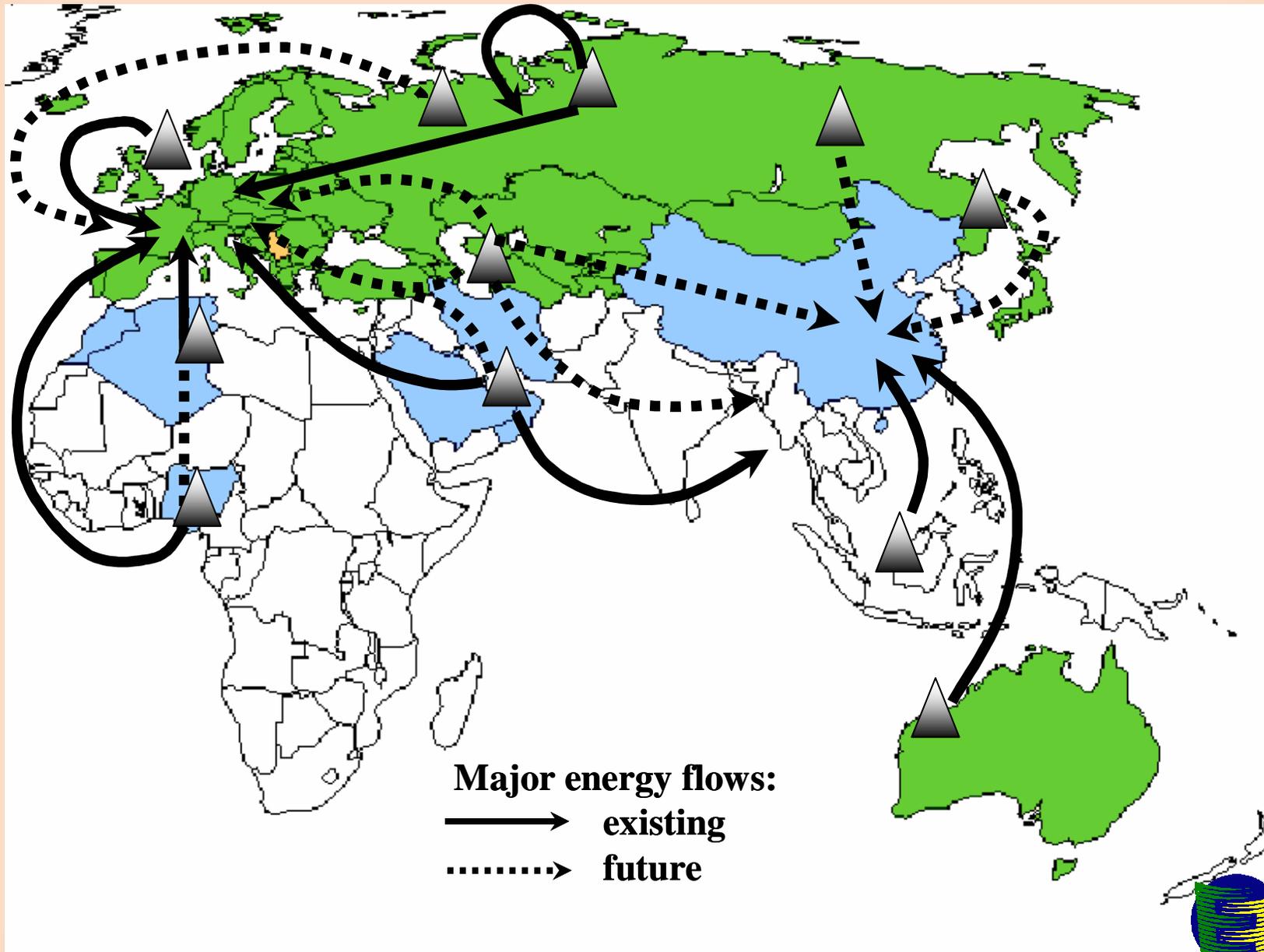


# **Caspian Gas Transportation via Trans-National Pipeline Systems and the Role of the Energy Charter Process**

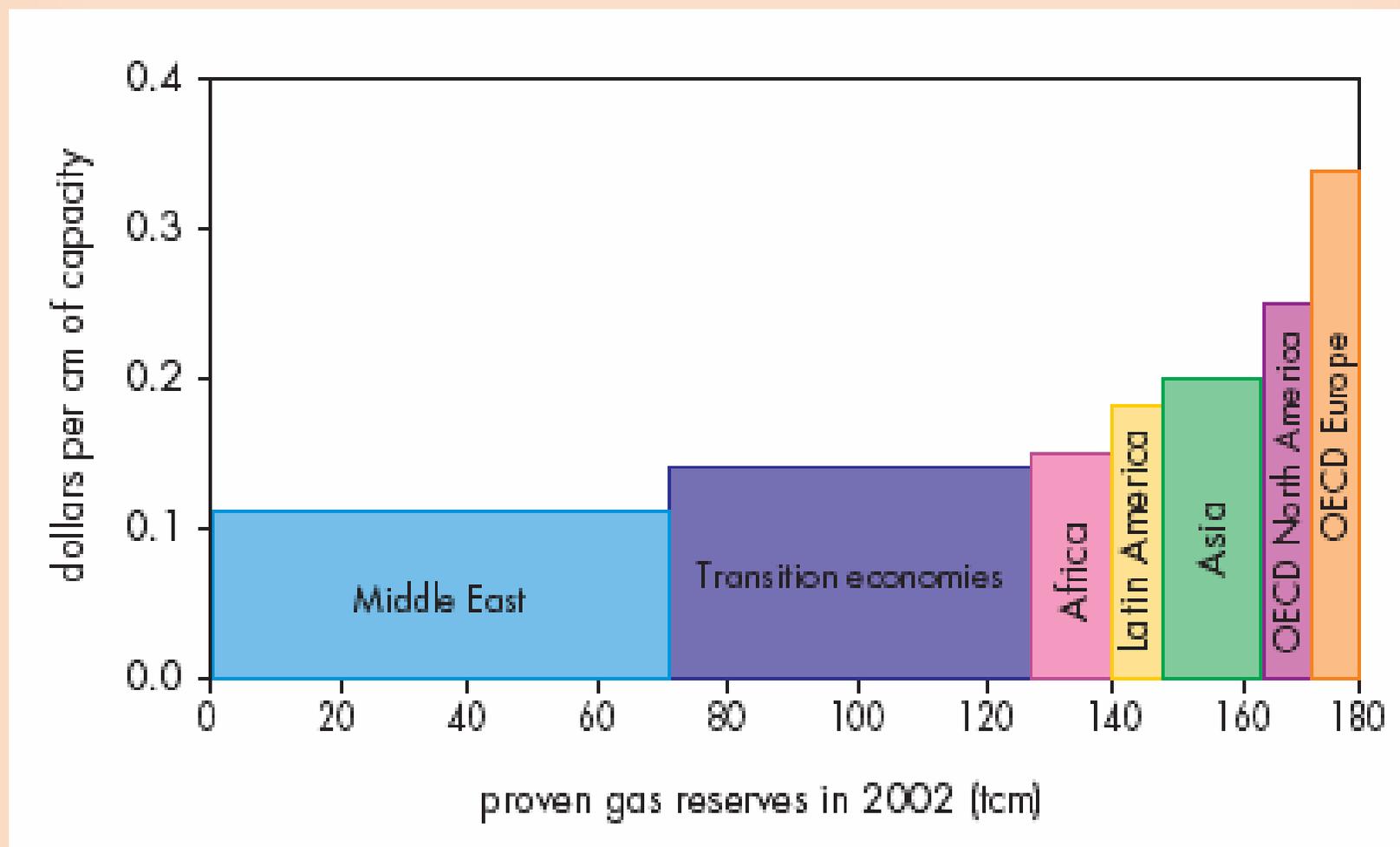
**Dr. Andrei Konopliank**  
**Deputy Secretary General**  
**The Energy Charter Secretariat**

**International Conference “Caspian Gas – Strategies for Development”**  
**17-18 November 2003, Brussels**

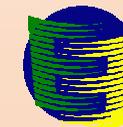
# MAJOR ENERGY FLOWS IN THE EASTERN HEMISPHERE: DEVELOPMENT OF CASPIAN ENERGY DEPENDENT ON TRANSIT



## EXPLORATION AND DEVELOPMENT COSTS VS. PROVEN NATURAL GAS RESERVES BY REGION, 2002



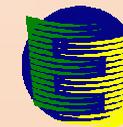
**Source:** World Energy Investment Outlook – 2003 Insights, International Energy Agency – IEA, 2003, p.199



## GAS TRANSIT ROLE FOR MAIN EXISTING (2000) AND PROSPECTIVE EXPORTERS TO EUROPE

Country-exporter	Direct supplies, % of volume of exports	Transit through the territory of: % of volume of exports			
		one country	two countries	three countries	four countries
<b>EXISTING EXPORTERS</b>					
Netherlands	76,2	13,8	10,0	-	-
Norway	67,7	7,5	21,4	3,4	-
Algeria	44,9	14,8	9,6	24,3	6,4
Russia	39,5	9,4	11,4	28,1	11,6
<b>PROSPECTIVE EXPORTERS</b>					
<b>Turkmenistan:</b>					
- NW bound	√	--	--	--	--
- SW bound (x)	--	√	√	√	√
<b>Kazakhstan:</b>					
- NW bound	√	--	--	--	--
- SW bound (x)	--	--	--	--	?
<b>Azerbaijan (x)</b>	--	√	√	√	√
<b>Iran (x)</b>	√	√	√	√	√
<b>Nigeria</b>	--	--	√	√	√

(x) Turkey = market and transit hub



# ENERGY CHARTER HISTORY AND ROLE OF TRANSIT ISSUES

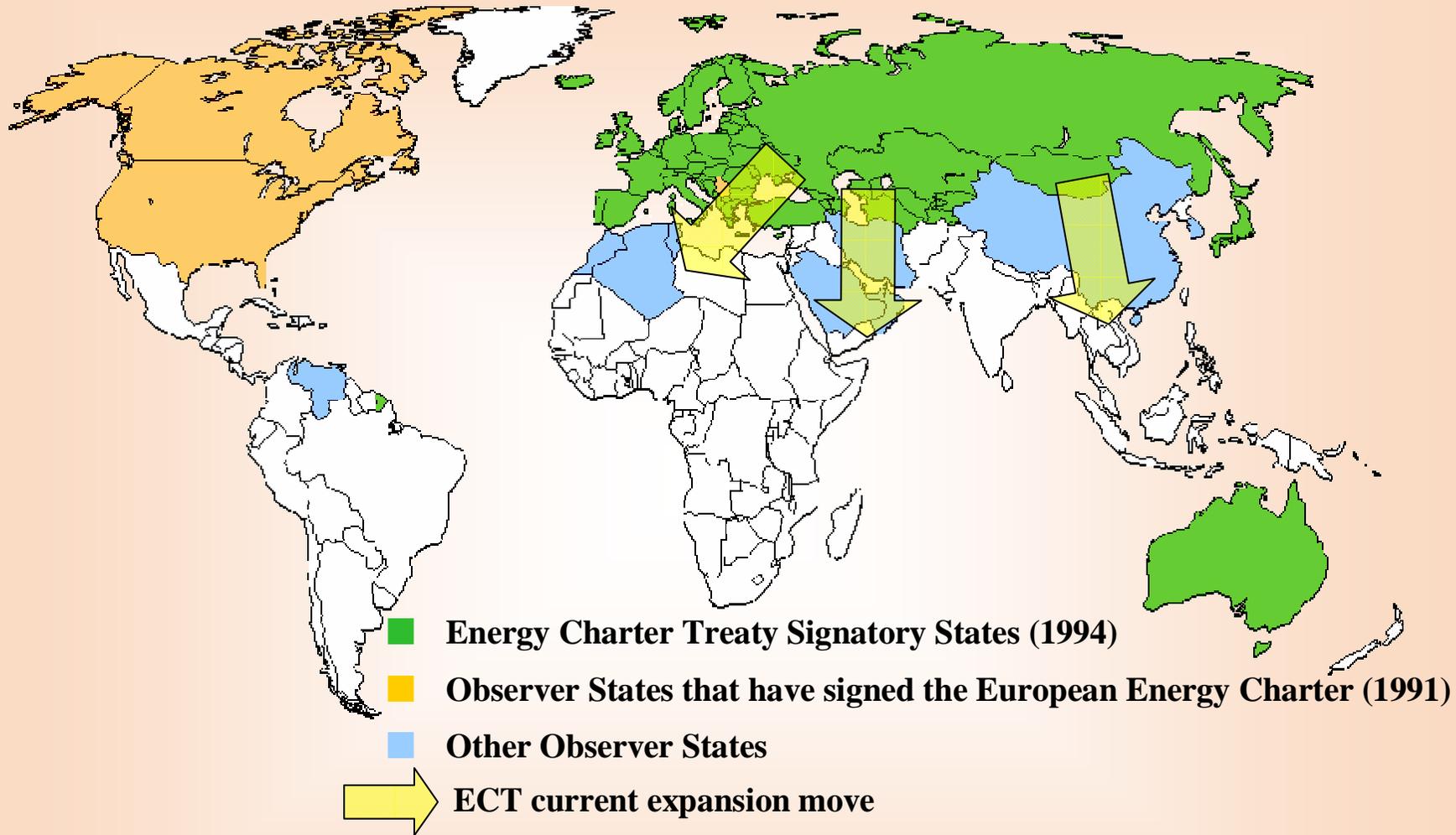
<b>June 25, 1990</b>	<b>Dutch Prime Minister Ruud Lubbers' initiative on common broader European energy space presented to the European Council</b>
<b>December 17, 1991</b>	<b>European Energy Charter signed</b>
<b>December 17, 1994</b>	<b>Energy Charter Treaty (ECT) and Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) signed</b>
<b>16 April, 1998</b>	<b>ECT enters into force and became an internal part of international law</b>
<b>As of today</b>	<ul style="list-style-type: none"> <li>• <b>ECT signed by 51 states + European Communities = 52 ECT signatories</b></li> <li>• <b>ECT ratified by 46 states + EC (excl. 5 countries: Russia, Belarus, Iceland, Australia, Norway )</b></li> <li>• <b>Russia and Belarus : provisional application of ECT</b></li> </ul>

**Russia has started ratification process in 1996**

**RF State Duma (2001): Russia will ratify ECT, but not yet (depending on Transit Protocol)**



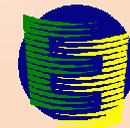
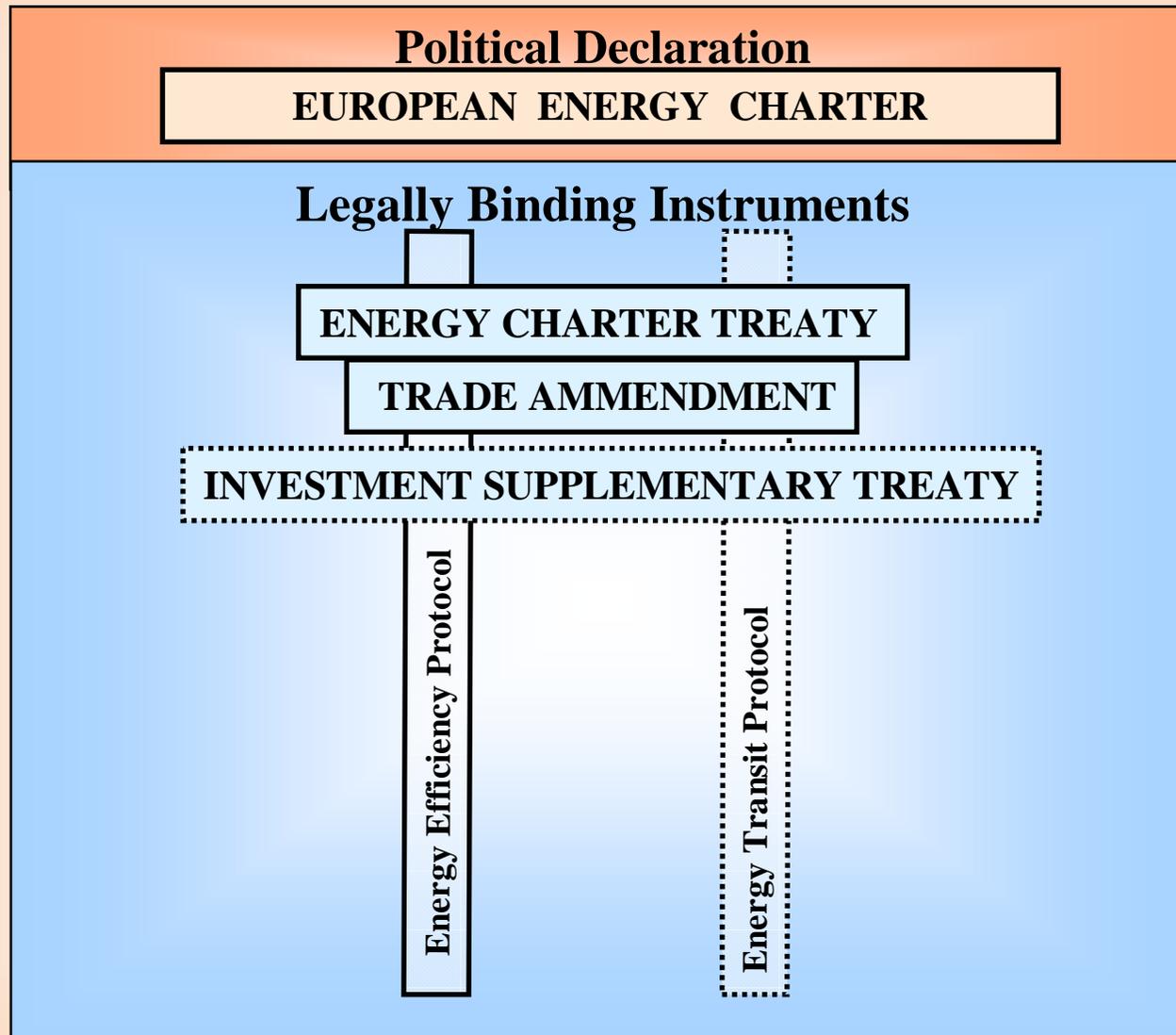
# ENERGY CHARTER TREATY: GEOGRAPHY



1. From trans-Atlantic political declaration to broader Eurasian single energy market
2. ECT expansion is an objective and logical process based on economic and financial reasons

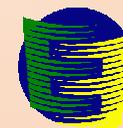


# ENERGY CHARTER AND RELATED DOCUMENTS



## **SPECIFIC ROLE OF THE ECT AS COMPARED TO OTHER INTERNATIONAL INVESTMENT AGREEMENTS**

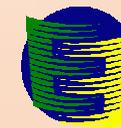
- **Is unique in covering all forms of energy cooperation (investment, trade, transit, energy efficiency);**
- **Is the first (and currently only) binding multilateral investment agreement with high standards of investment protection, including most broad and strong dispute settlement provisions (both State to State and Investor to State);**
- **Provides for a permanent policy forum among member-states of emerging broader Eurasian energy market for the discussion of energy-related issues – in the sphere of the most long-term and capital-intensive investment projects.**



## ECT MAJOR OPPONENTS IN RUSSIA AND THEIR ARGUMENTS

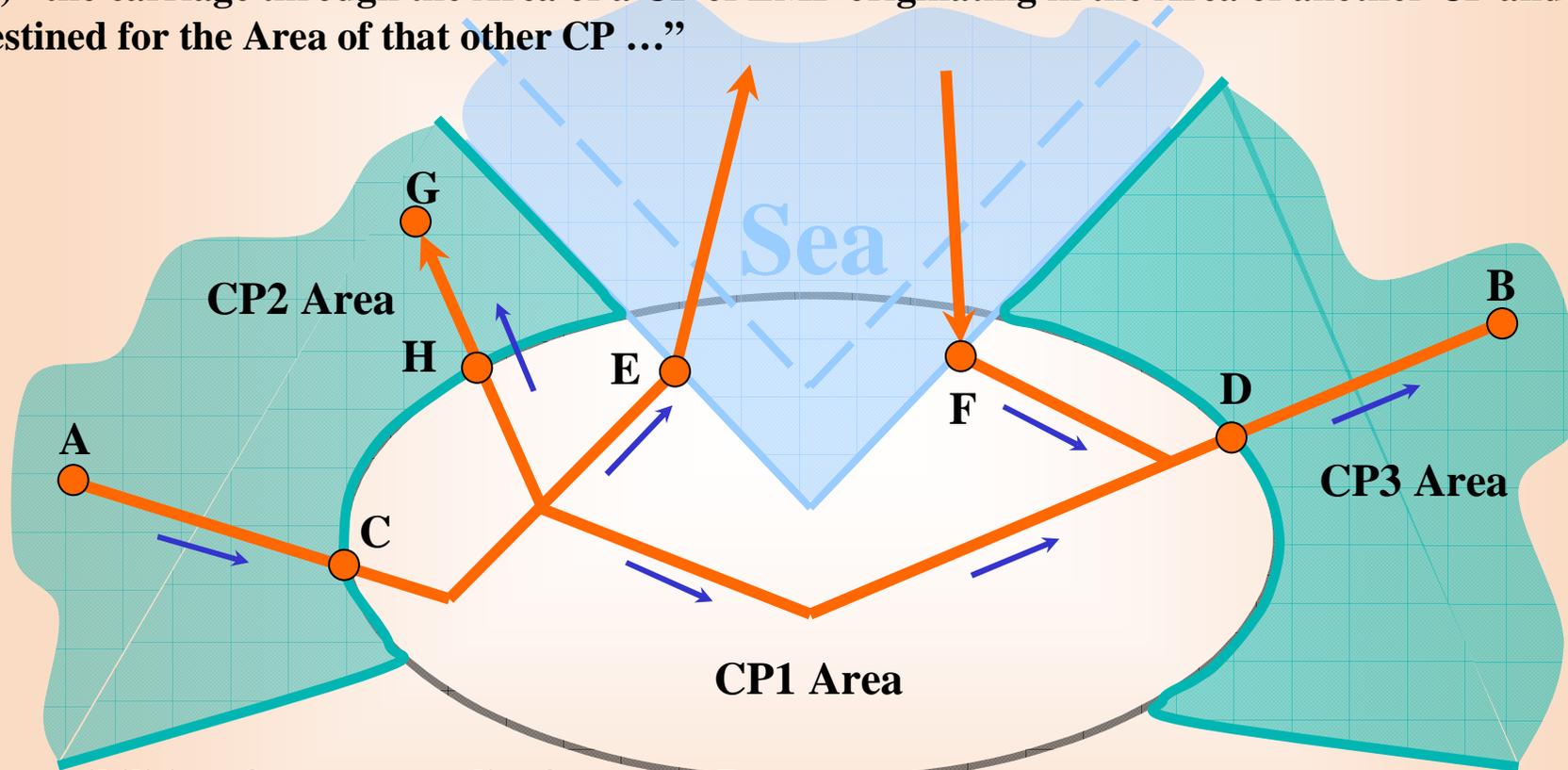
Arguments against ECT ratification	Comments
<p><b><u>Gazprom:</u></b></p> <p>1) ECT demands mandatory TPA to Gazprom's pipelines for cheap gas from Central Asia</p> <p>2) Obligation to transit Central Asian gas at low (subsidised) domestic transportation tariffs</p> <p>3) ECT will "kill" LTCs</p>	<p>1) No such obligation. "The provisions of the Treaty do not oblige any CP to introduce mandatory TPA" (ECT Understanding IV.1(b)(i)).</p> <p>2) No such obligations. Transportation and transit are different in non-EU (ECT Article 7(3)).</p> <p>3) Not true. ECT documents do not deal with LTC at all. Economic niche for LTCs will become more narrow due to objective reasons, but they will continue to exist as a major instrument of financing green-field gas projects.</p>
<p><b><u>Ministry of Nuclear:</u></b></p> <p>1) Bilateral RF-EU trade in nuclear materials is not regulated by ECT</p>	<p>Prior to ECT was signed in Dec'1994, RF and EU has agreed to regulate nuclear trade bilaterally (RF-EU P&amp;CA, July'1994).</p>

**Major Russia's concern regarding ECT ratification relates to gas transit issues**



## DEFINITION OF TRANSIT (Art. 7(10) ECT)

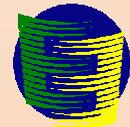
“...(a) Transit means: (i) the carriage through the Area of a CP, or to or from port facilities in its Area for loading or unloading, of EMP originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a CP; or (ii) the carriage through the Area of a CP of EMP originating in the Area of another CP and destined for the Area of that other CP ...”



### 3 possibilities of energy supplies from A to B:

No transit (on-boarder sales at C and D), f.i. RUF-EU, Turkm-RUF, Kaz-RUF

Transit: • through the pipe owned/leased by shipper, f.i. Fr-Germ, Norw-Fr; planned RUF-CIS/EE  
• through the pipe not owned by shipper



# ECT TRANSIT PROTOCOL

1. **Obligation to observe Transit Agreements**
2. **Prohibition of unauthorized taking of Energy Materials and Products in Transit**
3. **Definition of Available Capacity in Energy Transport Facilities used for Transit**
4. **Negotiated access of third parties to Available Capacity in Energy Transport Facilities used for Transit (mandatory access is excluded)**
5. **Facilitation of construction, expansion or operation of Energy Transport Facilities used for Transit**
6. **Transit Tariffs shall be non-discriminating, objective, reasonable and transparent, not affected by market distortions, and cost-based incl. reasonable rate of return**
7. **Technical and accounting standards harmonized by use of internationally accepted standards**
8. **Energy metering and measuring strengthened at international borders**
9. **Co-ordination in the event of accidental interruption, reduction or stoppage of Transit**
10. **Protection of International Energy Swap Agreements**
11. **Implementation and compliance**
12. **Dispute settlement**

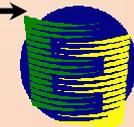
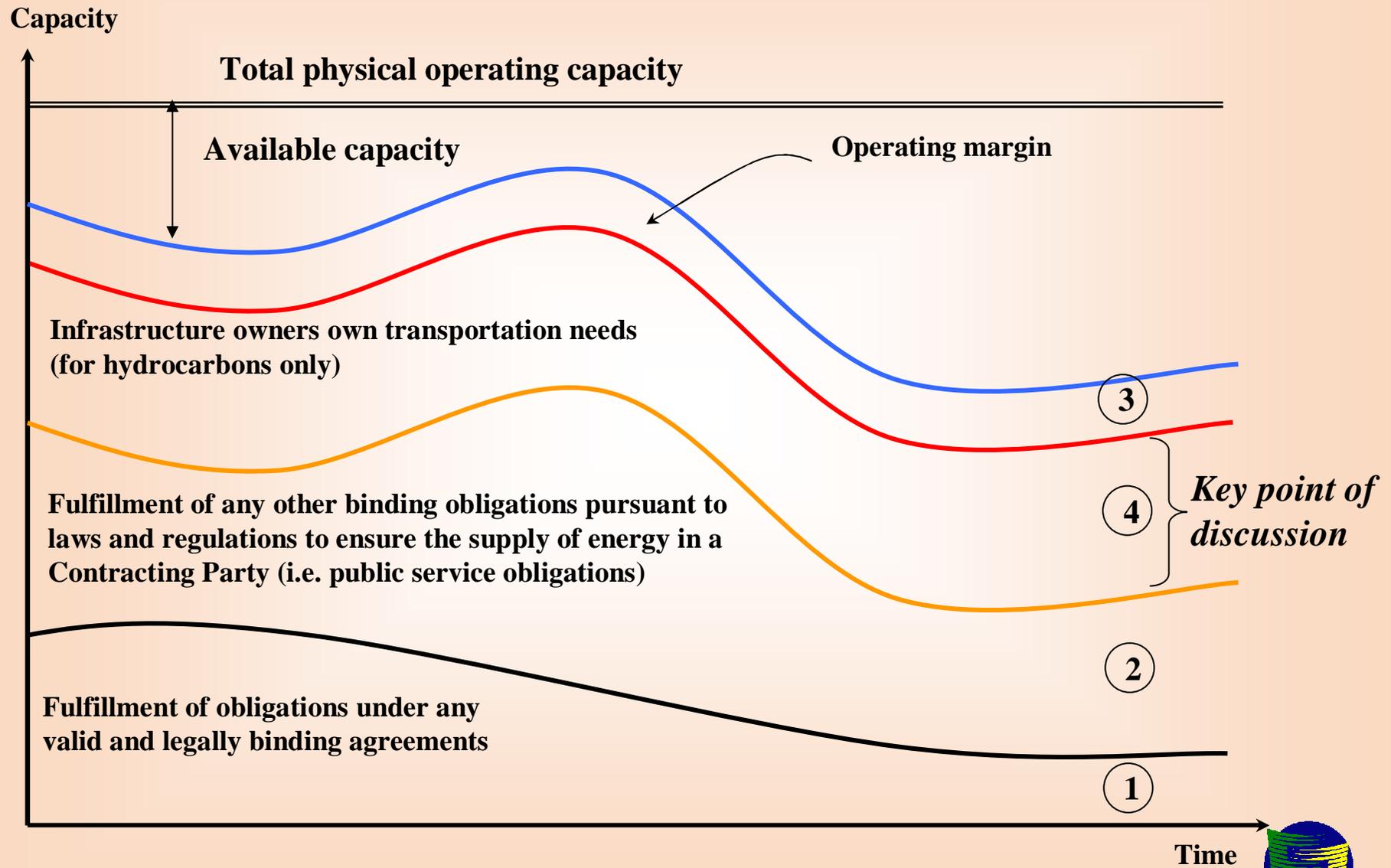
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## **Result:**

- **risks & costs related to transit diminishes**
- **competitiveness of transit supplies increases**
- **improves “energy security” (“security of supplies”+”security of demand”+”security of infrastructure”)**



# AVAILABLE CAPACITY



# FINANCING ENERGY PROJECTS: FROM EQUITY TO DEBT FINANCING

## Equity/debt financing ratio:

Pre-1970's = ~ 100 / ~ 0

Nowadays = ~ 20-40 / ~ 60-80,

f.i. most recent:

BTC pipeline = 30 / 70

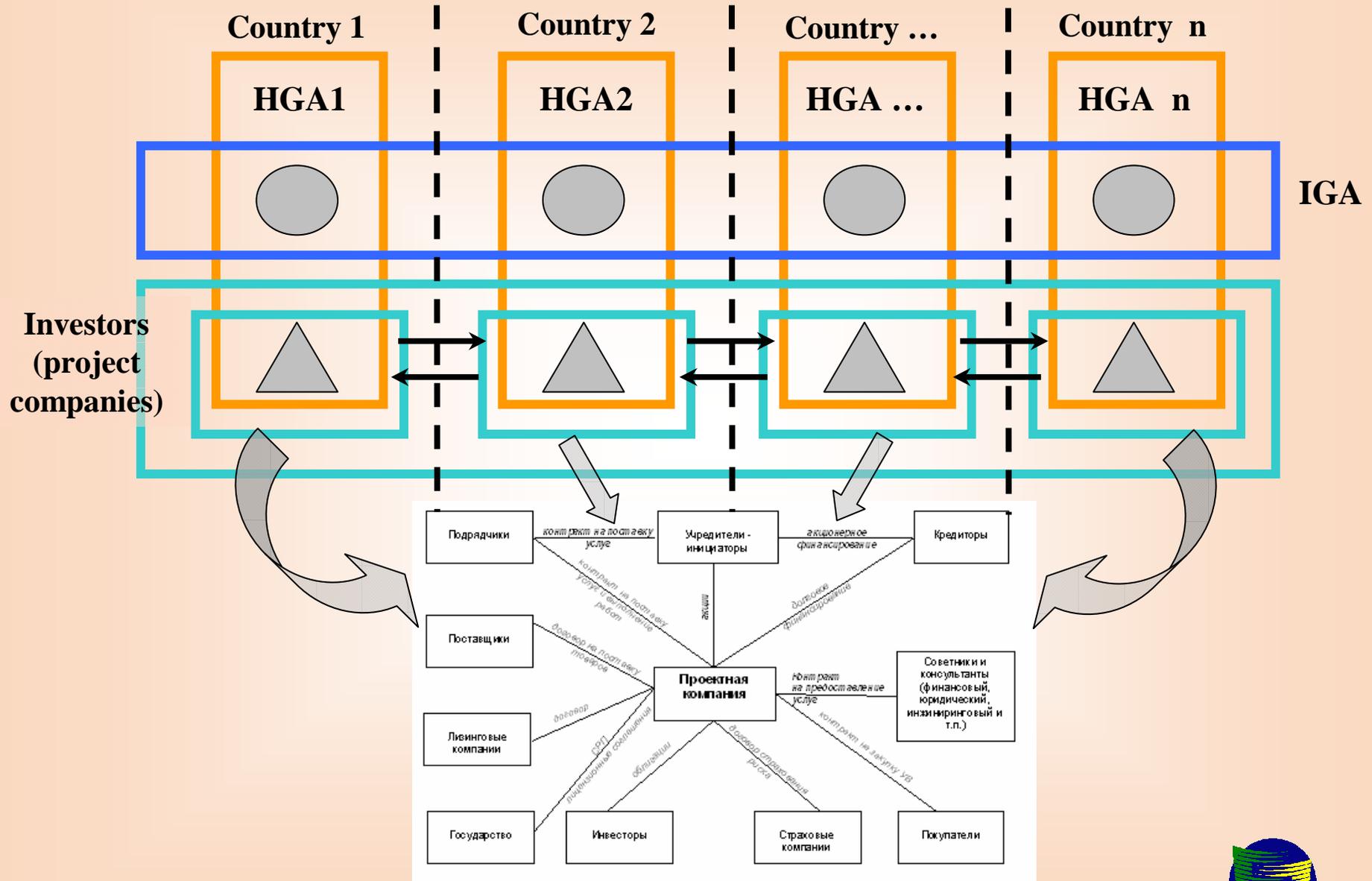
Sakhalin-2 (PSA) = 20 / 80

(2 fields+pipeline+LNG plant)

- ➔ Increased role of financial costs (cost of financing) of the energy projects
- ➔ Availability and cost of raising capital = one of major factors of competitiveness with growing importance in time



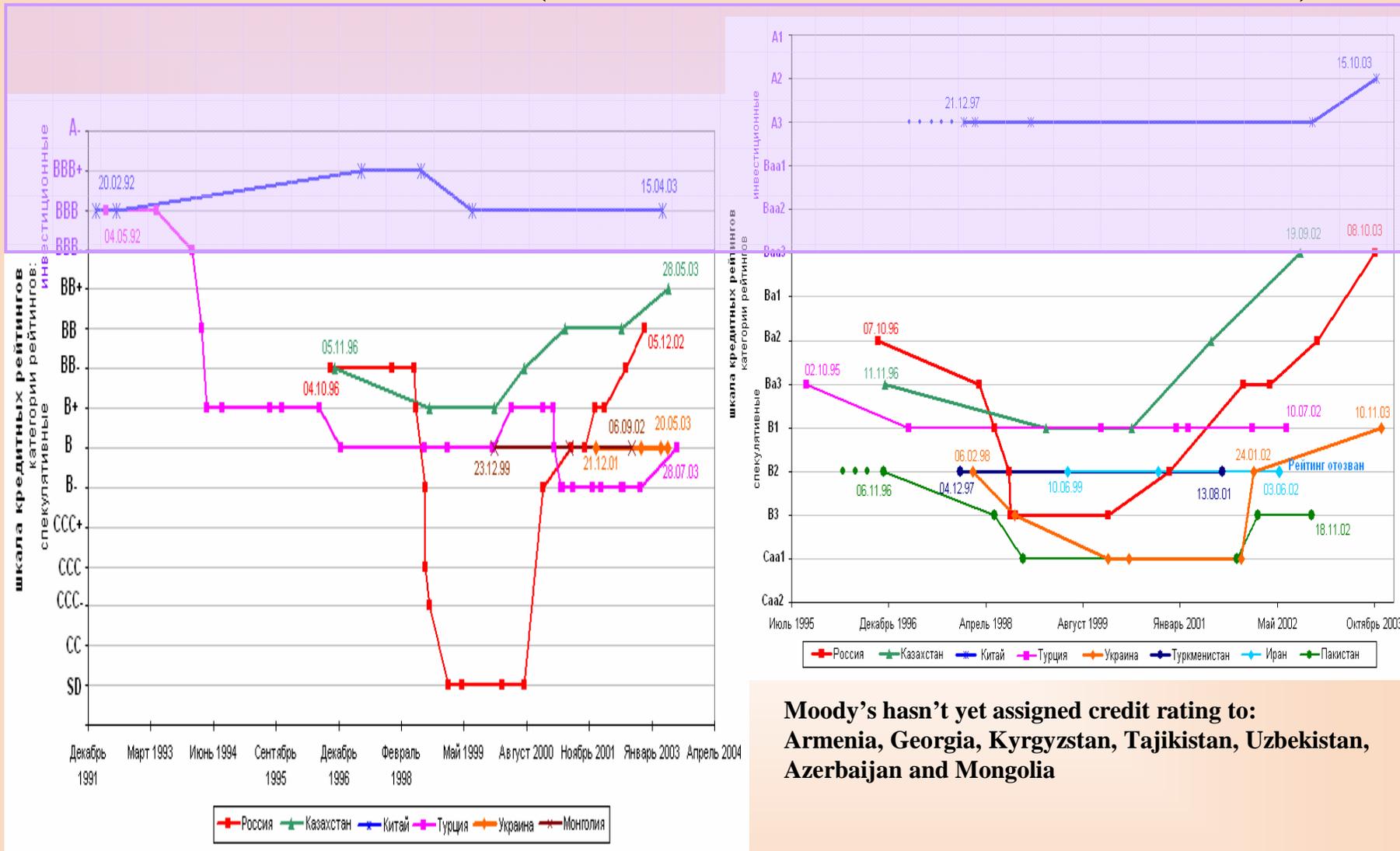
# LEGAL STRUCTURE OF THE [CASPIAN] PRODUCTION & TRANSNATIONAL PIPELINE TRANSPORTATION CONTRACTS AND ECT



Dr. A. Konoplianiuk, "Caspian Gas" - 17-18.11.2003, Brussels - Figure 13



# RATING HISTORY OF SOME ECT MEMBER-STATES IN THE CASPIAN AREA AND AROUND (MOODY'S AND STANDARD & POOR'S)



S&P hasn't yet assigned credit rating to:

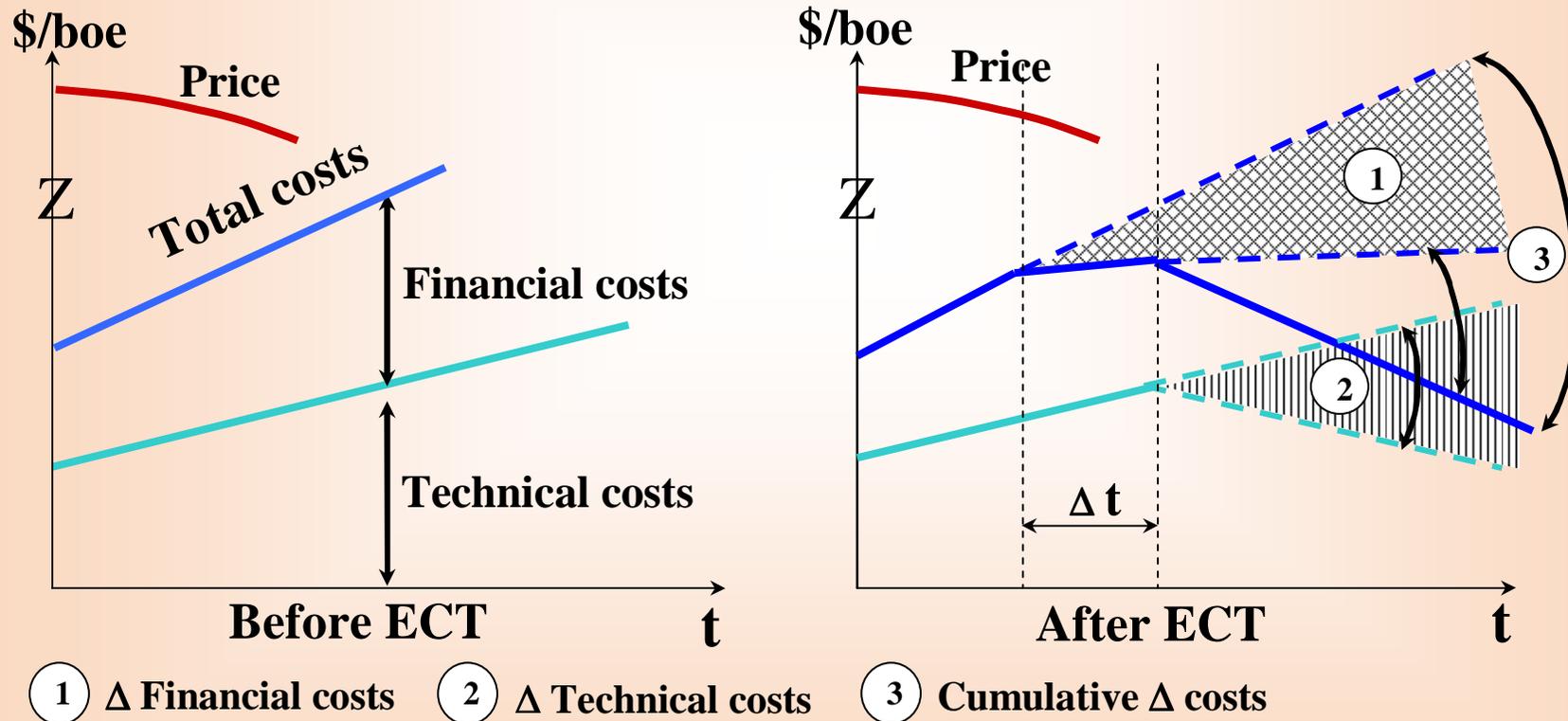
Armenia, Georgia, Kyrgyzstan, Turkmenistan, Tajikistan, Uzbekistan, Azerbaijan, and non-members - Iran and Pakistan



## ECT IS BUSINESS-ORIENTED TREATY

ECT/Legislation  $\rightarrow$   $\downarrow$  risks  $\rightarrow$   $\downarrow$  financial costs (cost of capital) = ①  $\rightarrow$   
 $\uparrow$  inflow of investments (i.e.  $\uparrow$  FDI,  $\downarrow$  capital flight)  $\rightarrow$   $\uparrow$  CAPEX  $\rightarrow$   $\downarrow$  technical costs = ②  $\rightarrow$   
 ① + ② = ③  $\rightarrow$   $\uparrow$  pre-tax profit  $\rightarrow$   $\uparrow$  IRR (if adequate tax system)  $\rightarrow$   $\uparrow$  competitiveness  $\rightarrow$   
 $\uparrow$  market share  $\rightarrow$   $\uparrow$  sales volumes  $\rightarrow$   $\uparrow$  revenue volumes

ECT provides multiplier legal effect in diminishing risks with consequential economic results in cost reduction and increase of revenues and profits



# **RUSSIAN AND CASPIAN GAS FOR EUROPE AND ASIA**

**Competitive disadvantages: longest distances to markets + (Russia) harsh natural conditions of producing areas**

- **Highest stimuli to diminish technical and financial costs of production and transportation**
  - (a) **technical costs ← investments ← legal environment in host and transit countries**
  - (b) **financial costs ← cost of capital ← credit (sovereign, corporate, project) ratings ← legal environment in host and transit countries**
  
- **ECT and related documents =**
  - = common legal environment, minimizing risks and technical and financial costs**

