

The Energy Charter Treaty and Transit Protocol and Related Issues

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DEVELOPMENT OF ENERGY MARKETS AND MECHANISMS FOR INVESTORS PROTECTION / STIMULATION

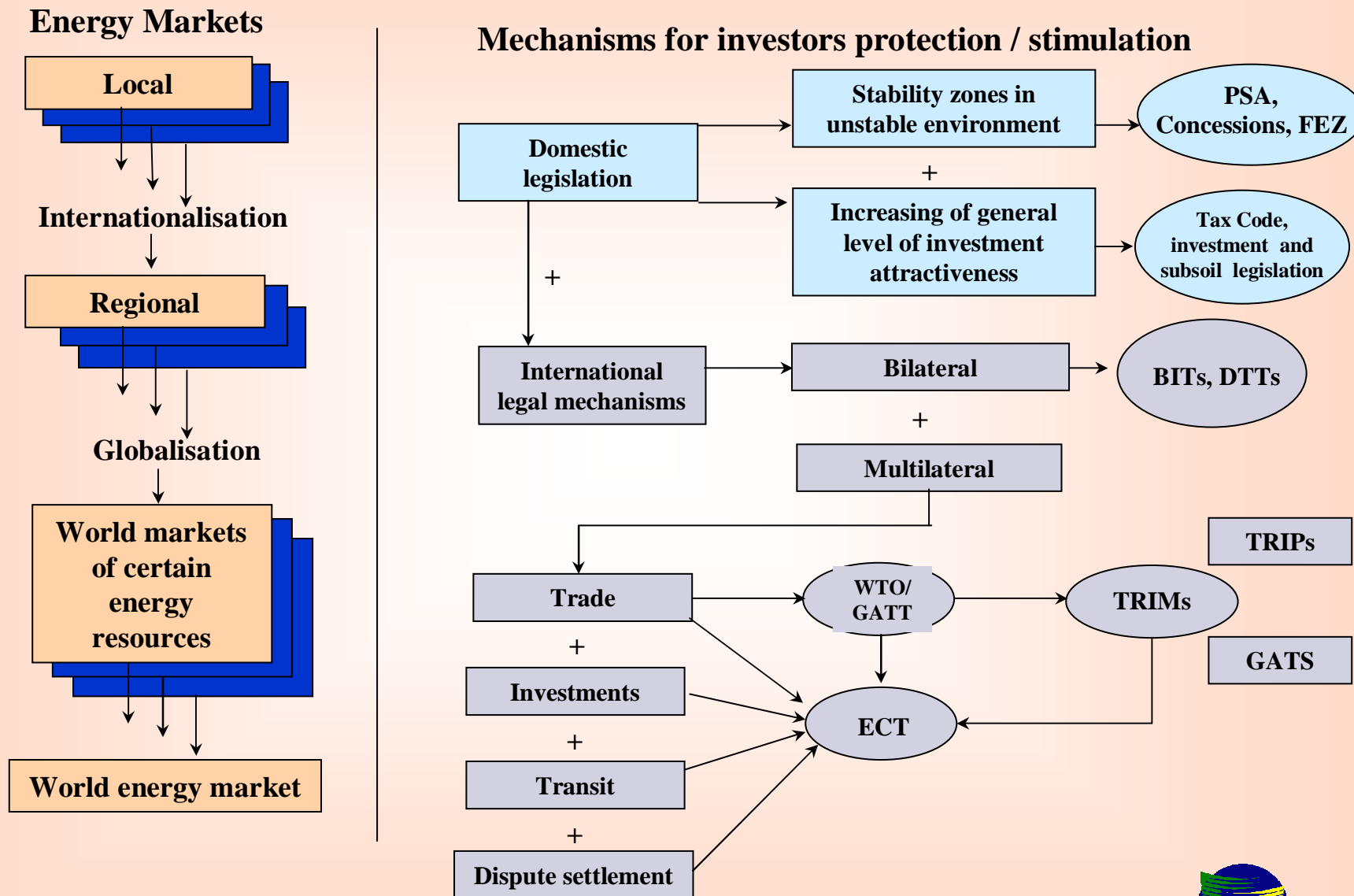
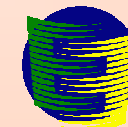
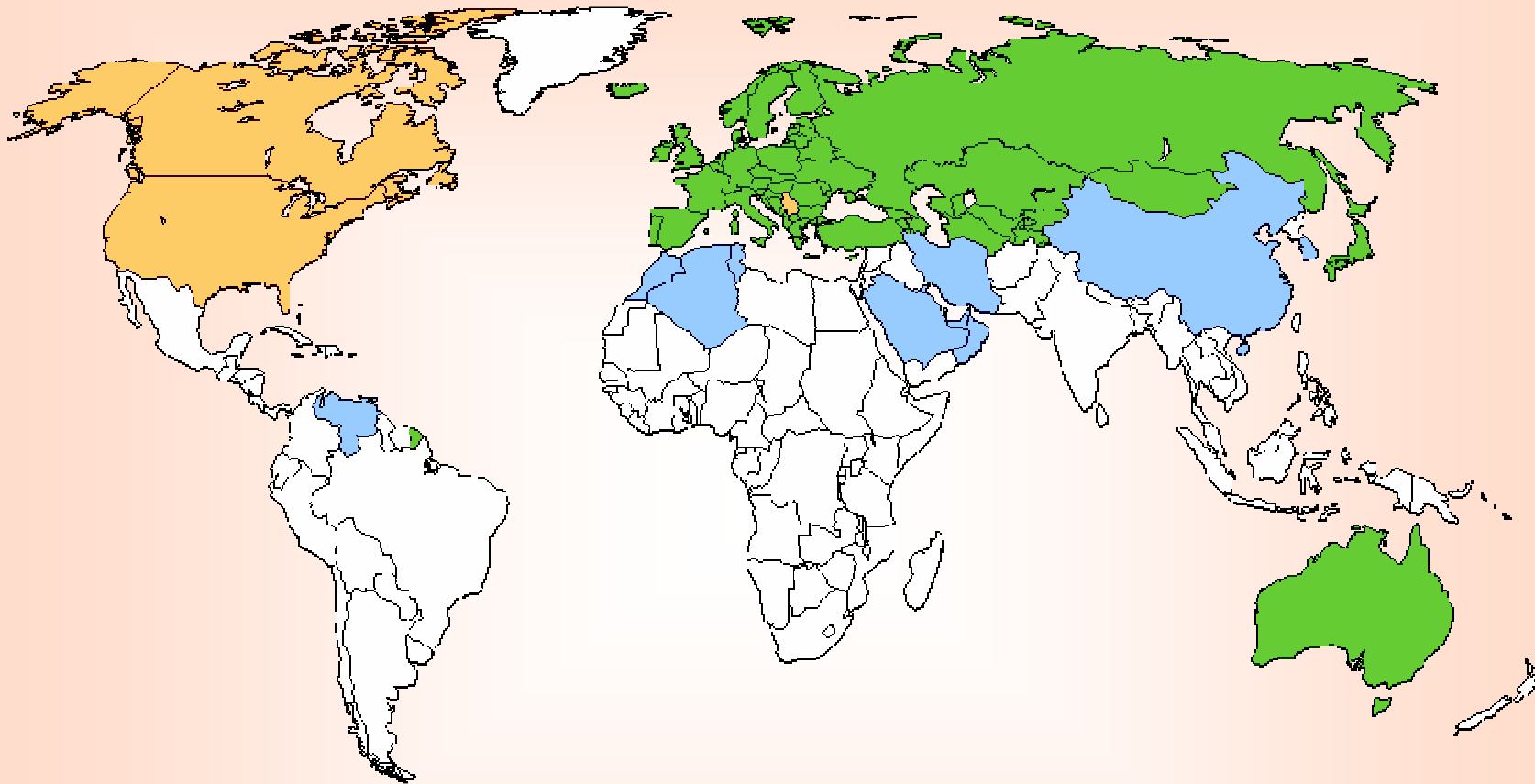


Figure1

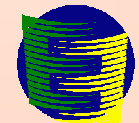


ENERGY CHARTER TREATY: GEOGRAPHY



- Energy Charter Treaty Signatory States (1994)
- Observer States that have signed the European Energy Charter (1991)
- Other Observer States

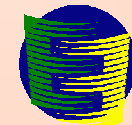
Figure 2



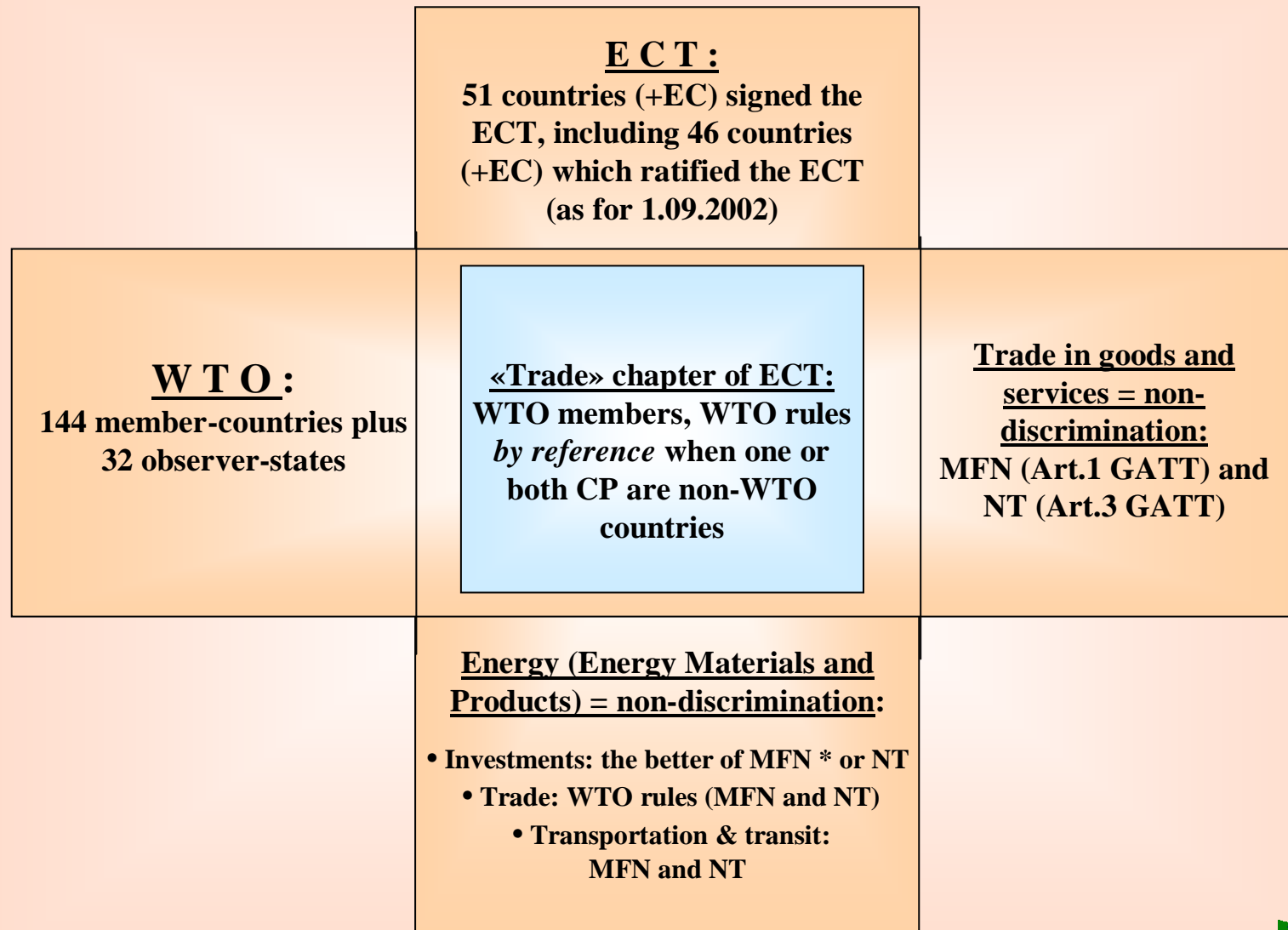
ENERGY CHARTER HISTORY

| | |
|------------------------------|--|
| June 25, 1990 | Lubbers' initiative presented to the European Council |
| December 17, 1991 | European Energy Charter signed |
| December 17, 1994 | Energy Charter Treaty (ECT) and Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) signed |
| June, 1996 | Russia started ECT ratification process for the first time (unsuccessfully). |
| 16 April, 1998 | ECT enters into force |
| January, 2001 | Russia restarted ratification process. RF State Duma: Russia will ratify ECT, but not yet (depending on Transit Protocol) |
| As of January 1, 2003 | <ul style="list-style-type: none"> • ECT signed by 51 states + European Communities = 52 ECT signatories • ECT ratified by 46 states + EC (excl. 5 countries: Russia, Belarus, Iceland, Australia, Norway) • Russia: provisional application, together with Belarus |

Figure 3

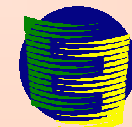


CORRELATION BETWEEN GEOGRAPHICAL SCOPE, ACTIVITY TARGET AND APPLICABLE REGIMES OF ECT AND WTO



*) i.e. MFN = preferential regime for FDI

Figure 4



ENERGY CHARTER AND RELATED DOCUMENTS

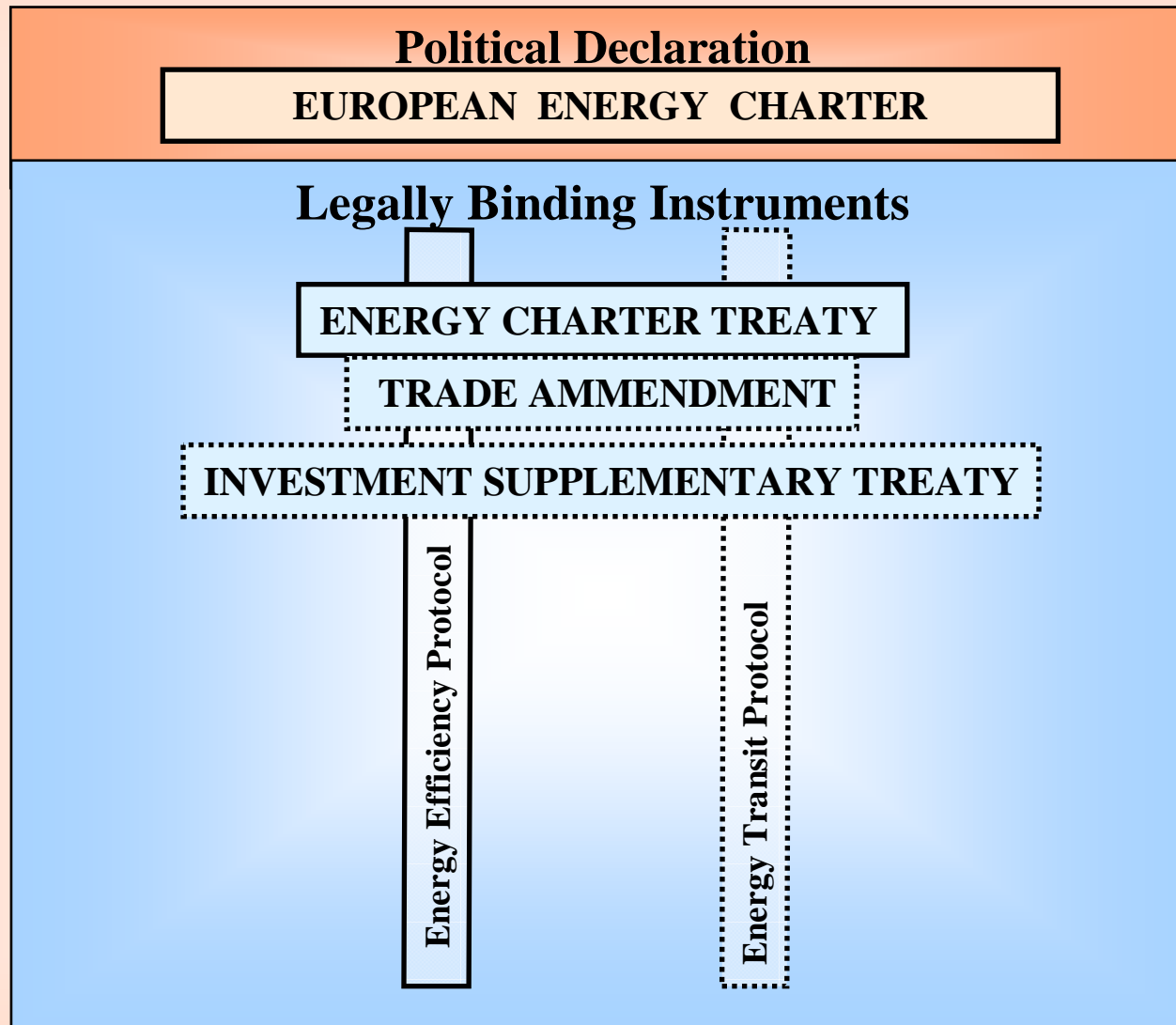
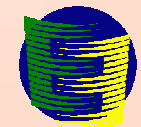


Figure 5



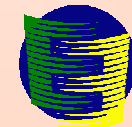
ECT MAJOR OPPONENTS IN RUSSIA AND THEIR ARGUMENTS

| Arguments against ECT ratification | Comments |
|--|--|
| <p><u>Gazprom:</u></p> <ol style="list-style-type: none"> 1) ECT demands mandatory TPA to Gazprom’s pipelines for cheap gas from Central Asia 2) Obligation to transit Central Asian gas at low (subsidised) domestic transportation tariffs 3) ECT will “kill” LTCs | <p>No such obligation. ECT excludes mandatory TPA (ECT Understanding IV.1(b)(i)).</p> <p>No such obligations (ECT Article 7(3)). Transit and transportation are different in non-EU.</p> <p>Not true. ECT documents do not deal with LTC at all. Economic niche for LTCs will become more narrow due to objective reasons, but they will continue to exist as a major instrument of financing greenfield gas projects.</p> |
| <p><u>Ministry of Nuclear:</u></p> <ol style="list-style-type: none"> 1) Bilateral RF-EU trade in nuclear materials is not regulated by ECT | <p>Prior to ECT signing in 1994, RF and EU has agreed to regulate nuclear trade bilaterally (P&CA).</p> |

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

Other debate – see publications

Figure 6



MOST RECENT PUBLICATIONS ON ECT:

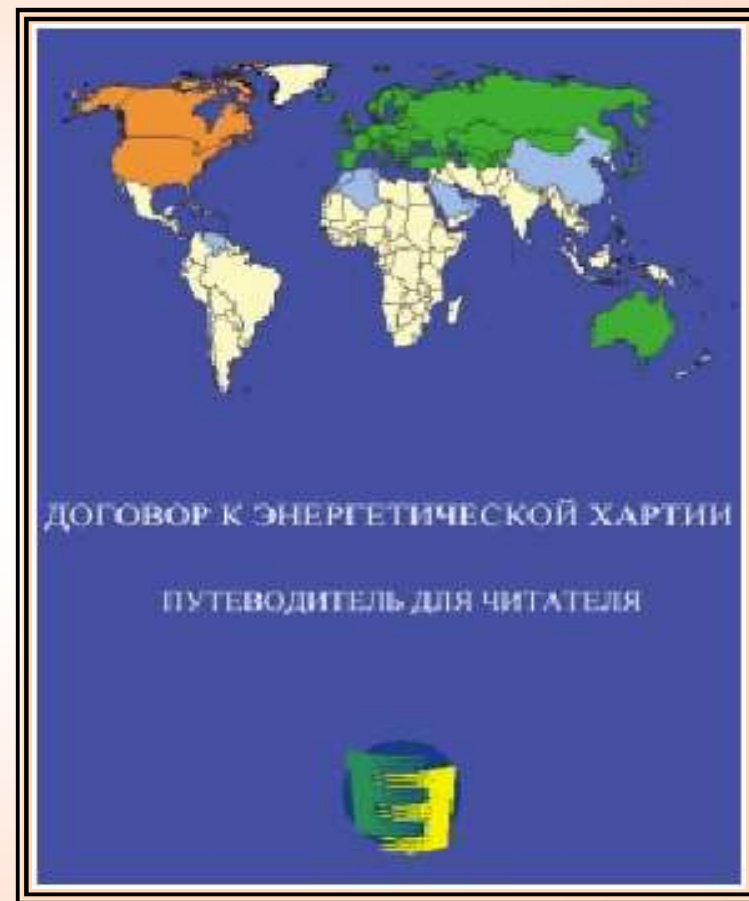
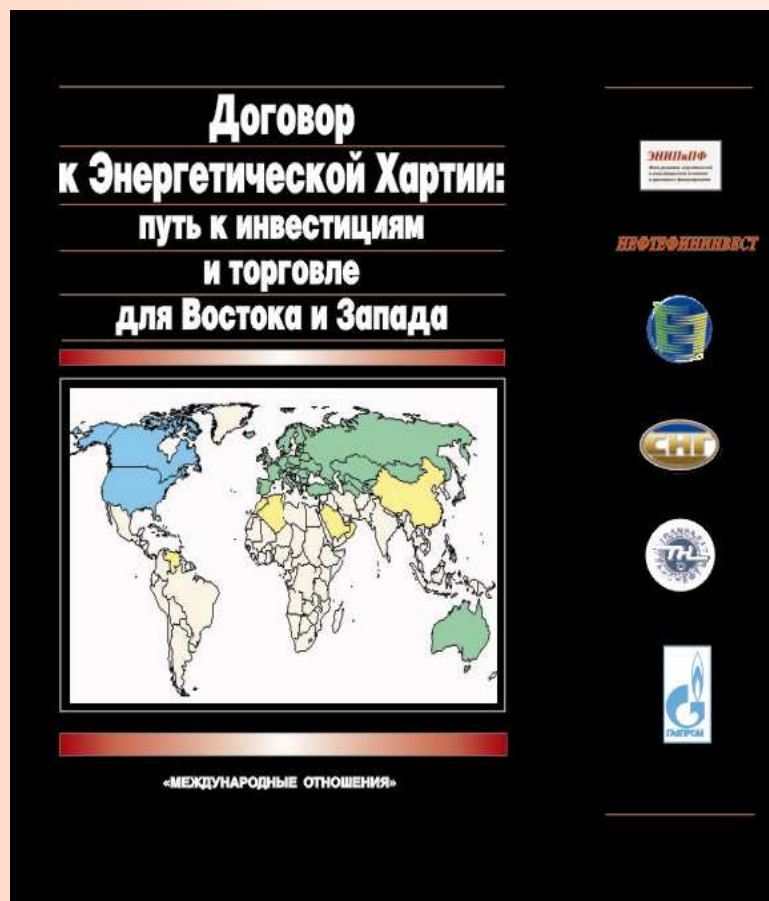
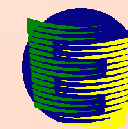


Figure 7

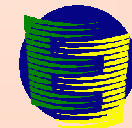


RUSSIAN OIL EXPORT INFRASTRUCTURE TO EUROPE AND ROLE OF TRANSIT

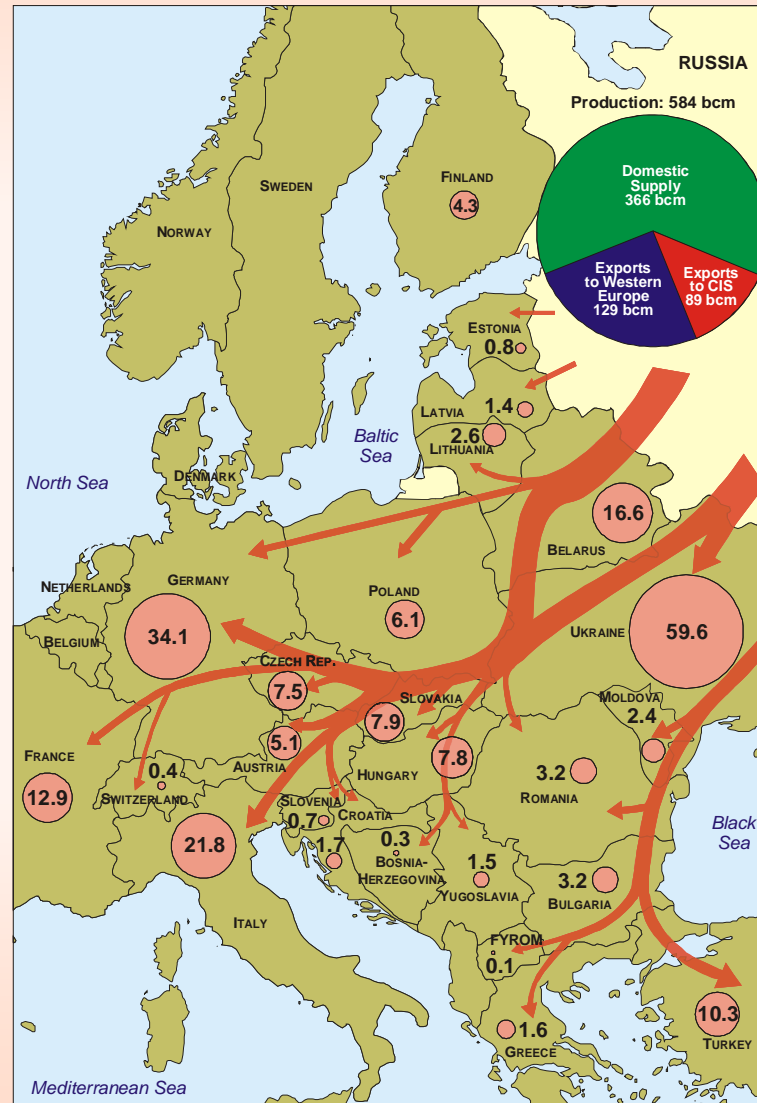


Source:
IEA/ECS "Russia Energy
Survey 2002"

Figure 8

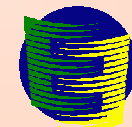


RUSSIAN GAS EXPORT TO EUROPE IN 2000 AND ROLE OF TRANSIT



Source:
IEA/ECS "Russia Energy
Survey 2002"

Figure 9



RUSSIAN GAS IN EUROPE

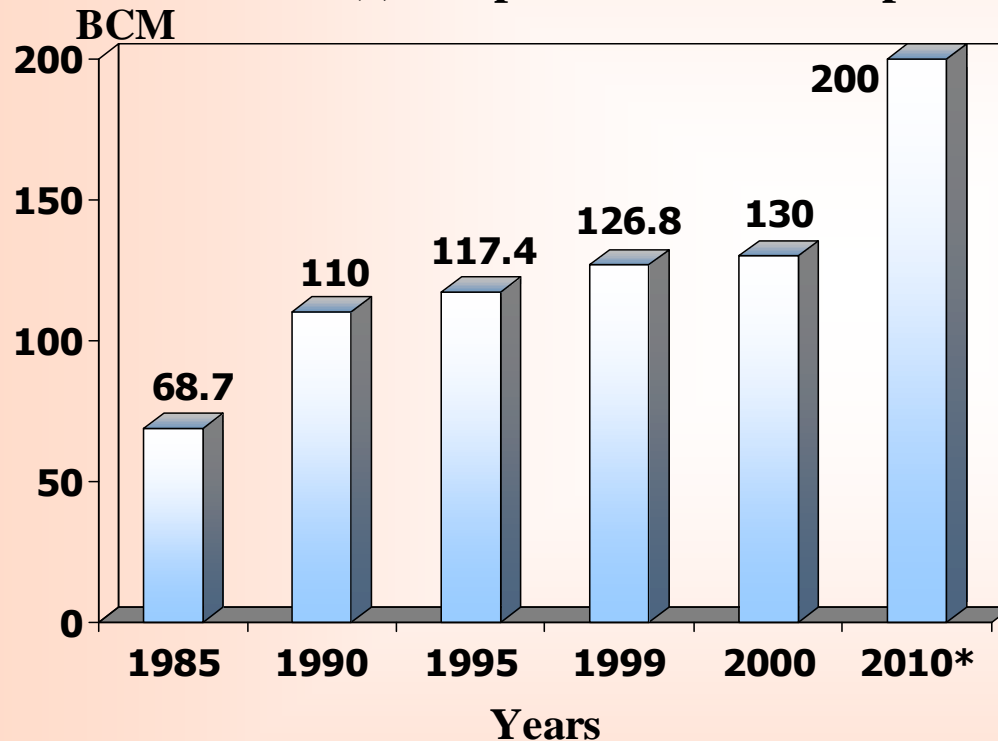
(a) Share of Russia in gas consumption:

| | |
|--------------------------|------|
| All Europe | >25% |
| Central & Eastern Europe | 40% |
| Eastern Europe | >90% |

(b) European importers of Russian gas

- **Austria**
- Belarus
- Bulgaria
- Bosnia
- **Hungary**
- **Germany**
- **Greece**
- **Italy**
- **Latvia**
- **Lithuania**
- Macedonia
- Moldova
- **Poland**
- Romania
- **Slovakia**
- **Slovenia**
- Turkey
- Ukraine
- **Finland**
- **France**
- Croatia
- **Czech Republic**
- Switzerland
- **Estonia**
- Yugoslavia

(c) Gazprom sales in Europe

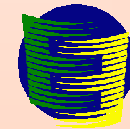


* Forecast

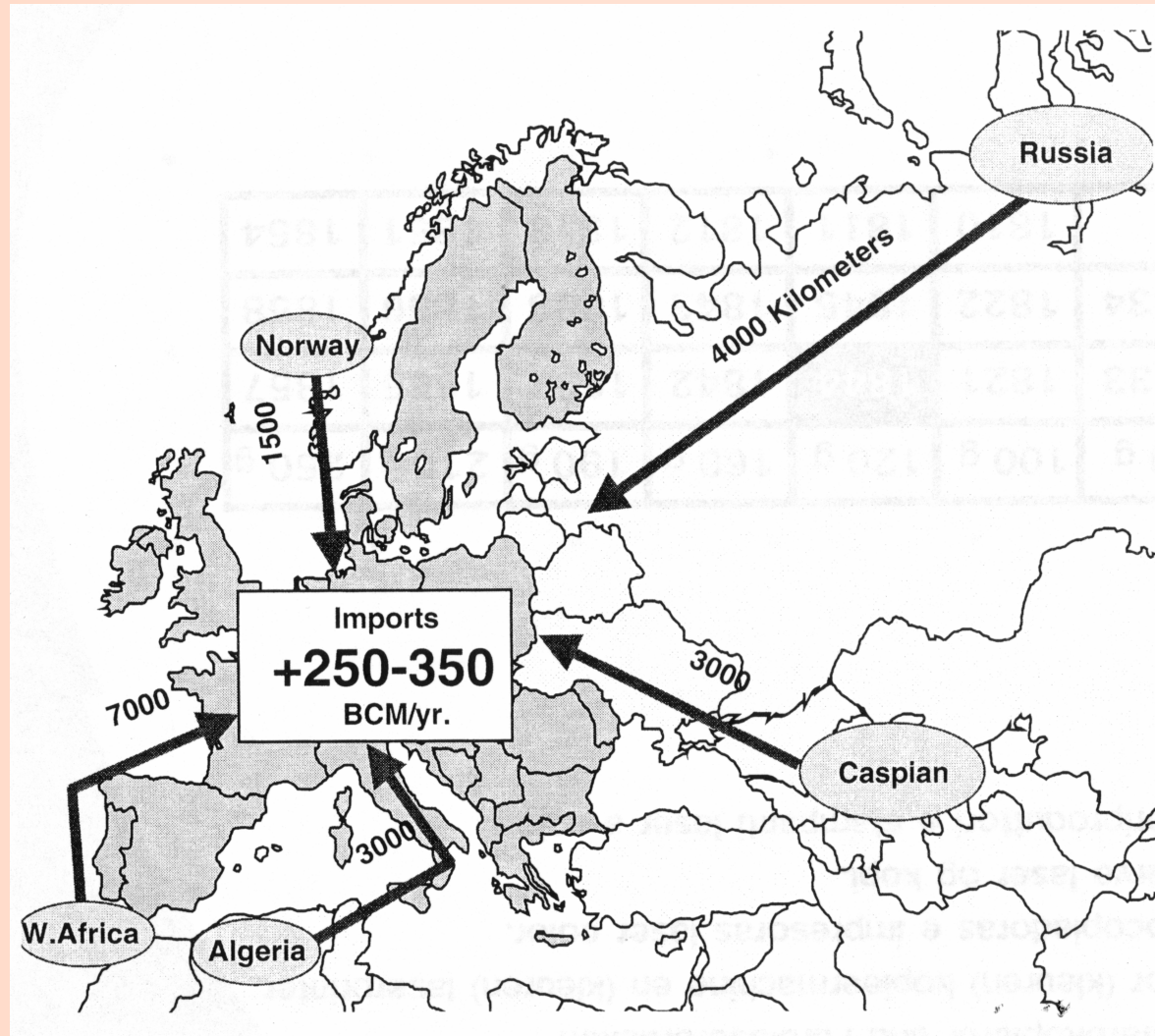
Source: OAO Gazprom

Figure 10

TOTAL: 25



EUROPEAN GAS MARKET OUTLOOK

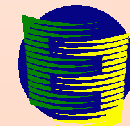


By 2020:

- Demand up 200-300 BCM/yr
- Imports up 250-350 BCM/yr
- New investments 250-300 billion \$

Source: J.V.Genova/Exxon Mobil

Figure 11

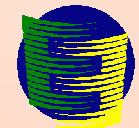


RUSSIAN GAS FOR EUROPE

Competitive disadvantages (distances, natural conditions of producing areas)

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

- **ECT and related documents =**
 - = common legal environment, minimizing risks and technical and financial costs**

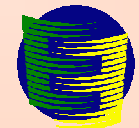


ENERGY CHARTER AND RELATED DOCUMENTS:

TRANSIT PROTOCOL

The Transit Protocol deals with the following issues:

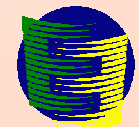
- 1. The obligation to observe Transit Agreements**
- 2. Prohibition of unauthorized taking of Energy Materials and Products in Transit**
- 3. Negotiated access of third parties to Available Capacity in Energy Transport Facilities used for Transit (mandatory access is excluded)**
- 4. Facilitation of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



TRANSIT PROTOCOL - FINALISATION

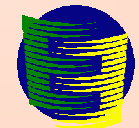
December 2002 meeting of the Energy Charter Conference agreed that, in view of the very wide measure of agreement reached on the Protocol on Transit, its text, in order to facilitate a rapid conclusion of the negotiations, should not be open for further negotiations with the exception of the following three interrelated issues:

- Right of First Refusal;**
- Application of REIO clause; and**
- Transit Tariffs (the text of which was provisionally agreed, subject to reserve).**



TRANSIT PROTOCOL – DRAFT ARTICLE 10: TRANSIT TARIFFS

- 1. Each Contracting Party shall take all necessary measures to ensure that Transit Tariffs and other conditions are objective, reasonable, transparent and do not discriminate on the basis of origin, destination or ownership of Energy Materials and Products in Transit**
- 2. Each Contracting Party shall ensure that Transit Tariffs and other conditions are not affected by market distortions, in particular those resulting from abuse of a dominant position by any owner or operator of Energy Transport Facilities used for Transit**
- 3. (a) Transit Tariffs shall be based on operational and investment costs, including a reasonable rate of return.**
(b) Subject to sub-paragraph (a), Transit Tariffs may be determined by appropriate means, including regulation, commercial negotiations or congestion management mechanisms.



TRANSIT TARIFFS AND AUCTIONS: “EXCESSIVE PROFITS RECYCLING” MACHINERY (EU PROPOSAL)

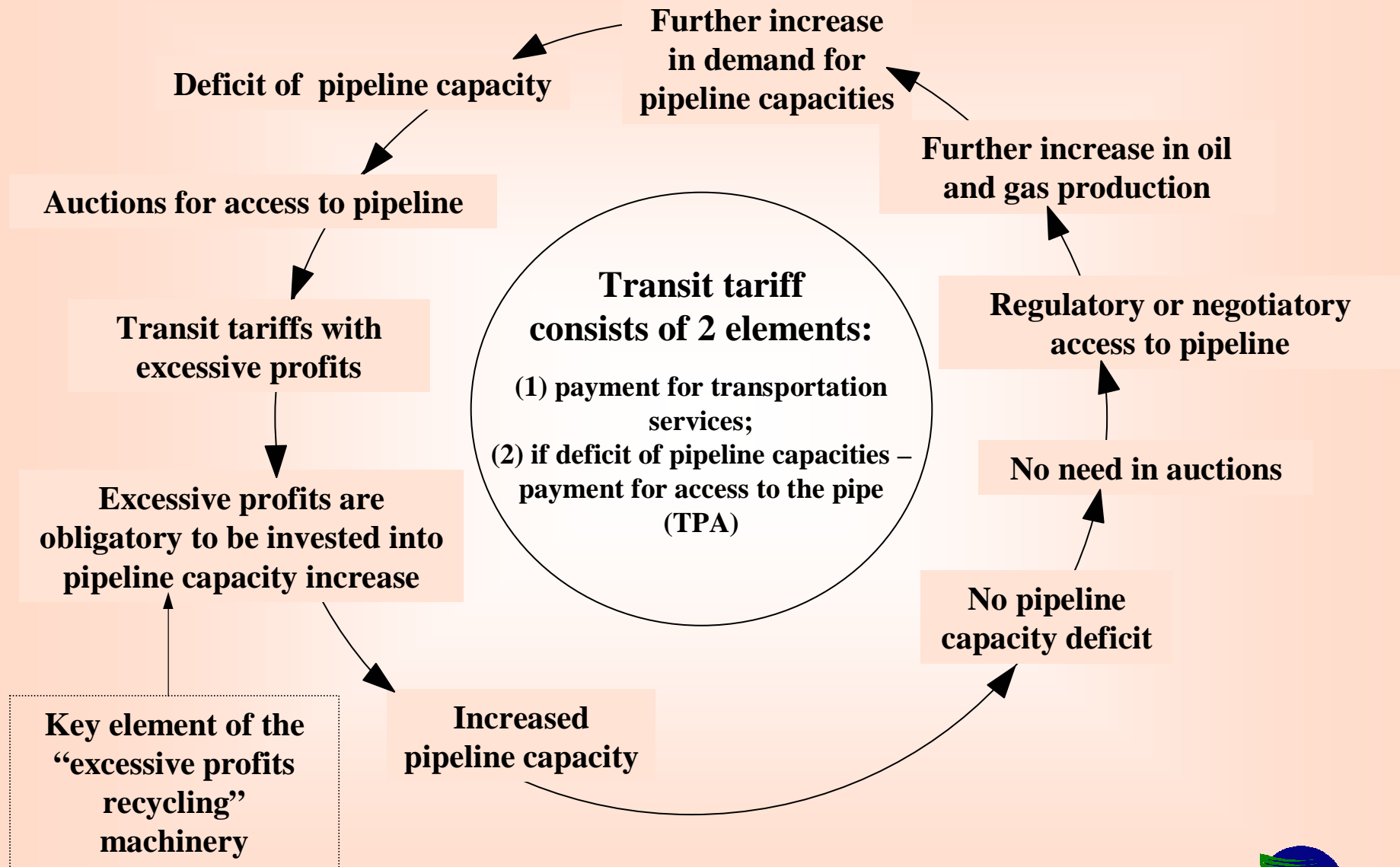
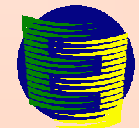


Figure 16



TRANSIT TARIFFS – HOW TO ACHIEVE REASONABLE RATE OF RETURN? (EU PROPOSAL)

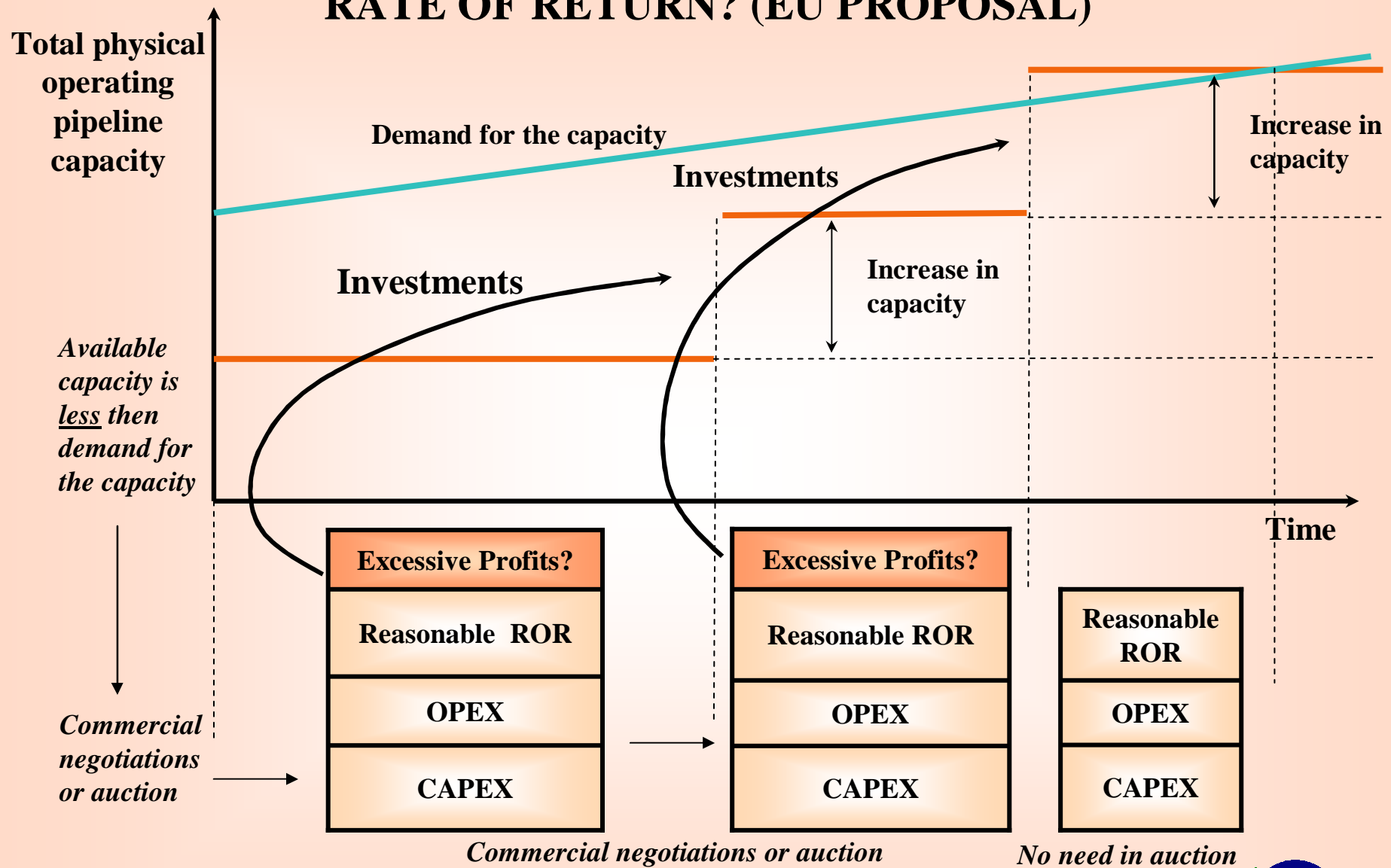
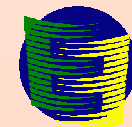
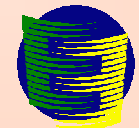


Figure 17



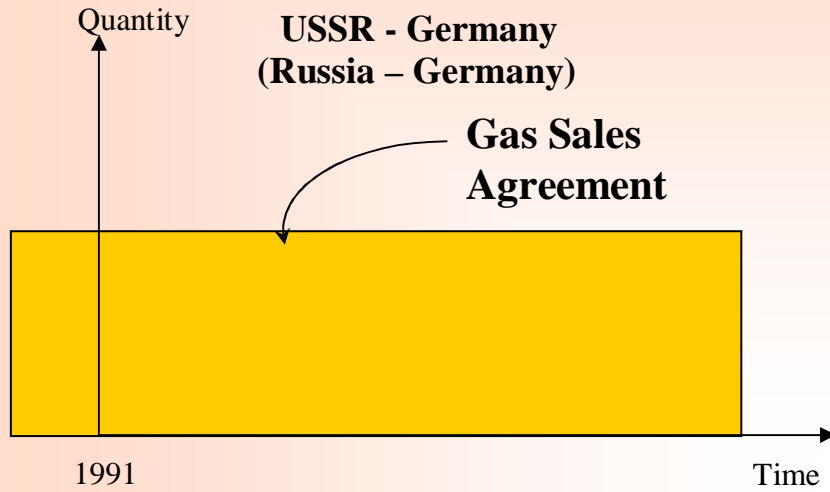
DRAFT DECISION WITH RESPECT TO THE TRANSIT PROTOCOL (RIGHT OF FIRST REFUSAL)

- 1. Where the duration of a Transit Agreement relating to Transit of hydrocarbons does not match the duration of a supply contract, the Contracting Party through whose Area the hydrocarbons transit ... shall ensure that the owners or operators of Energy Transport Facilities under its jurisdiction who are in negotiations on access to Available Capacity consider in good faith and under competitive conditions the renewal of such Transit Agreements. This means that the existing user upon the expiry of the Transit Agreement shall be treated neither better nor worse than other potential users at that time, except that the existing user shall be given the first opportunity to accept the conditions offered for any new Transit Agreement for that Available Capacity. (...)**
- 3. The application of this Decision becomes effective when the Russian Federation deposits its instruments of ratification of the Energy Charter Protocol on Transit. (...)**



RIGHT OF FIRST REFUSAL: TWO ASPECTS

Currently



In the future

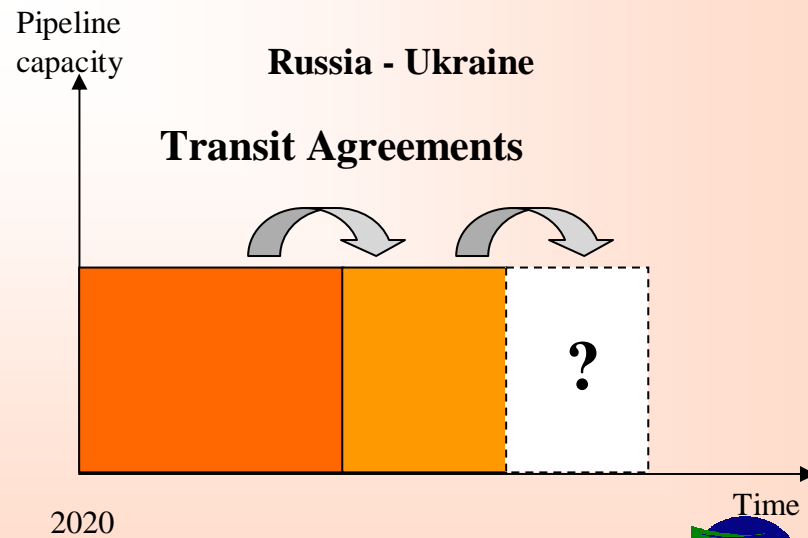
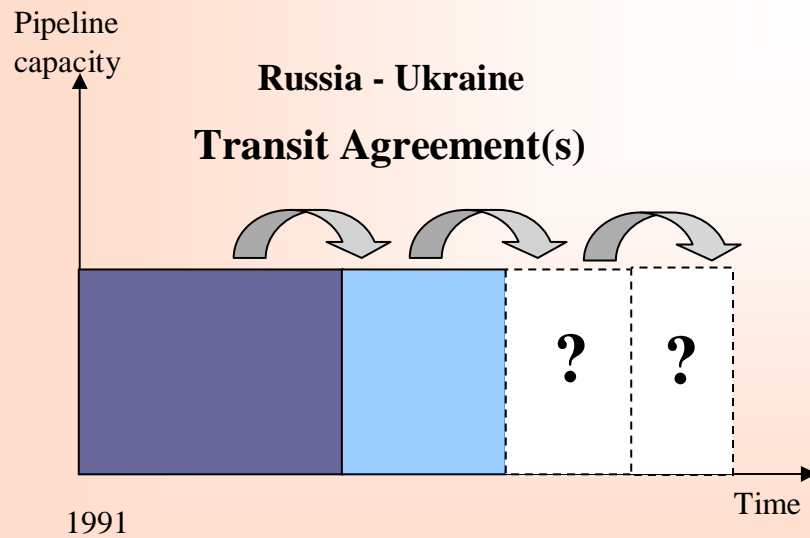
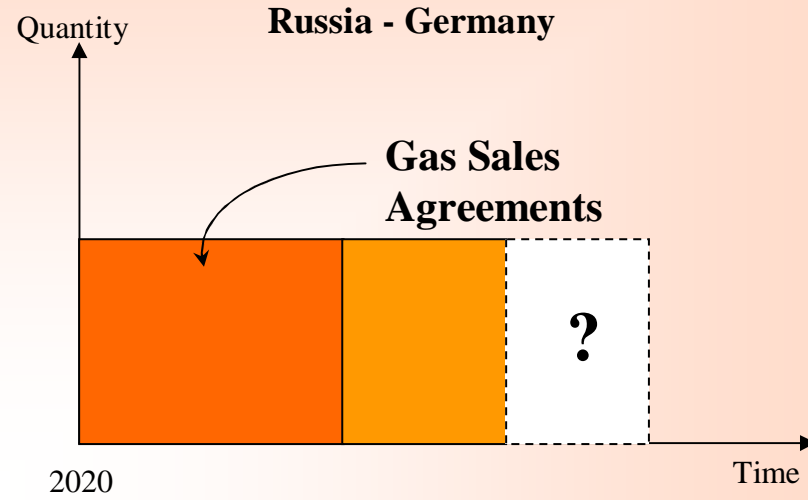
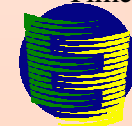
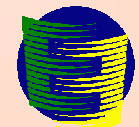


Figure 19



TRANSIT PROTOCOL – DRAFT ARTICLE 20: REGIONAL ECONOMIC INTEGRATION CLAUSE

For the purposes of this Protocol, the “Area” of a Contracting Party referred to in Article 7(10)(a) of the Treaty shall, as regards Contracting Parties which are members of a Regional Economic Integration Organisation, mean the area to which the Treaty establishing such a Regional Economic Integration Organisation applies.



REIO CLAUSE: GEOGRAPHICAL ASPECTS

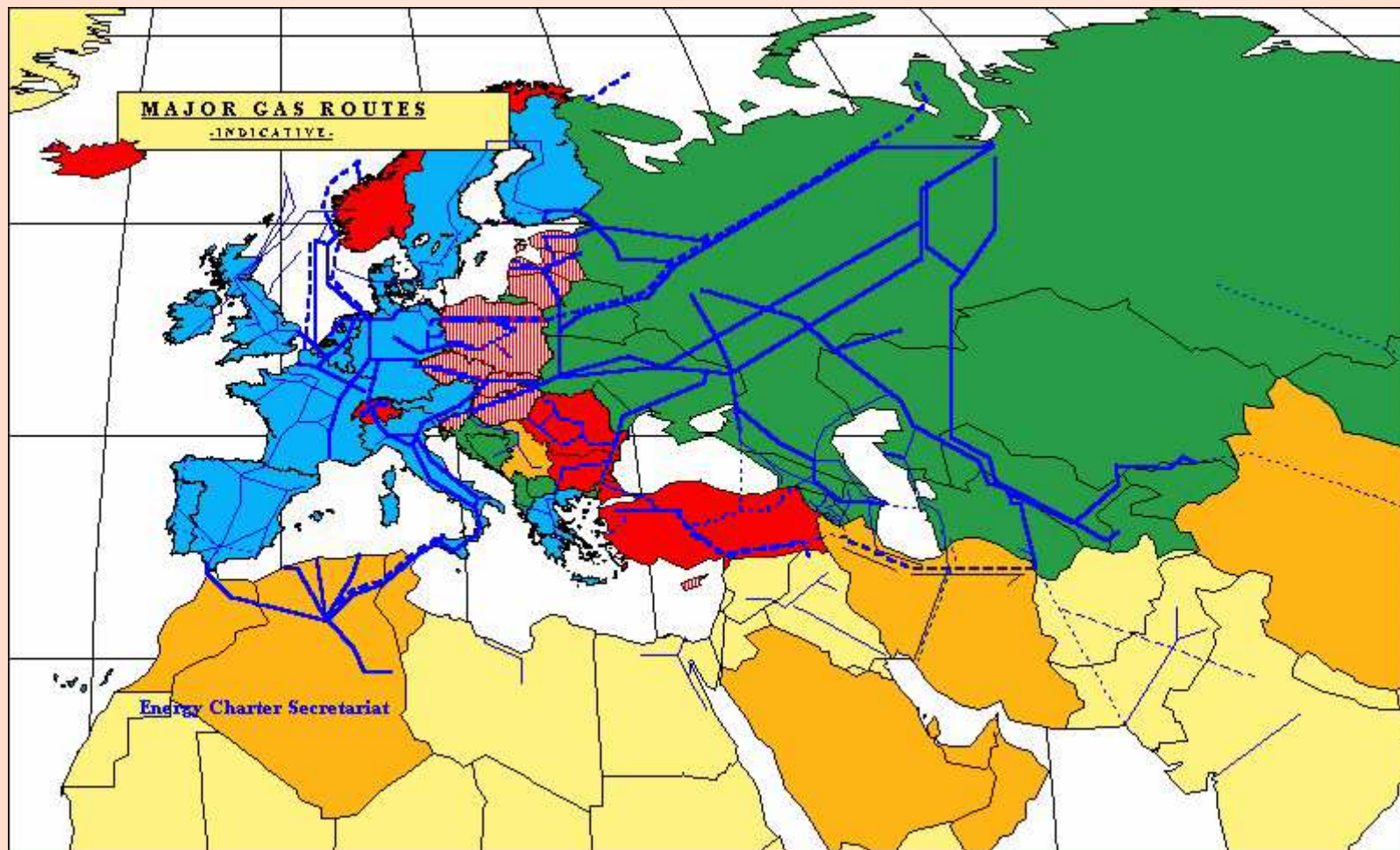
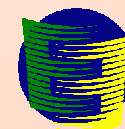
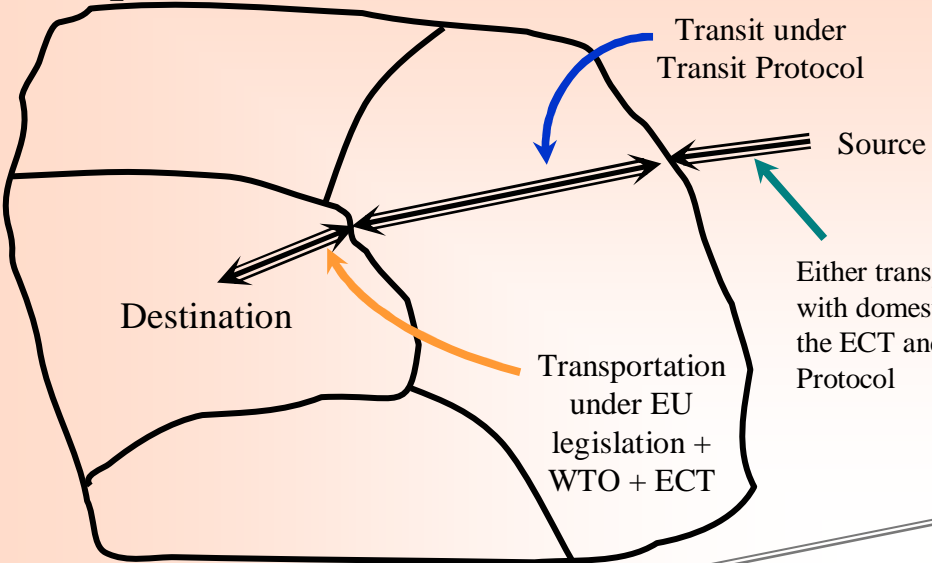


Figure 21



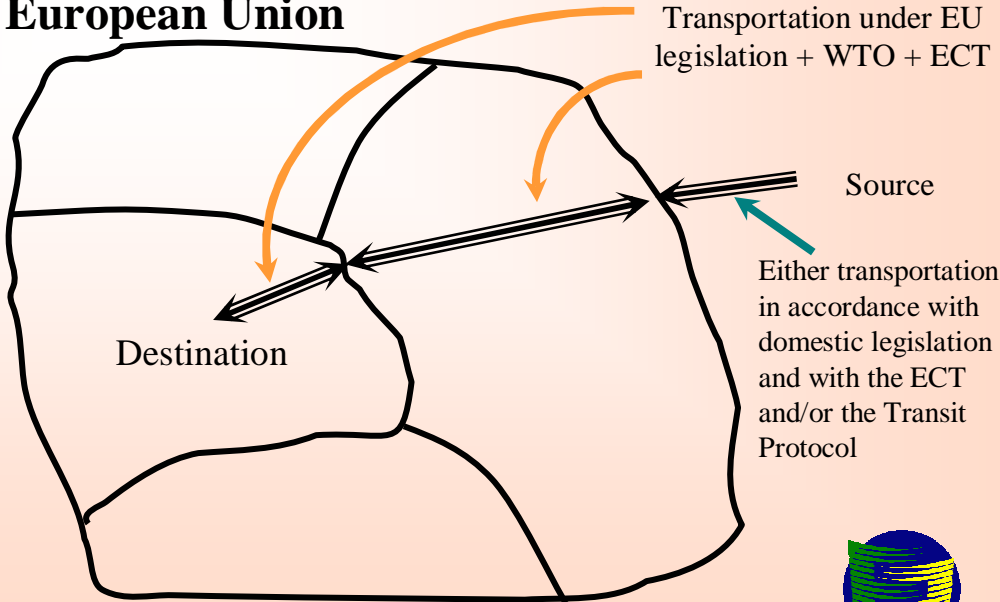
REIO CLAUSE: LEGAL ASPECTS

European Union



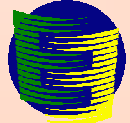
(a) Before REIO:

European Union



(b) After REIO:

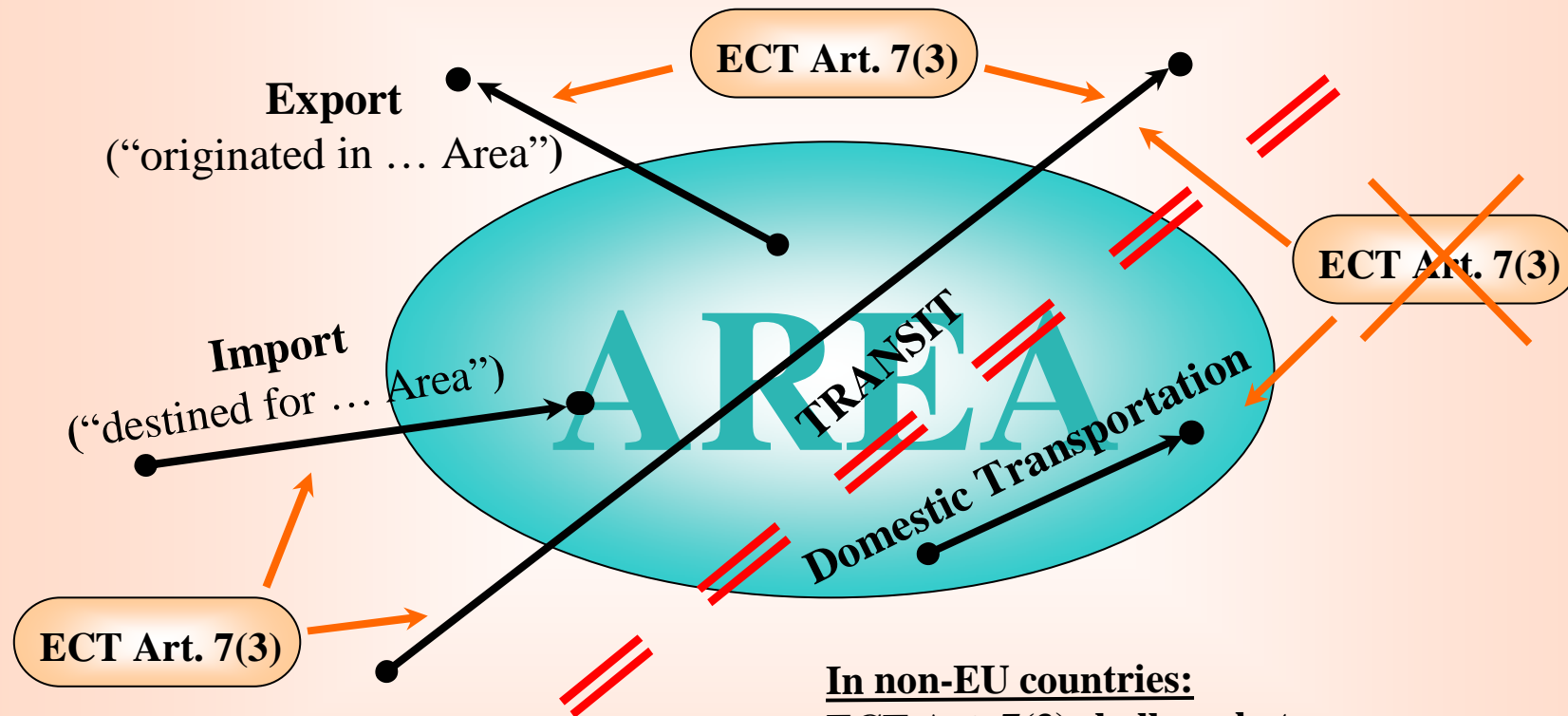
Figure 22



ARE THERE ANY BENEFITS FOR RUSSIA IN REIO CLAUSE?

ECT Article 7(3):

“Each Contracting Party ... shall treat Energy Materials and Products in Transit in no less favourable manner than its provisions treat such materials and products originating in or destined for its own Area ...”



In EU countries (with or without REIO):
ECT Art. 7(3) shall apply to all means of transportation (free movement of goods)

In non-EU countries:

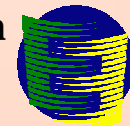
ECT Art. 7(3) shall apply to:

- transit vs. export / import

ECT Art. 7(3) shall NOT (?) apply to:

- transit vs. domestic transportation

Figure 23



REIO CLAUSE: TRANSIT VS. TRANSPORTATION (EU/non-EU)

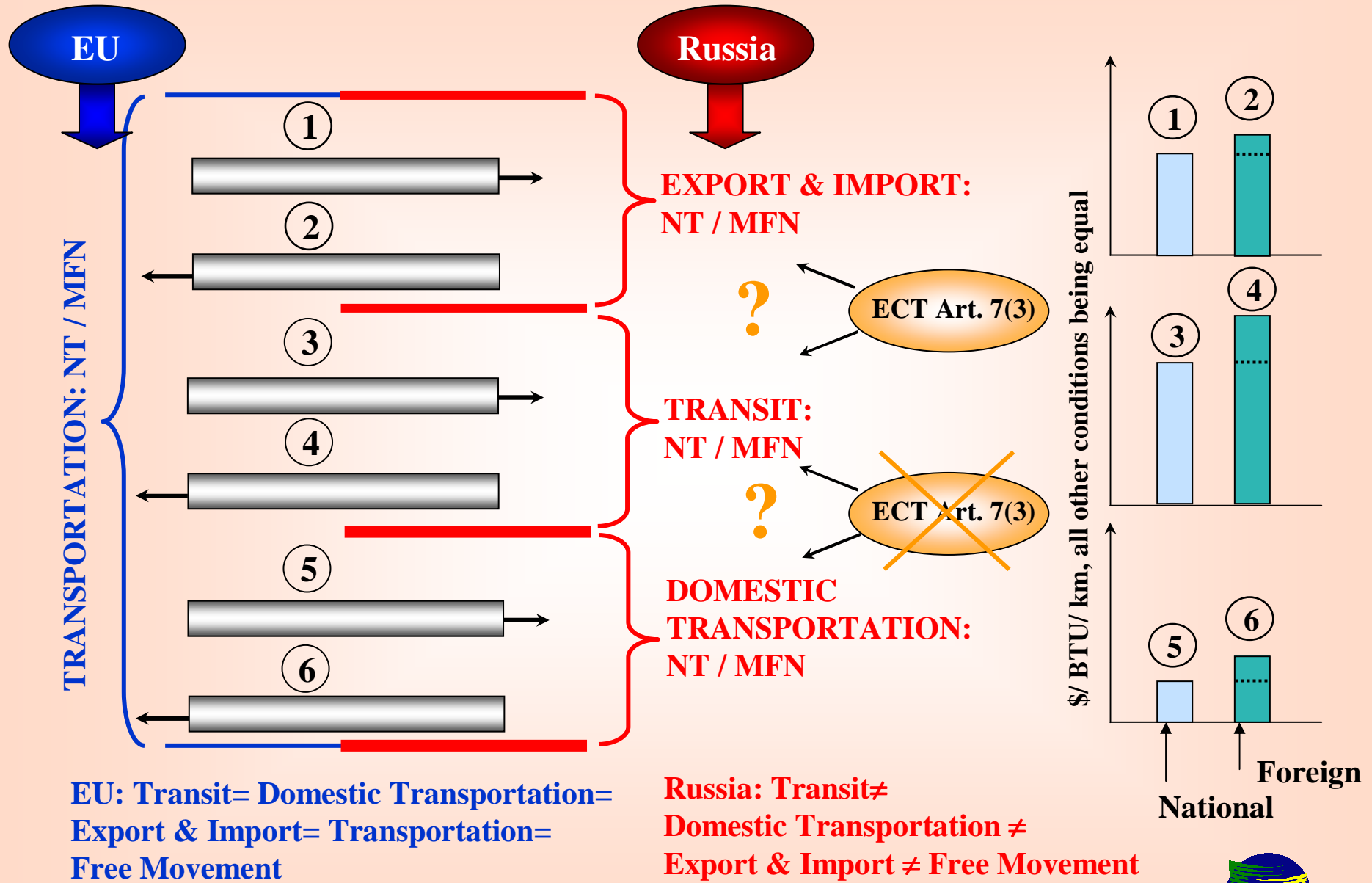


Figure 24

ECT & LEGISLATIVE PRIORITIES OF PRESIDENT PUTIN

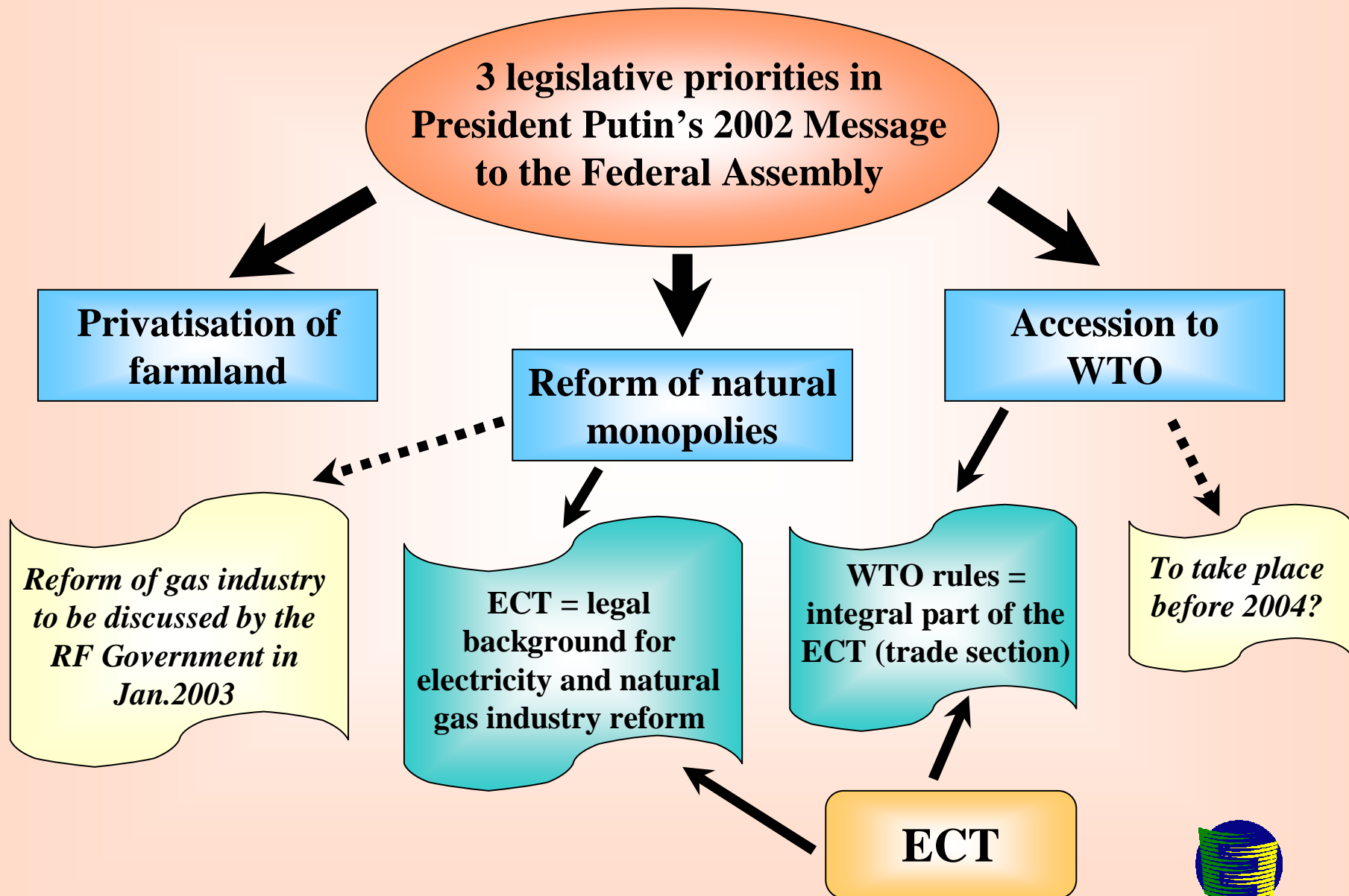


Figure 25