



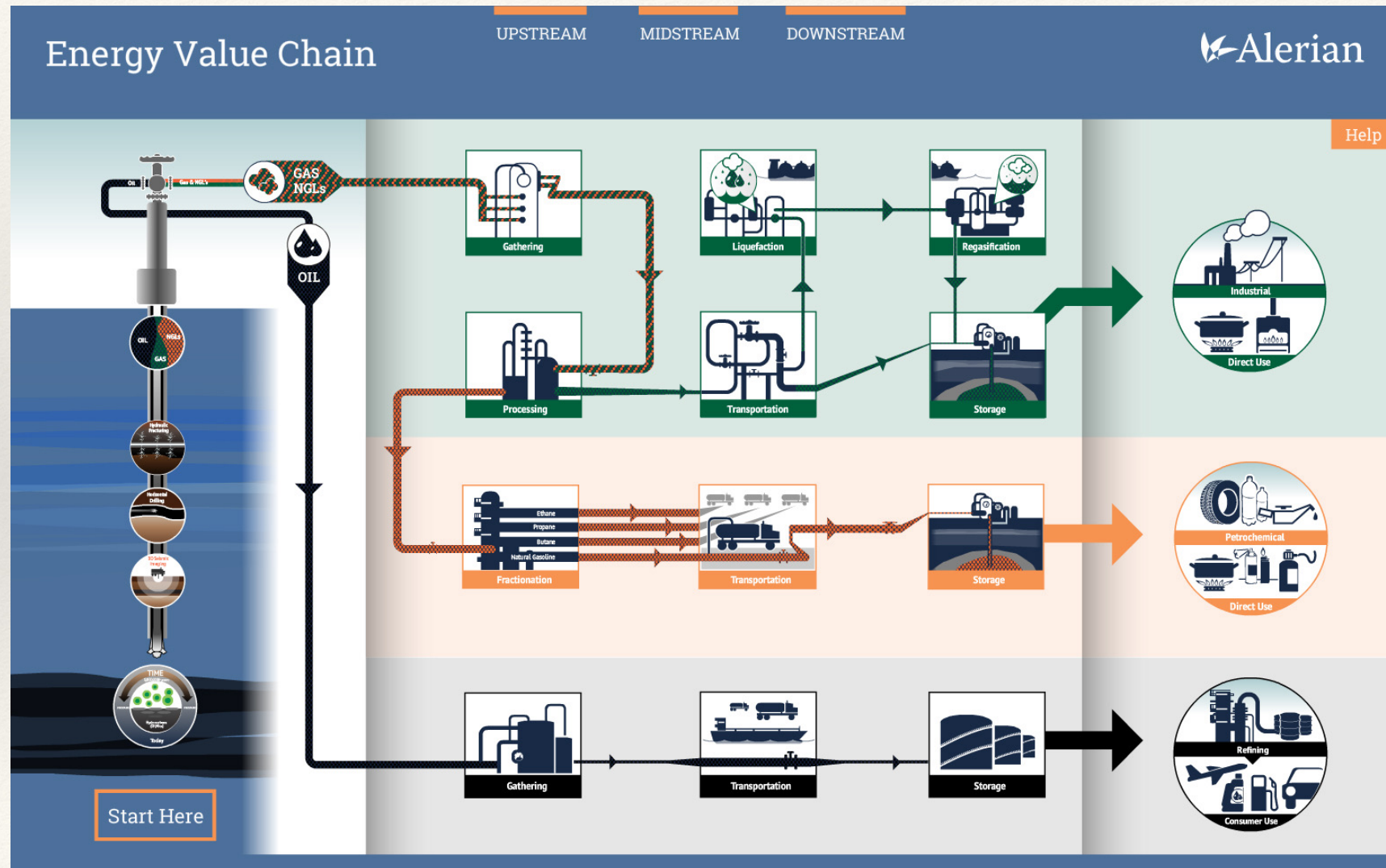
*International Arbitration in the Energy Sector
online, 10 May 2021*

*De-risking Energy Investments and
Investment Arbitration*

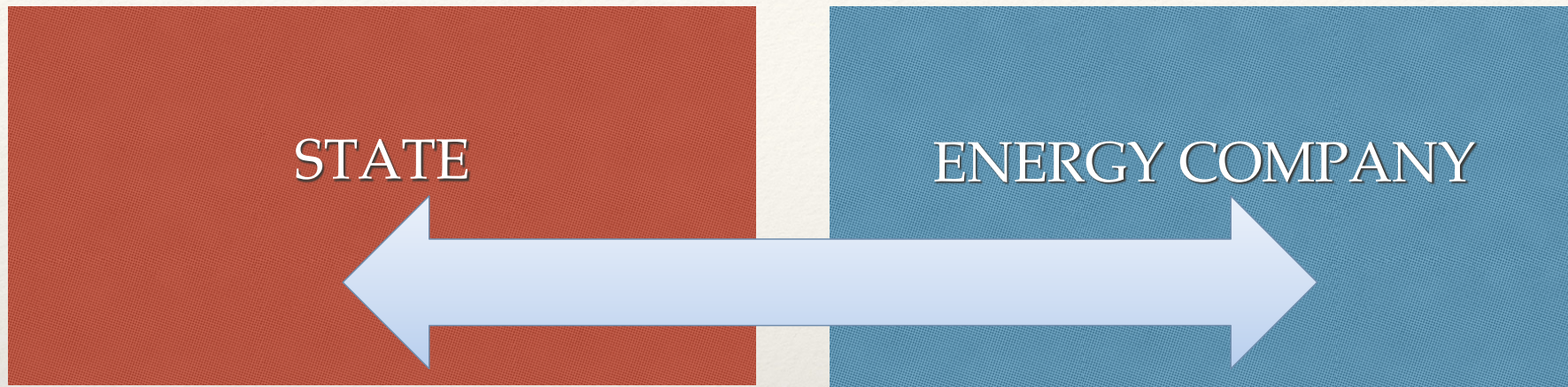
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Energy Investments

Energy Value Chain



UPSTREAM: Legal relations

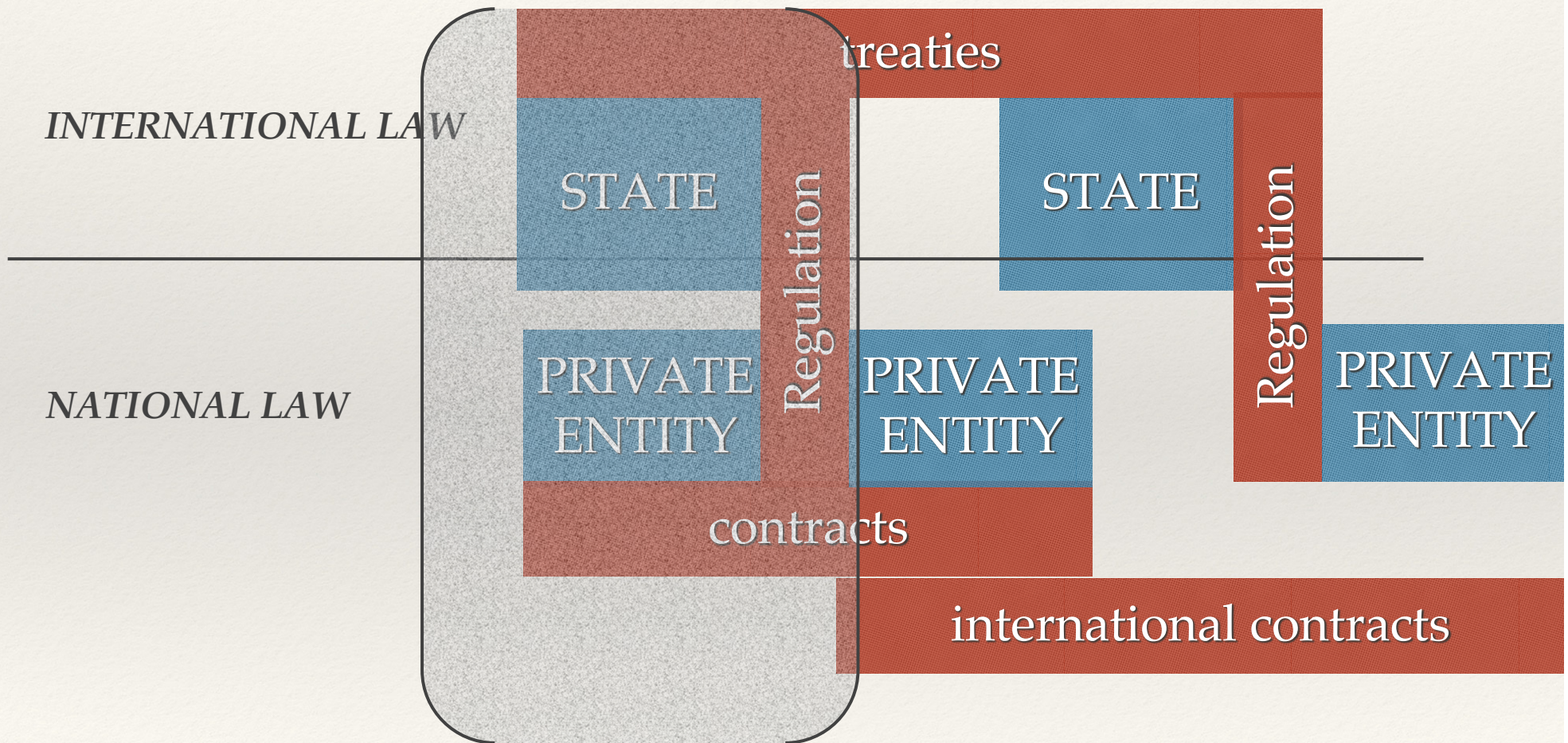


Permanent sovereignty over natural wealth and resources:

- 1) States set forth conditions under which natural resources are to be utilized.*
- 2) States pursue public interests such as the protection of environment or economic development.*

Disputes between states and energy companies

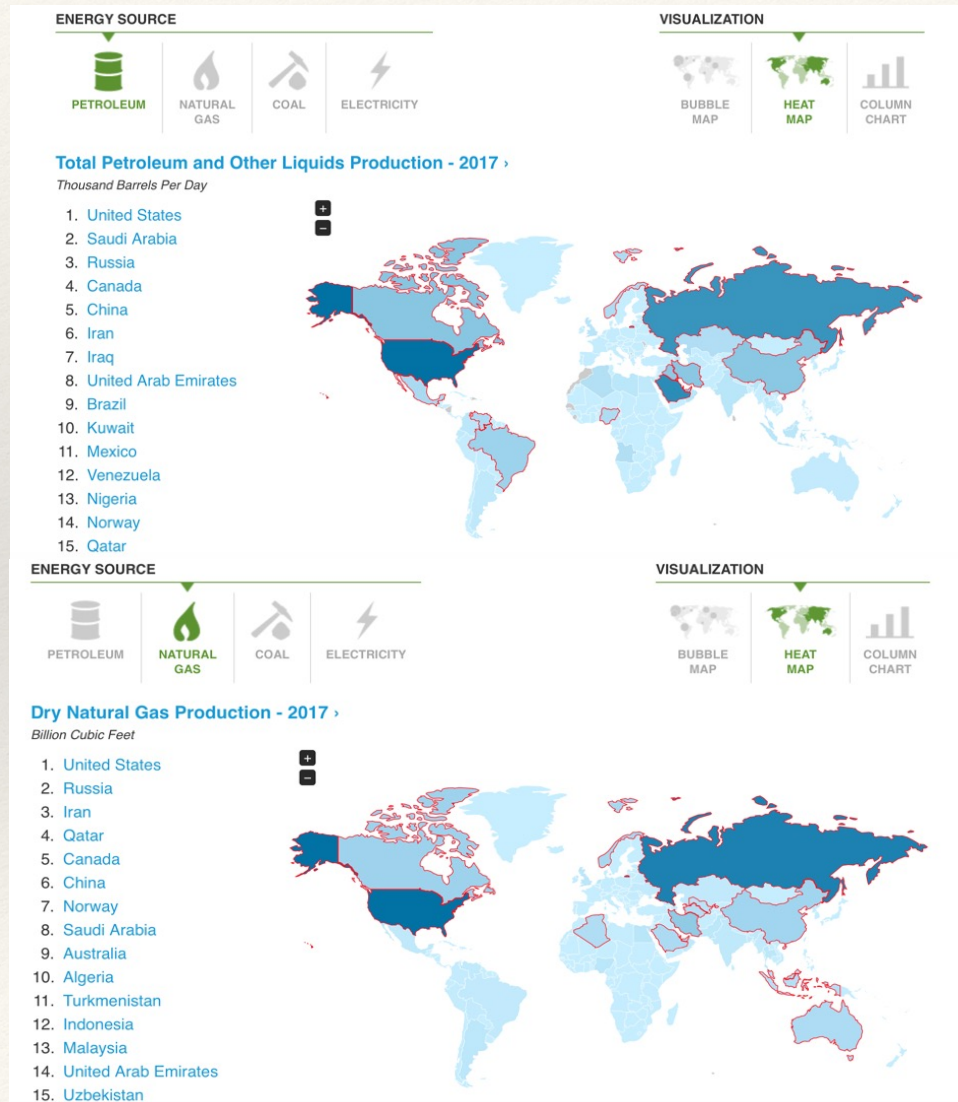
Stakeholders



State's Perspective:

*Permanent Sovereignty over
Natural Wealth and Resources
(PSNR)*

Exploration and Production



*Exploration
&
Production*

*Unequal distribution of
natural resources*



*Permanent sovereignty
over natural resources*

A state's perspective

Oil/Gas reserves are discovered in State A.

A. Who should benefit from such discovery?

- 1) A person who owns a land should also own the oil in place.
- 2) A State.

B. Should State A be engaged in the oil/gas production activities?

C. Should State A keep its energy resources for the purposes of its national development?

- ❖ Cheap energy?
- ❖ A wealthy state?

D. Should State A aim at making profit?

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

- 1) *Concession agreement* – the oldest concept: Under the concession agreement, a host country essentially concedes control over its energy resources to an energy company. Old concession agreements/contracts have following common features:
 - ❖ They granted *title of the oil* in place to the company
 - ❖ The concession area covered vast tracks 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* (usually 1/8)

Case: Anglo-Persian Oil Company

In 1933, *Anglo-Persian Oil Company and Iran* concluded a *concession agreement*. APOC obtained *an exclusive right to extract and process petroleum in a specified area in Iran up to 1993 (60 years)*.

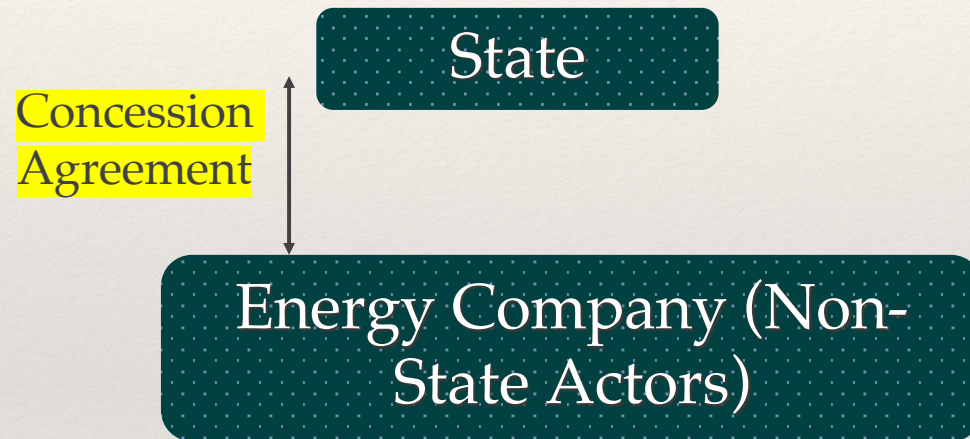
In 1951, the socialist government of Iran, led by P-M Mohammed Mossadegh, announced the official decision to *nationalize the property rights of the APOC and to terminate the concession agreement*.

Nationalized oil fields were to be exploited by newly established company – The National Iranian Oil Company.

A state's perspective

2) *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.

International Energy Law



PSNR

- ❖ PSNR is a materialization of the internal dimension of a state's sovereignty = *supreme/ultimate authority within a territory.*
- ❖ Was there a need to declare PSNR?
- ❖ *Against the background of the battle for decolonisation, the independence movement led by the then still colonies discovered the necessity to control the natural resources in their territory.*

PSNR: An introduction

- ❖ *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 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).*

UNGA Resolution 1803 (XVII) adopted in 1962

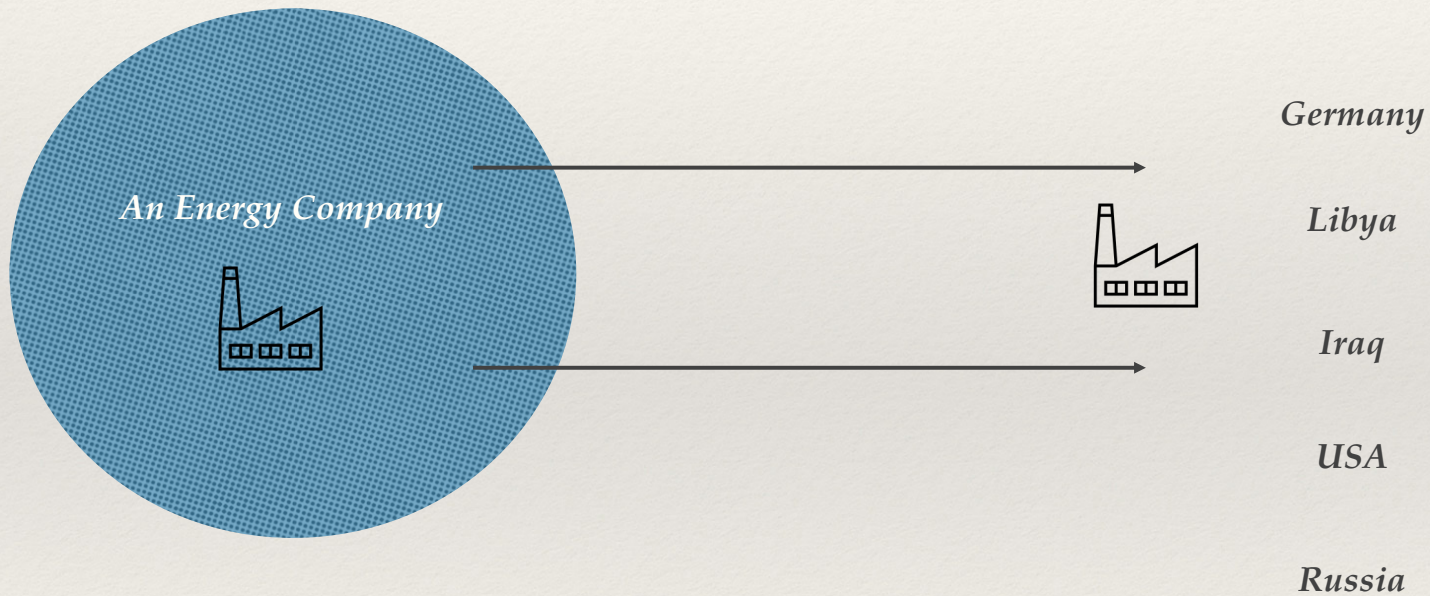
1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.
2. The exploration, development and disposition of such resources, as well as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

Investor's Perspective:

De-risking energy investments

Investment Risk

Makin a Foreign Investment



Investment Risk

Making a Foreign Investment in the Energy Sector:

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

- Median construction time required for nuclear reactors worldwide in 1981-2019 oscillated from around 84 months to 117 months.
- Operating life-time: 40-60 years.

Risks:

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

Investment Risk

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.

De-risking foreign investment

Concession Agreement

- 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)

Diplomatic protection

- 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.

Investment law

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

Investment risk: Examples

- ❖ 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.

Libya in 70s

- ❖ 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.***
- ❖ ***In response, foreign investors (including British Petroleum) invoked their rights arising from concession agreements.***

Libya: Concession Agreements

1) *Stabilization clause*

2) *Adjudication*

Arbitral tribunal

3) *Applicable law*

Domestic law + reference to the principles of international law (internationalization of contracts)

BP, TOPCO v. Libya

BP v. Libya

- ❖ expropriation was politically motivated and discriminatory, no compensation → violation of international law

TOPCO v. Libya

- ❖ Every state can invoke its sovereignty and expropriate assets of foreign companies, however, by doing so, such state cannot violate its contractual obligations (*pacta sunt servanda* principle), a contract is just another materialization of state sovereignty.
- ❖ *Pacta sunt servanda* is a principle of international law, Islamic law and even Libyan law.
- ❖ By adding a stabilization clause into the concession agreement, Libya effectively limited its sovereignty.

International Investment Law

Objectives:

- 1) *Mitigate investment risk.*
- 2) *Facilitate flow of capital between capital exporting countries and capital importing countries.*
- 3) *Economic growth.*

International Investment Law

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

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

A g r e e m e n t

between the Government of the Czech Republic

and the Government of the State of Israel

for the Reciprocal Promotion and Protection of Investments

National Treatment

Basic principle of international law.

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

MFN

“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.

MFN

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.

FET

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.

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) *2) under the due process,*
- 3) *3) non discriminatory,*
- 4) *4) compensation*

Expropriation

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.

ISDS

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 dispute.

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

ISDS

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

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*).

Arbitration centres

ICSID (International Centre for Settlement of Investment Disputes)

SCC (Stockholm Chamber of Commerce)

PCA (Permanent Court of Arbitration)

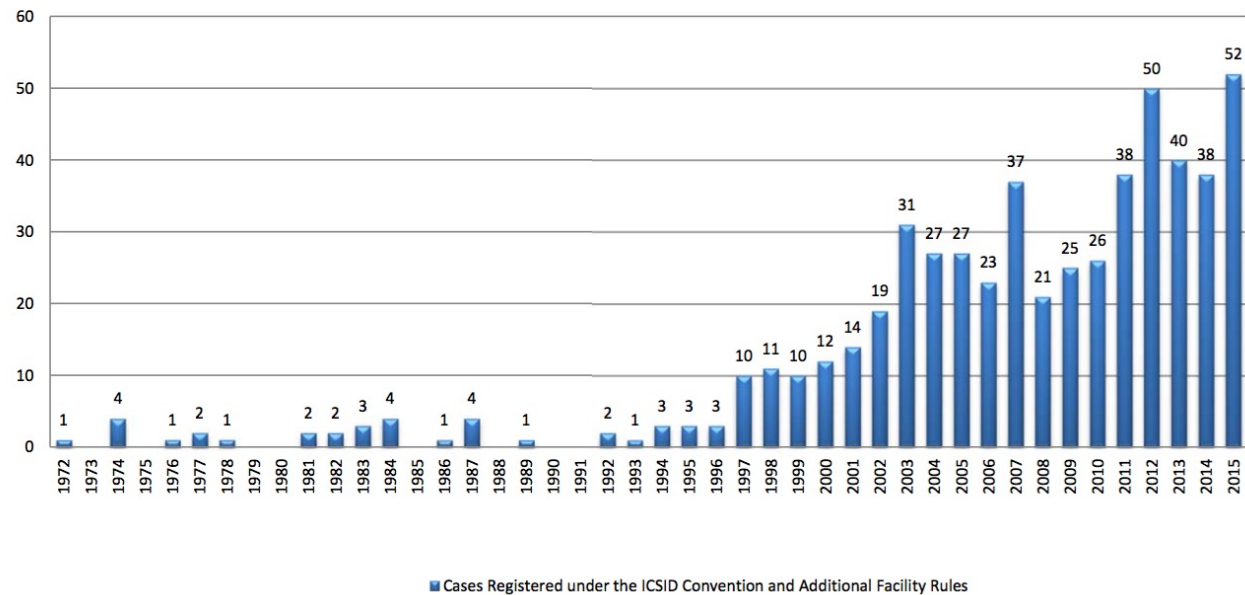
ICC (International Chamber of Commerce), Paris)

LCIA (London Court of International Arbitration)

Cases registered by ICSID

2. Cases Registered by ICSID

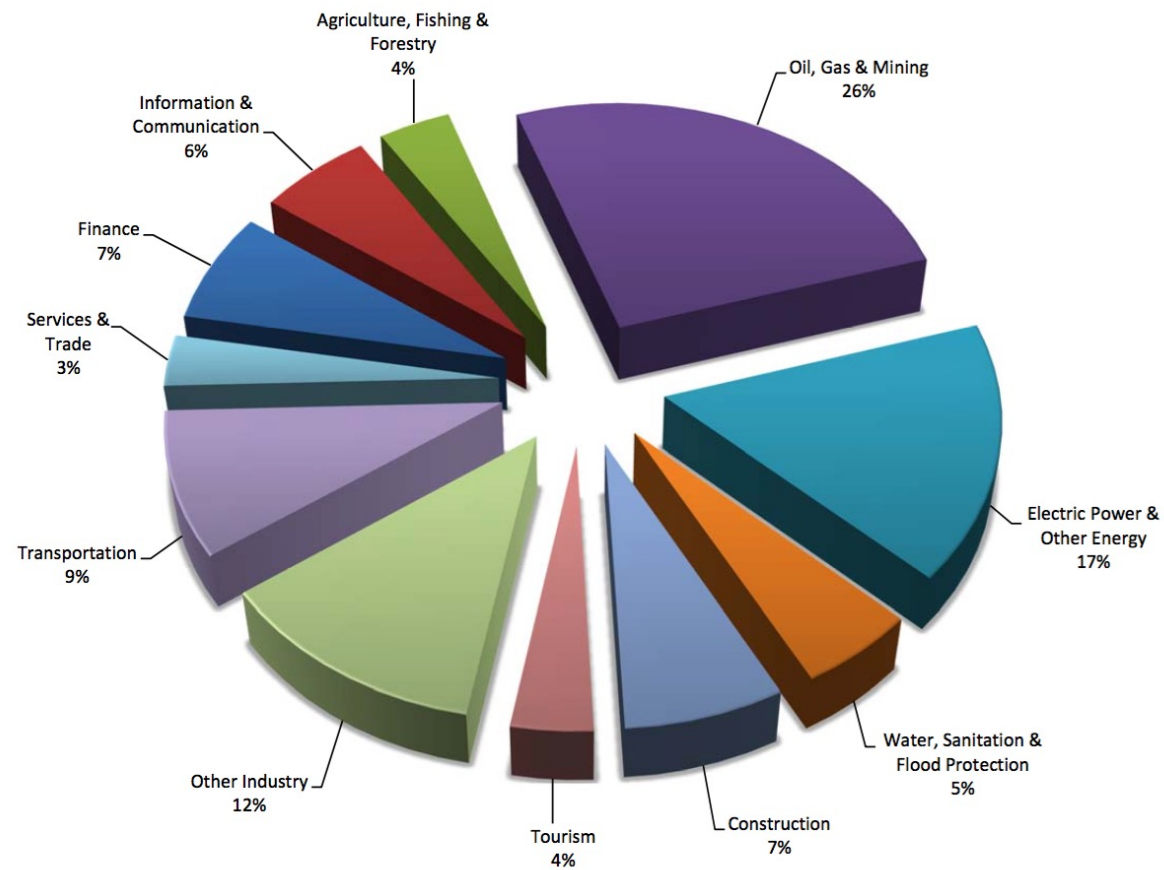
Chart 1: Total Number of ICSID Cases Registered, by Calendar Year:



Distribution of cases by economic sector

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*:



Conoco Phillips v. Venezuela

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.*

Chevron v. Ecuador and AMTO v. Ukraine

Chevron v. Ecuador (2018, PCA)

the tribunal found that (according to the US – Ecuador BIT) a 9.5 billion USD Ecuadorian court judgment against Chevron was procured through fraud and corruption by the plaintiff's legal team, including bribery of the presiding judge and ghost-writing of the judgment.

Limited Liability Company AMTO v. Ukraine (SCC Case No. 080/2005)