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by A.A. Konoplyanik

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Energy charter and the Russian initiative

(Future prospects of the legal base of international cooperation)[1]

Dr. Andrey A. Konoplyanik

On April 20, 2009, Russian President Dmitry Medvedev declared in Helsinki that "Russia intends to change the legal base for relationships with energy consumers and transit states." The next day "Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)" in five pages was published on the official Kremlin's website.[2]

Arkady Dvorkovitch, the Aide to the President of the Russian Federation, who most probably was in charge of preparing this "Conceptual Approach…", explained that the document may substitute the Energy charter (see *Vremya novostey* of April 22, 2009). "We are not satisfied with the Energy Charter and the documents, comprising the system of the Energy Charter in its present state... There is a need for a new international legal base", Dvorkovitch pointed out and recalled that Russia has signed the Charter, but yet not ratified it. "That means that we do not consider ourselves bound by this Charter... Regarding the Energy Charter Treaty, we do not consider ourselves bound by the obligations under this treaty either. These documents in fact did not apply to us", Dvorkovitch said.

Unfortunately, these assertions appear vulnerable and they may be disputed. 51 countries and two collective organizations (EU and Euratom) have signed the legally binding Energy Charter Treaty (ECT). Meanwhile, Russia and four other countries did not in fact ratify it. However, under Article 45 of ECT (Provisional application) Russia, along with Belarus, applies the treaty provisionally, that is "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations". The Treaty entered into legal force on April 16, 1998 and, since then, constitutes an integral part of international law, for Russia as well. As a matter of fact, Russia is bound by the ECT, but only to the extent its provisions do not come into inconsistence with national legislation.

This is quite obvious, and the statement about our country not being bound by the corresponding documents can be used by Russia's opponents as an argument to throw discredit on the adequacy and legal relevance of Moscow's position.

Let us suppose that Russia is debating the possibility of declaring the termination of the provisional application under Article 45(3)(b) of the ECT, in other words, about the intention not to become a Contracting Party to the Treaty. If this is the case, the negative consequences of such a declaration for Russia and its administration are quite obvious, whereas there are no convincing arguments in favor of it, in our opinion.

Consequences of withdrawal from the ECT

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[1] Originally published in Russian in Russian newspaper Vremya Novostey (The Time for News) on April 28, 2009.

[2] Also available at the OGEL Legal & Regulatory database, http://www.ogel.org/legal-and-regulatory-detail.asp?key=3212

Firstly, by declaring its intention not to become a contracting party and to withdraw from provisional application of the ECT, Russia will play into the hands of the anti-Russian political forces, which will repeatedly label Russia as a country that does not respect the rule of law.

Secondly, the ECT is the only multilateral instrument of investment protection and promotion in the most capital intensive and risky business field – the energy sector. In the course of time the ECT increasingly protects not only foreign investments in Russia, but also Russian investments abroad (in case of ECT ratification by the Russian Parliament), in the first place, from "liberalization risks", aggravating in the EU market in the context of certain anti-Russian provisions of the Third Liberalization Package, adopted recently by the European Parliament in its second reading.

Thirdly, the ECT is an integral part of international law since 1998. Russia's non-participation in the Treaty will not lead to its termination. It's only that other countries will enjoy its advantages due to a reduction of the costs of financing of their energy projects against Russian ones and thus increased competitiveness of their energy projects against Russian ones.

Fourthly, Russia's repudiation from ECT does not mean that our country will succeed in creating an alternative and more effective instrument in the foreseeable future. The window of political opportunities is much more narrow today than at the beginning of the 1990s when it lead to rapid completion of negotiations and signing of the ECT. On the other hand, it is most possible and necessary to work, consistently and on well-argued basis, on further improvement of the multifaceted Energy Charter process and its instruments. That must be the objective of all initiatives arising in connection with the ECT, and the Charter process provides for that through its incorporated adaptation mechanisms. The lack of effective crisis prevention and quick conflict resolver mechanisms in the ECT (this is a justified statement), along with the inaction of the Energy Charter Secretariat political leadership at the threshold of the January 2009 Russia-Ukraine gas crisis, provide a basis for initiating modernization of this part of the treaty by supplementing it with a corresponding agreement.

Finally, the EC system of international treaty-making with the third-party states is arranged so that it is extremely difficult, not to say impossible, to reach an agreement with the EU on the terms, which are not obviously compatible with European law. The EU has been exporting its legislation through its system of international treaties. Today only the ECT gives an opportunity to stand up to this trend. At the beginning of the 1990s, simultaneously with the negotiations on the ECT, the EU was preparing its first Directives on energy (adopted in 1996 and 1998); there are no principle disagreements between these Directives and the ECT. After adoption of new, more liberal second EU Directives (2003) and the expected adoption of even more radical third Directives (foreseen in 2009), the gap between the ECT and European energy law in the level of liberalization of the "open and competitive markets" will increase dramatically. This being the case, the ECT is an integral part of the EU legislation.

ECT application is based on the "minimum standard" principle, which means that every country can proceed further in its national legislation - than it is required to

under the ECT - in respect of competition, liberalization and non-discrimination levels, but cannot require the same from other member-states of the ECT, based on ECT provisions. Repudiation of the ECT under these circumstances will deny the possibility of non-member countries negotiating a “new global energy order” with European countries on the terms different from those provided for in the EU legislation.

Transit: common fallacy

The pet subject of ECT ratification opponents and supporters of the treaty's repudiation is Chapter 7, dedicated to transit.

In the course of Parliamentary Hearings on ECT ratification in January 2001, the State Duma came to the reasonable and legally feasible decision, that Russia’s justified concerns in connection with the ECT transit provisions could be resolved by executing a separate, legally binding Energy Charter Protocol on Transit (the negotiations on which started in 2000). During bilateral consultations on the draft Transit Protocol, Russia’s and EU’s experts have worked out special, mutually acceptable Understandings with regard to the relevant provisions of this ECT article which were agreed upon at multilateral level.

Russia’s declaration about non-participation in the ECT will block the completion of the Transit Protocol without prospects of resumption. As a result, Russia will not obtain the necessary and acceptable multilateral legal instrument of transit regulation, which it has been enforcing and which took over ten years of preparation.

In respect of the ECT, some politicians often express fear that in case of direct gas supply contracts between Central Asian producers and European customers, the ECT will bind Russia to permit access to its gas transportation system for cheap Central Asian gas for its transit at low Russian domestic transportation tariffs As a result, after its transportation through the territory of Russia, gas from Central Asia will compete with Russian gas in the European market and will gain a competitive edge (pricewise).

This is a common fallacy. The ECT does not stipulate the need to permit access to transit facilities for third-party countries. The Treaty sets forth that “each Contracting Party shall take the necessary measures to facilitate the Transit…” (Art.7-1) which means the existing transit, not a new one, and it "shall encourage relevant entities to cooperate" in the sphere of transit (Art.7-2). “… the Contracting Parties shall not place obstacles in the way of new capacity being established, except as may be otherwise provided in applicable legislation…” (Art.7-4), and for the country, applying the ECT provisionally, national legislation has priority over the ECT in case of conflict of laws. The transit country which is the party to the Treaty shall not be obliged to permit the construction or modification of its transit systems or to allow new or additional transit, “which it demonstrates to the other Contracting Parties concerned would endanger the security or efficiency of its energy systems, including the security of supply” (Art.7-5). In total, the ECT stipulates five levels of proved protection for the transit country of its interests if it does not want to allow new transit through its territory for the third states.

Thus, the ECT does not state as mandatory the grating of access to Gazprom’s GTS;

on the contrary, it provides internationally approved mechanisms for justifying denial of access to national GTS for a new (potential) transit. Moreover, within the Energy Charter framework the issue of correlation of transit tariffs and domestic transportation ones has been resolved at the expert level in the course of Transit Protocol finalization (and now it waits for approval at political level).

It should be remembered also that Central Asian gas is no longer cheap. Since January 2009 export gas price formation both in the EU and in the post-Soviet area is based on the net back to delivery points from replacement value of gas at the EU market. Selling Central Asian gas at a formula price at their external borders is a more profitable export scenario for these countries compared to transit by themselves of their gas to Europe. In the former case, the Central Asian exporters receives at their external border the highest marketable price (based on the EU values); and there is no need in transit through Russia. Moreover, it is Gazprom who transits the gas purchased in Central Asia through the territories of Uzbekistan and Kazakhstan and who faces corresponding costs and risks. In the latter case, Central Asian countries will have to bear costs and risks related to transit without having additional benefits.

There was also criticism of the ECT because of the YUKOS case: allegedly, the Energy Charter gave grounds for lodging a claim against Russia arising out of the YUKOS case and supported by the provisions of the ECT, and we should eliminate such a possibility in the future by withdrawing from the ECT. However, in the event that a signatory terminates provisional application, according to Art.45(3)(b), the obligation to apply Part III “Investment Promotion and Protection” and Part V “Dispute Settlement” of the ECT “with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination”. Thus, if, supposedly, Russia would like to withdraw from the ECT in 2009, this country’s obligations on investment protection will remain in force for the next 20 years (till 2029), as well as the possibility of arbitration proceedings against Russia arising out of a breach of ECT investment provisions.

Destroy or renew

“Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)”, proposed by Russia, cannot be seriously considered as an alternative to the ECT and related documents, but, in my opinion, it may be accepted by the international community as a proposal on future improvement of the Energy Charter process, the latter being a single universal mechanism of legal regulation in the international energy sector.

On the one hand, the promulgated document does not contain any suggestions as to its conceptual novelty or principle difference from the provisions of the Energy Charter documents. These proposals should be viewed not as an alternative, but rather as a list of questions, offered to the Energy Charter international community with the aim to analyze the efficiency of the multi-facet directions of its activity. This will allow a reduction to the negative effects of declarations and proposals made by the Russian party and will turn the discussion of the matter into something constructive and positive.

The fact is that once every five years the Energy Charter Policy Review, based on Art.34(7) of the ECT, takes place. Since 2007 the special Energy Charter Ad Hoc Strategy Group has been discussing the particularities of adaptation of the Charter process and the provisions of the Charter documents to new challenges and risks at the international energy markets, based on the Conclusions of the 2004 Policy Review. The next Policy Review Conclusions with the particular decisions on the adaptation of the Charter process and its documents will be adopted by the Energy Charter Conference at the end of 2009, following the results of the regular Energy Charter Policy Review, taking place this year.

This is an excellent opportunity to introduce a number of justified changes and amendments to the Energy Charter process and its documents which will alleviate proved and well-argued concerns of Russia. But to achieve this, my country's delegation must work efficiently within the framework of this adaptation process, including participation of the Russian delegation in all meetings and proper preparation for them.

It would also be quite reasonable to propose to the Charter community a transit agreement, indicated in the "Conceptual Approach…", aimed at preventing such crises as the Russia-Ukraine dispute in January, as part of the complex Russian initiative on adaptation of the Energy Charter to the new challenges and risks of the international energy markets development.

It should be noted that this draft agreement on transit crises prevention was prepared by Gazprom's experts explicitly as a document supplementing ECT and draft Transit Protocol, rather than substituting them. There is only one innovative element in the text of this agreement, but it is an important one – a system of international commissions authorized to resolve extraordinary situations, connected with transit, if a threat of their occurrence should arise.

Dr. Andrey A. Konoplyanik, Doctor of Economics; in 2002-2008 Deputy Secretary General of the Energy Charter Secretariat