

PREVENTING AND MANAGING CONFLICT IN ENERGY AND OTHER NATURAL RESOURCE INVESTMENT RELATIONS

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Energy and other natural resources: reshaping investment relations and conflict management

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The impetus for this symposium, as noted in the opening statements, was the recent developments in investment relations in the area of energy and natural resources, with particular regard to practices prompted by concern for the protection of national essential security interests. It also provided opportunity to present the essential conclusions of the *Yearbook on International Investment Law and Policy 2008-2009* (“Investment Yearbook”), published by Oxford University Press on that day. The Symposium, entitled “Preventing and Managing Conflict in Energy and Other Natural Resource Investment Relations”, was organized by the Center for Energy, Marine Transportation and Public Policy and the Vale Columbia Center on Sustainable International Investment, both at Columbia University, New York.

Speakers and discussants formed a diverse pool of state policy makers, legal practitioners, industry consultants and executives, and academics. In the course of the day, the participants examined the particular dynamic that the consideration of security interest has imposed on investors and states in the handling of their relations and the management of their conflicts at the level of national regulations and international treaty protections. At the level of bilateral transactions, participants analyzed a number of developments, ranging from requests for greater transparency to the pressure of surging energy demand and considered whether these new circumstances called for new model deals and rules. Contributions are summarized below and followed by a list of key questions and areas emerging from discussions that may warrant further reflection and research. The summary does not follow the chronological order of interventions but rather regroups contributions thematically.

Bilateral transactions: calls for transparency and other developments

Bilateral transaction issues were introduced early in the morning starting with a discussion of recent tensions over the fairness and coherence of resource extraction contracts in conflict affected countries and the ensuing process of public scrutiny. This started with a voluntary disclosure of contracts from Exxon Mobile and BP and had resulted in a steady demand for higher transparency. Also mentioned on this point were a number of related initiatives from the international community for the disclosure of payments

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(“publish what you pay”). It emerged that contracts are now being disclosed upon request of multilateral institutions such as the World Bank or the IMF, under strong pressure from civil society and NGOs or on a voluntary basis by companies realizing that confidentiality might work against them. The ramifications of this trend were also considered: higher transparency is changing the way in which investors and governments negotiate their deals and is redefining the type and quality of provisions on social, fiscal and environmental issues and limiting the scope of the so called stabilization clauses.

Bilateral transaction practices also received particular attention at a number of roundtable tables seating a large proportion of industry consultants and executives. It was noted that contracts are being (re)negotiated in the context of surging energy demand in particular from the developing world – adding pressure to existing energy sources, as well as against a backdrop of ongoing economic crisis. Testimony was provided to the effect that companies face the exploration of new reserves in riskier areas and renewed demands from states for regaining sovereignty over natural resources and obtaining more and better benefits out of the exploitation deals. This has resulted in novel mergers and acquisitions between private and public entities and a strong participation of states as shareholders in energy related companies. The case of ENI in Libya was offered as an example. Ultimately, this had confronted companies with the dilemma of accepting reduced revenues or diversifying to alternative forms of energy.

Finally, it transpired from the roundtable that new model transactions and rules appeared to be required to face the changing circumstances. Whether they should be adopted nationally or internationally and at the bilateral or multilateral level, was left open by the discussion.

National regulations and economic development: energy supply and geopolitical forces

Throughout the day, participants considered the repercussions of current energy linked geopolitical forces. Particularly noted was their impact on the use of the notion of security interest as well as on the economic development and geo-strategic role of states. Participants identified a number of ways in which national regulations aiming to protect security interests had recently affected investors in the energy sector. The case of Azerbaijan was offered as an example to illustrate the state’s perspective in this respect.

Firstly, energy politics was leading to greater regulatory intervention in energy and natural resource transactions. Several countries have adopted regulatory regimes for the screening of inbound foreign direct investment for security, public interest or other purposes. These countries include the United States, where such a regime is administered by the Committee on Foreign Investment in the United States (CFIUS), as well as Russia, Germany, Canada, Australia, and China. Discussants noted that the absence of clear content to the notion of security interest may increase the risk of abuse of an already highly discretionary ground of regulation. They also noted that perception of this risk appeared to be stronger in Europe than in the US.

Secondly, heightened energy concerns served to rationalize more aggressive governmental action, ranging from forced renegotiation, abrogation or rewriting of energy contracts to regaining physical control of key assets through seizures of property and re-nationalizations. The cases of Russia, Venezuela and Bolivia were discussed as recent evidence of this trend.

It was suggested that the lesson for companies in this particular context would be to remain below the threshold of political impact where they operate: “thriving business” would be reserved to small a-political players whose discretion would become their most valuable asset.

Finally, Dr. Elkhan Nuriyev of the Republic of Azerbaijan, in his keynote intersession address provided a State perspective on the complex relationship between energy strategies, foreign policy and Azerbaijan’s economic development and geo-strategic role. Development of the energy infrastructure that allows bringing Caspian energy resources to the world markets had contributed to economic growth and increased the significance of the region in the architecture of global energy security. Linking Kazakhstan and Turkmenistan to the South Caucasus energy corridor is changing the role of Azerbaijan from an energy producer to a transit hub country. Diversification is a common goal of all countries in the region;

development or expansion of the energy corridor should not be considered as competition against other energy producers. Energy cooperation with producers and transit countries in the region appears as an excellent opportunity for the European Union to establish reliable partnerships that would also meet security concerns. It is an opportunity to increase its involvement in the area and pave the way for further development of strategic relationships.

International treaty protections: essential security exceptions and questions on the evolution of the investment regime

The question of treaty protections received attention in a number of presentations by legal practitioners and scholars. In the scenarios described above states face a high risk of violating their international commitments: abuse of power in the screening process, discriminatory treatment, unlawful taking of property, among others. The presentations explained that the notion of security interests permitted a “justification” for such wrongdoing in the form of an “essential security clause” (*ESCs*) incorporated in trade and investment treaties. The interpretation of this clause, particularly its self-judging character, brought speakers to consider the changing US position towards investment treaties. In turn, the analysis of this position prompted questions as to the evolution of the investment regime.

It was observed that the US has departed from its initial rejection of the self-judging character of the ESC and has taken an opposite stance. Recent BITs concluded by the US include language that makes the clause clearly self-judging (e.g. *US-Mozambique BIT*). The US has gone as far as clarifying that this character precludes any kind of review (e.g. *US-Korea FTA*). Participants coincided in qualifying this move as unfortunate. The invocation of the exception is taken out of the hands of arbitration tribunals. In practical terms it inserts politics back into the BIT systems; the fate of the investor is left entirely in the hands of the state. A dissident voice pointed out, however, that the problem was not one of self-judgment, but one of compensation. Who but the state concerned is in the best position to determine the essential security interest and the appropriate measures to protect it? Yet, if the measures are harmful, the state should be held liable for compensation.

Participants also noted other changes to US investment treaties. It was argued that the US – once an advocate of liberalization and investment protection – is now leading the race to the bottom. It was also suggested that US BITs were possibly shifting to a “gentler” model of protection based on “less traditional capitalism.” The 2004 US Model, which already retreats from some of these principles, is now going to be reviewed. Considered as “troubling” was the fact that this revision would question the pillars of the system: whether investment protection rights to foreign investors should be based on international law or domestic law; whether all regulatory powers of the state should be subject to international law scrutiny or whether there should be blanket carve-outs; and whether investors should continue to enjoy the right to international arbitration against the host state.

The question was subsequently asked whether the treaty system of protection was experiencing a rebalancing or retreat and this prompted consideration of other elements. *Firstly*, with regard to the US it was noted that part of the perceived changes might be the result of a failure of the political leadership and the private sector to adequately articulate the benefits of outbound and inbound investments. *Secondly*, other key actors for FDI flows such as China are increasingly signing BITs which would be perfect cases-studies of the liberalization and protection of investments that the US once heralded. *Thirdly*, although Russia avoids dealing with Brussels or Washington and has a successful strategy of direct negotiation with investors, it seems to favor a multilateral approach and has proposed an alternative energy treaty. Although the overall legal framework of the proposal remains unclear, it appears that it maintains key principles and practices of the Energy Charter, including arbitration as the preferred dispute resolution mechanisms and even introduces the idea of non-discrimination at the pre-investment phase. The convenience and feasibility of this proposal remains a topic of debate.

The discussion of the ESC also included reference to the recent investment cases in which Argentina invoked Article XI – the ESC of the US-Argentina BIT – as part of its defense to alleged breaches of its

treaty obligations. Although tribunals disagreed on the application of the clause, they all agreed that the ESC was not self-judging (*CMS, Enron, Sempra, LG&E, Continental Casualty*). In the absence of an ESC – i.e. in nine out of ten BITs – it was submitted that the state still has recourse to the necessity exception of customary international law to preclude the wrongfulness of its conduct. The participants noted that the burden for states to prove this exception is, however, very high and had failed in most cases in which Argentina has invoked it (*CMS, Enron, Sempra, BG and National Grid* cases). It was then suggested that the defense of necessity does not provide a calibrated tool for assessing national interest. It was compared to a “doomsday button”: available in theory but practically beyond reach even in periods of crisis and turmoil.

Finally, participants considered data that suggests that arbitration may not be the ideal cost recovery mechanism for investors in energy and natural resource arenas. Data of amounts awarded in investment cases show that investors are asking a lot and not getting much. Energy related cases represent 23% of the total number of cases. Whether the energy sector is driving the overall data is for the time being uncertain but overall data was judged sufficient to give a hint.

Conclusion: to think strategically

Issues discussed between experts during the day of the symposium were organized by a group of researchers from the CEMTPP into a number of diagrams with the purpose of inducing a strategic analysis of the debate. This exercise elicited a number of key questions and areas that may warrant further research. The following points were a notable focus of interrogation.

- What rules and what transaction structures are required to address the reshaping of investor-state relations? How could regulation properly take into account the multifaceted aspects of investment transactions?
- Is it time to introduce a multilateral agreement on investment to align regimes that appear to be advancing at different paces and in different directions? In the meantime, how may these differing evolutions be traced and what impact will they have on investment treaty adjudication?
- What would be the impact of shifting to alternative sources of energy on national and international rule making?
- Would contracts emerging from the “transparency era” be better and fairer contracts? How may the impact of transparency be evaluated? Would companies and governments continue to abide by greater calls for transparency?
- Finally, how could more efficient cost recovery mechanisms be implemented in the energy sector in order to better manage conflicts? Does the answer lie in the creation of a specific mechanism for energy disputes? Or should it be sought in a new approach to dispute management that looks integrally and constructively to the different elements involved i.e. negotiation, conciliation, insurances etc?