

**Russian oil and gas export and
the Energy Charter Protocol on Transit :
Russia's concerns and draft solutions**

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Session 6: Exports of Russian oil and gas to international markets**

ENERGY CHARTER HISTORY

June 25, 1990	Lubbers' initiative presented in Dublin
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
April, 1998	ECT came into full legal power
January 1, 2002	<ul style="list-style-type: none"> • ECT signed by 51 states + European Communities = 52 • ECT ratified by 45 states (excl. 6 countries: Russia, Belarus, Iceland, Japan, Australia, Norway) + EC • Russia: provisional application, together with Belarus

State Duma: **Russia will ratify ECT, but not yet (depending on Transit Protocol)**

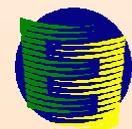


Figure 1

ENERGY CHARTER AND RELATED DOCUMENTS

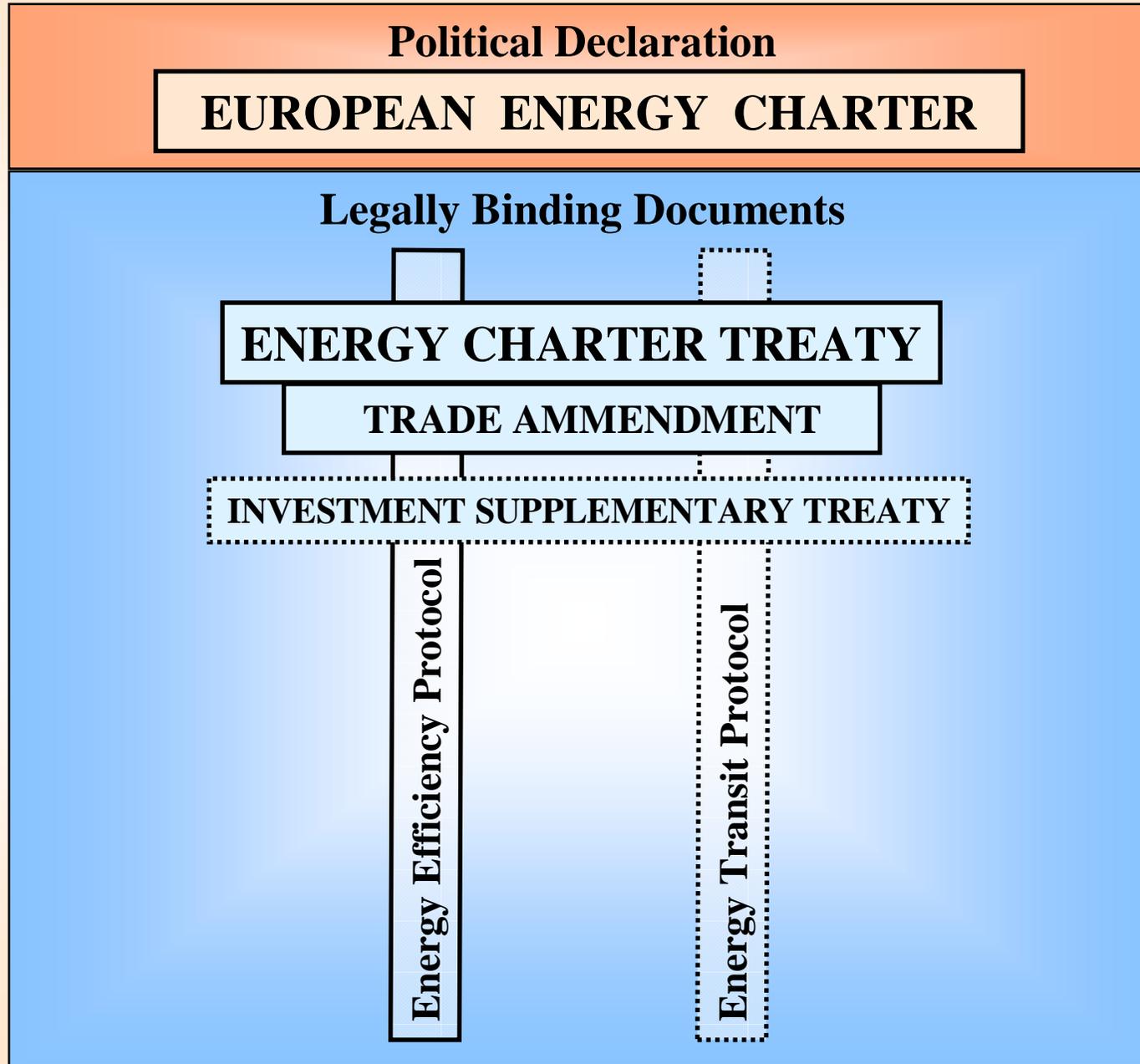
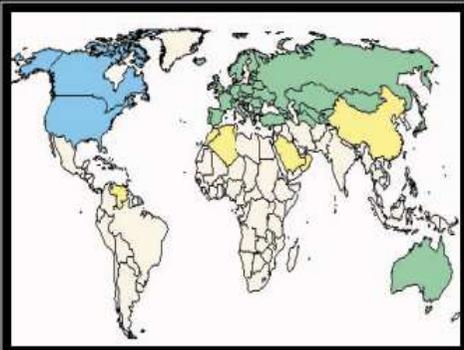


Figure 2

**Договор
к Энергетической Хартии:
путь к инвестициям
и торговле
для Востока и Запада**



«МЕЖДУНАРОДНЫЕ ОТНОШЕНИЯ»



ПРОТОНОВИДЕСТ



**THE ENERGY CHARTER
TREATY
A READER'S GUIDE**

LIST OF ISSUES RELATED TO TRANSIT OF ENERGY, THAT ARE OF RUSSIA'S CONCERN

TRANSIT PROTOCOL

- 1. Available capacity**
- 2. Transit tariffs**
- 3. Right of first refusal**
- 4. REIO clause**

TRANSIT RELATED ISSUES

- 5. Conciliation of transit disputes**

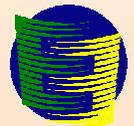


Figure 3

1. AVAILABLE CAPACITY

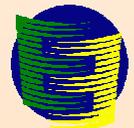
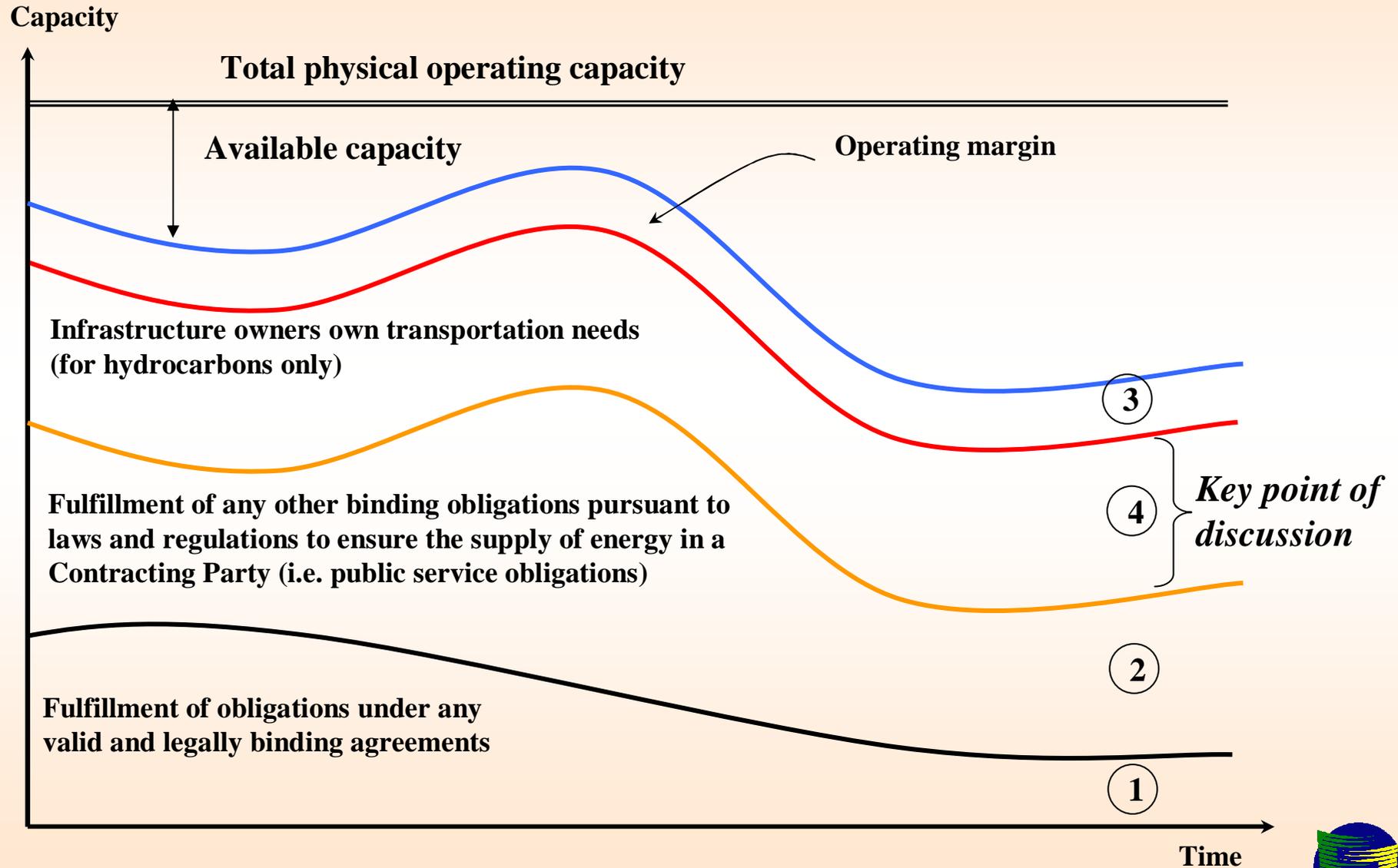


Figure 4

1. AVAILABLE CAPACITY (continued)

Russia's concerns:

Any definition of Available Capacity must take into consideration the present organisation of Russian oil and gas complex

* * * * *

A. Available Capacity = total physical operating capacity, less

- 1) Fulfillment of obligations under any valid and legally binding agreements
- 2) Fulfillment of any other binding obligations pursuant to laws and regulations
- 3) Operating margin
- 4) *Infrastructure owners own transportation needs (for hydrocarbons only)*

OR

B. Available Capacity = total physical operating capacity, less

- 1) Fulfillment of obligations under any valid and legally binding agreements
- 2) Fulfillment of any other binding obligations pursuant to laws and regulations
- 3) Operating margin

Conclusions (solution):

The concerns of Russia has been fully addressed by including “infrastructure owners own transportation needs (for hydrocarbons only)” into definition of Available Capacity

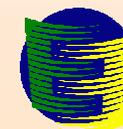


Figure 5

2. TRANSIT TARIFFS

Excessive Profits?
Reasonable profits, function of total investments and their financing
Operating costs per year
Investment cost per year, function of total investments in Energy Transit Facilities

Obligations:

Transit tariffs shall be objective, reasonable, transparent and non-discriminatory

States should prohibit the abuse of a dominant position

Given the fulfillment of these obligations, transit tariffs may be established by any method, such as:

- a) Regulated transit tariff**
- b) Negotiated transit tariff**
- c) Congestion management mechanism such as auctions**

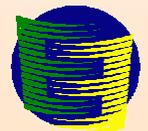


Figure 6

2. TRANSIT TARIFFS (continued)

Russia's concerns:

The transit tariffs shall be based on cost and shall include a reasonable profit. No special taxes should be included. Auctions systems can not give a reasonable profit.

Conclusions (solution):

Transit tariffs shall be based on cost stemming from internationally accepted accounting rules and shall yield an acceptable profit. Only taxes in conformity with international agreements may be included in the cost base.

Each of Contracting Parties can choose method for implementation, provided it fulfils the criteria specified.

Auctions can provide a machinery of a recycling-type mechanism transforming “excessive profits” into expansion of available capacity and thus diminishing the very need for further auctions, until the new deficit of available capacity will appear due to increase in demand for it.



2. TRANSIT TARIFFS (continued)

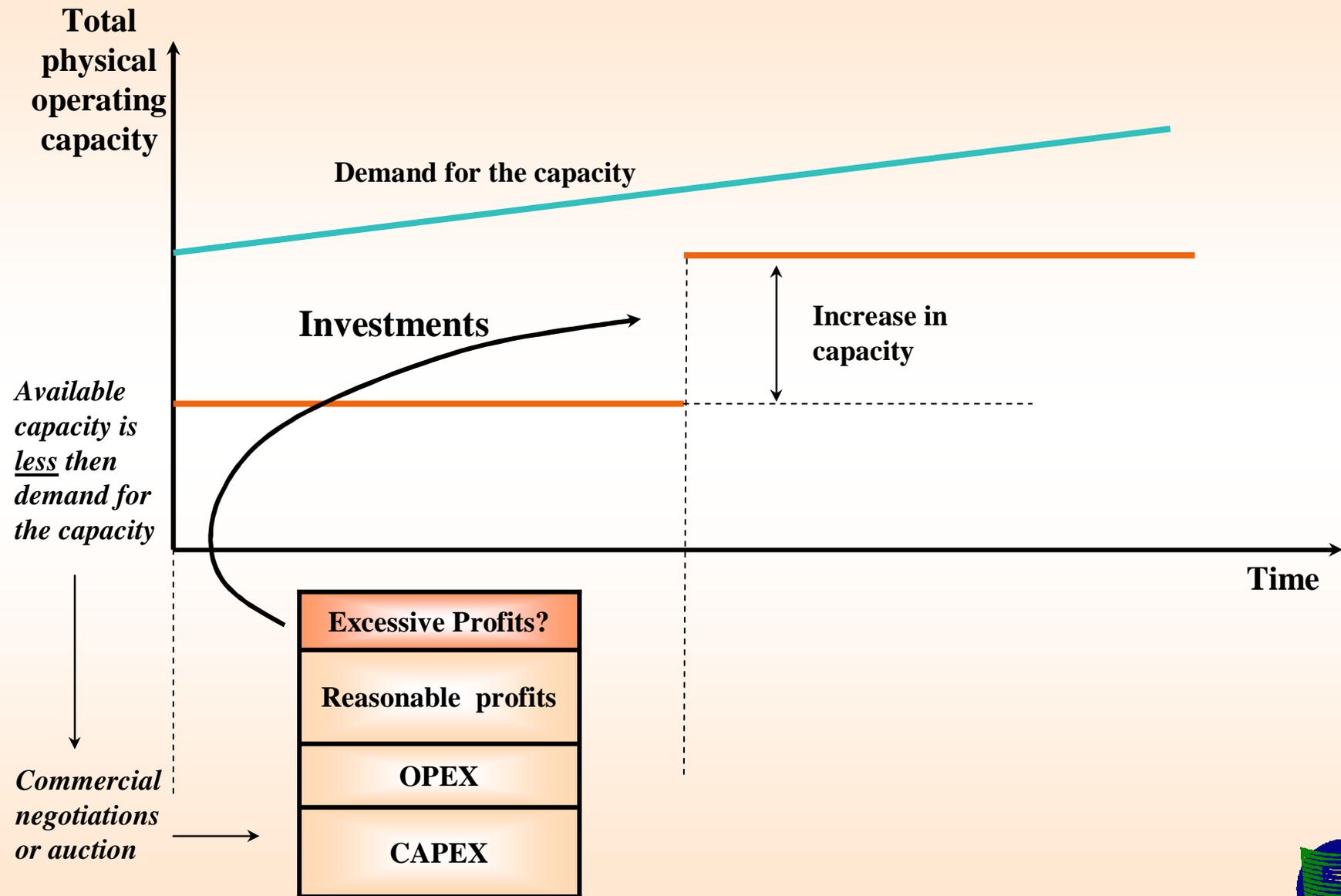


Figure 8 a

2. TRANSIT TARIFFS (continued)

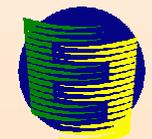
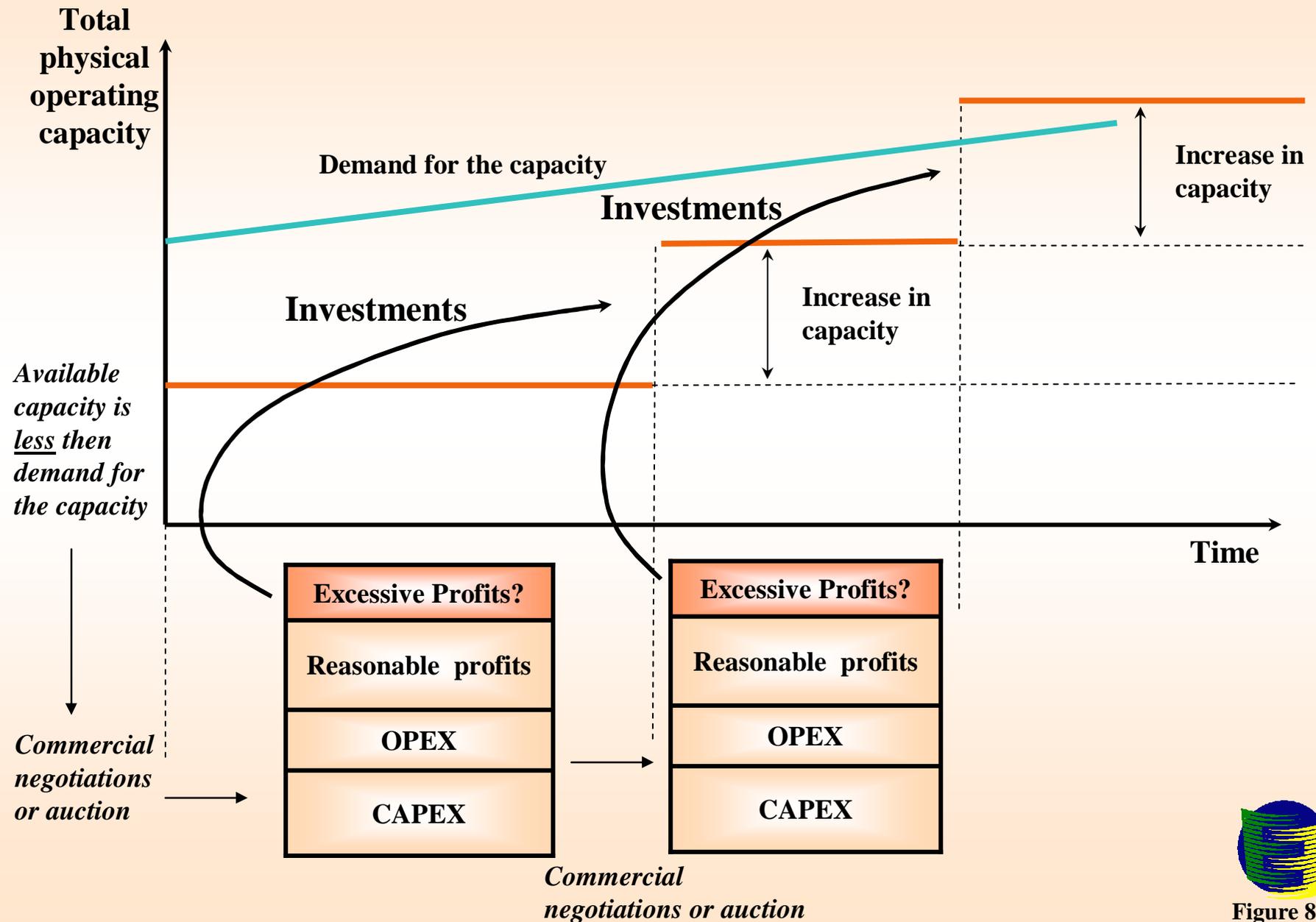


Figure 8 b

2. TRANSIT TARIFFS (continued)

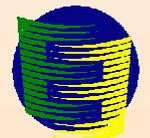
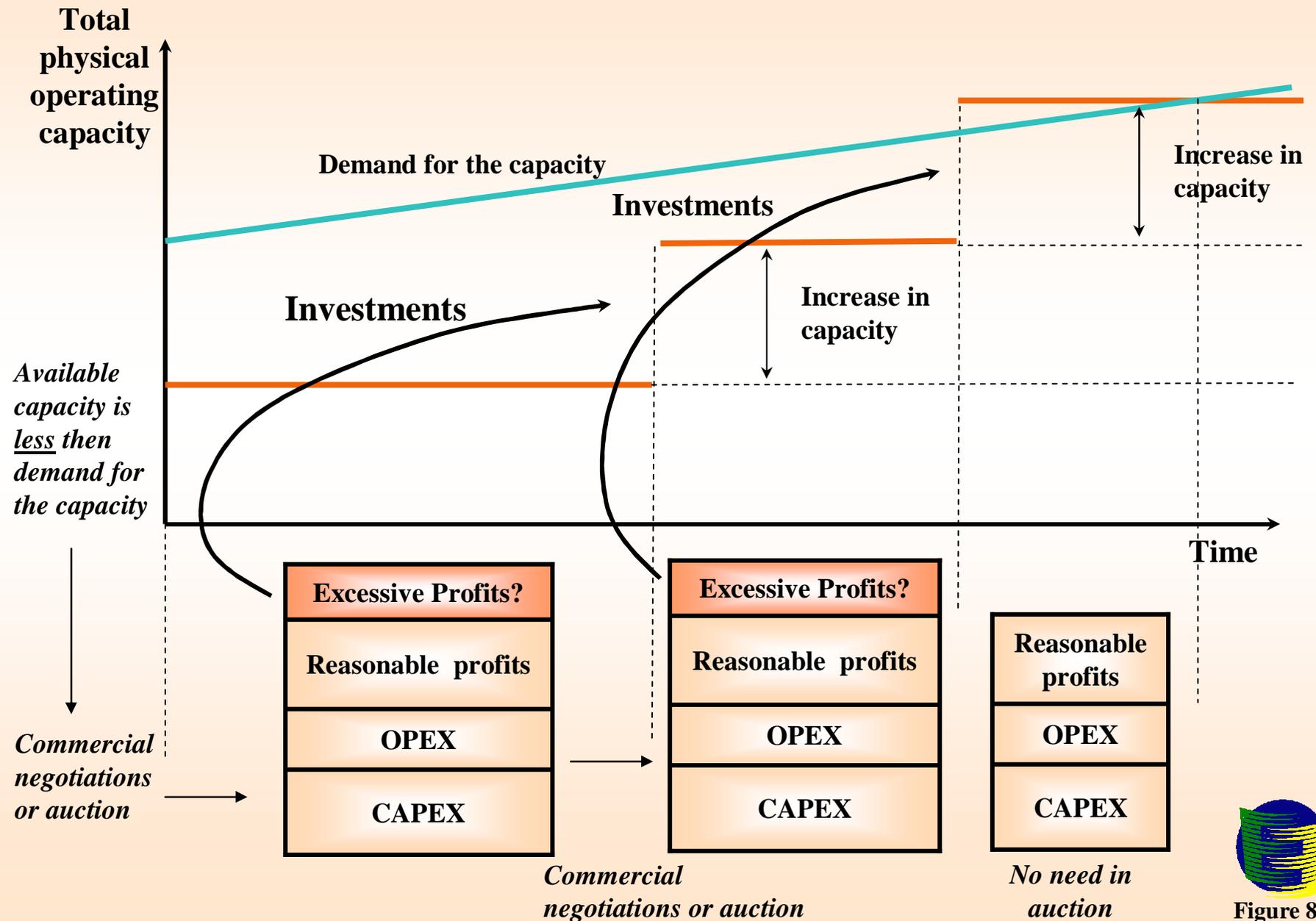
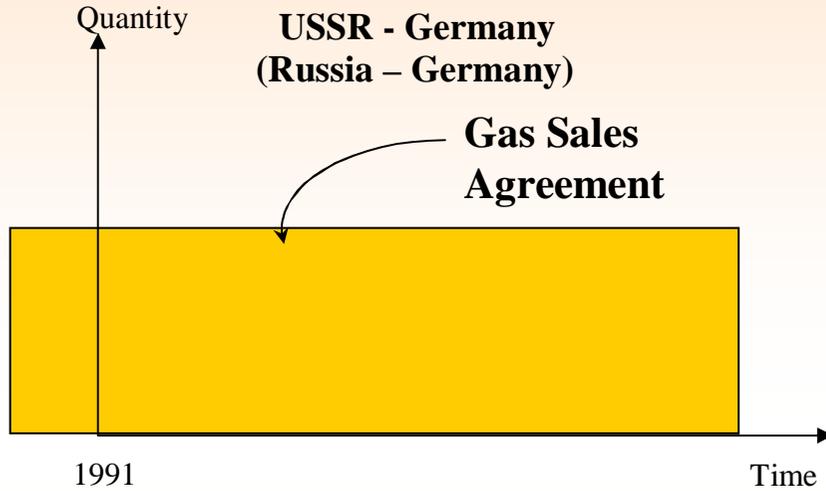


Figure 8 c

3. RIGHT OF FIRST REFUSAL

Currently



In the future

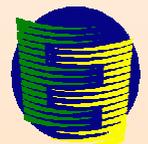
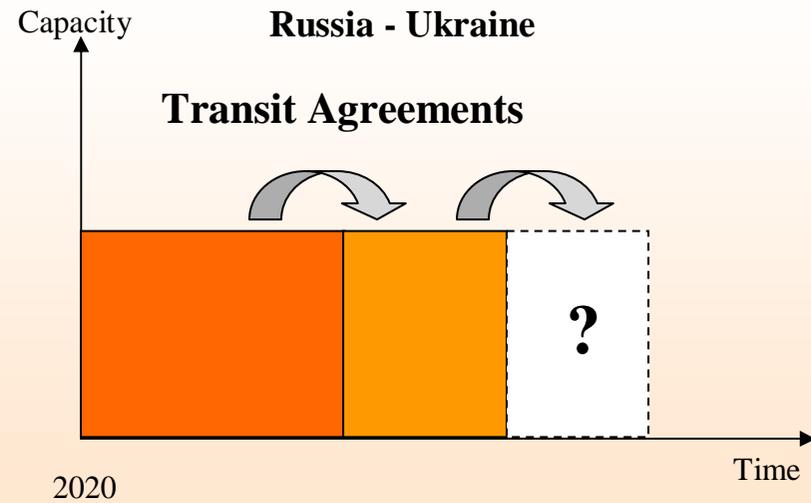
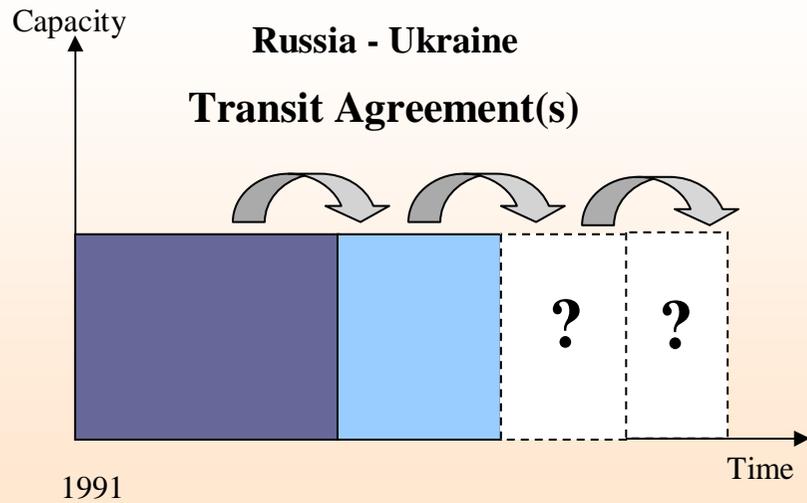
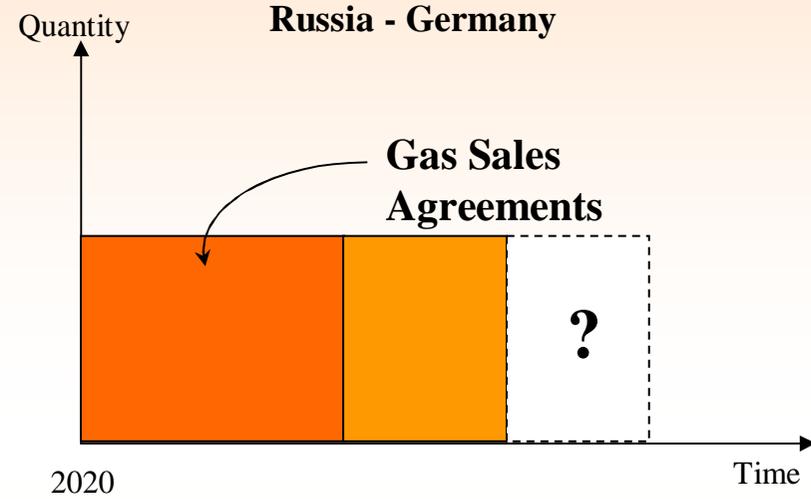


Figure 9

3. RIGHT OF FIRST REFUSAL (continued)

Russia's concerns:

- a) **Historical collapse of the Soviet Union, leading to mismatch between the duration of gas sales agreements and transit agreements outside the territory of Russia**
- b) **Market access or the allocation of limited pipeline capacities between existing gas market players and newcomers**

Conclusions (solution):

Item a) - solved in the Transit Protocol

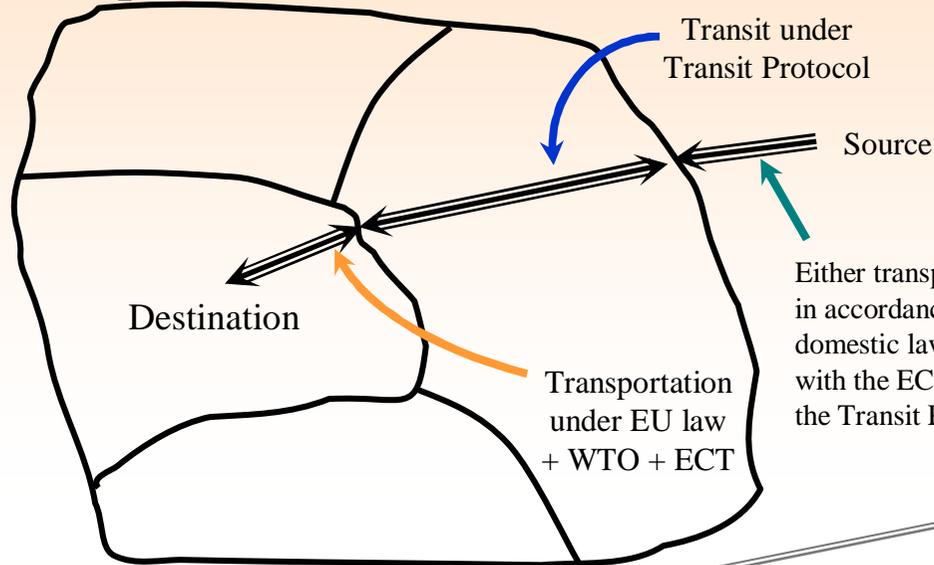
Item b) - still open for negotiations



Figure 10

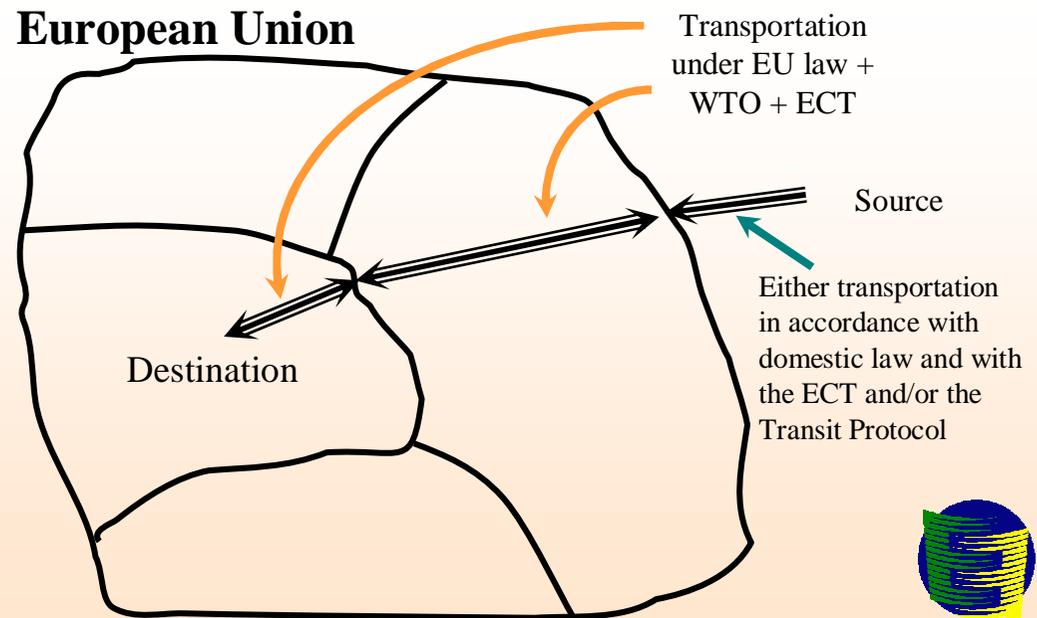
4. REIO clause

European Union



(a) Before REIO:

European Union



(b) After REIO:



Figure 11

4. REIO clause (continued)

Comparison of “Transit under Transit Protocol” and “Transportation under EU law +WTO+ECT”

Russia’s concerns:

- I) Maintain transit and transportation rights comparable to rights contained in the Transit Protocol on the territory of the European Union
- II) Transparency and stability of legal regime

Conclusions (solution):



Sources: EU legal analysis
ECS legal analysis

Russian delegation at the TWG meeting (8.03.2002) has agreed with the conclusions of the analysis

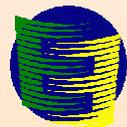


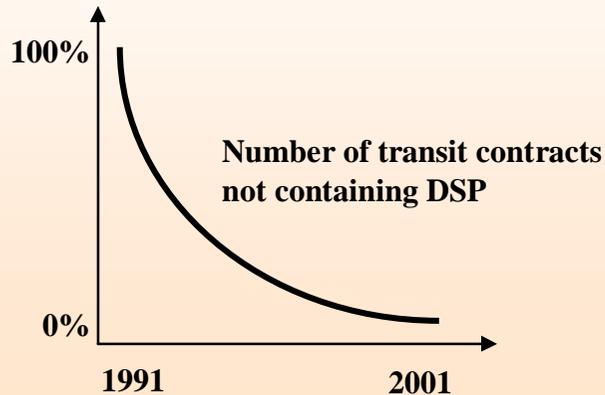
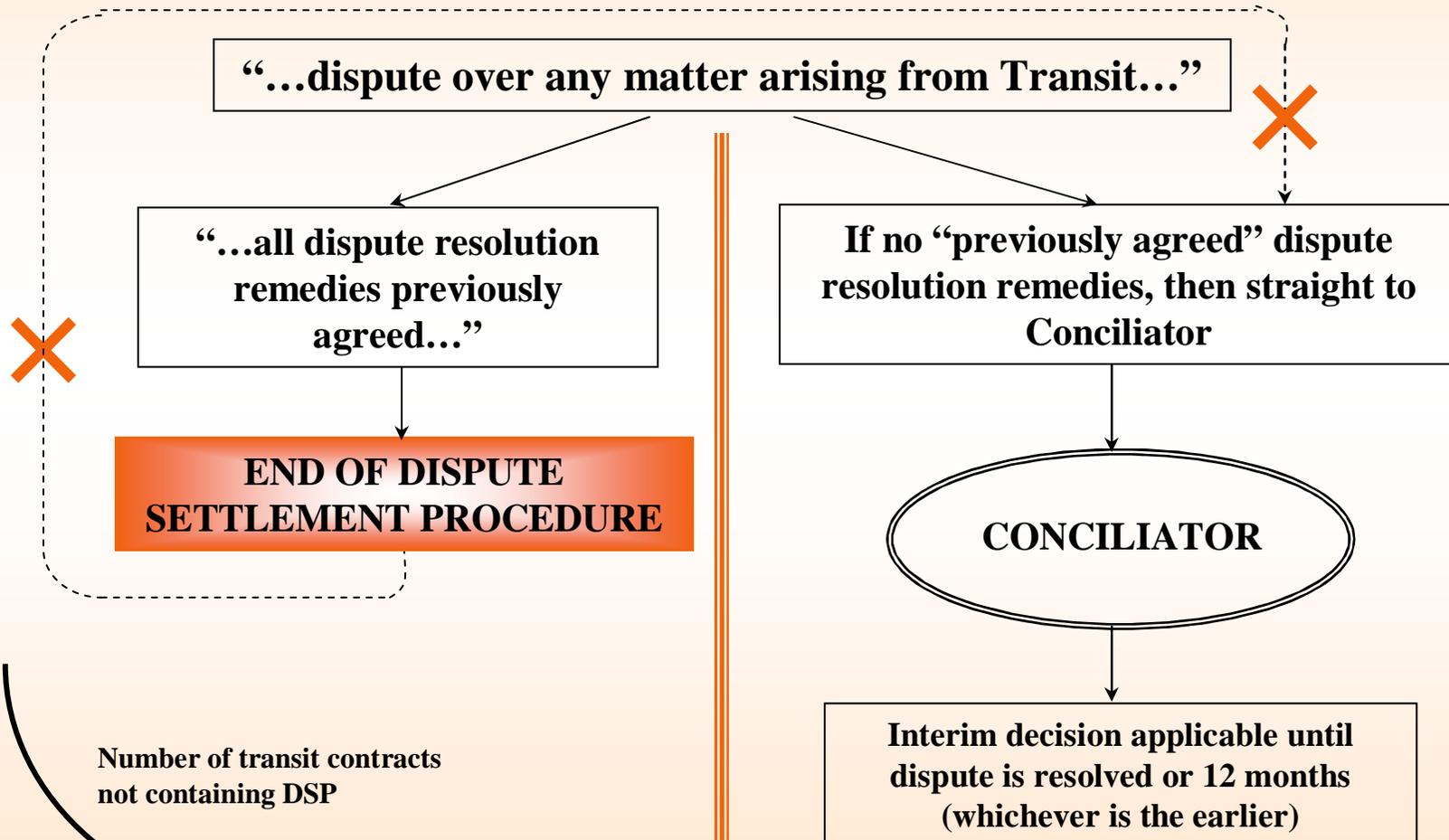
Figure 12

5. CONCILIATION

Dispute settlement procedure

(a) in the contract

(b) not in the contract



~100% of transit contracts

~ 0% of transit contracts

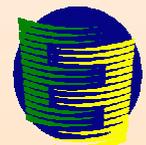


Figure 13

5. CONCILIATION (continued)

Russia's concerns:

The conciliation mechanism, relying on one Conciliator, can be used to “re-open” the result from an arbitration. In such a situation the Conciliator has too much power.

Conclusions (solution):

The ECT prescribes that the Energy Charter Conference, in which the Contracting Parties meet, shall adopt rules for the conduct of the conciliation.

The proposed solution is to amend the rules, by adding a new one, prescribing that the Conciliator has no jurisdiction if the dispute concerned has been resolved through a final and binding arbitration.

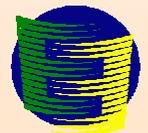


Figure 14

FINAL CONCLUSIONS

Major concerns of Russia has been adequately addressed in the latest draft of the Transit Protocol (TP), at least in substance if not in final legal wording.

Draft agenda for finalising of TP negotiations might be the following (if political will of the Contracting Parties is there):

- **Final TWG meeting – end of May 2002**
- **End of negotiations on TP – end of June 2002 (Energy Charter Conference)**
- **Signing ceremony of TP - mid-December 2002 (Energy Charter Conference)**

That might open the way for ECT ratification procedure in Russia

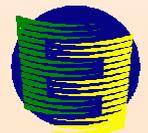


Figure 15