

# **Russia-EU common energy space: how to create it best - and how it correlates with Russian initiative on new international energy order**

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- Russia-EU common energy space & new Russian initiative on new international energy order

# Common energy space demands common rules – what options for common rules in energy between Russia & EU?

- 1) Export of EU *acquis communautaire* ?
- 2) New bilateral Russia-EU treaty – “based on the Energy Charter principles” ?
- 3) Energy Charter Treaty !

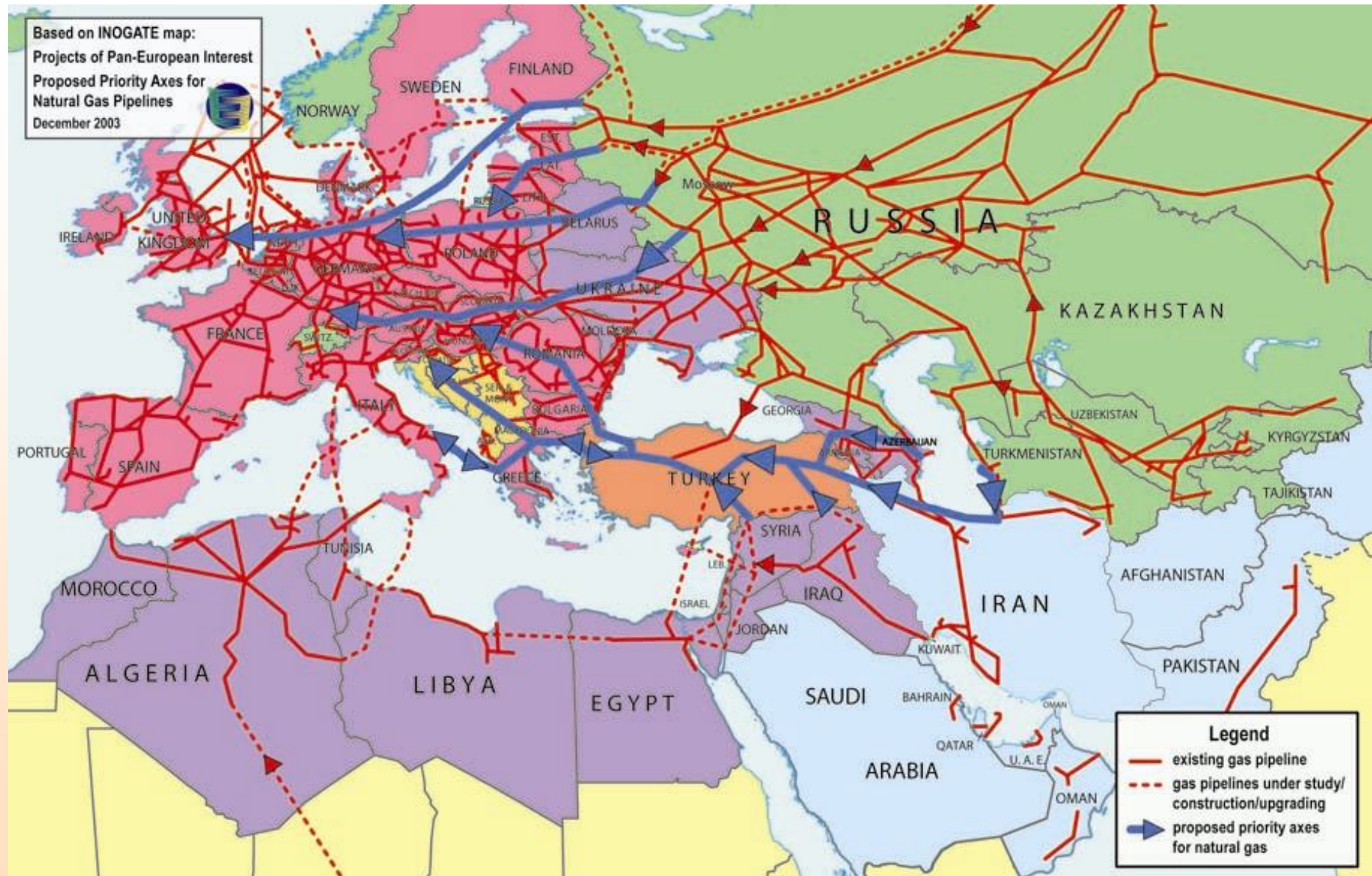
# Option 1: Export of “acquis communautaire”

- EU’s preference: for EU, harmonization of EU legislation with legal systems of third states means basically application of EU legislation within these third states, incl. in energy => “export of acquis”
- EU tries to expand geographical area of implementation of acquis in energy:
  - EU enlargement (EU15=>EU25=>EU27=>EU27+?)
  - EU-SEE Energy Community Treaty (EU27+7) + new observers/members
  - EU Neighborhood Policy (EU27 + 10NA + 8FSU/CIS)
    - EU has even initially included Russia in this Policy => strong negative respond from Khristenko to Lamoureux,

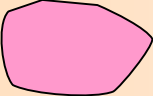
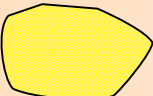
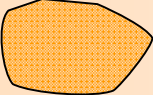
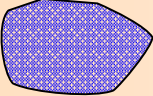
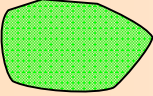
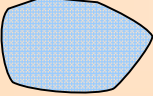
*but*

- EU acquis does not (and will not !) cover all segments of energy (gas) value chains destined for EU and originated from Russia & other key non-EU producers (Central Asian states, Iran, etc.)

# Common rules of the game in Eurasian energy & export of EU's acquis



## Common rules of the game in Eurasian energy & export of EU's acquis ? (legend)

Zone	States within the zone	Description
	<b>EU Members:</b> 27 EU countries	EU legislation, including the energy legislation, is fully applicable
	<b>Energy Community EU-SEE Countries:</b> Croatia, Serbia, Montenegro, Croatia, Bosnia, FYROM (Macedonia), Albania, UNMIK (Kosova); other Energy Community members are already EU members	Only EU legislation on internal electricity and gas markets is applicable
	<b>EU Candidate Countries:</b> Turkey (Croatia is already an Energy Community member so applying the EU energy market acquis)	Still in the process of alignment to the EU legislation but full compliance not likely before membership
	<b>EU Neighbourhood Policy Countires:</b> CIS (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine) and Northern Africa (Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority, Syria, Tunisia)	Enhanced energy cooperation based on National Action Plans with Ukraine and Moldova (as well as with Israel, Jordan, Morocco, the Palestinian Authority and Tunisia); partial application of EU energy policies and legislation may be possible in the future
	<b>EU-Russia Strategic Partnership:</b> EU & Russia	Based on shared principles and objectives; applicability of the EU legislation in Russia is out of question
	<b>ECT member-states:</b> 51 states of Europe & Asia	ECT is fully applicable within the EU as minimum standard; EU went further in liberalizing its internal energy market, BUT whether EU can demand that other ECT member-states follow same model and speed of developing their domestic markets?
	<b>ECT observer-states:</b> 20 states of Europe, Asia (e.g. Middle East, South-, SE- & NE-Asia), Africa, North & Latin America	Shared ECT aims & principles; did not take ECT legally binding rules; not ready to take more liberal rules of EU Acquis

## Option 2: New bilateral Russia-EU treaty – “based on the Energy Charter principles”

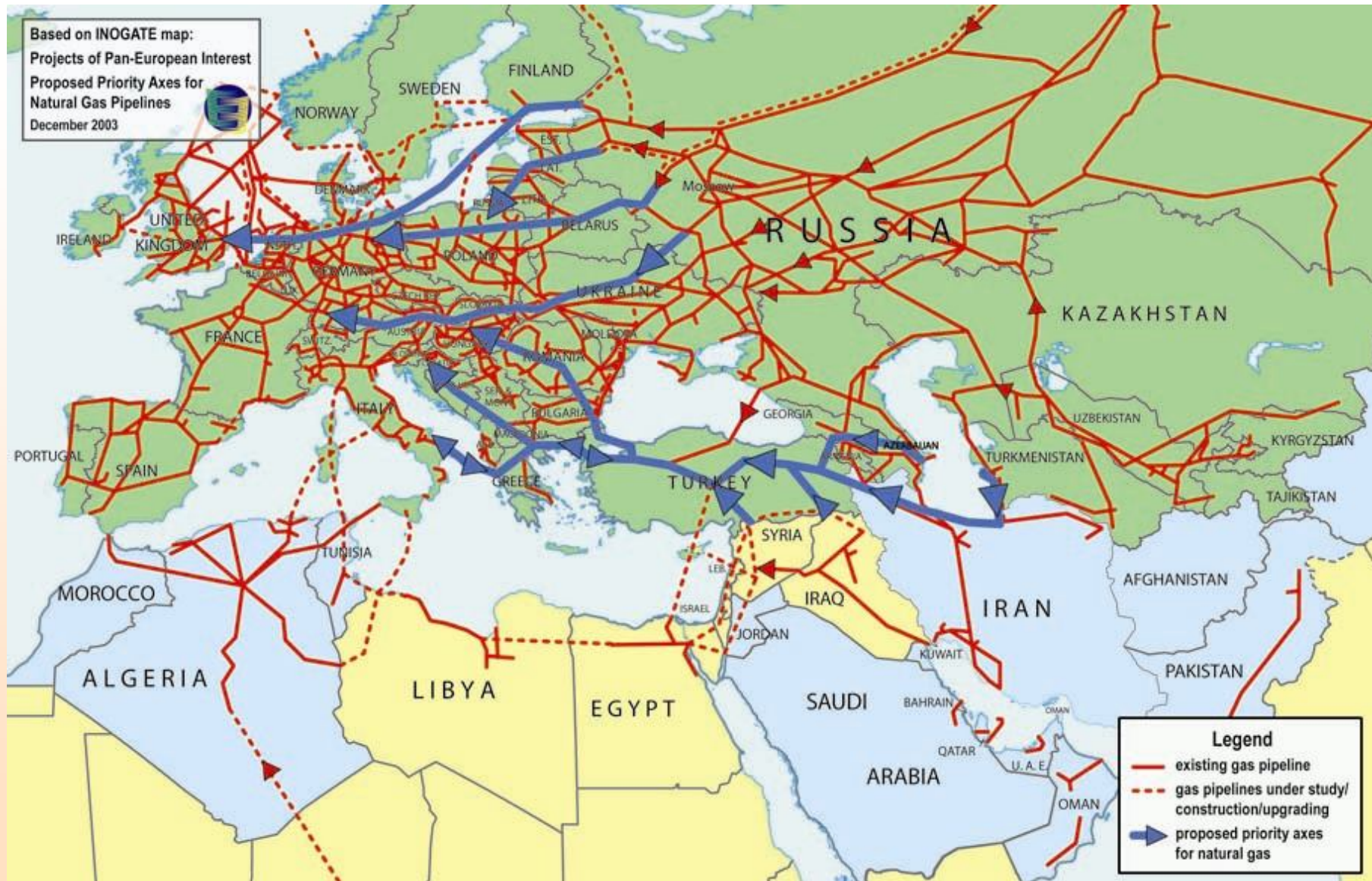
- Russia’s compromise proposal – some supporters in EU,  
*but*
- Any bilateral Russia-EU Treaty (PA) does not cover transit states between Russia & EU,
- If it based on “Energy Charter principles”:
  - What does this mean operationally? Different wording of ECT provisions in new PA? => if so, possibility for two standards (under new PA & under ECT) of (i) implementation of “provisions based on ECT principles” & (ii) of their interpretation in different arbitrations => instead of diminishing legal risks, this would increase such risks & the cost of capital for Russian and EU investors in energy projects of mutual interest,
  - To negotiate today new Russia-EU legally-binding Treaty (27+1+1 CPs) is much more difficult task than it was in early 1990’s with PCA & ECT negotiations (then - window of political opportunities, not now) => (3 open issues between Russia & EU in draft Energy Charter Transit Protocol took 6+ years already) => when this new broader Treaty can be finalized and ratified ? => risk of failure of new negotiations

# Option 3: Energy Charter Treaty as a legal background of Russia-EU common energy space

- ECT (incl. members & observers) covers all major current & future energy (gas) value chains to EU => minimum standard of common rules in a broader area than just Russia-EU space
- Optimal solution: Russia-EU PA energy chapter = ECT is a legal background of Russia-EU common energy space
- ECT (in force since 1998) is already a common legal background within 51 Eurasian states, incl. Russia & EU:
  - EU: ratified by all EU member-states & by EU => ECT is already an integral part of the EU acquis,
  - Russia: signed & applied on provisional basis (ECT Art.45) => Russia still to ratify ECT => this is crucial if ECT to become common legal background of Russia-EU common energy space



# Common rules of the game in Eurasian energy & expansion of ECT



# Russia ECT ratification: what obstacles?

- **Political concerns**

- Natural reaction on external political pressure on Russia to ratify ECT without considering Russia's concerns (like "Russia *must* ratify ECT" – f.i. Barroso et al prior to 2006 G-8 St.Petersburg Summit)
- Based on misinterpretations of ECT from both sides =>
  - part of Russian politicians, opposing ECT, just did not read ECT (f.i., concerns as if ECT requests mandatory TPA, etc.), *but*
  - Russian politicians reacts mostly not to the ECT provisions, but to their (mostly questionable or incorrect) interpretations by EU officials echoed by international press (like "ECT opens access to Gazprom transportation system at low domestic tariffs", etc.)

- **Concerns as "negotiating tool"**

- To possess something to give up later in search of compromise
- All general concerns regarding what is *not* present in the ECT (like "ECT does not address problems of Turkish & Danish straits", etc.)

- **Valid & substantiated economic concerns**

- 2001 Parliamentary Hearings: Russia will return to ECT ratification question after all her valid concerns are adequately addressed => two issues in regard to transit (ECT Art.7) => to be addressed in Transit Protocol => no ECT ratification without TP (Khristenko) => open issues in TP itself preventing its finalization

## Russia's ECT ratification & TP: how to proceed?

- **Option 1:** Russia first ratify ECT, afterwards Energy Charter community finalize & ratify TP => demand of EU, impossible for Russia
- **Option 2:** first finalize & ratify TP (with full consideration of valid Russia's concerns), afterwards Russia returns to ECT ratification issue => impossible by ECT rules (no state can join Energy Charter Protocol if not first ratified ECT)
- **Option 3** = the only workable compromise: Russia will ratify ECT & TP simultaneously => ECT community need to concentrate on practical ways of solving this problem

# ECT & TP: 2 + 3 = 5 open issues on transit

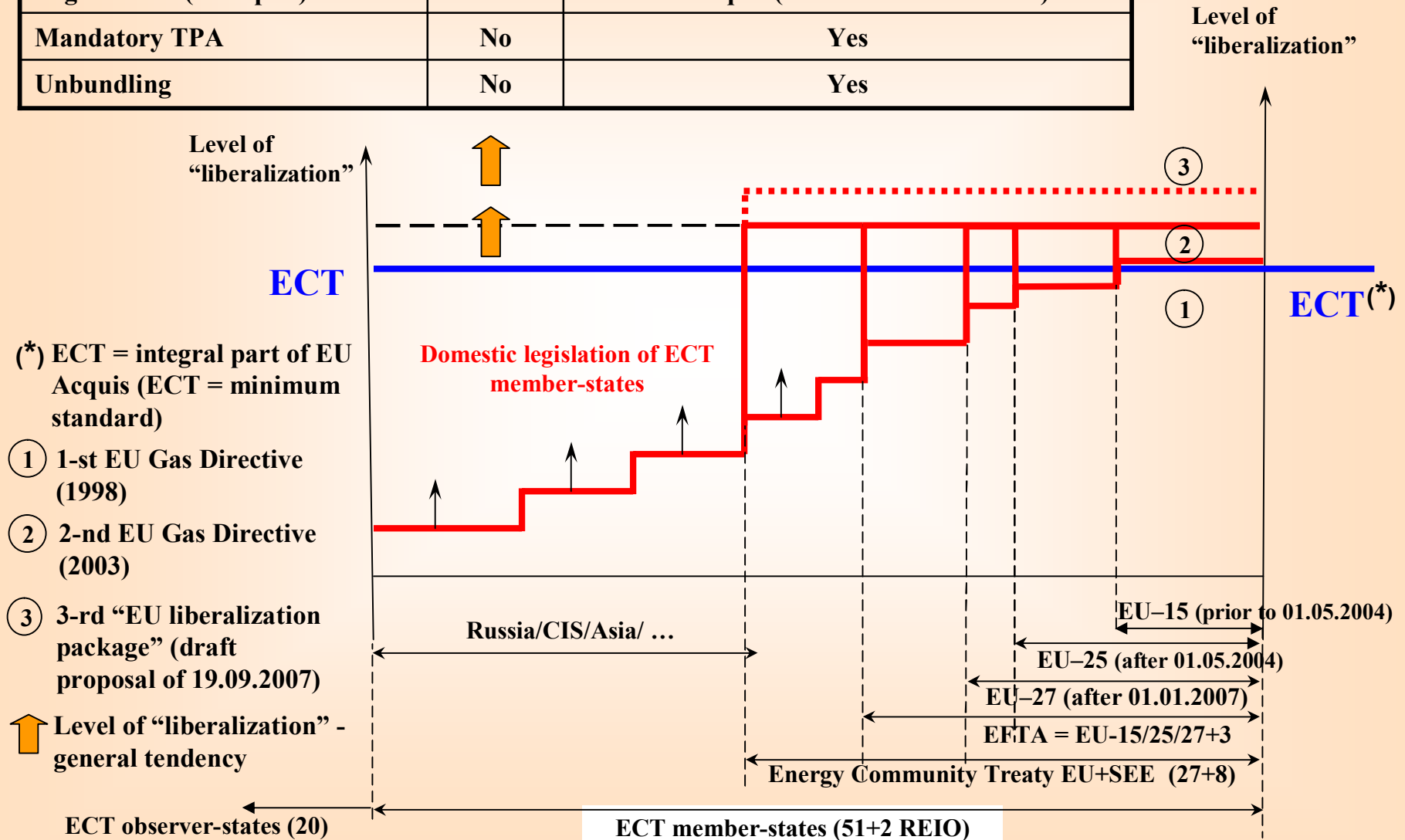
- 2 open issues in ECT (Art.7) for Russia:
  - Transit vs. domestic tariffs (ECT Art.7.3)
  - Conciliatory procedure (ECT Art.7.6-7.7)
- 3 open issues in draft TP for Russia & EU:
  - Auctions & cost-reflectiveness of transit tariffs (TP Art.10) => new article on congestion management (TP Art.10bis)
  - Problem of contractual mismatch (long-term access to transportation capacities for long-term supply contracts within unbundled energy systems) (TP Art.8)
  - Implementation of Transit Protocol within EU => EU proposal in TP Art.20/“REIO clause”: transit = if energy flow crosses whole EU territory and not territory of its individual member-states => key issue of disagreements between Russia & EU = internal EU issue (correlation between ECT and acquis within EU) => a key to ECT ratification by Russia is in EU hands
- Technical solutions to all issues (except REIO clause) agreed in principle informally at multilateral level; way forward on REIO clause agreed multilaterally with major input from Russia & EU (October 2008 TTG Group meeting)

# Key EU problems regarding ECT

- EU ratified ECT in two capacities: (a) each EU member-state and (b) EU as a whole (as REIO) => internal EU problems (“transit” according to ECT & TP/REIO clause, dispute settlement within EU, etc.)
- Increasing gap between level of liberalization of (a) internal energy market(s) within EU [First 1996/98 => Second 2003 => Third 2009 (?) EU Directives] and (b) ECT as a minimum standard for broader Eurasian community => different ECT vs EU acquis approaches (NTPA vs MTPA, unbundling, etc.) =>
  - ECT as an instrument of protection of non-EU and EU companies against “excessive” liberalization of internal EU energy space ?
- EU as ECT CP: ECT = international treaty, EU acquis = domestic legislation for EU => ECT to dominate over EU acquis =>
  - companies from EU member-states can litigate against EU (f.i. against Third liberalization package) in international arbitration courts outside EU (ICSID, UNCITRAL, SCC) based on ECT provisions => f.i. “ownership unbundling = expropriation” [EU gas company] => ECT Art.13 (on investment protection)
- Whether EU would really like to have ECT as a legal background of Russia-EU common energy space?

# ECT & EU acquis: “minimum standard” within evolving Eurasian common energy space vs. more “liberalized” model

Legal norms (examples)	ECT	EU Acquis (2-nd EU Gas Directive)
Mandatory TPA	No	Yes
Unbundling	No	Yes



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# Russian President D.Medvedev on new Russian initiative and Energy Charter (1)

- 20 January 2009: D.Medvedev during meeting with A.Miller, Gazprom:
  - criticised Energy Charter that it did not manage to prevent Russia-Ukraine gas crisis of Jan.2009,
  - “new international mechanisms needed”,
  - “to think either on changing the current version of Energy Charter (if member-states would agree to this) or on creating a new multilateral document...”,
  - Suggested that Government and Gazprom would “think on what mechanism in this sense would be appropriate to prepare and to propose to all members of international community”,
  - promised to propose some ideas during G-20 meeting in London early-April.



# Russian President D.Medvedev on new Russian initiative and Energy Charter (2)

- 1 March 2009 during interview to Spanish media D.Medvedev proposed to “prepare a new Energy Charter or a new version of the Energy Charter”
- 20 April 2009 in Helsinki D.Medvedev stated:
  - “Russia has intention to change legal basis of relations with consumer- and transit states”,
  - about “Energy Charter and related documents” that “we have not ratified these documents and do not consider ourselves to be bound by these decisions”,
  - “he will disseminate ... basic document which defines the issues of international cooperation in energy”.

# New Russian initiative and Energy Charter (2)

- 21 April 2009 “Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)” published at Russian President’s official website ([www.kremlin.ru](http://www.kremlin.ru)), total 5 pages, incl.:
  - 2,5 pages – “Main principles of the new legal framework for global energy cooperation”,
  - 1 page – Annex 1: Elements of the Transit Agreement, and
  - 1,5 pages – Annex 2: List of Energy Materials and Products
- Presidential Aide Arkady Dvorkovich ([www.kremlin.ru](http://www.kremlin.ru)):
  - “These documents are basically being suggested as a substitute for the Energy Charter”, “we probably need a new document” (within broader group of states)
  - “we are not satisfied with the Energy Charter and the related documents as they currently exist, and ... we feel a new legal base is needed”
  - “Russia signed the Energy Charter, but did not ratify it. This means that we do not consider ourselves bound by obligations under the Energy Charter. As for the Energy Charter Treaty, we also do not feel that we are bound by obligations under it... in fact, these documents never applied to us.”

# Russia: provisional application of ECT

- Under ECT Art.45 (“Provisional application”) Russia (plus Belarus), applies ECT provisionally, that is “to the extent that such provisional application is not inconsistent with its constitution, laws or regulations”.
- *The worst scenario of immediate future developments:* if Russia, based on results of internal debate, and under ECT Art. 45(3)(b), would decide to declare its termination of the provisional application of ECT (its intention not to become a Contracting Party to the Treaty)
- Visual signs of such internal debate:
  - 21 April, Helsinki, question to A.Dvorkovich: “Russia did not join in on the Energy Charter, so it cannot talk about leaving it”,
  - 29 April, Sofia, V.Putin: “Russia does not see sense in keeping its signature under Energy Charter”.

# Russia: Consequences of termination of provisional application of ECT

- Will play into hands of anti-Russian political forces (they will repeatedly label Russia as not respecting the rule of law),
- Should Russia ratify ECT, it will in the course of time increasingly protect Russian investments abroad, firstly, from “liberalization risks” within the EU market,
- Since 1998 ECT is an integral part of international law. Russia’s non-participation in the Treaty will not lead to its termination. It’s only that other countries will enjoy its advantages,
- Russia’s repudiation from ECT does not mean that Russia 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,
- The EU has been exporting its legislation through its system of international treaties. Repudiation of the ECT under these circumstances will deny the possibility for non-EU and non-ECT states to negotiate a “new global energy order” with EU member-states on the terms different from those provided for in the EU legislation.

# Common fallacy for quit Energy Charter

- **Two provisions ECT Art.7 “Transit” (interpretations):**
  - Art.7(3) – correlation of domestic transportation and transit tariffs,
  - Art.7(6)-7(7) – conciliatory procedure (correlation of temporary and final transit tariffs)
- **Central Asian gas - transit, tariffs, prices:**
  - As if under direct contracts between CA exporters and EU/CIS importers ECT would bound Russia to provide transit capacities at low domestic transportation tariffs, and thus cheap CA gas would compete with Russian gas at EU market, but
  - ECT, vice versa, presents 5 levels of internationally-accepted mechanisms of justified non-access to the national GTS for potential (new) transit,
  - CA gas is no more “cheap”: since 2009 its export price is based not on cost-plus, but on net-back EU-based replacement value pricing – the highest possible price
- **“YUKOS case”:** (to “quit ECT” to exclude repetition of similar cases):
  - in the event that a signatory terminates provisional application, acc. to ECT 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:
    - its 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.

# Russian initiative of 21 April 2009: instead of ECT – or to improve multi-facet Energy Charter ?

- **“Energy Charter” is multi-facet meaning:**
  - International organization with open and expanding membership - Energy Charter Conference,
  - Long-term process with its repeating life-cycle (legal negotiations – monitoring of implementation – political debate on adaptation – new legal negotiations - etc.)
  - Expanding package of documents
  - Executive body – Energy Charter Secretariat
- **“Conceptual Approach...”** can not be seriously treated as an alternative to Energy Charter/ECT, but it can be accepted by international community as a set of proposals on how to further improve and adapt existing Energy Charter multi-facet process:
  - Energy Charter Policy Review (ECT Art.34(7)) – once in 5 years: 1999, 2004, 2009,
  - Adaptation of Energy Charter process, with all its components, incorporated in Conclusion of 2004 Policy Review,
  - **“Mail principles...”**: bullet points of Russia’s broad interest to different facets of Energy Charter => to discuss within Ad Hoc Strategy Group & Policy Review 2009
  - **Annex 1 “Elements of the Transit Agreement”**: In draft Transit Agreement – a novelty: Ad Hoc international commissions authorized to settle and prevent transit-related emergencies in case of risk of their occurrences; this novelty was prepared as complimentary to ECT mechanisms and not instead of them; it can be easily incorporated into ECT dispute settlement procedures as second pre-arbitration mechanism in parallel with conciliation.
  - **Annex 2 “List of EMP”**: equal to Annex EM to ECT 1994 and is more narrow than Annex EM1 to Trade Amendment 1998 (energy-related equipment)

## Option 3 (ECT-based): how to proceed

- Finalize & sign Transit Protocol, incl. to cover Russia's substantiated concerns on transit both in TP and in ECT,
- Address other substantiated Russia's concerns re ECT of multilateral character (closed list to be presented by Russia to ECT community, based on Russia's proposals as of 21 April),
- Russia-EU PA energy chapter: "ECT is the legal basis of Russia-EU common energy space"; PA energy chapter entering into force linked to Russia's ECT & TP ratification,
- Russia simultaneously ratify ECT & TP,
- Further development of ECT based on results of current (Ad Hoc Strategy Group discussions aimed at 2009 Energy Charter Policy Review) and future regular policy debate on new challenges & risks of energy markets developments and how to most effectively address them by further improvement & expansion of ECT – based on Russian proposals as of 21 April,
- After all ECT members ratify ECT (today: 46 of 51), new negotiations on adaptation (actualization, modernization, amending) ECT possible – should Energy Charter Conference provide mandate on this

**Thank you for your attention !**

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