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Russia and the Energy Charter: Long, Thorny and Winding Way to Each Other

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ABSTRACT: The commentary analyses Russia's 'behavioural spiral' in regard to the Energy Charter, starting with strong support since early 1990s and ending in exit from the Energy Charter Treaty (ECT) provisional application in October 2009. The improper evaluation of the ECT's pros and cons for Russia and for withdrawal by the country's authorities are examined, based on myths and misconceptions, generated, *inter alia*, by the European Union (EU). The article proposes, that both the EU and Russia originally demonstrated a high interest in Energy Charter and its instruments, but since 2003, with further liberalisation of EU energy markets, expansion of the EU eastwards, signing of the Energy Community Treaty, the practical significance of the ECT for the EU began to sharply decline. The article argues that both the EU and Russia are equally responsible for Russia's withdrawal from the ECT provisional application. It concludes that the Energy Charter is the only mutually beneficial legal fundament for Russia-EU energy cooperation and for creation of the common energy and economic space within the "broader energy Europe" and means an inevitable full return of Russia to the Energy Charter community, though the multi-facet Energy Charter process would change as well.

KEYWORDS: European Energy Charter, Energy Charter Treaty, Energy Community Treaty, Provisional Application, Transit Protocol, REIO Clause, International Investment Law, Russia, European Union, Gas

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I. Introduction

With further liberalisation of European Union (EU) energy markets, which was established by the Second EU Energy Package (2003 Energy Directives),¹ the role of the Energy Charter Treaty (ECT)² as the promoter of EU energy *acquis* was substituted by the Energy Community Treaty and thus the role and significance of the ECT for the EU began to sharply decline, both in practice and in effective political support of the ECT process. On the other hand, the EU expansion to the East in 2004, when 10 new States mostly from Central and Eastern Europe joined the EU, resulted in the fact that all delivery points of Russian gas supplies to the EU, historically located at the external border of the 15 Member States (EU-15), since that time were located within the 25 Member States (EU-25) territory. This has created a number of misunderstandings and different interpretations of ECT rules between Russia and the EU, especially regarding transit inside the EU, on top of previous debate between the two on ECT agenda. On 30 July 2009, the then Russian Prime Minister *Vladimir Putin* signed Government Order No. 1055-r³ discontinuing the provisional application by the Russian Federation to the ECT. On 24 August 2009, in accordance with Article 45 (3)(a) ECT, Russia notified in writing the depositary of the Energy Charter (the government of Portugal) of its intention not to become a Contracting Party to the ECT. Sixty days later, Russia ceased to be a party applying the ECT on a provisional basis. On 19 October 2009, it became (along with Australia, Iceland, and Norway) a country that has signed but not ratified the Treaty, thereby taking a step back, while remaining within the Treaty (as the signatory of the ECT) and the Charter process. This commentary discusses whether there were reasonable grounds for this step to be taken and who 'wins' following Russia's termination of the provisional application of the only multilateral inter-State instrument protecting investments in the energy industry?

¹ For electricity, see EC Directive 2003/54 of 26 June 2003, OJ 2003 L 176, 37. For gas, see EC Directive 2003/55 of 26 June 2003, OJ 2003 L 176, 57.

² Energy Charter Treaty, 17 December 1994, ILM 34, 360 (ECT), reprinted in: *The Energy Charter Treaty and Related Documents – A Legal Framework for International Energy Cooperation* (2004), available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (accessed on 14 April 2014).

³ Document on file with author.

II. The Energy Charter

A. History and Interests of Parties

The end of the Cold War and the fall of the Berlin Wall, marking the removal of the political border between Eastern and Western Europe, offered an unprecedented opportunity to overcome the previous economic division on the Eurasian continent. In the energy sector, the prospects for mutually beneficial cooperation between the East and the West were clearer and more vital than in other sectors. Russia and the former Union of Soviet Socialist Republics (USSR or Soviet Union) communities had huge energy resources, their main export item, but needed considerable investments for their development.

At the same time, developed market economies of Western Europe had a strategic interest in diversifying their sources of energy supplies to reduce their dependence on the politically unstable Middle East countries. European companies had their own investment resources and were able to raise borrowed funds on acceptable commercial terms. The companies were ready to make investments into development of new energy producing regions outside the Middle East. For this reason, there was a recognised need to create a mutually acceptable foundation for development of energy cooperation among the States on the Eurasian continent. Based on these considerations, the Energy Charter process was 'born' in 1990.

It stands to reason that multilateral energy cooperation must be founded on an inter-State mutually-acceptable agreement. At the same time, it is also obvious that certain political prerequisites, an open 'window of opportunities,' are required to sign a multilateral international agreement, especially a legally binding one. This is particularly true for treaties relating to such broad and basic areas of economic activities as the energy sector (where projects are characterised by the highest capital intensity and longest life-cycles compared to other industries) that provides the basis of economic development, assures the export potential of many countries and includes such 'politically sensitive' issues, as, for example, State sovereignty over natural resources. These agreements must have the respective political foundation.

For the Energy Charter, the foundation was laid in 1975 by signing the Final Act of the Conference on Security and Cooperation in (transatlantic) Europe according

to the results of the pan-European conference in Helsinki. Two years later, the Soviet Union represented by *Leonid Brezhnev*, the General Secretary of the Central Committee of the USSR Communist Party, proposed the initiative to convene a pan-European energy conference. But at that time such a proposal seemed to be premature. However, the proposal of the USSR was revived 13 years later and in a somewhat different format. In June 1990, *Ruud Lubbers*, the then Prime Minister of Netherlands (the country presiding the EU at that time), put forward the idea of creating a pan-European energy community. The Energy Charter process was thus initiated offering the mechanism of assistance to former socialist countries in their transition to the market economy.⁴ Within the scope of those pan-European initiatives, Europe was understood as a transatlantic community of States.

Since *Lubbers'* initiative was put forward by the EU, the general strategy was formulated so as to combine Western European concerns (security of energy supplies) with Eastern energy assets (abundant oil and gas resources) by facilitating Western (predominantly European) investments in development of energy resources in the East and the transit of Eastern energy to Europe. That approach was beneficial for the EU for several reasons: it would assure further diversification of energy flows to the EU, provide new opportunities for oil and gas investments in the East for EU investors, and stimulate Eastern economic development. The latter was in the hope that the expanding eastern border of the European Union would be safer by having more prosperous and settled Eastern neighbours. It was expected to intensify interdependence between East and West in terms of energy and investment flows, which, in its turn, would reduce (if not totally eliminate) the remaining political confrontation within the European continent, which still existed as a consequence of the Cold War.⁵

This approach was also advantageous to Former Soviet Union (FSU) exporting countries, not only because they expected additional export earnings and tax revenues from extractive industries, but also because investment projects in the extractive industries generate huge multiplier effects in the processing industries and the econ-

⁴ This is why the Energy Charter process was often called 'the *Lubbers* plan,' especially at the initial stage.

⁵ *Andrey Konoplyanik/Thomas Wälde*, Energy Charter Treaty and its Role in International Energy, *Journal of Energy and Natural Resources Law (JENRL)* 24 (2006), 523–558.

omy in general. The multiplier effects in such a developed industrial country as the USSR might by far exceed direct export earnings from these projects.⁶

Naturally, the latent goal of the European Union was to increase its competitiveness in the global competition with the United States of America by securing stable (and, according to expectations, with lower risk – means, lower costs – as compared to the Middle East countries) energy supplies from the FSU countries.

Finally, at that time the EU developed the First Energy Directives, their provisions were the basis for the Energy Charter instruments (ECT and its Protocols). For this reason, there was a high level of correlation and consistency, including the ‘liberality,’ of legal ‘rules of the game’ provided for by both multilateral legal instruments: developed EU Directives with a narrower geographic scope⁷ and their acceptability for developed legally binding instruments of the Energy Charter with a broader scope.⁸ Thus, the Energy Charter was considered by the EU from the very beginning as a process of exporting its supranational legislation (*acquis communautaire*) to the East along the main energy supply chains within EU export-oriented, fixed energy infrastructure systems.⁹ And at that time, on the Eastern side, at the very beginning of the

⁶ Multiplier effects of investment projects in the extractive industries are the subject of a number of papers prepared under the guidance and with participation of Prof. *Alexander A. Arbatov*; for an example, on the subject see *Alexander A. Arbatov* (ed.), *Impact on Russia’s Socio-Economic Development of Large-Scale Investments in Oil and Gas Projects Within the Scope of Six Production Sharing Agreements* (text translated from the original Russian), KEPS-Petroleum Advisory Forum (1996); *id.*, *Visible and Invisible Effects*, *Chevron Today* 2000, No. 2 (3), 25–29; *id./Andrei Mukhin*, *Socio-Economic Effects of East Siberia – Development Projects* (text translated from the original Russian), *Neft, Gaz, Stroitelstvo* 2000, No. 1, 60–63; *id.*, *Oil and Gas Projects in Russia: Investor’s Arguments* (text translated from the original Russian), *Energy Sector* 2000, No. 2, 90–94. See also *Andrey Konoplyanik*, *Analysis of the Effects of Oil and Gas PSA Projects in Russia for Budgets of Different Levels* (on the Issue of Evaluation of Impact of Large-Scale Investments in Oil and Gas PSA Projects on the Socio-Economic Situation in the Country) (text translated from the original Russian), *Neftyanoe Khozyaystvo* 2000, No. 10, 24.

⁷ In the early 1990s, the European Union (EU) consisted only of fifteen countries.

⁸ More than 50 countries participated in the ECT negotiations.

⁹ On the hierarchical EU policy of its ‘export of *acquis*’ and its instruments, including the energy sector, to FSU States, see *e.g.* *Andrey Konoplyanik*, *A Common Russia-EU Energy Space* (The New EU-Russia Partnership Agreement, *Acquis Communautaire*, the Energy Charter and the New Russian initiative), in: Kim Talus/Piero Luigi Fratini (eds.), *EU – Russia Energy Relations: Legal and Political Issues* (2010), 45; *id.*, *Ukraine’s Inclusion into the EU Energy Community Treaty With the Countries of South Eastern Europe: Consequences For All Interested Parties* (text translated from the original Russian), *Oil and Gas*, September 2010, 20–22, 24, 26, 28, 30, 32, 33–36; *id.*, “Third way” for Russia: Moscow Should Choose One of Three Variants of Building the Common Energy Space with the EU (text

Energy Charter process, import of the then being developed EU rules was acceptable for the broader Energy Charter constituency.

In other words, in the absence of local national legislations in the new FSU and the former Council for Mutual Economic Assistance sovereign countries, the legally binding instruments of the Energy Charter process were supposed to fill the legal vacuum in the most important sphere of new transitional economics, the energy sector, for both East (energy exporters and transit countries and capital importers) and West (energy importers and capital exporters). The legal vacuum was supposed to be filled by the most up-to-date (predominantly liberal) global and European models of the State regulation of the energy sector, primarily, through the mechanisms of stimulation and protection of direct foreign investments: legally binding documents of the Energy Charter were developed based on the EU legal instruments, World Trade Organization (WTO) agreements,¹⁰ the North American Free Trade Agreement (NAFTA),¹¹ and a system of almost 400¹² bilateral investment protection agreements, or Bilateral Investment Treaties (BITs), that existed by the early 1990s.

The negotiations began in the summer of 1990 and were completed within a year by signing the political declaration: the European Energy Charter of 17 December 1991 in The Hague, Netherlands.¹³ The declaration was signed by 50 countries from Europe, North America, and Asia. The list of parties to the declaration was defined by the fact that, firstly, on the Western side there were Organisation for Economic Co-operation and Development (OECD) countries;¹⁴ secondly, 'Europe' was under-

translated from the original Russian), *Neft Rossii* [Russian Oil] 2009, No. 6, 16–21; No. 7, 14–19; No. 8, 11–16; No. 9, 13–18; *id.*, A Common Russia–EU Energy Space: the New EU–Russia Partnership Agreement, *Acquis Communautaire* and the Energy Charter, *JENRL* 27 (2) (2009), 258; *id.*, To Bypass the Sticking Points, *Politicheskii Zhurnal*, Nos. 6–7 (183–184), 21 April 2008, 40–44.

¹⁰ See General Agreement on Tariffs and Trade, 30 October 1947, UNTS 55, 194 (GATT 1947); also see General Agreement on Tariffs and Trade, 15 April 1994, UNTS 1867, 187 (GATT 1994); Marrakesh Agreement Establishing the World Trade Organization, 15 April 1994, UNTS 1867, 154.

¹¹ North American Free Trade Agreement, 17 December 1992, ILM 32, 289.

¹² UN Conference on Trade and Development (UNCTAD), *Bilateral Investment Treaties: 1959–1999*, UNCTAD Doc. UNCTAD/ITE/IIA/2 (2000), 1, available at: <http://unctad.org/en/Docs/poiteiid2.en.pdf> (accessed on 22 April 2014).

¹³ Concluding Document of the Hague Conference on the European Energy Charter (EEC), 17 December 1991, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (accessed on 14 April 2014).

¹⁴ At that time including developed countries of Western Europe, North America (USA and Canada), Japan, Australia, and New Zealand. All these countries signed the political declaration of the EEC in 1991, see EEC (note 13).

stood in terms of the pan-European Conference on Security and Cooperation in Europe of 1975, *i.e.* as 'transatlantic Europe.' For this reason, despite the term 'European' in the declaration's name, the Energy Charter and its instruments have never been considered as merely and exclusively a European initiative and a European-only instrument.

The legally-binding ECT and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and took effect in April 1998. In connection with the creation of the WTO on the basis of GATT, in 1998, the Amendment to the Trade-Related Provisions of the Energy Charter (Trade Amendment)¹⁵ was adopted, that came into effect in 2009.¹⁶ There are also some incomplete documents in the Charter package.¹⁷

¹⁵ ECT, Amendment to the Trade-Related Provisions of the Energy Charter (Trade Amendment), in: ECT, Main Trade-Related Provisions of the Energy Charter Treaty as amended by the Trade Amendment adopted on 24 April 1998, 44 *et seq.*, available at: http://www.encharter.org/fileadmin/user_upload/document/Trade_Provisions_of_the_ECT_-_2003_-_ENG.pdf (accessed on 14 April 2014).

¹⁶ They are now called the Treaty Applicable Trade Provisions of the Energy Charter Treaty (2003), available *via*: <http://www.encharter.org/index.php?id=168> (accessed on 14 April 2014).

¹⁷ The framework of the Energy Charter and related documents thus consists of a political declaration (see EEC (note 13)) and, *inter alia*, a set of legally binding instruments. Thus the Energy Charter political principles are incorporated in the legally-binding ECT and related documents, both of 'horizontal' and 'vertical' type, including both those that have entered into force and those that are in the making or placed 'in the fridge' (*e.g.* which further development and drafting is postponed). There are two 'horizontal-type' Energy Charter legally-binding documents that came in effect (the first figure is the date of signing, the second figure is the date of coming into effect): the ECT (note 2) (1994/1998), which is the 'Constitution' of the Energy Charter process, and the Trade Amendment (note 15) (1998/2009), which brought the trade-related sections of the ECT in line with the WTO language or rules and expanded its coverage from Energy Materials and Products to also energy-related equipment. One 'horizontal-type' document (to be legally-binding) was placed in the 'fridge': the Supplementary Treaty (on investment, aimed to expand national investment treatment to the pre-investment stage as well); the draft version is available *via*: <http://www.encharter.org/index.php?id=33> (accessed on 24 April 2014). Among 'vertical-type' legally-binding instruments one came onto force, the Protocol on Energy Efficiency and Related Environmental Aspects, 17 December 1994, available *via*: <http://www.encharter.org/index.php?id=43> (accessed on 24 April 2014) (1994/1998) and one is in the making (see Final Act of the Energy Charter Conference with Respect to the Energy Charter Protocol on Transit, Draft Version, 31 October 2003, available at: http://www.encharter.org/fileadmin/user_upload/document/CC251.pdf (accessed on 24 April 2014)). A number of specific energy industries-related Protocols were suggested to be developed at the initial stage of the negotiations on the ECT. The Protocol on Nuclear Energy was initially drafted but negotiations were closed afterwards. From this author's view, one further Protocol (multilateral document) could have been suggested by Russia or the EU in 2009, after the unfortunate Russia-Ukraine gas transit crisis (with a possible title Protocol on Preventing Emergencies in Transit), but instead Russia and the EU has signed a bilateral document of this kind – the Early Warning Mechanism ("Memorandum on an Early Warning

As of May 2014, the ECT has been signed or acceded to by 52 countries of Europe and Asia,¹⁸ as well as European Communities and the European Atomic Energy Community, so the total number of signatories is 54, with 46 States that have ratified the Treaty. This ratifying States include all the EU States. Five States – Australia, Belarus, Iceland, Norway, and Russia – have not yet ratified the ECT, though Belarus applies the Treaty on a provisional basis; Russia also applied the Treaty on a provisional basis until October 2009 when it discontinued its provisional application. The Energy Charter observers are 23 countries and ten international organisations.¹⁹ Key dates of the Energy Charter development process are presented in Table 1.

25 June 1990	<i>Ruud Lubbers</i> , Prime-Minister of The Netherlands, presents an EU initiative on forming the pan-European Energy Community at the European Council meeting in Dublin, Ireland.
17 December 1991	The European Energy Charter (EEC), a political declaration, is signed in The Hague, Netherlands.
17 December 1994	The ECT and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) are signed in Lisbon, Portugal.
16 April 1998	ECT enters into full legal force after its 30th ratification.
23–24 April 1998	The Trade Amendment to ECT is adopted, which brought trade-related provisions of the ECT in line with the WTO norms, also expanding the ECT scope to 'energy-related equipment.'
February 2000	Negotiations on the Energy Charter Protocol on Transit begin.
December 2002	Multilateral phase of the negotiations on the Energy Charter Protocol on Transit concludes; three open issues on the draft Protocol were to be first resolved within bilateral consultations between Russia and the EU.

Mechanism in the Energy Sector within the Framework of the EU-Russia Energy Dialogue”) available at: http://ec.europa.eu/energy/international/russia/dialogue/warning_en.htm (assessed on 10 May 2014)). So the Energy Charter package of legally-binding and non-binding documents is designed as a modular legal structure, e.g. open-end set of both instruments and members, which opens the way for its multifaceted and multi-directional further development.

¹⁸ With Pakistan's accession to the ECT (making it the 53rd) member country, supported by the Energy Charter Conference (the supreme body of this international organisation) in November 2006.

¹⁹ List of countries are available via: <http://www.encharter.org/> (accessed on 10 May 2014).

December 2004	On the results of the second five-year Review (mandated under Article 34 (7) ECT) of the Energy Charter activities, the Energy Charter Conference decided on regular adaptation of the Energy Charter process to the new challenges and risks of the energy markets development.
End of December 2005	On the threshold of the Russia-Ukraine gas transit crisis, informal working agreement was reached by the then acting leadership of the Energy Charter Secretariat (ECS) with the high-level Russian and Ukrainian authorities, that should the two parties not reach their bilateral agreement, they will use the Energy Charter's conciliatory procedure for resolution of transit dispute. Both parties also informally adopted the candidacy of the conciliator proposed by the ECS; and a corresponding letter by the newly appointed ECS Secretary General was sent on his first day in the office in his new capacity, on 3 January 2006, to both parties proposing this already agreed procedure. This however was not used, as on 4 January 2006, Russia and Ukraine had come to a bilateral settlement of their dispute after three days of termination of Russian export supplies to Ukraine.
July 2006	The Group of Eight (G-8) Summit in Saint-Petersburg, which concluding documents regarding enabling energy security, especially in regard to its investment aspects, are prepared mostly with the use of the ECT and its related documents.
April 2007	The Special Energy Charter Working Group on Strategy Issues is formed to implement and enforce decision of the December 2004 Energy Charter Conference.
September 2007	Russia-EU bilateral consultations are concluded and transformed into multilateral consultations on the draft solutions reached by Russia and the EU.
September 2008	Multilateral negotiations on finalisation of the Energy Charter Transit Protocol are resumed.
1-19 January 2009	Second Russia-Ukraine gas crisis; on its results Russia's highest political leadership claimed that the Energy Charter in its incapability or unwillingness to solve the problems, related to violation of the ECT provisions; this was factual blaming of the Energy Charter in lack of dispositive legal capacity and political leadership of its Secretariat in incompetency.
21 April 2009	An initiative of the then Russian President <i>Dmitry Medvedev</i> on the "Conceptual Approach to the New Legal Base of International Cooperation in the Energy Sphere (Aims and Principles)" is adopted based mostly on the Energy Charter documents.
June 2009	ECT Trade Amendment enters into full legal force after its 35th ratification, now known as the Treaty Applicable Trade Provisions of the ECT.
19 October 2009	Russia withdraws from the provisional application of the ECT.
November 2009	On results of the third five-year Review of the Energy Charter activities, the Energy Charter Conference converted the status of the <i>ad hoc</i> Strategy Group into permanent one; the Trade and Transit Group is given one year to finalise negotiations on Transit Protocol; Russia expressed its support to Energy Charter process.

The Energy Charter Treaty can be considered as a multilateral investment agreement with a much broader scope than just purely investment-related document. The Treaty is different from other bilateral investment agreements by its application to the energy sphere but in a broader sense. During its preparation, the ECT did not draw much public attention, which was primarily focused on WTO and Multilateral

Investment Agreement (MAI) negotiations. But with the failure of MAI negotiations in 1998, which factually paved the way to the termination of further activities on the Energy Charter draft Supplementary Treaty, and the lack of any promising initiatives in this area at that moment within the scope of OECD, WTO or elsewhere, the Energy Charter Treaty became one of the most impressive achievements in the international treaties process of the 1990s.

B. Aspects of the Energy Charter

The Energy Charter is a comprehensive multifaceted notion – meaning a process, an international organisation, and a system of documents at the same time. This includes all of the following:

1. A set of multilateral documents of different character, such as:
 - a. EEC political declaration of 1991,
 - b. Legally binding documents of 1994 (ECT, PEEREA) and 1998 Trade Amendment (Treaty Applicable Trade Provisions of the ECT),
 - c. Other numerous legally binding and non-binding documents: Protocols, Understandings, Decisions, Declarations, Statements, model agreements, etc.;
2. Long-term Energy Charter process and the objective cycle of its development with the following consecutive phases:
 - a. Negotiations on development of legally binding documents,
 - b. Monitoring of their execution and efficient application,
 - c. Multilateral political discussions on compliance of the Energy Charter instruments with new realities of the energy markets development and on agreement of measures to adjust these instruments to such new realities,
 - d. New multilateral negotiations on modernisation of operating instruments or preparation of new Energy Charter instruments; the whole cycle is repeated at the next level;

3. International organisation (Energy Charter Conference) as a political forum; within this forum the working process of different working groups of this international organisation is convened;
4. Energy Charter Secretariat as an administrative body of the multilateral international organisation.

The Energy Charter Treaty is a sort of a 'constitution' of the Energy Charter process. Only legally binding documents are subject to ratification. At the same time, it is not possible to sign and ratify any legally binding document of the Energy Charter without signing and ratifying the ECT and, prior to that, the EEC, and the political declaration under Article 33 (3) ECT. The ECT is the only legally binding international legal instrument relating exclusively to the inter-State cooperation in the energy sector and covering, in its essential part, international investments, energy trade and transit, energy efficiency, and dispute resolution procedures.²⁰

The fundamental goal of the ECT is to strengthen the rule of law on energy issues by creating a level playing field of rules to be followed by all participating governments, thus minimising the risks associated with energy-related investments and trade.

C. ECT and Project Financing: Operation of the Treaty

The main part of the ECT outlines the investment protection regime (Part III). It is modelled on Chapter XI NAFTA and on the contemporary BIT types. The section must be considered in combination with Article 26 ECT, Part V, which allows an investor to litigate directly against the government of the host country violating one of the contracted liabilities under the ECT, immediately in front of an independent arbitration tribunal – this provision is a legal innovation and novelty of the Treaty.

²⁰ For detailed economic and legislative analysis of the Energy Charter Treaty, its historical prerequisites and negotiations history, as well as Russia's concerns with respect to the ECT ratification, see *Thomas Wälde* (ed.), *European Energy Charter Treaty: An East-West Gateway for Investment & Trade* (1996); *id.*, (ed.), (English version)/*Andrey Konoplyanik* (ed.), (Russian version), *Energy Charter Treaty: The Way to Investments and Trade for East and West* (2002); a brief complex analysis of the ECT is presented in *Konoplyanik/Wälde* (note 5), 523–558; *id.*, *The Energy Charter Treaty and its role in the global energy sector*, *Neft, Gas i Pravo* 2008, No. 6, 56–61; 2009, No. 1, 46–50; No. 2, 44–49; No. 3, 48–55.

The fundamental feature of the ECT investment provisions is ensuring a 'level playing field' for energy sector investments within the ECT member countries to minimise non-commercial risks associated with energy investments. In this respect, "the energy sector" in the ECT (Article 1 (5)) has the broadest possible meaning, including initially a wide range of Energy Materials and Products (Article 1 (4)). After the Treaty Applicable Trade Provisions of the ECT came into force in 2009, the notion also covers energy-related equipment and all parts and stages of the full investment and production cycle in the energy sector. 'Investments' in the ECT (Article 1 (6)) also have an extensive definition providing investors with stimuli for broadest spectrum of what can be considered as 'investment activities' within the energy sector by providing protection to such activities.

The ECT provides protection of foreign investments in the energy sector based on the principle of non-discrimination in Article 10 (2) and (3). By accepting the ECT rules, a country undertakes to extend the national investment regime or the most favoured treatment to individuals and legal entities of other signatory States which have invested in its energy sector.

The ECT distinguishes between the pre-investment stage (Articles 10 (2), (3) and (5)) and the post-investment stage (Article 10 (7)). In the first case, the ECT sets only 'soft-law' obligations of the parties, *i.e.* those with a more flexible framework and less specific content such as 'shall endeavour.' In the second case, the ECT provides for 'hard-law' legal obligations presented expressly as a must: "the parties shall encourage and create," which means that *the parties must* (are obliged to) *encourage* and *must* (are obliged to) *create*. The reason for the distinction is that States should be relatively free to make decisions with regard to specific investors and areas of investments. But once an investor is admitted to the internal market, and has made concrete investments, and is thereby exposed to considerable political risk, the tougher the obligations are for the host State to behave fairly towards the investor.

Obligation to adhere to providing foreign investors with non-discrimination access to the internal market is realised in the form of two flexible liabilities, *i.e.* obligations to pursue the following:

1. Not to impose new restrictions for foreign investors with respect to new investments under Article 5 (a) ECT (the stand-still rule), and
2. To gradually eliminate existing restrictions under Article 5 (b) ECT (the roll-back rule).

Introduction of these rules reflects the international practice of the last 20 years to consistently liberalise and/or eliminate restrictions for direct foreign investments. However, since 2003–2004 (when oil prices started to soar) there has been a gradual increase in restrictive developments with respect to direct foreign investments in national legislations. The share of these has amounted to 30 % in 2009 against 0–10 % in pre-2003.²¹

Stabilisation (non-deterioration) and/or improvement of investment conditions by legally binding (hard and soft law) provisions of the ECT bring into action the ECT's economic and legal instruments. They lead to lower non-commercial risks and reduced costs of borrowed funds, with corresponding financial and economic effects for an investor and the host country.

The ECT is an instrument for project financing efficiency improvement. As an international treaty, it is aimed, however, at achieving business results. As an integral part of the international legislation the ECT assures reduction of investment risks and, as a result, financial costs of project implementation in case of a more protectionist and less non-discriminatory nature of the national legislation (in comparison with the ECT). This means improvement of prospects to receive higher and/or faster returns on investments, *i.e.* projects become more competitive on the capital market. As a result, the country's positive capital balance grows in two directions: through reduction of domestic capital outflow and increase in direct foreign investment inflow.

Inflow of capital in the form of direct investments is transformed into more capital expenditures. Since capital expenditures are the carriers of the scientific and technological progress and innovations, a somewhat lagged reduction in technical costs of project implementation thus takes place. Both factors (reduced financial and technical costs) ensure an increase in taxable profit which, in case of an adequate fiscal

²¹ UNCTAD, Trade and Development Report (2010), 76–77.

system, results in a higher internal rate of return (IRR). As a result, the project's competitiveness on the commodities market rises, as does the market share of its output (sales). The company enjoys higher revenue and capitalisation, lower credit rates, *etc.* This means growth of tax revenues and royalty payments for the host country and increase in direct and indirect, including multiplier, effects from the project within the host country.

Thus, the ECT has the multiplier legal effect on lowering the risks with the resulting economic benefits regarding reduction in costs and growth of profits and revenues. Consequently, competitiveness of investment projects rises, with more direct and indirect investment revenues for the host country.

But despite these evident positive effects of the Treaty and the Charter process for the energy-rich host countries, Russia did not ratify the ECT and has finally withdrawn from its provisional application. For what reason or purpose was this?

III. Russia's Criticism of the ECT: Reasonable and Far-Fetched Claims

Since the beginning of the ECT ratification procedure in Russia in 1996, its opponents have been raising different objections against ratification. These objections were analysed by the author in detail earlier.²² The major part of the ECT opponents relates to foreign investment antagonists *per se*. They consider foreign direct investment presence in Russia and in the energy sector and mineral extractive industries in particular, as a "bargain sale of the Motherland." The most frequently repeated arguments against ECT ratification in Russia boils down to four: of which one related to trade in nuclear materials, and the other three related to natural gas trade. Two of the 'gas' objections concern transit issues and the last one deals with long-term contracts. At the same time, both 'transit' objections to the ECT do not

²² *Andrey Konoplyanik*, Ratification of the ECT: First Of All, Opponents' Bona Fide Ignorance Should Be Assuaged (text translated from the original Russian), in: Wälde/Konoplyanik (eds.) (note 20), Chapter 22; *id.*, Fighting the Myths: On Imaginary Benefits and Threats of the Energy Charter Treaty (text translated from the original Russian), *Politicheskii Zhurnal*, 13 June 2006, No. 21 (116), 32–36; *id.*, Power of Argument and Argument of Power. What is the Energy Charter for Russia? (text translated from the original Russian), *Mirovaya Energetika*, June 2004, No. 6, 50 *et seq.*

relate to Russian gas transit through the territories of foreign States when gas is supplied to Europe, but focus on prevention (non-admission) of transit gas supplies from the Central Asia *via* Russia to Europe on the terms (as though when interpreted according to ECT rules) will discriminate against Russian producers and exporters. Thus, the main objections to the ECT were initially associated with transit issues. As is shown below, two transit objections are valid. A procedural solution was found: development of a Transit Protocol with an acceptable solution with the two issues of Russia's concern in substance as a prerequisite for ECT ratification by Russia. The question remains, whether the prerequisite will be sufficient.

On the eve of the 2006 G-8 Summit in Saint-Petersburg, in the light of strong (inherently counterproductive) pressure on Russia from Western countries, some of which were not contracting parties or signatories to the ECT, called on to Russia to ratify the ECT irrelatively to completion of the Transit Protocol, Russia raised further objections to the ratification, namely, the incompleteness of the Supplementary (Investment) Treaty.²³

However, some Russian politicians seemed not to be conversant with the ECT and seemed to be unaware of the modern practice of preparation and conclusion of multilateral agreements which always reflect an achievable multilateral balance of interests, *i.e.* the minimal set of provisions satisfying all participating parties, and not the set of provision which, as it used to be, a country could impose on a wider community or another country in a bilateral agreement. Therefore, they were dissatisfied by the fact that the ECT did not contain some important, from their point of view, provisions²⁴ and demanded the non-ratification of the ECT and a rewrite of the Treaty to include in its new version some amendments and alterations allegedly beneficial for Russia, before the State *Duma* returned to the ECT ratification issue. At the same time, the politicians did not consider that 46 countries have already ratified the ECT in its given version making it practically impossible to

²³ *Andrey Konoplyanik*, Russia-EU, G-8, ECT and Transit Protocol, Russian/CIS Energy & Mining Law Journal 4 (3) (2006), 9, 12.

²⁴ The present author has, on numerous occasions, including his publications and presentations, argued against the ECT opponents and their objections to the Treaty. See *e.g. id.*, Fighting the Myths: On Imaginary Benefits and Threats of the Energy Charter Treaty (note 22), 32–36; *id.*, Power of Argument and Argument of Power. What is the Energy Charter for Russia? (note 22), 50–53.

make them walk away from ECT ratification in favour of a new – yet to be developed and thus yet unknown in substance – document.

IV. ECT: Transit and Draft Transit Protocol

Since the Russian government introduced the topic of ECT ratification in the Russian State *Duma* in August 1996, Russia's legitimate – from this author's view – concerns about the ECT only focused on two matters covered by Article 7 ECT 'Transit':

- (1) Whether it is possible to interpret the provisions of Article 7 (3) concerning the correlation between the levels of transit tariffs and domestic transportation tariffs in a detrimental to Russia manner; and
- (2) The absence in Article 7 (7)(c) of a mechanism for converting the interim transit tariffs set by a conciliator in the course of transit dispute settlement through conciliation to final transit tariffs upon dispute resolution.²⁵

Therefore, these legitimate concerns of the nation were evidence not that they (and or the Treaty as a whole) were unacceptable *per se* but only that various interpretations were possible for the said ECT provisions, including those that would go against the grain for Russia. It was necessary to make practical decisions,²⁶ which

²⁵ Apart from these legitimate concerns that needed clarification, the opponents of ECT ratification by Russia, whose mouthpiece has been and remains the incumbent (now former) deputy chair of the RF State *Duma* and CEO (now also former) of Russian Gas Society *Valery Yazev*, have voiced a great many other complaints about the ECT, which should be categorised as 'myths' due to the fact that the authors of the objections had not even read the ECT for themselves (a case in point is debate of many years between the author and Mr *Yazev*, who has strongly insisted that the ECT required mandatory third-party access to the gas-transportation infrastructure whereas the ECT explicitly states the opposite in its Understanding IV.1(b)(i), 25 of the text in its September 2004 publication by the Energy Charter Secretariat, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (accessed on 24 April 2014)), but judged it based on the interpretation given to ECT provisions by the international media or EU politicians, who discussed not what is set forth in the Treaty (since most of them seemed not to have read the Treaty as well) but what they would have liked to find there, governed by and based upon the evolution of EU legislation and their ambition to expand its jurisdiction over the EU neighbouring countries.

²⁶ These were what the author of this paper mostly worked to elaborate and achieve when serving as Deputy Secretary General of the Energy Charter Secretariat in 2002–2008.

would enable addressing Russia's reasonable complaints without amending the Treaty itself.

In the course of parliamentary debates in January 2001 on the issue of ECT ratification, the State *Duma* took a pragmatic and legally feasible decision that Russia's legitimate concerns about the ECT transit provisions must be addressed in a dedicated legally binding Energy Charter Protocol on Transit.²⁷ Pursuant to Article 1 (13)(a) ECT, 'Protocol' means "a treaty [...] in order to complement, supplement, extend or amplify the provisions of this Treaty with respect to any specific sector or category of activity [...]." Therefore, using the Energy Charter Protocol on Transit to elucidate the interpretation of the provisions of Article 7 ECT on transit is legitimate and does not require editing or amending the ECT itself. The many years of bilateral informal consultations between Russian and EU experts about the draft Transit Protocol, which were particularly intensive and effective in 2004–2007, produced special mutually acceptable understandings, which had been agreed at the multilateral expert level and set forth therein (but which, however, have not yet been given political support by the stakeholders), with respect to the ECT provisions on transit.

By 2007, all matters in dispute in the Transit Protocol, except for one provision, had been resolved. Differences persisted with respect to the EU proposal (Article 20 of the draft Transit Protocol – so-called 'REIO²⁸ clause') that the movement of Energy Materials and Products within the European Union be not classified as transit. This is based on the EU's argument that no transit can exist – in the legal meaning of the term as set forth in Article 7 ECT – within the EU single market.²⁹

²⁷ Negotiations on it started in 2000 (see Table 1 above).

²⁸ Regional Economic Integration Organization (Art. 1 (3) ECT): "Regional Economic Integration Organization" means an organization constituted by [S]tates to which they have transferred competence over certain matters a number of which are governed by this Treaty, including the authority to take decisions binding on them in respect of those matters.

²⁹ A few years later, after the Third EU Energy Package came in force in September 2009 and the EU Gas Target Model (GTM) was developed since 2010 based on provisions of the Third Energy Package, it became clear that this earlier EU delegation's argument – about as if homogenous single EU gas market – was nil and void, since the GTM vision of the EU single market is based on the combination of a number of EU market zones of a pool character (entry-exit zones) with virtual trading point in each zone. Cross-border points with bundled capacity products in each such interconnection point will stay to exist. So cross-border character of the internal EU gas market will continue to be its characteristic feature even at the later stage of its evolution towards its further liberalisation. This means that the 'REIO clause' introduced by the EU delegation in 2002 at Transit Protocol negotiations, (i) was based

This EU proposal may have created additional transit risks for supplies of Russian gas to Europe (for example, the risk of ‘contractual mismatch’ which was a result of the key novelties implemented by the Second EU Gas Directive:³⁰ unbundling of vertically integrated companies and mandatory third-party access within the EU territory) because after the EU expansion in 2004–2007 a significant portion of these supply routes – up to gas delivery points in Russia’s or Gazprom’s long-term gas export contracts – passed through EU territory.³¹

However, the draft “Energy Charter Plus Roadmap,”³² which was discussed in 2009 (see *infra*, VII. C.), ushered in a very important and then new idea that would have paved the way to a radical solution of the problem (though this proposal was not recalled by the parties) – the option of incorporating into the Transit Protocol a provision that Article 20 will be automatically deleted from it in the event of the Transit Protocol ratification by Russia. It means that this would apply to ECT ratification by Russia, too, because Russia can only ratify the ECT and the Transit Protocol concurrently (see Table 2). However, the failure by the Russian delegation

on factually incorrect interpretation by the EU delegation of the very concept of the EU internal gas market, and (ii) has factually prevented negotiations on the draft Transit Protocol to be finalised.

³⁰ EC Directive 2003/55 of 26 June 2003 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 98/30/EC, OJ 2003 L 176, 57. See also *Andrey Konoplyanik*, Third EU Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Incl. Non-EU Suppliers) and Consumers, Oil, Gas and Energy Intelligence Law (OGEL) 3 (2011), available at: <http://www.ogel.org/article.asp?key=3130> (accessed on 16 April 2014).

³¹ For the nature of the risks, see *e.g.* *Andrey Konoplyanik*, On the Evolution of Contractual Arrangements for Supplies of Russian Gas to Europe (text translated from the original Russian), *Perspektivy Energetiki* [Energy Industry Prospects] 10 (1) (2006), 1; *id.*, Russian Gas for Europe: Evolution of Contractual Arrangements (from Long-Term Contracts, Border Sales and Final Destination Provisoes to other Forms of Contractual Relationship?) (text translated from the original Russian), *Neft, Gaz i Pravo* 2005, No. 3, 33–44 and No. 4, 3–12.

³² *Id.*, Energy Charter Plus – Russia to Take the Lead Role in Modernizing ECT?, OGEL 4 (2009), available at: <http://www.ogel.org/article.asp?key=2955> (accessed on 16 April 2014).

to attend a number of key meetings³³ made it impossible to continue promoting that roadmap.

Table 2. Possible and Impossible Procedural Solutions for ECT & Transit Protocol Ratification by Russia

Scenario 1: First, Russia to ratify the ECT, afterwards the Energy Charter Community complete, sign and ratify Transit Protocol.

Result: historical EU proposal, not acceptable for Russia.

Scenario 2: First, to complete, sign and ratify Transit Protocol with due consideration of justified concerns of Russia regarding transit provisions of the ECT and still open issues of the draft Transit Protocol. After that Russia will return to ECT ratification issue.

Result: would be preferable for Russia, but it is impossible according to Energy Charter rules (no one State can become a party to an Energy Charter Protocol without ratification of the ECT).

Scenario 3: The only workable and mutually acceptable compromise: Russia ratifies 'modified ECT' and Transit Protocol simultaneously. The term 'modified ECT' does mean existing ECT being complimented and expanded (based on necessity and pursuant to agreement of Energy Charter parties) by the new Protocols and other legally-binding and non-binding instruments. 'Modified ECT' does not mean 'rewritten' ECT, *i.e.* it does not mean that ECT legal text *per se* can be amended and/or changed until the moment when all ECT signatories ratify it.

Result: Energy Charter community should concentrate on practical ways of solving Russia's justified concerns regarding ECT and draft transit Protocol. Nowadays this task is more difficult due to Russia's withdrawal from ECT provisional application. Furthermore, there is no consensus in assessment of legal consequences of this Russian action and related disappointment in the Charter and broader international community.

³³ Which can be viewed as "counteraction by inaction," see discussion on the issue of whether it is possible to achieve practical results in multilateral negotiations by irregular participation in the negotiations, started in *Andrey Konoplyanik, Voting with Feet* (lit. "counteraction with inaction") (text translated from the original Russian), *Vedomosti*, 23 October 2002, A4; *id.*, Not to Lose Face: Successful Finalization of the Negotiations on Energy Transit Dependent on Russia's Readiness to Participate in Them and To Search for Mutually Acceptable Solutions with the EU (text translated from the original Russian), *Mirovaya Energeticheskaya Politika* [Global Energy Policy], December 2002, No. 10, 54-57; *id.*, Energy Charter: Counter-acting through Inaction, OGE 2 (2003).

V. Common Misconceptions by Russia

A. Common Misconception 1: Obligation to Provide Transit

Some Russian politicians³⁴ have been regularly voicing their fears that if Central Asian producers and European buyers make direct contracts for the supply of gas to Europe, the ECT would allegedly require (*oblige*) that Russia enable such companies to use the Russian Gas Transportation System (GTS) for transit of 'cheap' Central Asian gas to the EU at Russia's low domestic transportation tariffs. The bottom line is that, having crossed over Russia's territory, Central Asian gas will compete against Russian gas in the European market and will have a competitive (price) edge as it is much cheaper to be produced and is much closer (thus cheaper to be transported) to the European markets.

This is what is widely believed. However, the ECT has no such requirement, pure and simple. First, the ECT 'Understandings' IV.1 (b)(i), explicitly state that "[t]he provisions of the Treaty do not oblige any Contracting Party to introduce mandatory third party access."³⁵ Second, it should be understood that transit is only one of three possible (alongside swaps, *i.e.* replacement transactions, and on-border sales) options to move Energy Materials and Products across the territory of a country that separates a producer and an end-user (Article 7 ECT).³⁶ Therefore, a request from a supplier or end-user, even if backed up by a supply contract made between them, for transit to be provided across the territory of a third country does not constitute for this third

³⁴ As was presented in the earlier publications of the author in his polemics with the ECT opponents. See, for instance, *Andrey Konoplyanik*, Energy Charter Treaty: "To Be Ratified But Not Today ..." (text translated from the original Russian), *Promyshlenny Mir* [Industrial World] 2001, No. 2, 44–48; *id.*, Only One Way to Ratify the ECT: To Reach Agreement, the Objections of the Opposite Party Must Be Understood (text translated from the original Russian), *Neft i Kapital* [Oil and Capital] 2001, No. 3, 8–10; *id.*, 'We Must Ratify Energy Charter Treaty – But Not Yet,' *Russia & CIS Energy Magazine*, April 2001, 6–8; *id.*, Force of Argument or Argument of Force: What Does the Energy Charter Provide for Russia (text translated from the original Russian), *International Energy* [Mirovaya energetika] 2004, No. 6, 50 *et seq.*

³⁵ This is the clause that made it necessary for the author to engage in a long debate with many opponents of the ECT and the discussion of which gives evidence of whether the opponents of the ECT have read the text of the Treaty or not.

³⁶ *Andrey Konoplyanik*, Gas Transit in Eurasia: Transit Issues between Russia and the European Union and the Role of the Energy Charter, *JENRL* 27 (3) (2009), 445, 462–465.

country either a necessary or sufficient condition, let alone an obligation, to provide transit. A potential transit country is entitled to choose – and this will be its sovereign decision – whether to make its territory available for transit or provide either of the two other specified options. A refusal to provide transit across its territory, but with an arrangement offered instead to cross it, say, on the terms of ‘on-border sale,’ will not constitute a breach of ECT provisions. However, if a country takes the decision to provide transit and enters into talks on the arrangements for the provision thereof, the provisions of Article 7 ECT and of the Transit Protocol will apply. However, even when in such talks, the parties may naturally fail to reach an agreement on the terms and conditions of transit – and this will also constitute no breach of ECT provisions because the potential transit country has at least five levels of ‘protection’ for its interests in this matter if it does not want to provide new transit to third parties.³⁷

The ECT says nothing about the duty to grant access to transit facilities for third parties. The Treaty only says that “Each Contracting Party shall take the necessary measures to facilitate the Transit of Energy Materials and Products” (Article 7 (1) ECT) – *i.e.* the existing, rather than new, transit, and “shall encourage relevant entities to co-operate” in the area of transit (Article 7 (2) ECT). Article 7 (4) ECT says that “[...] the Contracting Parties shall not place obstacles in the way of new capacity being established, except as may be otherwise provided in applicable legislation [...]” (and for a country that applies the ECT on a provisional basis – which has been true for Russia up to October 2009 – the national legislation takes precedence over the ECT in the event of conflict of laws). Moreover, Article 7 (5) ECT says that a transit Contracting Party shall not be obliged to permit the construction or modification of transit facilities or permit new or additional transit if it demonstrates to the other Contracting Parties concerned that this “would endanger the security or efficiency of its energy systems, including the security of supply.”

³⁷ This has also been necessary to bring home to ECT opponents on more than one occasion because they, too, apparently neglected to read the Treaty. See *e.g.* *Andrey Konoplyanik*, *Promyshlenny Mir* (note 34); *id.*, *Only One Way to Ratify the ECT: To Reach Agreement, the Objections of the Opposite Party Must Be Understood* (text translated from the original Russian), *Neft i Kapital [Oil and Capital]* 2001, No. 3, 8–10.

Therefore, the ECT does not require to give access to Gazprom's Gas Transportation System; quite the opposite, it enshrines the internationally accepted mechanisms for justified denial of national GTS to new (potential) transit.

B. Common Misconception 2: Obligation for Equal Tariffs

Another complaint about the ECT was that it allegedly requires transit of gas from Central Asia across Russia's territory to be at *subsidised* domestic tariffs for transport.³⁸ Discussions, especially within Energy Charter first multilateral negotiations, and then Russia-EU bilateral consultations on draft Transit Protocol,³⁹ revealed that it was indeed possible, though far from unconditionally, to interpret the provisions of Article 7 (3) ECT as providing for equal tariffs for export, import, transit and domestic transportation.

Such interpretation of Article 7 (3) ECT was put forward, specifically, by the EU delegation – and not only during the talks on the Transit Protocol but also in the course of talks on Russia's accession to the WTO (one of the six points of the so-called '*Lamy package*' of early October 2003).⁴⁰ However, such requirement for equal tariffs in Russia is at least contestable, and is arguably incorrect,⁴¹ all the more so given that (see *infra*) they are not equal even within the EU.

For a long time, the possibility of interpreting Article 7 (3) ECT as if requiring equal tariffs, has provided grounds for ECT ratification opponents in Russia to call for amending the ECT or for an even more radical measure – to start talks on a new

³⁸ Lower domestic transportation tariffs for pipeline gas of Gazprom as the owner of the GTS and its affiliated companies are established by Article 21 ("Regulation of gas prices and tariffs for gas transportation services") of the Russian Federal Law No. 69-FZ as of 31 March 1999 on Gas Supply in the Russian Federation.

³⁹ See author's publications on the issues related to Transit Protocol at his website.

⁴⁰ *Andrey Konoplyanik*, Russia-EU Summit: WTO, the Energy Charter Treaty and the Issue of Energy Transit, *International Energy Law & Taxation Review* 2 (2005), 30.

⁴¹ *Id.*, Russia – EU Summit: Energy-Related Results (text translated from the original Russian), *Neftegazovaya Vertikal* 2004, No. 10, 10–12; *id.*, What Are the Energy-Related Results of the Summit? (text translated from the original Russian), *Neftegaz* 2004, No. 3, 37–42.

Treaty, which was supposed to replace the 'imperfect,' in their opinion, ECT, as a condition for ECT ratification by Russia.

This proposal, however, falls into the category of 'pipe dreams.' The ECT has been an integral part of international law since April 1998, and will remain in full force and effect for the 46 States that have ratified it. One cannot improve the Treaty except after joining it as a full member, *i.e.* after ratification. Therefore the parties eventually opted for another – practical – approach to address the concerns of Russia. First, the Energy Charter Secretariat conducted a study⁴² which showed that five out of the six ECT countries targeted by the comparative review of transit and domestic tariffs had transit tariffs that were higher than the domestic ones, including four EU countries (where, in accordance with the EU delegation's arguments at the talks on the Transit Protocol and on Russia's accession to the WTO⁴³ alike, the transit tariff should have been equal to the domestic ones): Austria 1.9 times, Belgium 2.8 times, Poland 2.4 times, Slovakia 1.3 times (to put this into perspective: Russia, as evidenced by the same study, 1.6 times), with Germany alone having equal tariffs.

The study established that a wide variety of procedures were used for gas transit tariffication. Neither the ECT nor the draft Transit Protocol, however, imposes any specific procedures for transit tariffication. Therefore, the Contracting Parties are free to develop procedures that are the best for their transportation and transit systems as long as these procedures meet the requirements of transparency, recognition of actual costs, and non-discrimination. Therefore, as a solution to the problem in interpreting Article 7 (3) ECT, the draft Transit Protocol proposed an 'Understanding' stipulating that the transit tariffs and domestic transport tariffs are not obliged to be equal (Article 10 of the draft Transit Protocol).

Finally, Central Asian gas is no longer cheap, at least for the buyers. Since 2009, all export gas has been priced both in the EU and in the post-Soviet space using the same methodology – based on the net-back replacement value from EU end-user price, *e.g.*

⁴² Energy Charter Secretariat, *Gas Transit Tariffs in Selected ECT Countries*, January 2006, available at: http://www.encharter.org/fileadmin/user_upload/document/Gas_Transit_Tariffs_-_2006_-_ENG.pdf (accessed on 22 April 2014).

⁴³ See *Konoplyanik*, note 40.

netted back to delivery points at the former EU-CMEA⁴⁴ border in case of Russian gas deliveries to the EU. Central Asian countries find it more profitable to export gas using this pricing formula with the delivery points at their national border rather than arrange for transit supplies to Europe.⁴⁵ As for West-European companies, they have thus lost their economic incentives for buying Central Asian gas directly since 2009 because of the price edge, the so-called 'Hotelling' rent, is no longer available. The latter is the difference between the 'replacement value' of gas in Europe (based on the end-user prices of gas substituting energies which compete with gas), adjusted or netted-back to the border of Central Asian exporting countries (*i.e.* net of the applicable transportation costs), on the one hand, and the export price at the national border of the Central Asian exporting countries, as calculated to the end of 2008 on the principle of 'cost-plus,' on the other.⁴⁶

It is therefore this author's opinion that it makes better sense for Central Asian exporting countries supplying gas to European destinations to sell their gas to their traditional business partners in Russia at their national borders within the infrastructure in place rather than arrange transit for it through Russia and/or sell it to new business partners in Europe, with supplies to be sent through new proposed (not yet completed – and some of them already cancelled, like *Nabucco*) pipelines bypassing Russia through the Southern Corridor.⁴⁷

C. Common Misconception 3: Russia-EU Nuclear Trade

Due to complaints about the ECT, the opponents of its ratification have repeatedly asserted that the Treaty does not regulate bilateral trade in nuclear

⁴⁴ *E.g.* in Waidhaus at the German-Czech or in Baumgarten at the Austria-Slovak border.

⁴⁵ See *Andrey Konoplyanik*, Russian Gas in Continental Europe and the CIS: Evolution of Contractual Arrangements and Pricing Mechanisms (text translated from the original Russian), Institute for National Economic Forecasts of the Russian Academy of Sciences, Open Seminar on Economic Problems of Energy Complex, 99th Meeting, 25 March 2009 (2010); *id.*, 'The Evolution of Gas Pricing, Europe & CIS Energy Economist, Issue 347 (September 2010), 9–10.

⁴⁶ *Ibid.*

⁴⁷ *Id.*, Upcoming Export Strategy Change (text translated from the original Russian), *Neft Rossii* 2010, No. 3, 57–59; *id.*, Russia has Trumped Nabucco in Central Asia, *Petroleum Economist*, September 2010, 24–25.

materials between Russia and the EU.⁴⁸ This being the case, Russian spokespersons have submitted that the situation has been worsening with time: to begin with, prior to 2004 the restrictions applied to the EU consisting of the 15 Member States; from 2004 to 25 Member States, and since 2007 reaching 27 Member States; with now 28 Member States.

The Final Act of the EEC Conference signed in December 1994 (which includes the ECT and documents related thereto) has indeed as its integral part the Joint Memorandum of the Delegations of the Russian Federation and the European Communities on Nuclear Trade. The EU expansion, naturally enough, expands the jurisdiction of the Memorandum. The Memorandum documents states that Russia is interested in increasing the volume of nuclear trade with the EU, and that “[r]epresentatives of the Commission and of the Russian Government will meet in the near future in order to examine the difficulties encountered by Russian exporters of nuclear materials.”⁴⁹ These provisions reflect the essentially bilateral relationship between the Parties and in the event of failure by either Party to be entirely satisfied with the development of the relationship envisioned in the Memorandum, cannot and must not be regarded as a failure of the multilateral Treaty.

Moreover, by signing, six months before the commencement of the signing of the ECT, the Russia-EU Partnership and Cooperation Agreement (PCA) in June 1994, both Parties agreed to regulate the nuclear trade issues on the bilateral basis and PCA provided a framework for addressing the matters of nuclear trade on a bilateral basis. Thus, in this regard, what problems could the ECT cause?

D. Common Misconception 4: Supplementary Treaty on Investment

Another complaint about the ECT is sometimes linked to the situation with the Supplementary Treaty on Investment, the talks on which, according to Article 10 (4)

⁴⁸ *Konoplyanik* (note 22), 11–12.

⁴⁹ Joint Memorandum of the Delegations of the Russian Federation and the European Communities on Nuclear Trade of Annex II to Document CONF 115, 6 January 1995 (not published), sourced from the ECT, 159, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (accessed on 16 April 2014).

ECT, were expected to start immediately after the signing of the ECT with a view to concluding it by 1 January 1998. The complaint was directed against the EU, which arranged for the Supplementary Treaty to be taken off the negotiation table in 1998 and put on hold due to the suspension of work by the Organisation for Economic Co-operation and Development on the Multilateral Agreement on Investment which was in progress up to that time.⁵⁰ The question being raised supposedly shows that Russia was seemingly motivated to resume talks on the Supplementary Treaty, to have it drafted and signed. Two considerations come into play in this context, however.

Firstly, the ECT in place, an integral part of international law, and the as-yet-virtual Supplementary Treaty on Investment are two independent legal instruments. Tying in the completion of work on the Supplementary Treaty with ECT ratification would have made sense, as it was in the case of the Transit Protocol, had it proved instrumental in addressing the matters of vital importance for Russia. It would have made sense to link together the existing ECT and yet-to-be developed Supplementary Treaty if the latter would have moved the EU in the direction to benefit Russia by clarifying the issues which failed to find adequate coverage in the ECT (as did the draft Transit Protocol in elucidating and developing the provisions of Article 7 on 'Transit'). The content of the Supplementary Treaty, however, is predetermined by Article 10 (4) ECT – it is only expected to expand the jurisdiction of national treatment of investment from post-investment (as provided for in the ECT) to pre-investment stages in making the investment which seems not to be in line with the Russia's current energy and investment policy regarding access of foreign investors to the Russia's subsoil onshore and offshore.

Secondly, for quite a number of years the situation with Russia's commitment to the Supplementary Treaty is quite likely to be the reverse: the Russian domestic legislative scene suggests that the nation is not ready to apply the national treatment of investment at the pre-investment stage. The revised Law on the Subsoil, the Foreign Strategic Investments Law, the Continental Shelf Law, among others, bring it home in no uncertain terms.

⁵⁰ *Konoplyanik* (note 22), 9, 12.

E. Common Misconception 5:
ECT Does not Permit Long-Term Contracts

This objection of ECT opponents, if made in good faith, is a result of their misunderstanding of market development trends and of mixing together (considering as synonyms) ECT and EU *acquis* through the whole period of ECT existence until the present time.

One should distinguish the period before and after 2003. Before 2003, when the First EU Energy Package was in force, there was a full correlation between ECT and EU *acquis*. After the Second EU Energy Package came into force in 2003, deviation (qualitative gap) between ECT and EU energy *acquis* took place which was further broadened when the Third EU Energy Package⁵¹ became applicable within the EU from 2009.

Thus, if any criticism exists towards the ECT based on EU actions and statements, this would be valid only for the period prior to 2003. Afterwards such criticism can only be addressed towards the EU as a Contracting Party to the ECT.

Prior to Second EU Gas Directive, the targeting of long-term contracts would not be pragmatic, as they were, are and will be an important and essential element of contractual arrangements in the gas market.⁵² If ECT opponents entertained the notion that the EU had intended to make a special effort to scrap such contracts by unilateral administrative actions or introduce at its discretion amendments to this effect to the long-term contracts in place between Gazprom and its European counterparts, then either the EU intentions were misinterpreted or (if the EU

⁵¹ The Third EU Energy Package consists of two Directives and three Regulations: (1) EC Directive 2009/72 of 13 July 2009 concerning Common Rules for the Internal Market in Electricity and Repealing Directive 2003/54/EC, OJ 2003 L 211, 55; (2) EC Directive 2009/73 of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC, OJ 2009 L 211, 94; (3) EC Regulation No. 714/2009 of 13 July 2009 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity and Repealing Regulation (EC) No. 1228/2003, OJ 2009 L 211, 15; (4) EC Regulation No. 715/2009 of 13 July 2009 on Conditions for Access to the Natural Gas Transmission Networks and Repealing Regulation (EC) No. 1775/2005, OJ 2009 L 211, 36 and (5) EC Regulation No. 713/2009 of 13 July 2009 on Establishing an Agency for the Cooperation of Energy Regulators, OJ 2009 L 211, 1.

⁵² See e.g. *Andrey Konoplyanik*, Development of Gas markets, Long-Term Contracts and Energy Charter Treaty (text translated from the Russian original), *Neftegaz* 2002, No. 4, 25–33; *Kim Talus*, Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law (2011).

intentions were interpreted correctly) the intentions were based on erroneous notions of market dynamics on the part of the EU entities involved.

But in 2002 Russia and the EU made a joint statement that:

Providing a secure legal framework and regulatory environment for the supply of gas is of fundamental interest to both the E.U. and Russia. [...] Both the E.U. and Russia consider that these [long-term gas] contracts have not only underpinned investments in Russia in new capacity in the past, but will remain necessary in the future. The [European] Commission has made it clear that long-term take-or-pay gas contracts are indispensable. The [European] Commission will, together with Russia in the context of the dialogue, closely monitor the developing situation, and the Commission is determined to ensure that contractual and regulatory conditions continue to exist that enable the financing of the major investment necessary to ensure future E.U. gas security of [supplies].⁵³

Therefore, the perceived conflict over long-term contracts between Russia and the EU within the period when ECT was equal to EU rules and thus when ECT could have been criticised for EU faults by the ECT opponents, can be considered as invalid.

Presently, the whole gas market in the EU suddenly changed since 2009 its major characteristic features (transformation from undersupplied to oversupplied) due to a number of reasons,⁵⁴ with the Third EU Energy Package coming into force in the same period, a radically new architecture of the EU gas market (entry-exit zones with virtual trading points in each zone) was established, which really puts under question the continuation of the existing models of long-term gas export contracts with petroleum product price indexation. Therefore all the claims regarding these issues should be addressed directly to the EU and no longer to the ECT.

F. The Media as the 'Collective Disorganiser'

The Charter and its instruments are now, not as often as in the past, mentioned in the media on a regular basis, including in the headlines of broadsheets. However, the

⁵³ EU-Russia Energy Dialogue, Second Progress Report – Presented by Russian Vice-Prime Minister *Victor Khristenko* and European Commission Director-General *François Lamoureux* (2002), Section II.3: Legal Security for Long Term Supplies, available at: http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/progress2_en.pdf (accessed on 18 April 2014).

⁵⁴ See for instance *Andrey Konoplyanik*, Russian Gas in Europe: Why Adaptation is Inevitable, *Energy Strategy Reviews* 1 (1) (2012), 42–56.

Western and Russian media alike are quite often guilty of loose, for example, with respect to "freedom of transit," and/or incorrect interpretation of ECT provisions, for example, with respect to the required provision of transit rights or access to the subsoil for foreign investors. Or they continue to rehash the old-hat arguments of opponents of ECT ratification by Russia put forward by them many years ago and long rebutted by its advocates, for example, with respect to the ECT's alleged requirements for privatisation of the fuel-and-energy sector and/or unbundling of energy companies, or granting of mandatory third-party access, or its alleged agenda of abolishing long-term contracts. All this brings about are imaginary problems and phantom pains. The result is that in their effort to nudge the process of ECT ratification by Russia, the media often use incorrect or spurious arguments as if in support of the ECT, more often than not, thus, rendering it a disservice.

In the Western media, quotes by European politicians urging Russia to ratify the ECT were normally accompanied by comments, including ones provided by the media themselves, extolling the benefits that ECT ratification by Russia would give to the West. Quite a lot of such comments suggest that the Charter's scope and the Treaty's relation to it are misunderstood. It is quite unfortunate that such comments often misrepresent, intentionally or unwittingly, the provisions of the Treaty – for example, in matters that are of special interest or concern to Russia and Gazprom, bearing as they do on energy transit or access to export pipelines (see *supra*, V. A., V. B.). ECT misinterpretation, presented as the 'real McCoy', and flying in the face of stated priorities of Russian energy policy, provoked a quite-predictable backlash in Russia – in political and business circles alike.

For its part, in covering the debate centred on the ECT, the Russian media quite often simply reprinted the idle speculations in the Western media, sometimes taking them to a level that was bizarre and inaccurate.

Whereas, some Russian politicians, without the legal 'know-how' required to understand a document such as the ECT, spoke vehemently against its ratification in their drive to be more 'royalist than the king' and gain 'political capital' in the "struggle to protect national interests," usually responded to the media, supplying them, in turn, with opportunities to quote 'authorities', giving rise to a vicious circle. In this way, the focal point of the debate about the ECT shifted in point of fact into

a kind of virtual space, where hot discussions centred on provisions allegedly present in the ECT but in actual fact absent from it. What is unfortunate is that this 'virtual scene' created the informational background that prompted Russia to make its decision to roll back provisional application of the ECT.

VI. Russia's Criticism of the ECT: 2009 Timeline and the Resulting Termination of the Provisional Application

Nevertheless, the criticism levelled at the ECT by Russia's leadership, resulting in the termination of the provisional application of the ECT, was sparked off not by the complaints about the ECT that had been voiced on more than one occasion but by the January 2009 Russian-Ukrainian gas crisis.

The criticism of the ECT and Energy Charter by the Russian leadership was ratcheted up over January to June 2009. The first serious shot against the ECT was fired at this level in the course of Russian-Ukrainian gas crisis in January. The criticism was triggered by Ukraine's infringement of the ECT transit provisions, absence of an adequate assessment of the breach by the European Union and its member States and inaction by the political leadership of the Energy Charter Secretariat before and during the Russian-Ukrainian gas conflict.

On 20 January 2009, during a meeting with the Gazprom Chairman of the Board, *Alexei Miller*, the then Russian President *Medvedev* expressed criticism of the Energy Charter for its failure to prevent the Russian-Ukrainian gas crisis that ended the day before and called for "new international mechanisms." The President urged "to think about either amending the Energy Charter in place [if allowed by the signatories] or drafting a new multilateral instrument [...]." The President invited the Government and Gazprom "to think about what mechanism would make sense in this context to develop and offer to all members of the international community." The President promised to table a number of ideas during the London meeting of the G20 in early April of that year.⁵⁵

⁵⁵ *Andrey Konoplyanik*, Energy Charter and the Russian Initiative – Future Prospects of the Legal Base of International Cooperation, OGEL, Special Issue on EU-Russia Relations, No. 2 (2009) 2, *et seq.*, available at: <http://www.ogel.org/article.asp?key=2872> (accessed on 16 April 2014).

Having voiced harsh criticism against the Energy Charter, levelled against the then political leadership of the Energy Charter Secretariat, the Russian President nevertheless outlined an alternative course of action: either revamp the Charter (on a large scale) or draft a new document. On 1 March 2009 in an interview with the Spanish media, the President proposed to “develop a new Energy Charter or a new version of the Energy Charter,” in that way confirming the either-or nature of the proposal.⁵⁶ It should be noted, that the then Russian President (now Prime-Minister) *Medvedev* has regularly and constantly referred to his legal background, thus it could be assumed that the difference between the non-legally binding Energy Charter (political declaration) and legally-binding Energy Charter Treaty was clear.

In late April 2009, however, the import of the presidential intentions changed. On 20 April 2009, while in Helsinki, President *Medvedev* said that “Russia intends to change the legal framework for its relationship with energy users and transit countries.” Speaking about the “Energy Charter and other documents,” the former President said that “we have not ratified these documents and do not consider ourselves bound by these decisions.”⁵⁷ President *Medvedev* also indicated that “[...] a framework document which covers matters of international cooperation in energy,” would be disseminated.⁵⁸

The following day, 21 April, the official website of Russia’s President posted the aforementioned ‘framework document’.⁵⁹ This was a five-page “conceptual approach to a new legal framework for international cooperation in energy [objectives and principles].”⁶⁰

⁵⁶ TVE/El Pais, Europe Needs New Energy Charter – Medvedev, Interview of *Dmitry Medvedev* with Spanish journalists, 1 March 2009.

⁵⁷ *Konoplyanik* (note 55).

⁵⁸ 1TV.ru, News Report, 30 October 2009, available at: <http://www.1tv.ru/news/polit/142214> (accessed on 22 April 2014).

⁵⁹ Official website of the President of Russia, Framework Document, 21 April 2009, available at: <http://news.kremlin.ru/news/3812/print> (accessed on 22 April 2014).

⁶⁰ For a critical analysis of the Conceptual Approach and its relation to the ECT, refer, for example, to the following publications by the author: see *Andrey Konoplyanik*, Energy Charter and the Russian Initiative: What To Do With the Legal Framework for International Cooperation (text translated from the original Russian), *Vremya Novostey* (News Time), 28 April 2009; *id.* (note 55); *id.*, Energy Charter Plus – Russia to Take the Lead Role in Modernizing ECT?, OGE 7 (2009), 5 August 2009 (reprinted in: OGE 7 (December 2009), N4); *id.*, Russia’s Termination of Provisional Application of the ECT:

The April initiative of then Russia's President naturally changed the 'alternative' nature of criticism against the ECT, to improve the Charter process and its instruments or develop a new package of documents, to a 'zero-option' approach. After 21 April 2009, the Russian government gave voice to the second option only – to develop a new package of documents based on the Russian proposals. The Russian proposals to set up new system *in lieu* of the ECT, however, aroused little if any enthusiasm among potential partners. Brussels and certain EU members said that abandoning the Energy Charter was out of the question.⁶¹ And that made sense. After coming into effect in 1998, the ECT has become part of the system of international law, having been signed by 51 (now 52) countries and ratified by 46.

Nonetheless, on 28 April 2009, in Sofia, the then Russian Prime Minister *Putin* said that

unfortunately, the Energy Charter [...] has failed in its role. The Russian Federation considers, and has always said before that we do not consider ourselves bound by this instrument because we have not ratified it. And today we can say exactly and definitively that we see no point in even keeping our signature on this instrument.⁶²

On 5 June 2009 in St Petersburg, the then Russian President *Medvedev* reiterated the Russian position that the Energy Charter is incapable of dealing with all problems in international gas trade. President *Medvedev* continued by asking, "was this Energy Charter of any help in the course of the gas conflict early this year?" and stated that "the procedures set forth in this Charter failed; the incentives it offers failed," and concluded by saying that "the Energy Charter Treaty was not applied," and "this means that we must have some other framework to smooth over conflicts of this nature."⁶³

Mythical Threats Prove Stronger than Tangible Benefits? (text translated from the original Russian), *Neft i Gaz*, November 2009, No. 9, 32–35 (Ukraine).

⁶¹ See *supra*, note 57.

⁶² *Vladimir Putin* and Prime-Minister of Bulgaria *Sergei Stanishev* made statements for the press on results of the intergovernmental talks, 28 April 2009, available on the Website of the Prime-Minister of the Russian Federation.

⁶³ Statement by President *Medvedev*, 5 June 2009, available at: <http://www.rian.ru/economy/20090605/173397918.html> (accessed on 22 April 2014).

On 29 June 2009, in the course of an inter-ministerial working meeting chaired by then Vice Premier *Igor Sechin*, its attendees were informed that (despite objections from all major agencies) it had been decided to terminate the provisional application of the ECT by the Russian Federation.

Hence, on July 30, 2009, the then Russian Prime Minister *Putin*, signed Government Order No. 1055-r terminating the provisional application of the ECT by the Russian Federation. On August 24, 2009, pursuant to Article 45 (3)(a) ECT, Russia notified the depository of the Treaty (the government of Portugal) in writing that it did not intend to become a Contracting Party to the ECT. Sixty days later, Russia ceased to be a party applying the ECT on a provisional basis. On 19 October 2009, it became (along with Australia, Iceland and Norway) an ordinary signatory of the Treaty (while Belarus stays the only one ECT signatory applying it on a provisional basis), *i.e.* it took a step back, as it were, nevertheless remaining a party to the Treaty and the Charter process.

At present, internationally, there is no alternative to the ECT. So, rather than being abolished, it should be continually improved in line with the development of global energy markets, as envisioned by the December 2004 resolution of the Energy Charter Conference.

It is hoped that Moscow's discontinued provisional application of the ECT would not be viewed as a proverbial 'burning of bridges' because the Russian delegation said in a statement made at the twentieth session of the Energy Charter Conference in Rome on 9 December 2009 that "despite terminating the provisional application of the Energy Charter Treaty (ECT), Russia considers the ECT an important multilateral agreement in the energy area."⁶⁴ Moreover, Russia's signature is still placed under the ECT. So, what are the implications of Russia's termination of the provisional application of the ECT?

⁶⁴ Statement by Russian Delegation at the 20th Session of the Energy Charter Conference in Rome, 9 December 2009, available at: http://www.encharter.org/fileadmin/user_upload/Conferences/2009_Dec/Russia_RUS.pdf (accessed on 22 April 2014).

VII. General Conclusions

A. Effects of the Termination of the Provisional Application

First, by terminating the provisional application of the ECT, Russia played into the hands of anti-Russian interests in global politics, with critics stating that Russia had confirmed its reputation as a country seen to flout the rule of law.⁶⁵ In economic terms, this perception will increase the risks of lending to Russia, push up the cost of raising capital under credit lines opened to the country, and cut the volume of financing. In the final analysis, this will increase the financial costs of (*i.e.* raising capital for) investment projects in the Russian energy sector.

Second, the ECT is the only multilateral instrument available for protecting and encouraging investment in the most capital-intensive and high-risk area of business, energy. As time goes by, the ECT increasingly protects not only foreign investment in Russia but would have also protected, in the event of ECT ratification by the parliament, Russian investment abroad, first of all against the 'risks of liberalisation' in the EU market, which has increased following the enactment of the EU's Third Energy Package, of which a number of its provisions are viewed by many observers as anti-Russian.⁶⁶ The ECT is believed by the Russian party to be inadequate in protecting the interests of producers, a thesis that at the very least needs to be proved, particularly in the context of other instruments for protecting and encouraging investment in the energy industry. As things stand now, however, the ECT is the highest multilateral legally binding compromise achieved by the international community. And incidentally, the ECT will continue protecting European companies against anti-investment measures of the EU Third Energy Package, and not the Russian ones.

Third, Russia's withdrawal from the ECT will not bring about the collapse of the treaty. Its positive aspects, *i.e.* as a risk reduction mechanism, will simply be used by

⁶⁵ See, for instance, *Emmanuel Gaillard*, Russia cannot walk away from its legal obligations, *Financial Times*, 18 August 2009.

⁶⁶ Like Article 11 "Certification in relation to third countries" of the Third EU Gas Directive which it often called an 'anti-Gazprom' clause.

other countries whose costs of financing of their energy projects will go down *vis-à-vis* Russia, giving them a competitive edge. By its failure or unwillingness to ratify the ECT (and thus to come in full under its protective umbrella), Russia will, firstly, widen the gap in the level of competitiveness between the Russian investment projects in the energy industry and the competing projects in third countries and, secondly, staying outside, will be unable to influence the rules in this field to accommodate its interests. It may face the same situation as with GATT/WTO in 1947 when the USSR was invited to be involved in developing the rules for global trade, but Joseph Stalin, the then leader of the Soviet Union, declined since it was fairly expected that the USSR would not manage to dominate the process and thus would be one among equals. The GATT rules were then developed without Russian (Soviet Union) involvement and with no regard for its interests. Therefore, it took post-Soviet Russia nineteen years to join this global union that had been set up without its involvement. It seems that with regards to the ECT, the current Russian authorities have adopted the same approach as USSR authorities did with GATT almost 70 years ago.

Fourth, Russia's abandonment of the ECT does not mean that by this it will succeed within the foreseeable future in arranging the development of an alternative and more effective multilateral instrument. The window of political opportunity that enabled the fast completion of talks and signing of the ECT in the early 1990s has dramatically narrowed today. The current conditions being what they are, the ECT, even as it reads now, will most likely not have been signed. The proper course of action would have been to continue the efforts to gradually improve the multifaceted process of the Energy Charter and its instruments. For this, as noted above, the charter process has inbuilt adaptation mechanisms (see *supra*, Table 1).

The absence in the ECT of a mechanism for effective prevention of crisis situations and fast resolution thereof, as well as inaction by the political leadership of the Energy Charter Secretariat in the run-up to the January 2009 Russian-Ukrainian gas crisis, should have been used not as an excuse to terminate the provisional application of the ECT but to launch and spearhead the process of upgrading the Treaty, by proposing, among other things, to add a new agreement (Protocol) to it, which would have been more beneficial as it had already been drafted by Gazprom at

that time. Instead, Russia signed an agreement with the EU to prevent – by early warning – emergency situations in transit on a bilateral basis.⁶⁷ However, it seems unlikely that the mechanism for the prevention of emergency situations in transit will work effectively without the involvement of transit countries. That said, the mechanism proposed by Russia (an Early warning Mechanism) could have been used as a starting point for developing at next step a functional mechanism within the framework of a multilateral forum of producing and consuming countries and transit States. Especially given that the Energy Charter is the only such forum that is based on a multilateral framework of international law in place.

Fifth, the abandonment of the ECT today will not bring about its substitute. This means that the abandonment of the ECT will, on the one hand, create for Russia a legal vacuum – lack of adequate legal infrastructure – in the most high-risk area of business. On the other hand, after the ECT came into effect in 1998 and while it was provisionally applied by Russia, many Russian ministries and agencies started to use the statutes of the ECT as benchmarks in their rule-making, for example, the Federal Anti-Monopoly Service. Having abandoned the ECT, Russia will nevertheless hang on to its legacy which has been to some extent already incorporated in the Russian legislation. Will Russia have to patch up its legislation, generating additional investment risks – which is always a result of any revision of any laws, however good the intentions of the legislator, whether in Russia or in Europe – when what investors need first and foremost are rules that remain the same?

Sixth, Russia's statement that it does not intend to become a Contracting Party to the ECT either suspends the completion of the Transit Protocol or (as was the case with GATT/WTO) will cause it to be finalised with no regard for Russia's legitimate concerns. The bottom line is that the nation will have no legally binding multilateral instrument (or none that it can accept) for transit, considering that the Transit Protocol was an instrument Russia insisted upon and which took more than ten years to produce.

⁶⁷ Memorandum on an Early Warning Mechanism in the Energy Sector within the Framework of the EU-Russia Energy Dialogue, available at: http://ec.europa.eu/energy/international/russia/dialogue/warning_en.htm (accessed on 12 May 2014).

At the same time, by proposing the documents published on 21 April 2009⁶⁸ “to all intents and purposes as a replacement for the Energy Charter” (*Arkady Dvorkovich*, Russian Deputy Prime Minister),⁶⁹ Russia thus *de facto* proposes to build two parallel systems for legislative regulation of international energy trade, both of which, as is evident from the analysis of new Russian proposals,⁷⁰ are being constructed on the principles of the Energy Charter and fully consistent with its purposes. It would seem, however, that one and the same foundation cannot be used to put up two different buildings at the same time, or, more precisely, to build another house on the foundation of an existing house as an annex thereto. It is very doubtful that Russia will succeed in motivating other countries to start a new negotiation process, focused on practical results, from scratch based on the new Russian proposals. Nevertheless, the international community could accept Russia’s proposals as a starting point to bring the multifaceted Energy Charter in line with new circumstances “in order to reflect new developments and challenges in international energy markets” – the requirement set forth in the Conclusions of the 2004 Political Review of the Charter process.⁷¹ This has really happened within the Energy Charter Process.

B. To Destroy or to Upgrade?

So, a number of complaints made by the Russian leadership about the process of the Energy Charter and the ECT as its core legally binding instrument are perfectly reasonable: the Treaty has provisions that are ambiguous in their interpretation; the ECT is not enforceable in some areas it covers; the ECT has no mechanisms to force the Contracting Parties to perform the obligations assumed; to quickly and effectively prevent and resolve on a multilateral basis emergency situations in energy; to impose prompt and effective sanctions for a breach of the provisions of the ECT. All these

⁶⁸ Translated from Russian, see Website of the President of Russia, Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles), 21 April 2009, available at: <http://archive.kremlin.ru/text/docs/2009/04/215303.shtml> (accessed on 18 April 2014).

⁶⁹ Website of the President of Russia, Press Conference, 21 April 2009, available at: http://news.kremlin.ru/ref_notes/186/print (accessed on 22 April 2014).

⁷⁰ See *supra*, note 60.

⁷¹ ECT, Final Review Conclusions (2004), available at: http://www.encharter.org/fileadmin/user_upload/document/Final_Review_conclusions_rus.pdf (accessed on 22 April 2014).

assertions are quite fair. However, the call for the ECT to be abandoned and for a new instrument to be developed to replace it is the least effective way to address the reasonable complaints of the Russian party about the Energy Charter, even if abandonment is a feasible option.

The April 2009 Russia-proposed Conceptual Approach⁷² cannot be treated as an alternative to the ECT, but the international community may in all likelihood accept it as an opening bid for improving the process of the Energy Charter as the only versatile mechanism for legislative regulation of international relations in energy.

Once every five years, pursuant to Article 34 (7) ECT, a Review is conducted of the Energy Charter activities and a discussion is held dealing with the progress made in adapting it to the new conditions in energy markets (see *supra*, Table 1). Decisions based on the results of the latest Review were made in late 2009. That Review presented a good opportunity to make a great number of demonstrable changes in, and additions to, the Energy Charter process and instruments, which would have made it possible to meet Russia's legitimate concerns.⁷³ This could not be done without active involvement in the adaptation process. What seems to have happened, however, is that Russia jumped the gun on the ongoing decision-making process. Thus, with a Russian government edict to terminate the provisional application of the ECT not yet signed, it has already brought to a halt all government activities necessary to continue, or increase the involvement of the Russian delegation in the Energy Charter process, including to promote within the framework of the Charter process the April 2009 presidential proposals aimed at enabling Russia to take point on the adaptation of the Charter process.

C. Conclusion: Energy Charter – A Lost Opportunity?

Russia could have offered the Charter community a roadmap that would have implemented the presidential proposals of 21 April 2009 as part of the Energy Char-

⁷² Website of the President of Russia, Conceptual Approach, 21 April 2009, available at: <http://news.kremlin.ru/news/3812/print> (accessed on 22 April 2014).

⁷³ See ECT, Energy Charter Process Review, available at: <http://www.encharter.org/index.php?id=22&L=1> (accessed on 22 April 2014).

ter process. Up to the release of the government edict of 30 July 2009, the informal draft roadmap for reforming the Energy Charter process, known as the "Energy Charter Plus,"⁷⁴ was discussed informally with some of the key players in the process, and through them with spokespersons for some European States, supported by the States in principle.

The next step forward would have been to develop a detailed game plan based on the Russian proposal of 21 April 2009. The plan could have become part of a balanced package solution at the next Energy Charter Conference in December of 2009. Such a solution would have accommodated Russia's legitimate concerns about the Energy Charter. Naturally enough, it would have had to be ironed out with other countries in short order, for it to be finalised by December of that year. Any progress, however, was effectively stopped by the Russian government edict of 30 July 2009.

Generally speaking, the termination of provisional application of the ECT does not prevent Russia from joining forces with other countries in implementing the Energy Charter Plus roadmap. Norway, for example, which has also signed the ECT but does not apply the Treaty on a provisional basis, is making a strong contribution to the Charter process.

A quick reverse in Russian attitude towards the Energy Charter may be too optimistic. But at least some positive signs can be viewed in what should have reflected the *modus operandi* of Russia's bureaucracy since it always tries to react to and reflect the changing intentions of the State leaders. Russia for long could not have managed (or would not have liked) to settle its arrears for membership in the Energy Charter process, at least for the full period of its provisional application of the ECT. Finally, not least due to the efforts of the new ECS Secretary General *Urban Rusnak*, the country has done this recently, though at this stage only for the period through its provisional application of the ECT.

However, Russia remains a signatory to the ECT; therefore, all Russia's valid complaints remain on the table, as do the accommodations made for them.

⁷⁴ The Energy Charter Plus roadmap is described in *Konoplyanik*, *Neft i Gaz* (note 60), 32–35 (Ukraine); *id.*, *Energy Charter: Why Russia Takes a Timeout* (text translated from the original Russian), *Mezhdunarodnaya Zhizn* 2010, No. 1, 27–44; *id.*, *Why Is Russia Opting Out of the Energy Charter?*, *International Affairs* 56 (2) 2010, 84.

Therefore, nothing prevents Russia in its new status from rethinking the matter of ECT ratification later on. What is important, is to continue its involvement in the Charter process and work for it to incorporate the April 2009 presidential proposals, rather than presenting them as an alternative to the multilateral instrument of international law in place – the only multilateral treaty to protect and encourage energy investment, trade and transit, improve energy efficiency and resolve disputes, for which no substitutes are available. Rather than spurning it, what is needed is to pool efforts to improve, perfect, upgrade, and expand the scope and territorial jurisdiction of this unique Treaty and the entire multifaceted Energy Charter process. All the more so as the latest statement by then Russian President *Medvedev* on the Charter subject, made in the course of the press conference following the Russia-EU Summit in Stockholm 18 November 2009, that the April 2009 “energy initiative [...] was proposed by Russia *in addition* to the existing energy instruments including the Energy Charter,”⁷⁵ rather than *in lieu* of the ECT and instruments related thereto, seems to have opened up new prospects for consolidating the processes involved.

It is only by remaining closely involved in the Energy Charter process that the desired results can be achieved: Russia’s legitimate concerns addressed, the multifaceted Energy Charter process improved and its instruments adapted to new challenges and risks of the evolving international energy markets. This multifaceted adaptation process is on the way now, culminating in the January 2014 formal opening of negotiations on the updated Energy Charter by signatories of the EEC.⁷⁶

On 29 April 2014 negotiations opened on updating 1991 Energy Charter – the political declaration underpinning the whole Energy Charter Process. The original Charter signatories were joined in Brussels by representatives of a further thirty countries. It is expected that the updated Energy Charter will be adopted in early 2015.⁷⁷ The negotiations are another step in the ongoing modernisation of the

⁷⁵ Website of the President of Russia, Transcript of Press Conference, 18 November 2009, available at: <http://news.kremlin.ru/transcripts/6034/print> (accessed on 22 April 2014).

⁷⁶ See Energy Charter Secretariat, Energy Charter 2013 Annual Report (2014), available at: http://www.encharter.org/fileadmin/user_upload/Publications/AR_2013_ENG.pdf (accessed on 22 April 2014).

⁷⁷ See ECT, Negotiations Begin on the Updated Energy Charter, 30 April 2014, available at: http://www.encharter.org/index.php?id=19&cid_article=503&L=0 (accessed on 9 May 2014).

organisation aimed at widening its geographic scope and strengthening its framework for cooperation. But this new stage of the Energy Charter development cycle is the topic for another analysis.

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