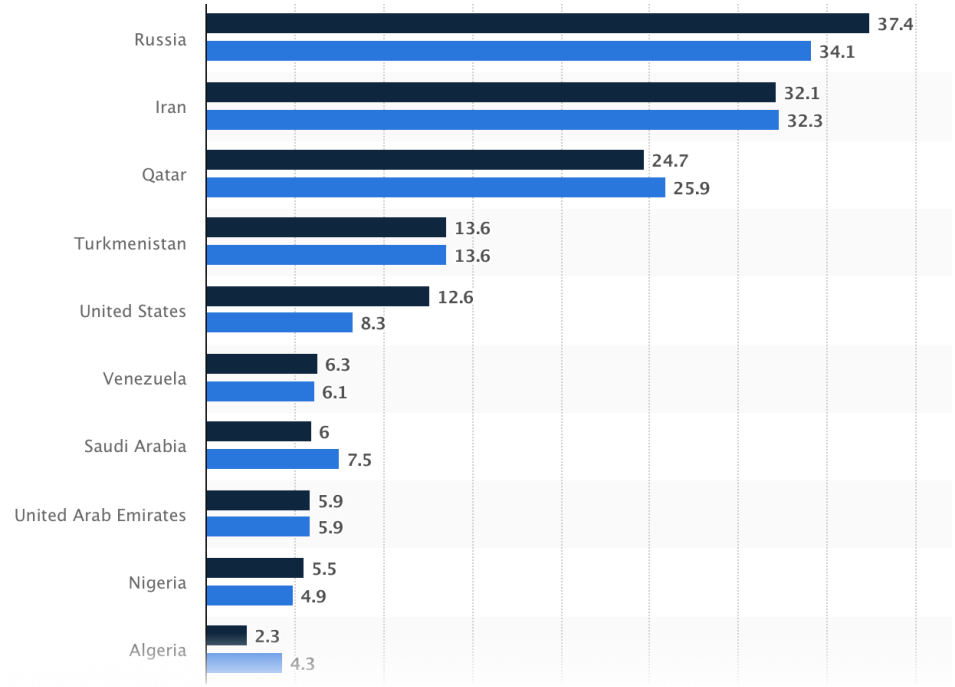
TOP Countries having the largest oil reserves

1. Venezuela
2. Saudi Arabia
3. Iran
4. Canada
5. Iraq
6. Russian Federation
7. Kuwait
8. UAE
9. Libya
10. USA
11. Nigeria

TOP Countries having the largest natural gas reserves



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UPSTREAM: Legal Disputes

STATE

ENERGY COMPANY

Permanent sovereignty over natural wealth and resources:

1) States set forth conditions under which natural resources are to be utilized.

2) States pursue public interest such as the protection of environment, economic development.

Disputes between states and energy companies

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MIDSTREAM AND DOWNSTREAM

STATE

States set forth conditions under which energy is to be transported and traded.
States pursue public interests.

TRANSIT STATES (regulation)
ENERGY MARKETS (regulation)

ENERGY COMPANY

Transportation of oil / gas.

Sales from the producer to the wholesaler in a particular market, sales from wholesalers to the end users.
International dimension:
Cross-border transportation of oil/gas (pipelines / tankers)
Cross-border trade in energy products.

Exploration & Production

In many countries, underground natural resources, such as oil, gas or groundwater, belong to the state.

The content of ownership and the restrictions within which the individual can exercise the right of ownership is defined by each sovereign state.

Whether natural resources may be the object of a private property rights is determined by the body of domestic administrative law setting forth conditions under which natural resources may be explored and exploited (agreements, licenses, concessions, environmental regulation) as well as conditions under which the property rights are transferred to non-state actors (taxes, royalties).

Unequal distribution of natural resources

UNGA Resolution 1803 (XVII) adopted in 1962

1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.

2. The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities.

3. In cases where authorization is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law. The profits derived must be shared in the proportions freely agreed upon, in each case, between the investors and the recipient State, due care being taken to ensure that there is no impairment, for any reason, of that State's sovereignty over its natural wealth and resources.

4. Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.

5. The free and beneficial exercise of the sovereignty of peoples and nations over their natural resources must be furthered by the mutual respect of States based on their sovereign equality.

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Energy Value Chain: Oil & Gas

Upstream

Exploration and Production

Searching for potential underground or underwater crude oil and natural gas fields, drilling exploratory wells, and subsequently drilling and operating the wells that recover and bring the crude oil or raw natural gas to the surface.

PIONEER NATURAL RESOURCES

ConocoPhillips

Midstream

Transportation Storage

Companies operating tanker ships, pipelines or storage facility.

KINDER MORGAN

ENBRIDGE

Downstream

Refining Consumer use

Valero

Oil Service Companies

Provide products and/or services to the oil and gas industry. Usually a combination of labor, equipment, and/or other support services.

Baker Hughes

HALLIBURTON

SAIPEM

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A: Investment Arbitration

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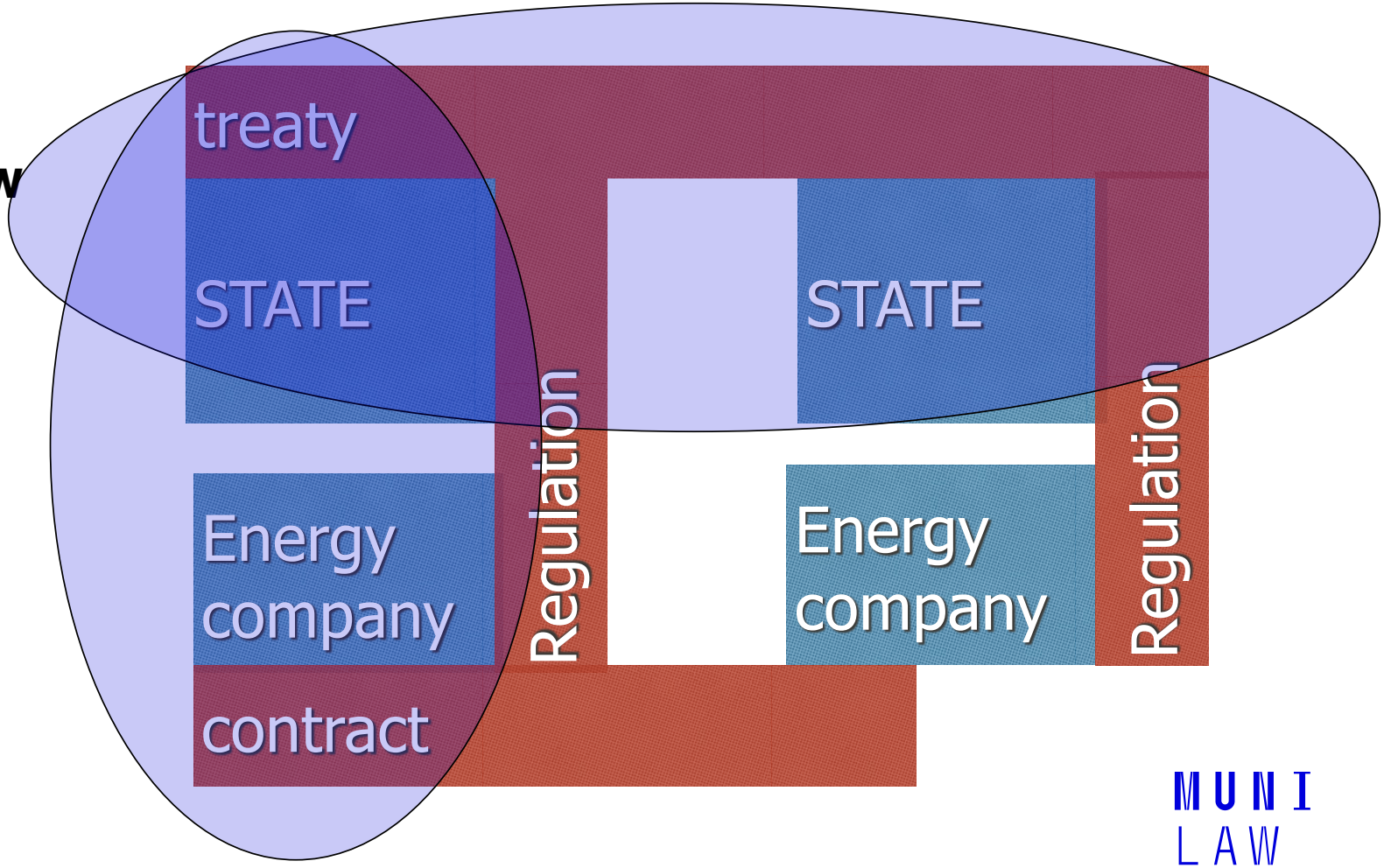
State – State Arbitration

INTERNATIONAL LAW
dimension

NATIONAL LAW
dimension



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Oil/Gas reserves are discovered in a state („Arrakis").

A. Who should benefit from such discovery?
B. Should "Arrakis" be engaged in the oil/gas production activities?
C. Should Arrakis keep its energy resources exclusively for the purposes of its national development?

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State's perspective

Libya was under foreign rule for centuries until it gained independence in **1951**.
Libya was one of the poorest country (*hostage to hostile geography*).
Libya's first oil fields were discovered in 1959 and oil exports began in 1961.
Rapid economic growth:

GDP in 1951 was 11,4 mil. USD
GDP in 1977 was 10 bil. USD

In 1973 Libya nationalized its energy sector.

Oil/Gas reserves are discovered in a state („Arrakis").

State's perspective

Most countries follow *the dominial system* regarding **ownership of subsurface minerals**. Under the system – subsurface minerals belong to, or are controlled by, the sovereign – a state.

Energy companies need permission form the state to operate in these countries. **States define conditions for investors to carry out their activities, and these are ultimately reflected in a concession agreement**.

Concession agreement – Under the concession agreement, a host country essentially concedes control over its energy resources to an energy company. Concession agreements/contracts have following common features:

They granted **title of the oil** in place to the company

The concession areas covered vast tracts of land

The term of the concession (was often 60 years or more)

The **oil company had control** over the schedule and scale of operations

The government received a **royalty** (traditionally 1/8)

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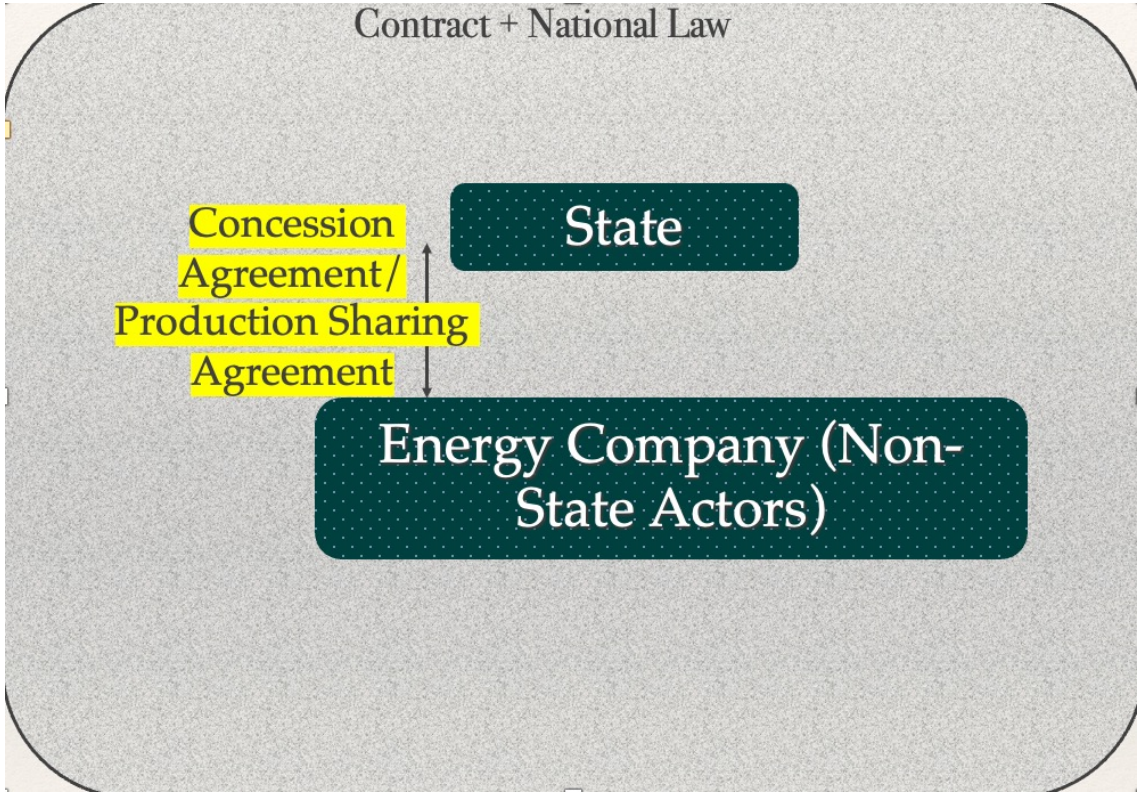
Oil/Gas reserves are discovered in a state („Arrakis").

In 1933, *Anglo-Persian Oil Company (APOC) and Persia (later Iran)* concluded **a concession agreement**. APOC obtained **an exclusive right to extract and process petroleum in a specified area in Persia (later Iran) up to 1993 (60 years).**
In 1951, the socialist government of Persia, led by P-M Mohammed Mossadegh, announced the official decision to **nationalize the property rights of the APOC and to terminate the concession agreement**.
Nationalized oil fields were to be exploited by newly established company – The National Iranian Oil Company.

State's perspective

Production sharing agreements often require the participation in drilling and production activities of a local, government-owned company. Through the government-owned company's **participation in the project**, as well as **royalties**, **bonuses** and **taxes** paid to the government, the government's percentage "take" of the total revenues of a projects is often substantial.



State's perspective

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Investor's perspective

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TOP Countries that Have the Largest Oil Reserves

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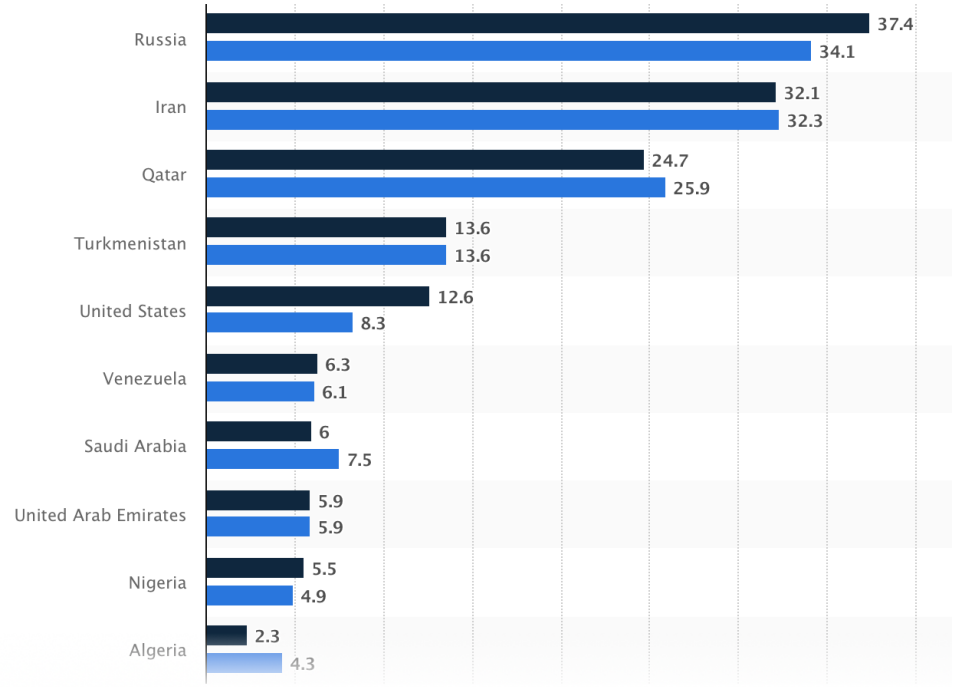
TOP Countries that Have the Largest Natural Gas Reserves



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Investor's perspective

Making a Foreign Investment in the Energy Sector:

Investment projects are long-term and **capital-intensive** in their nature.

Risks:

- **Environmental regulation, Legal framework, Tax legislation**
- **Political cycles**
- **Local conflicts/Wars**
- **Weak rule of law**

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Investor's perspective

The main host country determinants for foreign direct investment (FDI):

(a) the general policy framework for foreign investment, including economic, political and social stability, and the legislation affecting foreign investment;

(b) economic determinants, such as the market size, cost of resources and other inputs (e. g. costs of labour) or the availability of natural resources; and

(c) business facilitation, such as investment promotion including investment incentives.

All three determinants interact, enhancing or reducing the attractiveness of countries for a foreign investment.

Investor's perspective

1) **International arbitration**, **foreign law** as a governing law, **stabilization clause** (addressing changes in law in the host state during the life of the project)

2) **Diplomatic protection**: Under traditional international law individuals did not have standing to bring claims directly against governments. Diplomatic protection was the only remedy available to a citizen of a state with a claim against a foreign government. However, the investor's government had the discretion to espouse the claim against the foreign government.

3) **Obligations arising from international investment law (bilateral investment treaties or the Energy Charter Treaty)**

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Energy Investments are risky

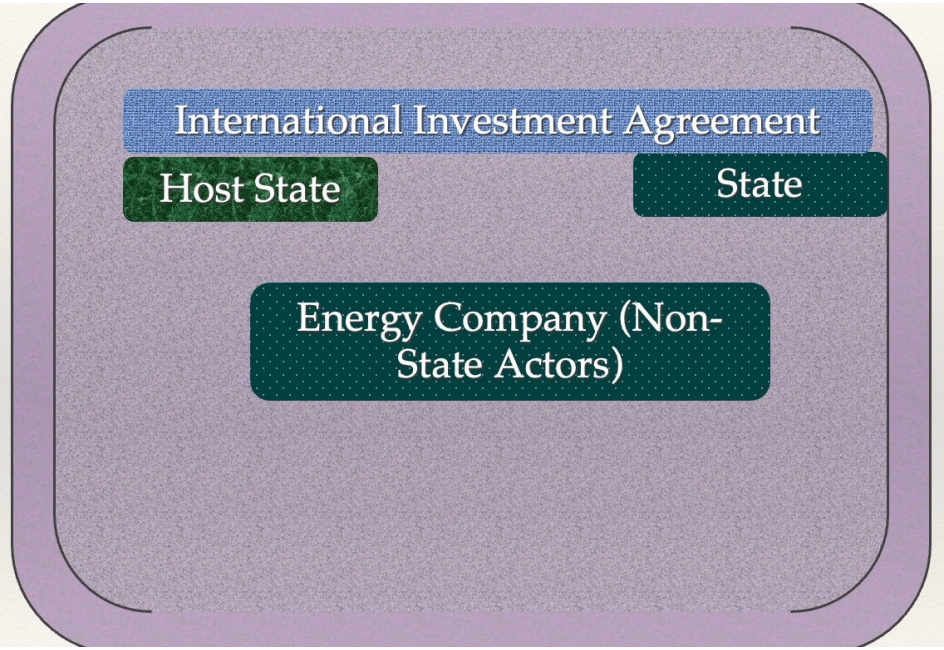
Nationalization of the energy sector in the Soviet Union in 1918-1920.

Expropriation of the Standard Oil's assets in Bolivia in 1937.

- „*For the first time in world history the most powerful company (Standard Oil) on the planet was morally rebuked by a state.*"

Nationalization of the energy sector in Mexico in 1938.

- 18. March is in Mexico celebrated as *Día de la Expropiación Petrolera (*Since 1938, oil belongs to all Mexicans and is understood as a symbol of its sovereignty).



Bilateral investment treaties (BIT):
The first BIT was concluded between Germany and Pakistan in **1959.**
Multilateral treaties, **regional treaties**, **sector specific**: NAFTA (USMCA), ENERGY CHARTER TREATY
2342 international investment agreements are in force.

International Investment Law

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Substantive rights:

National Treatment (NT)
Most-Favoured-Nation Treatment (MFN)
Expropriation against adequate compensation, under due process and carried in public purpose
Fair and Equitable Treatment
Free transfer of capital

Procedural rights:

ISDS (Investor-State Dispute Settlement)

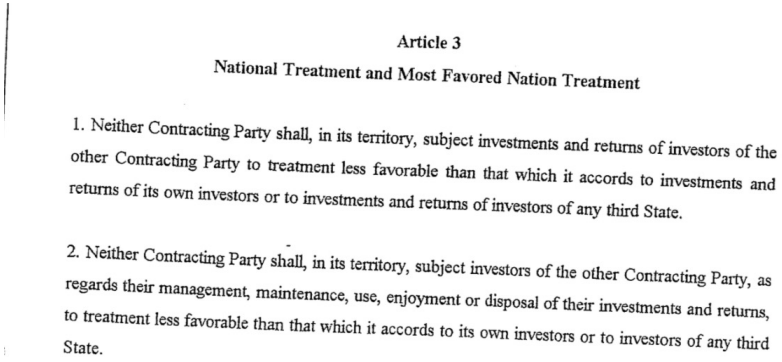
International Investment Law

NT: The principle of giving others the same treatment as one's own nationals.

"Most favoured nation (MFN) clauses have formed part of international economic treaties for centuries."

Privilege granted by one contracting party to investor of other contracting party will be unconditionally granted to all other investors invoking the MFN clause.

MFN clause is meant to ensure an equality of competitive conditions between foreign investors of different nationalities seeking to set up an investment or operating that investment in a host country.



Article 3

National Treatment and Most Favored Nation Treatment

1. Neither Contracting Party shall, in its territory, subject investments and returns of investors of the other Contracting Party to treatment less favorable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State.

2. Neither Contracting Party shall, in its territory, subject investors of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments and returns, to treatment less favorable than that which it accords to its own investors or to investors of any third State.

National Treatment + MFN

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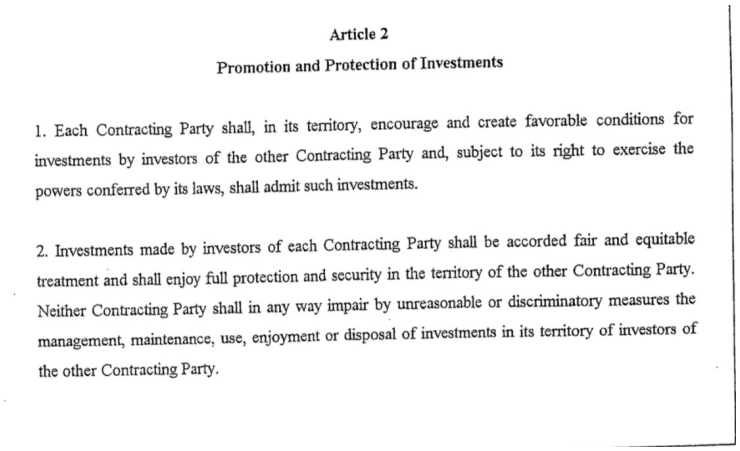
The essential elements of the FET include fundamental standards as good faith, due process, non-discrimination, and proportionality.

"Fair and equitable treatment comprises four principles: reasonableness, consistency, non-discrimination, transparency".

UNCTAD enumerates **legitimate expectations; denial of justice and due process; manifest arbitrariness in decision making; discrimination; and outright abusive treatment as elements of FET standard.**

FET: "Investments shall at all times be accorded fair and equitable treatment."

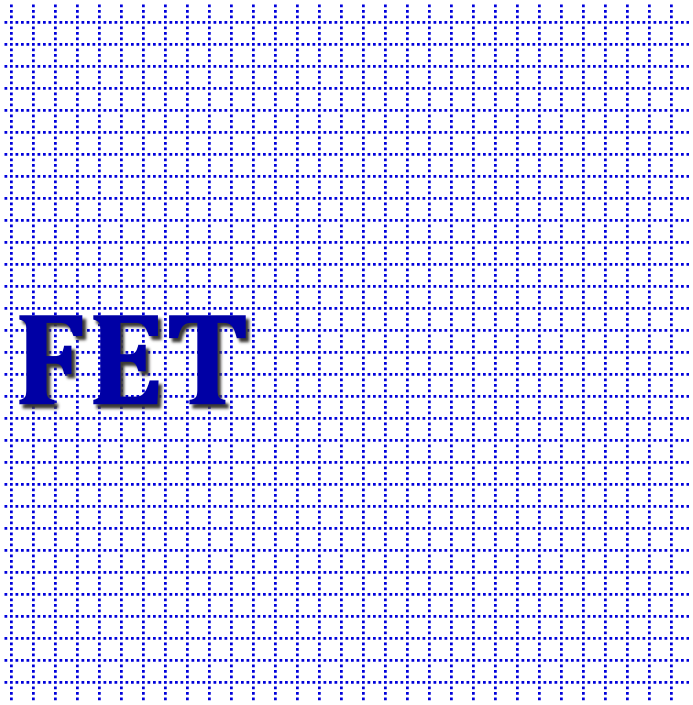


Article 2

Promotion and Protection of Investments

1. Each Contracting Party shall, in its territory, encourage and create favorable conditions for investments by investors of the other Contracting Party and, subject to its right to exercise the powers conferred by its laws, shall admit such investments.

2. Investments made by investors of each Contracting Party shall be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of investors of the other Contracting Party.



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Expropriation

Expropriation is not considered to be unlawful *per se*; however, international investment law requires the fulfilment of **the following conditions**: expropriation must be carried out for the public purpose, under due process of law, on a non-discriminatory basis, and must be accompanied by the provision of prompt, adequate and effective compensation.

Direct Expropriation (nationalisation and the transfer of title of the investor's property).

Indirect Expropriation (state measures with the effect of substantially depriving investor of value of the investment, e.g. revocation of a license, erosion of the investor's rights).

Expropriation to be lawful:

1) **public purpose,**
2) **under the due process,**
3) **non discriminatory,**
4) **compensation**

Article 5

Expropriation

1. Investments of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation (hereinafter: „expropriation") in the territory of the other Contracting Party, except for a public purpose related to the internal needs of that Contracting Party on a non-discriminatory basis under due process of law and against prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier, shall include interest until the date of payment, shall be made without delay, be effectively realizable and be freely transferable in a freely convertible currency.

2. The investors affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Contracting Party, of his or its case and of the valuation of his or its investment, in accordance with the principles set out in this Article.

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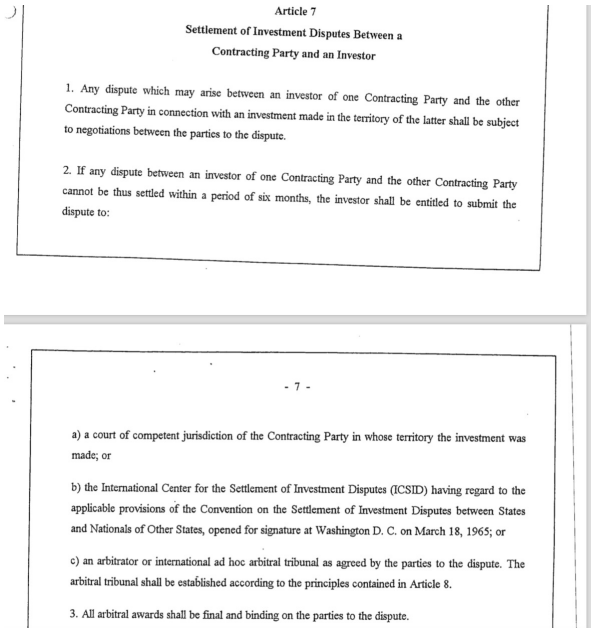
Unconditional consent to the submission of a dispute to **international arbitration.**

Instead of relying on their home states to espouse their claims through diplomatic protection, the investors are provided with a direct and effective dispute settlement mechanism.

Delocalisation of a depute.

Arbitral tribunal applies international law and examine compliance of state's behaviour with its international obligations arising from International Investment Agreements.



Article 7

Settlement of Investment Disputes Between a Contracting Party and an Investor

1. Any dispute which may arise between an investor of one Contracting Party and the other Contracting Party in connection with an investment made in the territory of the latter shall be subject to negotiations between the parties to the dispute.

2. If any dispute between an investor of one Contracting Party and the other Contracting Party cannot be thus settled within a period of six months, the investor shall be entitled to submit the dispute to:

- 7 -

a) a court of competent jurisdiction of the Contracting Party in whose territory the investment was made; or

b) the International Center for the Settlement of Investment Disputes (ICSID) having regard to the applicable provisions of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature at Washington D. C. on March 18, 1965; or

c) an arbitrator or international ad hoc arbitral tribunal as agreed by the parties to the dispute. The arbitral tribunal shall be established according to the principles contained in Article 8.

3. All arbitral awards shall be final and binding on the parties to the dispute.

ISDS

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Advantages:

Faster than litigation before national courts. (no appeal)

Delocalisation of a dispute.

Easy to enforce -> **New York Convention 1958**

Most of the proceedings are **confidential** (however, you should be aware of the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration, known as the **Mauritius Convention** on **Transparency**).

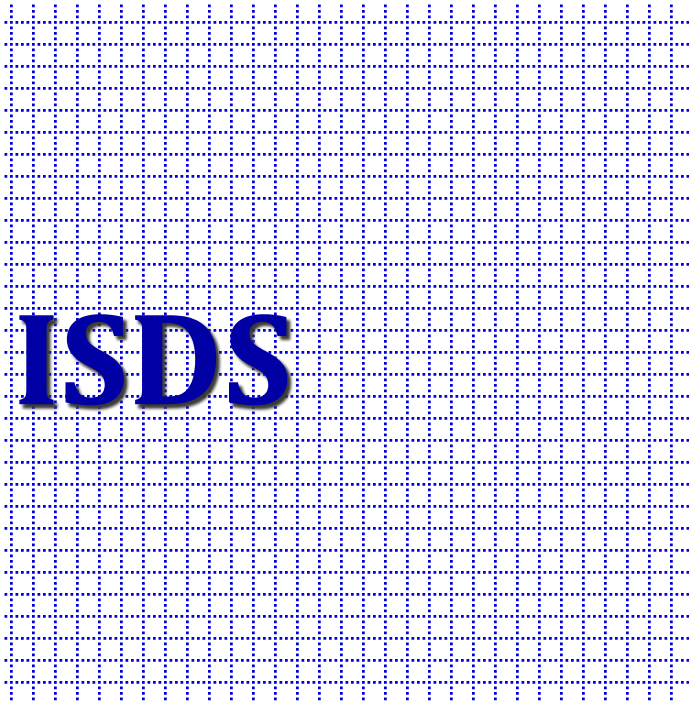
ICSID (International Centre for Settlement of Investment Disputes)

SCC (Stockholm Chamber of Commerce)

PCA (Permanent Court of Arbitration)

ICC (International Chamber of Commerce), Paris)

LCIA (London Court of International Arbitration)



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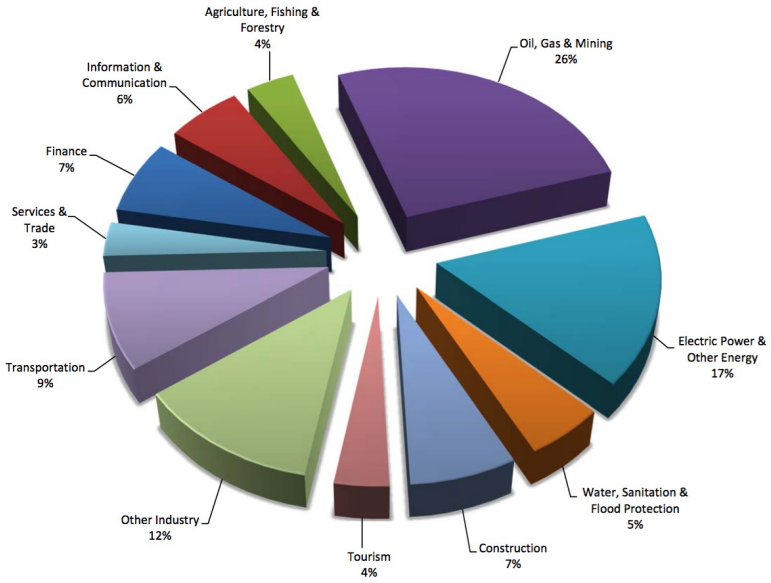
6. Distribution of All ICSID Cases by Economic Sector

Chart 7: Distribution of All Cases Registered under the ICSID Convention and Additional Facility Rules, by Economic Sector*:



ISDS

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Nationalization of Venezuela's energy sector in 1975.
-Settled *via* diplomatic channels.
Oil fields around Orinoco river required sophisticated technologies (unconventional exploitation)
-"***La Aperatura Petrolea***" – process of opening of the energy sector to the foreign investors
-In addition, Venezuela entered into various BITs (in order to attract foreign investors).
Nationalization of the energy market in 2007.
-Hugo Chavez becomes a president and nationalized the sector.
-He required an increase of the government's shares in oil projects in Venezuela from 40 percent to 60 percent.
-Exxon and Conoco Phillips refused and were expropriated.
-**An ICSID tribunal awarded over USD 8.7 billion plus interest to ConocoPhillips for Venezuela's unlawful expropriation of three oilfield investments made by Netherlands-based subsidiaries of U.S. corporation ConocoPhillips.**

Conoco Philips v. Venezuela

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Energy Charter Treaty

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Origins of the ECT

1) Energy Charter is a political initiative launched in 1990 by Dutch Prime Minister Ruud Lubber

2) Rationale behind:

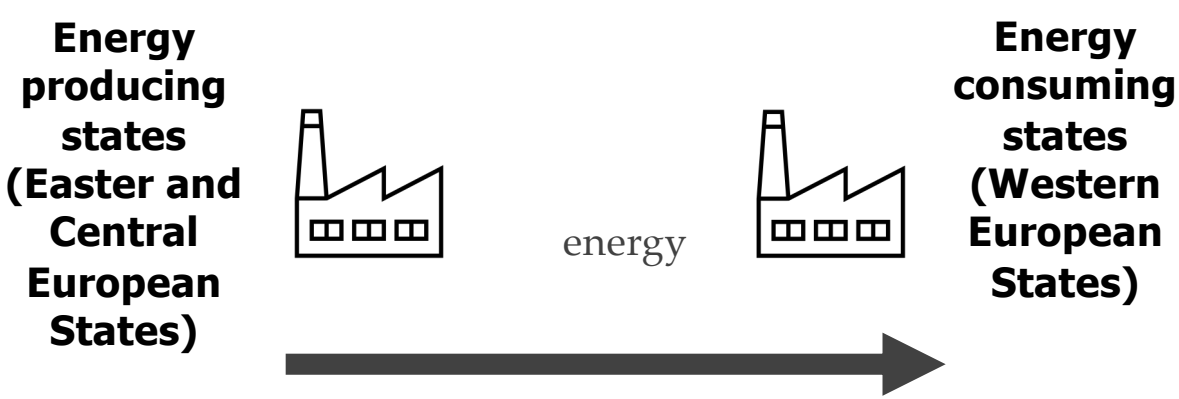
   a) **Russia and many of the neighbouring states of the Former Soviet Union** were rich in energy resources but needed major investments to ensure their development

   b) **Western Europe** had a strategic interest in diversifying their sources of energy supplies to diminish their dependence on the Middle East and to meet their growing energy demand

3) Political declaration having non-binding character

4) Energy Charter builds on **a shared interest in secure energy supply** and sustainable economic development

Rational behind the Energy Charter



Energy resources was increasingly being **transported across multiple national boundaries** (newly independent post-Soviet states) on their way from producer to consumer.

Western European States aimed at **diversifying their energy supplies and reducing their dependency on fossil fuels** being imported from the Persian Gulf.

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From the European Energy Charter to the Energy Charter Treaty

The original European Energy Charter (a political non-legally binding) declaration was signed in The Hague on 17 December 1991. **It was a political declaration of principles for international energy cooperation in trade, transit and investment**, together with the intention to negotiate a legally binding treaty.

Negotiators succussed and **the Energy Charter Treaty** was signed in December 1994.

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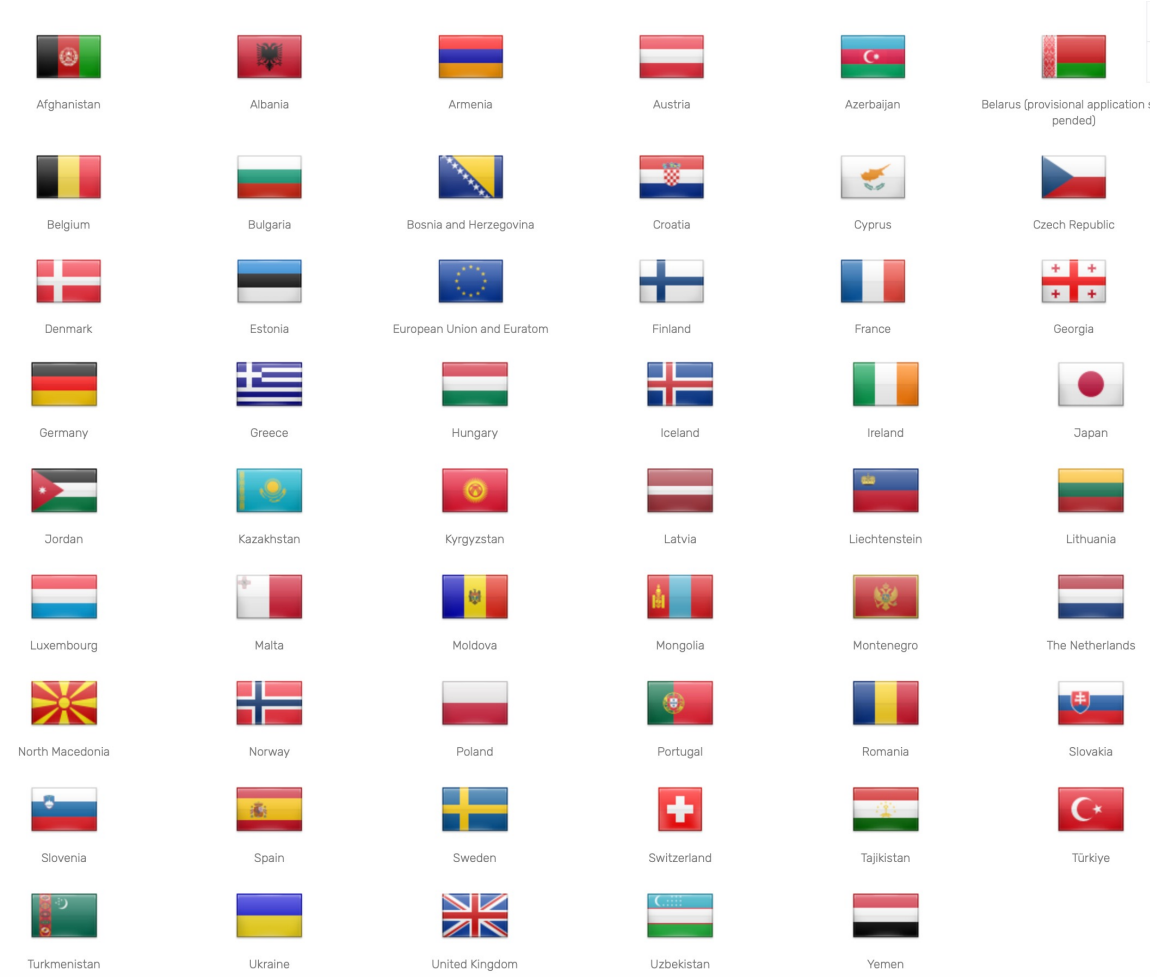
The ECT

The ECT provides for legally binding obligations and sets a legal framework for energy cooperation based on following principles:

A. Non-discrimination
B. Open and competitive energy market
C. Freedom of transit
D. Promotion and protection of foreign energy investments
E. Energy Efficiency
F. Free trade in energy materials
G. Resolution of state-to-state and/or investor-to-state disputes
H. Rule of law
I. Reducing the negative environmental impact



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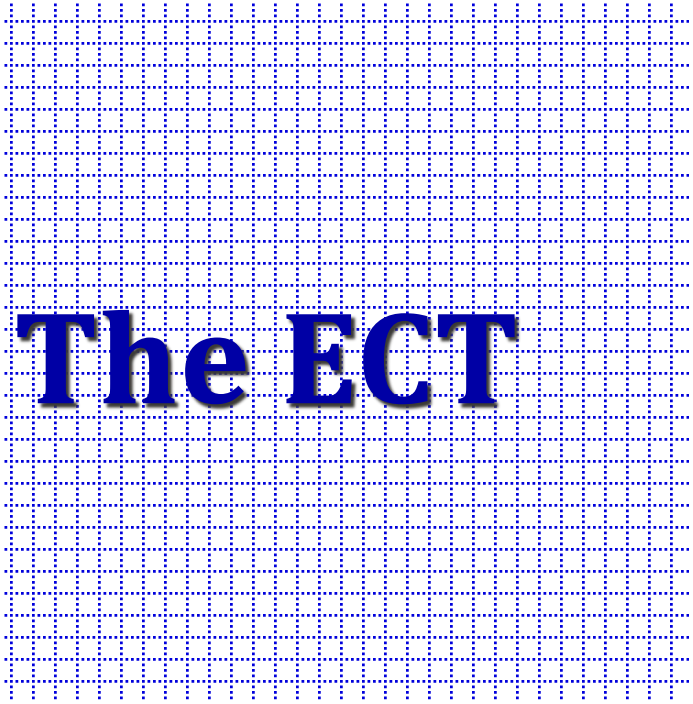
Part III: Investment Promotion and Protection

Article 10: Promotion, Protection and Treatment of Investments

Article 13: Expropriation



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Article 10: Promotion, Protection and Treatment of Investments

Each Contracting Party shall, in accordance with the provisions of this Treaty, ***encourage and create stable, equitable, favourable and transparent conditions for Investors*** *of other Contracting Parties to make Investments in its Area. Such* ***conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment****. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal.* ***In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.***

The ECT

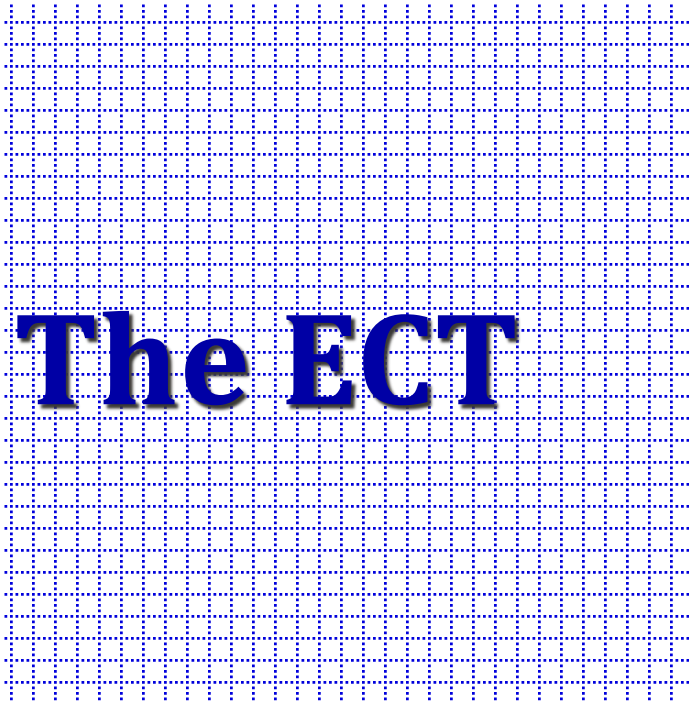
MUNI LAW

Article 10: Promotion, Protection and Treatment of Investments

Stable and transparent regulatory environment

"a legal framework is by definition subject to changes as states adapt to new circumstances" HOWEVER, The ECT protects investors from a fundamental change to the regulatory regime in a manner that does not take into consideration existing investments made in reliance on the prior regime.

Mamidoil v. Albania:
The tribunal made an initial statement with respect to the specific situation of the respondent State. Referring to the fact that Albania had just emerged from its communist regime and a subsequent economic crisis, the tribunal said: The Tribunal holds that these circumstances matter. An investor may have been entitled to rely on Albania's efforts to live up to its obligations under international treaties, but that investor was not entitled to believe that these efforts would generate the same results of stability as in Great Britain, USA or Japan.



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Article 10: Promotion, Protection and Treatment of Investments

Legitimate expectations

To demonstrate that a breach of FET has arisen from an investor's legitimate expectations, tribunals consider whether:

a) representations or assurances were given by the host state to the investor,

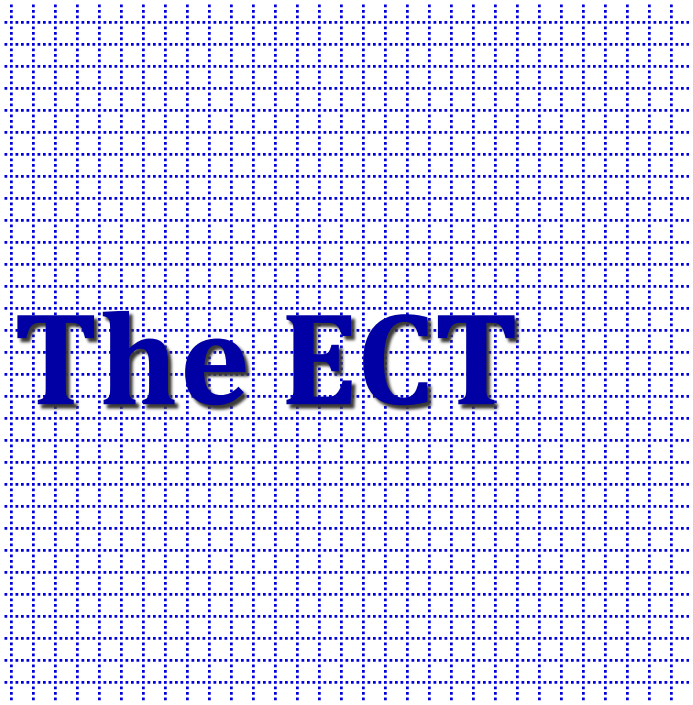
b) the investor reasonably relied on these representations and assurances in making its investment,

c) the state's conduct was contrary to these representations or assurances.

Charanne v. Spain:

The claimants made their investments in 2009 against the background of then existing regulatory framework in Spain. The legal framework was reformed in 2010 – Spain retroactively reduced feed-in tariffs. Claimants argued that Spain violated the FET standard since their legitimate expectations were frustrated. The claimants argued that they relied on the legal and economic regime when making their investments.

Tribunal: A State cannot induce an investor to make an investment, thereby generating legitimate expectations, and later ignore the commitments which had generated such expectations. However, in the present case no specific commitments, directed to the claimants, had been adopted by Spain. The tribunal rejected the argument by the claimants that the regulatory framework existing at the time of the investment constituted specific commitments because the provisions in question were limited to a specific and limited group of investors.



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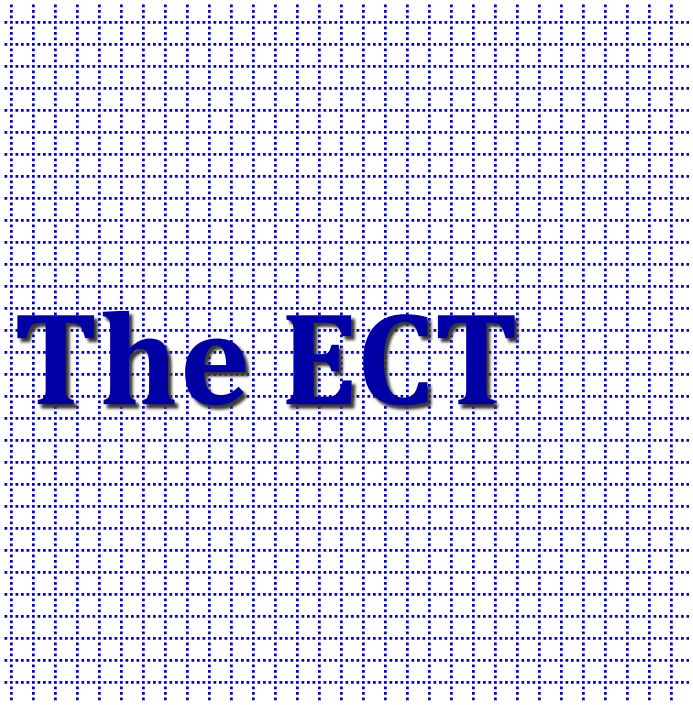
Article 10: Promotion, Protection and Treatment of Investments

Denial of justice

Energoalians v. Moldova: Moldova breached FET when the court of accounts – a financial oversight body – issued a decree that found, *contrary to clear evidence*, that the investor had not supplied electricity pursuant to certain contracts, when there was no evidence that Energoalians had ever been paid.

Petrobart v. Kyrgyz Republic: the Vice Prime Minister sent a letter to the Chairman of the Bishkek Court requesting the postponement of the execution of a judgment entitling the claimant to money from the state joint stock company KGM in payment for delivered gas condensate. A few days later, the request was granted and before the stay ended, KGM declared bankruptcy, making enforcement of judgment impossible.



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Article 13: Expropriation

(1) **Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:**

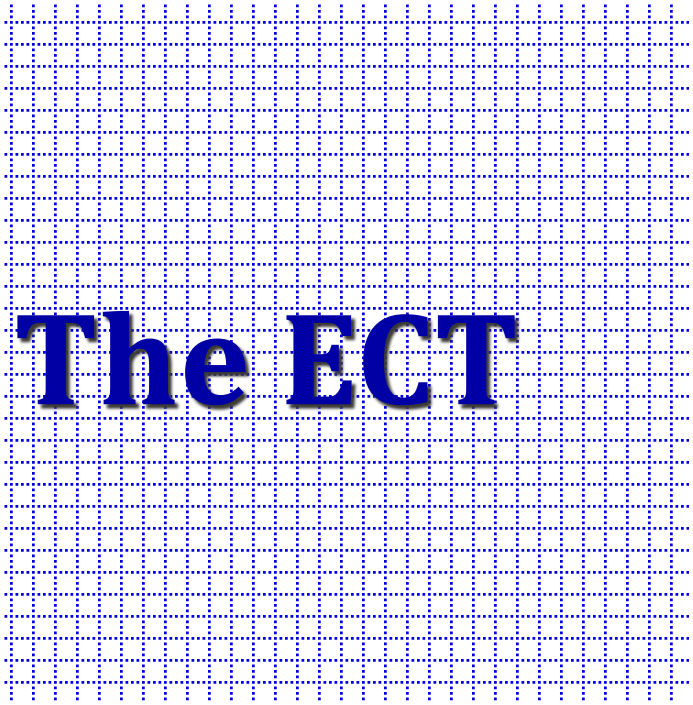
(a) for a purpose which is in the public interest;

(b) not discriminatory;

(c) carried out under due process of law; and

(d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").



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Article 13: Expropriation

-**DIRECT EXPROPRIATION**

-There have been only a few direct expropriation cases, the majority of which rejected claims for direct expropriation.

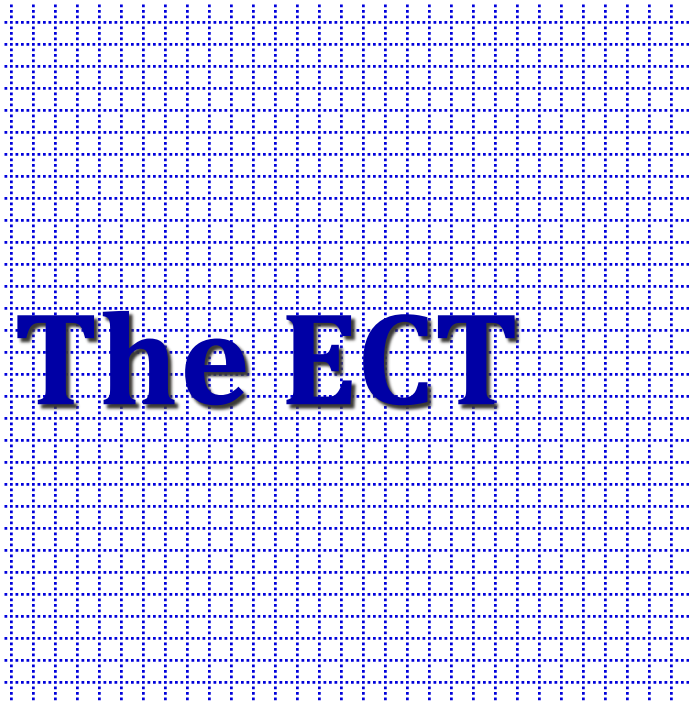
-Kardassopoulos v. Georgia: "a classic case of direct expropriation", Georgia took away the claimant's concession to distribute oil and gas in Georgia, transferring them to a state-owned entity, and failing to provide compensation or due process of law.

-**INDIRECT EXPROPRIATION**

- "a measures having effect equivalent to nationalization or expropriation"

YUKOS v. Russian Federation: the tribunal found that Russia's primary objective regarding its tax treatment of Yukos was "not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets. Russia had not explicitly expropriated Yukos, however, the measures were equivalent to nationalization or expropriation.

- Investor is required to establish the substantial, effective neutralisation or factual destruction of its investment, its value or enjoyment. Indirect expropriation implies a substantial effect on the property rights of the investor which requires an effective deprivation of all or part of the assets constituting the investment or a loss of value that could be equal in magnitude to a deprivation of the investment.



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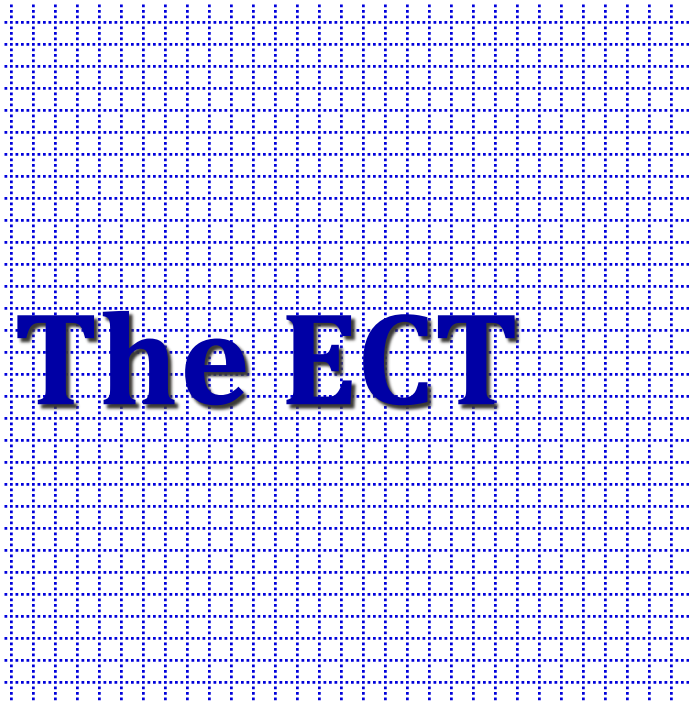
Part V: Dispute Settlement

Article 26: ISDS – Investor-State Dispute Settlement



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Article 26: ISDS – Investor-State Dispute Settlement

(1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.

(2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:

(a) to the courts or administrative tribunals of the Contracting Party party to the dispute;

(b) in accordance with any applicable, previously agreed dispute settlement procedure; or

(c) in accordance with the following paragraphs of this Article.

(…)

(4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to:

(a) (i) **The International Centre for Settlement of Investment Disputes**, established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington, 18 March 1965 (hereinafter referred to as the "ICSID Convention"), if the Contracting Party of the Investor and the Contracting Party party to the dispute are both parties to the ICSID Convention; or

(ii) The International Centre for Settlement of Investment Disputes, established pursuant to the Convention referred to in subparagraph (a)(i), under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre (hereinafter referred to as the "Additional Facility Rules"), if the Contracting Party of the Investor or the Contracting Party party to the dispute, but not both, is a party to the ICSID Convention;

(b) **a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter referred to as "UNCITRAL");** or

(c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.

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