

## A Russian Perspective on the Energy Charter Treaty (ARI)

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**Theme:** The need for a new energy transit regime has brought the Energy Charter Treaty back to the limelight.

**Summary:** The recent gas crisis between Russia and the Ukraine and a number of political declarations on the need for a new energy transit regime have brought the Energy Charter Treaty back to the limelight. In both Russia and Europe many analysts consider the Energy Charter to be either outdated or born dead. Moreover, a recent Russian proposal to create a 'New Energy Charter' has added further confusion to the issue of a multilateral energy regime. This ARI aims to explain the Energy Charter's political role and weaknesses by looking at the entire legal process in its political and historical context.

### Analysis:

#### *Historical Background: From Declarations to the Treaty*

The Energy Charter is one of the consequences of the ending of the Cold War, which brought about a new East-West relationship that incorporated the idea of co-operation. The Charter of Paris signed between the two former ideological blocks in 1990 is often seen as a starting point for the 'New Europe', with a 'steadfast commitment to democracy based on human rights and fundamental freedoms; prosperity through economic liberty and social justice'.<sup>1</sup> Europe's new image is related to the 'security community', where multilateralism and 'seminar diplomacy' aim to integrate 'academic and diplomatic discourse in practice'.<sup>2</sup>

Likewise, there have also been number of moves towards the creation of a multilateral regime in energy investment, trade and transit. The first multilateral declaration on energy cooperation was signed immediately after the break-up of the Soviet Union in December 1991. Then the European Energy Charter declaration was signed, and its conclusion included the following statements:

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<sup>1</sup> Charter of Paris for a New Europe, 1990.

<sup>2</sup> The concept of 'seminar diplomacy' is defined by E Adler (1997), 'Imagined (Security) Community', *Millennium*, 26/II/1997, p. 275-277.

'The representatives of the signatories meeting in The Hague on 16 and 17 December 1991, Having regard to the Charter of Paris for a New Europe, signed in Paris on 21 November 1990 at the summit meeting of the Conference on Security and Cooperation in Europe (CSCE); Having regard to the document adopted in Bonn on 11 April 1990 by the CSCE Conference on Economic Co-operation in Europe; Having regard to the declaration of the London Economic Summit adopted on 17 July 1991; having regard to the report on the conclusions and recommendations of the CSCE meeting in Sofia on 3 November 1989, on the protection of the environment, as well as its follow-up; Having regard to the Agreement establishing the European Bank for Reconstruction and Development signed in Paris on 29 May 1990; Anxious to give formal expression to this new desire for a European-wide and global co-operation based on mutual respect and confidence.

'Resolved to promote a new model for energy co-operation in the long term in Europe and globally within the framework of a market economy and based on mutual assistance and the principle of non-discrimination [...]'].

Following the declaration there was a first round of multilateral negotiations for an international energy regime. It lasted for three years and resulted in a legally binding Treaty which included a set of provisions on trade, transit and investments in the energy sector. The provisions of the Energy Charter Treaty (ECT) were mainly initiated by the EU Member States given the lack of experience in the former Soviet Union regarding trade and investment negotiations.<sup>3</sup>

The Energy Charter was limited geographically on account of the US withdrawal from negotiations in 1993. Many producing countries, including Saudi Arabia, Iran and Venezuela, gained observer status without signing the Treaty. Hence, the ECT's implementation remained within the scope of EU-Russia relations.

#### *Facing Difficulties*

The ECT became the first Treaty in international law to include almost all aspects of energy cooperation. The document, signed in 1994, comprises eight parts: (1) definitions of energy materials and products; (2) commerce (both trade and transit); (3) investment protection (non-discrimination for existing investments and protection against expropriation); (4) miscellaneous issues (stipulating sovereignty over natural resources, environmental aspects, transparency, state and privileged enterprises, security provisions, etc); (5) dispute settlement (investor-to-State and State-to-State disputes); (6) transitional provisions; (7) institutions of the Energy Charter (Conference and Secretariat as well as provisions on the quinquennial review of the Energy Charter process); and (8) final provisions.

As in any other international legally-binding regime, the ECT is ever evolving. Since the signing of the Treaty, a number of adaptations have been proposed. For instance, in 1998 a trade amendment was adopted in order to make the ECT compatible with the WTO.

A more difficult task was to reach an agreement on investment provisions. The text adopted in 1994 required the protection of the existing investments (the so-called post-

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3 C. Bamberg & T. Waelde (2007), 'The Energy Charter Treaty', in M. Roggenkamp *et al.* (Eds.), *Energy Law in Europe*, 2nd edition, p. 149.

investment phase). Its Article 10 (7) introduced a most favoured nation clause in energy investments. Both Russia and the EU were willing to ensure investment protection outside their geographical areas but were reluctant to provide non-discriminatory access for any energy activity at the pre-investment phase. Although it could be argued that there is the possibility of pre-investment phase arbitral protection,<sup>4</sup> the ECT does not foresee hard-law mechanisms for it. In 1994, pre-investment phase discussions were postponed and subsequent initiatives to extend the scope of the ECT's protection to the pre-investment phase were aborted.<sup>5</sup> Since then, there has been a toughening of pre-investment access conditions in both the EU and Russia. Indeed, many EU Member States require the application of the reciprocity principle for access to network infrastructures.<sup>6</sup> Russia has adopted new legislation on investments, introducing the notion of control.<sup>7</sup>

The most difficult issue in the Energy Charter process related to the transit of energy as it was adopted right after the break-up of the USSR. Article 7(1) of the ECT stipulated the following:

'Each Contracting Party shall take the necessary measures to facilitate the Transit of Energy Materials and Products consistent with the principle of freedom of transit and without distinction as to the origin, destination or ownership of such Energy Materials and Products or discrimination as to pricing on the basis of such distinctions, and without imposing any unreasonable delays, restrictions or charges'.

The terms 'facilitate transit' has often been considered unclear, especially regarding transit theft and transit tariffs, which were already a problem in relation with the gas trade with the former Soviet Union.<sup>8</sup> In order to clarify the provisions of Article 7 a Transit Protocol was proposed by the Energy Charter Conference in 2000. The protocol covered the definition of access to pipelines, cost-effectiveness of transit tariffs, definition of available capacity and transit theft.

The Transit Protocol negotiations were the main focus of EU-Russian disputes over the Energy Charter. According to the Russian position, the document should include the 'right of first refusal' if a long-term supply contract (ie, a pure trade transaction) does not match the long-term transit contract (ie, only access to pipelines), while the EU considered this unacceptable. In contrast, the EU wished to see both transit and supply contracts shortened in order to enhance competition. Consequently, no agreement was possible and the signing of the Protocol was postponed. The delay in the Transit Protocol negotiations became a political obstacle to the entire Energy Charter process. Indeed, in

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<sup>4</sup> T. Waelde & W. Ben Hamida (2008), 'The Energy Charter Treaty and Corporate Acquisition', in G. Coop & C. Ribeiro, *Investment Protection and the Energy Charter Treaty*, p. 172-185.

<sup>5</sup> In 1998 a Multilateral Investment Agreement was proposed within a framework of the OECD. Likewise, discussions on the Supplementary Investment Treaty were proposed within the ECT framework in 1994. However, the Supplementary Treaty has never been agreed. See C. Bamberger and T. Waelde (2007), *op. cit.*, p. 150-157.

<sup>6</sup> See the Conclusions of the Energy Council of 10 October 2008, according to which EU Member States are allowed to limit non-EU investments.

<sup>7</sup> A parallel can be drawn with the US Foreign Investment and National Security Act (24 October /2007), where the definition of control is likewise present. See R. Nowinski & Thanfield Chambers (2008), 'Recent Changes to Russia's Subsoil Laws', 8<sup>th</sup> Seminar, CGES, London, 26 June.

<sup>8</sup> A. Belyi (2008), 'Energy Dimension of Pan European security', *Oil, Gas, Law Intelligence*, November, issue nr 3.

2001 the Russian Parliament linked the ratification of the Treaty to an acceptable Transit agreement within the ECT.

#### *The Russian Position on the ECT Process*

It would be wrong to define Russia's non-ratification as the rejection of the entire process. Unlike other countries, such as the US, Russia did not withdraw its signature from the Treaty. Indeed, it refused to ratify the ECT but applies the Treaty provisionally in accordance with its Article 45.<sup>9</sup> Nevertheless, there are political concerns even in its provisional application.

The main reason is that the Russian gas company Gazprom was convinced that the freedom of transit also involved third-party access for Central Asian producers.<sup>10</sup> Gazprom, which is Russia's largest gas company, has warned against a transit corridor from Central Asia to Europe through Russia, as it would result in Russia losing control over the flow of energy. Moreover, Gazprom considers that the transit dispute settlement mechanism foreseen by Article 7(7) is imperfect and cannot be applied in its relations with the Ukraine, which remains the largest transit country from Russia to Europe. According to Gazprom, Article 7(7) attributes too much power and responsibility to the conciliator, who can decide on tariffs and supplies for a period of up to six months. Gazprom prefers to deal bilaterally with the Central Asian producers as well as with its Ukrainian transit obligations.<sup>11</sup> Legally, Russia could have used the ECT transit provisions during the transit disputes<sup>12</sup> with the Ukraine in 2006 and 2009 because of their provisional application.

One of the greatest concerns for Russia is the perception of the ECT as an EU-sponsored Treaty. Although the ECT and EU law have different legal perspectives, Russia has viewed the former as an instrument of the latter. The reason lies in the very nature of EU policy. The EU presents itself as the perfect model for energy market regulation. Moreover, with its neighbourhood policy and with the Energy Community Treaty, the EU tends to export its gas market liberalisation practices (although it still has domestic problems with its implementation) beyond the EU. At the same time, during the negotiations on the Transit Protocol, the EU claimed the particularity of its own regime compared with the ECT and proposed that a clause of the Regional Economic Integration Organisation (REIO) applied within the Transit Protocol. In this context, the EU could exempt itself from obligations in the Treaty,<sup>13</sup> despite Brussels imposing them on Moscow. Hence, if the Transit Protocol is exempt from EU law, the ECT is of no help for Russia to use it as a legal instrument to gain non-discriminatory access to the EU's networks and markets. In a situation in which only EU law applies, Russia is concerned that it must comply with a regime in which it does not participate.

<sup>9</sup> On the effect of the provisional application of the ECT, see S. Nappert (2008), 'Russia and the Energy Charter Treaty: The Unplumbed Depths of Provisional Application', OGEL 3.

<sup>10</sup> O. Butchnev & M. Nedzveckiy (2006), 'Vlianie Processov glovizacii na rossijskuu gazovuu promyshlennost', *Gazovyy Biznes*, May-June, p. 40-42.

<sup>11</sup> See J. Stern (2004), *Future of Russian Gas and Gazprom*, OIES; and A. Belyi & U. Klaus (2007), 'Dispute Resolution Mechanisms in Energy Transit – Missed Opportunities for Gazprom or False Hopes in Europe?', *Journal of Energy and Natural Resources Law*, vol. 25, nr 3, August, p. 205-224.

<sup>12</sup> On gas transit disputes see J. Stern (2006), 'The Russian-Ukrainian Gas Crisis of January 2006', Oxford Institute for Energy Studies, January; and A. Kovasevich (2009), 'The Impact of the Russia-Ukraine Gas Crisis in South Eastern Europe', Oxford Institute for Energy Studies, March.

<sup>13</sup> For a detailed analysis of the EU position towards the ECT, Russia and the export of legislation see A. Belyi (2007), 'EU External Energy policy', in M. Roggenkamp *et al.* (Eds.), *Energy Law in Europe*, 2nd edition, pp. 195-220.

Consequently, the reason for Russia's refusal to sign the dispute settlement mechanism appears not to lie so much in its non-ratification of the ECT, as in its political unwillingness to accept an 'EU-sponsored Treaty'. However, in the aftermath of the gas crisis of 2009 Russia demonstrated its interest in achieving a multilateral energy regime, but not an EU-sponsored one.

#### *The Russian Proposal: In Line With or Against the ECT?*

Since the January 2009 gas crisis, top-level Russian officials have suggested that the Energy Charter Treaty should be reviewed. A few weeks after the January crisis, President Medvedev proposed a 'new Energy Charter'. In his 1 March 2009 interview for the Spanish daily *El País*, he pointed out that it should focus not only on the consumers but also on the producers and transit countries. On 20 April he tabled an 'alternative' to the ECT: the 'Conceptual Approach to the New Legal Framework for Energy Cooperation'.

Broadly worded and in the form of a statement of principles at this stage, the Treaty includes many principles and practices which have previously been debated and adopted: sovereignty over natural resources, ensuring non-discriminatory access to markets, transparency, access to technologies, exchange of information, etc.<sup>14</sup> Russia supported the idea of extending the ECT to other countries (including the US and producing countries) and to cover a broader scope of energy sources (eg, nuclear).

Due to the serious transit disputes at the beginning of 2009, the new Russian proposal is mainly focused on transit. Once again, Russia calls for the reform of the transit dispute settlement mechanism. The Russian proposal could bring the investment debate back on the table. The new concept introduces the idea of non-discrimination at the pre-investment phase: 'non-discriminatory investment promotion and protection, including *new investments* in all energy chains'. Hence, Russia has reintroduced the issue of the Supplementary Treaty 10 years after the first attempt but, unfortunately, the current proposal does not elaborate further on this topic.

The proposal does not introduce any 'revolutionary' changes to the ECT and it could actually be in line with the quinquennial reviews of the Energy Charter Secretariat.<sup>15</sup> The chance to replace the ECT or to establish a new agreement on energy between the EU and Russia are slim<sup>16</sup> but the new proposal attempts to prevent an EU monopoly on the creation of international norms and practices. It can furthermore establish the basis for a new round of Energy Charter discussions.

**Conclusion:** The Energy Charter process continues to have a mainly EU-Russian focus. At the beginning of the process, the EU actively participated in the creation of norms for the Charter. However, with its domestic market integration, the Treaty has been exempted from the EU's domestic regime. Moscow cannot accept that the ECT regime should only apply to the countries of the former Soviet Union. However, in the aftermath of the gas

<sup>14</sup> The full text is available at [www.kremlin.ru](http://www.kremlin.ru).

<sup>15</sup> A. Belyi & S Nappert (2009), 'A New Energy Charter: Myth or Reality?', *Oil, Gas, Energy Law Intelligence*, and on *Transnational Dispute Management*, April.

<sup>16</sup> A. Konoplyanik (2009), 'A Common Russia-EU Energy Space: The New EU-Russia Partnership Agreement, Acquis Communautaires and the Energy Charter', *Journal of Energy and Natural Resources Law*, vol 27 (2), p. 258-291.

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transit dispute between Russia and the Ukraine,<sup>17</sup> the Russian President proposed the introduction of a new concept to the Energy Charter: to reinforce the transit regime and extend its geographical scope. For the EU, the broadening of the regime, both geographically and in terms of the energy resources covered, would almost certainly have the effect of weakening it. But the main objective for Russia is to de-monopolise the EU's initiatives regarding norm creation in cross-border energy relations.

But the overall legal framework of the recent proposal, however, remains unclear: should the proposal be the subject of a specific EU-Russia agreement? Or should it completely replace the ECT? Neither of these two options seems possible to implement.<sup>18</sup> A new EU-Russia agreement would require 29 separate ratifications, which would be even harder to achieve in the current EU-Russian political climate.<sup>19</sup> A 'new ECT' is even more difficult. The EU's Member States will certainly resist an attempt to redefine the 1994 text.

Consequently, without a very clear political compromise between the EU and Russia, new initiatives will only serve to confirm divergences between producers and consumers regarding a multilateral energy regime. At the same time, the ECT offers a significant scope for further improving both energy transit and investment regimes.

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<sup>17</sup> See A. Belyi (2009), 'Why a Political Accord is Needed to Make EU-Russia Relations Work', Working Paper nr 19/2009, Elcano Royal Institute, p. 7-11.

<sup>18</sup> A. Konoplyanik (2009), *op. cit.*, p. 258-291.

<sup>19</sup> For an analysis of EU-Russia relations see T. Bordachev, *The New Strategic Union, Russia and Europe Before the 21<sup>st</sup> Century's Challenges: Possibilities for a 'Grand Deal'*, (in Russian), Evropa, Moscow.