

# Russia: don't oppose the Energy Charter, help to adapt it

Russia should improve the Energy Charter process, not abandon it, says Andrey A Konoplyanik

RUSSIA "did not ratify Energy Charter and other documents and does not consider itself to be bound by these decisions", Russian President Dmitry Medvedev said on 20 April. And the country intends to "change the legal base for relationships with energy consumers and transit states", he said in Helsinki.

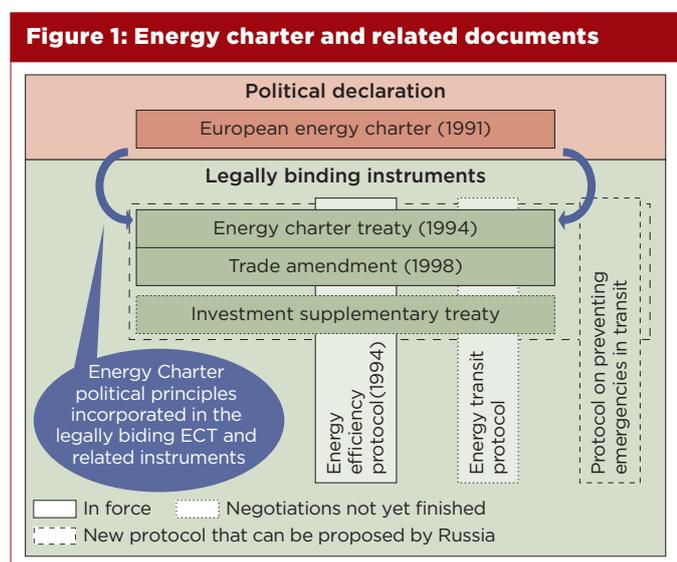
The following day, a document entitled *Conceptual approach to the new legal framework for energy co-operation (goals and principles)* appeared on the Kremlin's official website. Presidential aide Arkady Dvorkovitch – who probably oversaw the document's preparation – said it could replace the Energy Charter Treaty (ECT). "We are not satisfied with the Energy Charter," he said. "There is a need for a new international legal base." He added: "Regarding the ECT, we do not consider ourselves bound by the obligations under this treaty either. These documents, in fact, did not apply to us", Dvorkovitch said.

## Russia is bound by the ECT

The legal basis for this claim is dubious and may be disputed. A total of 51 countries and two collective organisations (the EU and Euratom) have signed the legally binding ECT. Russia and four other countries have not yet ratified it, but, under Article 45 of the ECT, Russia and Belarus applied the treaty provisionally – "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations". Since the treaty entered legal force on 16 April 1998, it has been an integral part of international law for all the contracting parties and signatories that provisionally apply it – including Russia. This country is bound by the ECT as long as it does not conflict with its national laws. Russia's claim that the ECT does not apply opens it to accusations of failing to follow the rule of law.

Moreover, Energy Charter is a multi-faceted term; it can refer to:

- An expanding package of multilateral documents. These include the basic political (and legally non-binding) declaration of 1991's European Energy Charter; the ECT and the Protocol on Energy Efficiency and Related Environmental Aspects (both of 1994); the Trade Amendment of 1998; and other binding and non-binding existing and future documents, including the draft Transit Protocol (see Figure 1);



- The long-term Energy Charter process. This involves: multilateral negotiations on new market instruments; the monitoring of their implementation and political discussions on their adaptation to new realities in international energy markets; and new multilateral negotiations on adaptation of existing instruments and/or development of new ones;

- The international organisation, The Energy Charter Conference and its working groups; and

- The Energy Charter Secretariat as an administrative body of this international organisation.

Only legally binding documents from the Charter package need to be ratified. It is not possible to sign and ratify any Charter document if, first, the Energy Charter political declaration is not signed, and, second, if the ECT is not signed and ratified.

Decisions are taken by the Energy Charter Conference (Article 36) and by its working bodies and do not require ratification. After approval by the Conference (usually by consensus), decisions become obligatory for member-states with a right to vote. All ECT signatories (both those that have ratified and not yet ratified the ECT) have the right to vote (the voting procedure for selection of the new secretary general in 1995 proved this in practice); through the act of voting, countries bind themselves by the terms of whatever decision is taken.

On 29 April, Russian prime minister Vladimir Putin said: "Russia does not see sense in keeping its signature under Energy Charter." But if Russia is considering terminating the provisional application under Article 45(3)(b) of the ECT – and not becoming a Contracting Party to the Treaty – it would have negative consequences for Russia and its government, but there are no convincing arguments in favour of it.

## Consequences of withdrawal

First, by withdrawing, Russia would play into the hands of anti-Russian political forces, opening the country to accusations that it does not respect the rule of law.

Second, the ECT is the only multilateral instrument that provides investment protection in the most capital-intensive and risky business field – the energy sector. It protects not only foreign investments in Russia, but also Russian investments abroad (following ECT ratification by the Russian parliament). This would include protection from liberalisation risks – of use to Russia in the context of certain anti-Russian provisions in the European Commission's third energy package, adopted recently by the European Parliament in its second reading.

Third, the ECT has been an integral part of international law since 1998. Russia's non-participation in the treaty will not lead to its termination. Other countries, however, will enjoy its advantages – such as reduced energy-financing costs – giving them a competitive advantage over Russian firms.

Fourth, Russia's rejection of the ECT does not mean the country will succeed in creating an alternative, more effective instrument in the foreseeable future. It would be more practical instead to work on improving the multifaceted Energy Charter process and its instruments. For example, the ECT lacks effective mechanisms for preventing crises and resolving conflicts – as reflected by the inaction of the political leadership of the Energy Charter Secretariat during January's Russia-Ukraine gas crisis. Modernising these areas of the Energy Charter process by adding new legally binding instruments to the existing treaty and other documents – such as, for example, a protocol on preventing emergencies in gas transit – would be preferable to attempting to define a completely new international agreement.

Fifth, it is virtually impossible for third parties to reach an agreement on international treaties with the EU on terms not compatible with European law; the EU has for years been exporting its legislation through its system of negotiating international treaties. Any new treaty deviating



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from internal EU rules would be very difficult to negotiate and finalise within the desired time-frame. The ECT – an integral part of EU legislation, despite numerous differences between the EU's energy-liberalisation directives and the ECT – provides Russia and other countries with their only opportunity to resist the expansion of Eurocentric legislation.

ECT application is based on the minimum-standard principle, which means every country can proceed further in its national legislation than is required under the ECT – in respect of competition, liberalisation, market openness and non-discrimination against foreign investors. However, no member can require the same measures from other member-states. In other words, the ECT is designed to remove barriers to foreign investment and to establish a level-playing field from country to country based on a minimum-standard, not a maximum-standard basis. Rejection of the ECT under these circumstances prevents non-member countries from negotiating a new global energy order with European countries on the terms different to those provided for in 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 Russian Duma (parliament) came to the reasonable, pragmatic and legally feasible decision that the country's justified concerns in connection with the ECT transit provisions could be resolved by executing a separate, legally binding Energy Charter Protocol on Transit.

During bilateral consultations on the draft Transit Protocol, Russia and the EU agreed on all except one of the protocol's provisions. Russia's declaration about non-participation in the ECT will block the completion of the Transit Protocol, leaving no prospect for resumption. As a result, Russia will not obtain acceptable multilateral legal instruments governing transit regulation, which it has been enforcing and which took over 10 years of preparation.

Some politicians 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. As a result, after its transportation through Russia, gas from Central Asia would be able to compete with Russian gas in the European market.

This is a fallacy. The ECT does not stipulate the need to permit access to transit facilities for third-party countries. The Treaty says: "Each Contracting Party shall take the necessary measures to facilitate transit" (Article 7-1). This refers to existing transit arrangements, not new ones. It also says it "shall encourage relevant entities to cooperate" in the sphere of transit (Article 7-2).

In addition: "The Contracting Parties shall not place obstacles in the way of new capacity being established, except as may be otherwise provided in applicable legislation" (Article 7-4). And when applying the ECT provisionally, national legislation has priority over the ECT in case of conflict of laws. The transit country that is 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" (Article 7-5). In total, the ECT stipulates five levels of proved protection for a transit country's interests if it does not want to allow new transit through its territory for the third parties.

As a result, the ECT does not make the granting of access to Gazprom's gas-transmission system (GTS) mandatory; on the contrary, it provides internationally approved mechanisms for justifying denial of access to the GTS for a proposed transit route. Moreover, within the Energy Charter framework, the issue of the correlation of transit tariffs and domestic transportation tariffs has been resolved in the course of finalisation of the Transit Protocol (it is awaiting approval at political level).

Also, Central Asian gas is no longer cheap (in comparative terms). Since January 2009, the gas export-price formation in the EU and in the former Soviet Union is based on the same pricing principle – a netback to delivery points from the replacement value of gas in the EU market. Selling Central Asian gas at a formula price at their borders is more profitable for these countries than transiting the gas to Europe themselves, because they receive the highest possible price for their gas and avoid transit costs and risks. It also means Gazprom must assume the risk of the onward transport of the gas through Uzbekistan and Kazakhstan, and to Europe.

The ECT was also criticised in relation to the Yukos case: allegedly, the Energy Charter gave grounds for a claim to be lodged against Russia arising from the dismantling of Yukos. It was argued that this possibility should be prevented from recurring by withdrawing from the ECT. However, in the event that a signatory terminates provisional application, according to Article 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 20 years following the effective date of termination".

If Russia decides to withdraw from the ECT, say, in 2009, its obligations on investment protection will remain in force until 2029; the possibility of arbitration proceedings against Russia arising from a breach of ECT investment provisions will also remain during this period.

## Destroy or renew

Russia's *Conceptual approach to the new legal framework for energy cooperation (goals and principles)* cannot be seriously considered as an alternative to the ECT. But elements of it could be introduced to the ECT to strengthen the treaty and the whole Energy Charter process. Proposals presented as "goals and principles" should be viewed not as an alternative, but rather as a list of questions to the Energy Charter international community about the efficiency of existing Charter instruments.

Every five years, the Energy Charter Policy Review, based on Article 34(7) of the ECT, takes place. The next policy review conclusions are due in late 2009. This is an excellent opportunity to introduce changes and amendments to the ECT process and its documents, alleviating Russia's reasonable concerns. But to achieve this, Russia's delegation must work within the framework of the Energy Charter adaptation process – and should not try to develop a new process. Russian authorities have a valid point by criticising the Energy Charter for its inaction during and in advance of the January gas crisis with Ukraine. But that was not the fault of the Charter process as such – it constituted a lack of adequate action by the Energy Charter Secretariat's present leadership.

Russia has an excellent opportunity not to oppose the Energy Charter process, but to lead the work on its adaptation, based on the proposals it made in April. This *Conceptual approach* creates a road map for modernisation (or actualisation) of the Energy Charter process. ●

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