International Journal of Energy Security and Environmental Research (ISSN 2047-3354) Vol. 1 1-16

From Russia with Cold Feet: EU-Russia Energy Relations, and the Energy Charter Treaty

By Amelia Hadfield and Adnan Amkhan–Bayno

Abstract

On 20 October 2009, the Russian Federation terminated its provisional application of the Energy Charter Treaty. The event has since galvanized international attitudes to investment obligations, the scope of international investment treaties and more particularly, the role of energy in EU–Russia foreign policy. To explore these sea changes within the context of EU–Russia energy relations, this article examines the primary reasons behind Russia's decision, from the Duma's initial misgivings with the ECT, to Gazprom opposition to key provisions, the impact of the Yukos–related arbitration cases, and the Russian 'Conceptual Approach to the New Legal Framework for Energy Cooperation' (2009). From an overview of the legal consequences of Russian provisional application, the article considers both the future of the ECT, and the foreign policy implications for EU–Russia relations, concluding that states are not entirely ready to subject their energy policies to a regulatory legal framework.

Category: Article
Keywords: EU, Russia, energy security, Energy Charter Treaty, provisional application, Yukos, arbitration, Gazprom, investment.

Introduction

On 20 October 2009, the Russian Federation terminated its provisional application (PA) of the Energy Charter Treaty (ECT). This dramatic event is something of a contemporary watershed in terms of examining national obligations of investment provisions, the scope of international investment treaties, the meaning of provisional application and ultimately the role of energy in modern politics. This article has four goals. First, it establishes the geopolitical and legal context of contemporary European energy politics. Second, via analysis of the largely unexplored working documents of the ECT (*Travaux Preparatoire*), it explores the primary reasons behind Russia's termination of its provisional application, from initial misgivings with the ECT, to the catalytic role of the Yukos–related arbitration cases, and the Russian 'Conceptual Approach to the New Legal Framework for Energy Cooperation' of 2009. Moving from an overview of the legal consequences of this decision, it concludes with an analysis on the future of the ECT and foreign policy implications for EU–Russia relations.

The emergent system of energy governance attempts to both mobilize investment and facilitate a secure energy trade; yet stalwart business climates can only be ensured by robust legal frameworks like that established by the ECT, itself the product of sophisticated and long–term political agreements between a series of high–level national actors. Whilst the original idea of brokering east–west energy cooperation via a binding multilateral framework retains support amongst its signatories, the contemporary suitability of the ECT is now being challenged in a variety of quarters, on issues of investment protection, third party access, transit provisions, and non–discriminatory treatment. While neither the wording nor the meaning of the ECT has changed, in both Russia and the EU, private investors and indeed some states now find ECT obligations problematic to their national interests.

European Energy Dilemmas

A number of contextualising elements need to be mentioned. First, it is axiomatic that energy imports are a critical factor in the EU's energy make–up; comprising 53.9%. Oil, gas and solid fuel comprise the bulk of EU energy imports, with Russia maintaining its position as the EU's main supplier of all three (see Annex I). Russia provided 33.1% of the EU–27's 2009 crude oil imports[1] and 30.2% of hard coal imports. Russia's share of EU–27 natural gas imports were 34.2% in 2009 (down from a high of 47.7% in 2001, relative to Norway's 2001–09 share rise from 22.8% to 30.7%.)[2] The current EU import picture is thus one of declining domestic production, compounded by protracted and rising energy dependence upon imports. (Eurostat September 2011).

1. Norway, Libya, Saudi Arabia, Iran, Kazakhstan, Iraq and Nigeria represent in descending order the EU's principal oil importers.

2. Norway, Algeria, Nigeria, Libya, Qatar, Egypt and Oman represent in descending order the EU's principal natural gas importers.

Second, because Russian gas arrives to European markets exclusively by pipeline, the EU is dependent upon the crucial role played by key transit states, including Ukraine and Belarus, as well EU transport states such as Poland, Slovakia and the Czech Republic. Pipeline infrastructure, and in particular access to the available capacity by key gas exporters in major pipelines is thus another key factor.

Third, diversification projections about which energy exporters should be relied upon to the EU, and to what extent, are increasingly ambiguous. The EU–Russia Energy Dialogue's Tenth Progress Report states that 'energy markets of the EU and CIS countries will remain Russia's major consumers until 2030' (2009: 5). After 2030 however, the EU's share of Russian imports 'is expected to decrease with regard to supply diversification and increase of Easter exports to China, Japan, the Republic of Korea and the countries of the Asian–Pacific Region'. The EU is similarly persuaded: while dealing with Russia as a Strategic Partner, it speaks openly of widening its gas portfolio to Norway, Algeria, Qatar and a variety of states in the Neighbourhood area (including post–revolution Libya and Egypt), complimented by additional oil imports from the Gulf of Guinea, Iran and Iraq. Diversification projections inject an element of brinkmanship to the EU–Russia energy relationship, throwing mid and long–term forecasts into doubt.

Fourth, it is difficult to speak accurately of an EU market as uniformly dependent because the 27 EU Member States differ drastically in terms of their material reliance upon Russian imports. Romania and Poland for instance have low import dependence on Russia, while Croatia, Lithuania and Slovakia have near or total dependence. The political consequence of entrenched unevenness between key regions of Europe is that Russia encounters a cacophony of EU voices arising from states whose attitudes vary widely in viewing Russia as either the only solution or an increasing problem to future energy supplies.

Unfortunately, material unevenness produced imbalances in political dialogue, which creates the most intractable problem of all. Despite post–spat attempts at creating an Energy Policy for Europe (2006), the EU will remain politically, operationally and economically at loggerheads with Russia, simply because each side procures energy security differently. As argued by Kalicki and Goldwyn, energy security is an 'assurance of the ability to access the energy resources required for the continued development of national power … and adequate infrastructure to deliver these supplies to market' (2005: 9). For European importing states, energy security means security of supply, in which the consistent delivery of affordable energy sources is paramount. For exporter states like Russia, security of demand requires access to a developed and reliable market for the long–term sale of energy products. Economic concerns about maintaining supply and demand, and minimizing disruptions are coupled with political concerns about exporter leverage exercised over importer and transit countries.

In terms of geopolitics, Russian energy dominance is the EU's main anxiety. Energy dominance provides Russia with a regional instrument that has been used repeatedly in recent years to keep CIS neighbours in line, but evidently operates further afield in the form of 'gas spats' with CEE and Baltic states whose political or market attitudes fail to confirm to Kremlin expectations. Russia is able to operate

thusly because its largest energy company, Gazprom, is managed by the Russian state, and whose ambitions in recent years have lain close to the political orientations of the Kremlin. Centralized political power twinned with concentrated non–liberal market power is not only doubly anathema to the democratic, liberalized EU market structure, it keeps Russia an unpredictable negotiating partner. While Russia is not alone in exercising energy exports as a form of national power, it is so far the only state to do so (in the form of gas spats) with serious material consequences for European living conditions.

Energy in Post Cold-War reform

The break–up of the Soviet Union was instrumental in realising the foreign policy potential of energy in Europe. The original European initiative was one of deep engagement with Russia, in order to minimize the potential political chaos and economic disarray emerging from the collapse of communism in Russia and its satellite states. The solution appeared simple: integrate the ex–Communist countries in the world market. Energy was a key candidate in achieving this objective, as both a qualitative staple of modern statehood, and quantitatively hugely available in the majority of Euro–Asian states.

The first political initiative took the form of a memo submitted to the Council of Ministers by Dutch Prime Minister Ruud Lubbers in June 1990. The Lubbers' memo was received favourably by the Ministers of the European Council who tasked the Commission to prepare a European (and to some extent a global) international energy policy document with its main focus on east–west energy cooperation. The European Energy Charter (EEC) was the resultant blueprint. By 1991, Russia, CIS, eastern and western EU countries along with the United States, Canada, Japan and Australia had negotiated its contents and signed the EEC. The EEC 'establishes a framework for international cooperation between European countries and other industrialised countries with the aim of developing energy potential of central and Eastern European countries and of ensuring security of energy supply for the EU'.[3] The EEC also entailed a commitment to negotiate further legally–binding agreements on various energy issues, and the outcome was the 1994 Energy Charter Treaty (ECT), along with the Protocol on Energy Efficiency.[4]

The purpose of the ECT (Article 2) is that it "establishes a legal framework in order to promote long–term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter" (Energy Charter Treaty 2004: 44). This incorporates the political declaration as found in the EEC into the ECT which is a legally binding agreement, with provisions on trade, competition, access to capital, transfer of technology, environment and transit. The ECT, which entered into force in 1998 was thus designed to be interpreted and

3. See: http://europa.eu/legislation_summaries/energy/external_dimension_enlargement/l27028_en.htm.

4. The ECT negotiations (1992–1994) during the same period as the negotiations to establish the WTO; a period when the EC had no coherent internal or external energy policy.

applied in light of the principles of the EEC, thereby joining energy policy and law. As of 2012 it has 46 signatories that have ratified (including the European Community as a Regional Economic Integration Organisation (REIO).[5]

The Duma and the ECT: a Lukewarm Reception

Throughout the ECT negotiation (1991–1994), the Russian Federation played an active role in the negotiations of the EEC and the ECT, raising no objection regarding the Provisional Application of the ECT, nor did Russia any concerns about the investment dispute settlement mechanism.

However, a brief review of the ECT's Travaux Preparatoires which record its negotiating history (1991–1994) reveal key Russian concerns, including the coverage of trade in services by the ECT; other trade provisions thus the relationship between the ECT and GATT; transit issues; transitional arrangements (arising from the adjustment of policies and law to comply with the ECT provisions); nuclear trade issues; aspects of expropriation; balance of payments; access to capital; the scope of the obligation of non–discrimination; the scope of 'control' in the definition of investment (Article 1 (5)), and the coverage of environmental issues. Ultimately, a consensus was struck on these issues, and the outcome incorporated into the final ECT text to the apparent satisfaction of Russia. Russian participation in the ECT negotiations was high on the political agenda of all negotiating parties, most of whom viewed Russia as a key player. As evident from the Travaux Preparatoires every possible effort was made to accommodate Russian concerns. In this way, Russia played a substantial and crucial role in affecting the direction, and the ultimate outcomes of the ECT through this negotiating period.

On 17 December 1994, Russia signed the ECT in Lisbon, and accepted to apply it provisionally in the manner set out in Article 45 ECT, entitled 'Provisional Application' (hereinafter referred to as PA).[6] Whether the Russian government was fully aware of the implications of ECT obligations, and the decision to apply it provisionally remains unclear. This apparently 'lesser' commitment would seemingly allow Russia to remain an ECT signatory, bow out of ratifying investor obligations whilst retaining areas for future negotiation. However, as explained below, there can be no 'legal half–way house' between the soft and hard application of a treaty. Politically, the outcome was not a compromise, but stasis and ambiguity. While PA gave a strong indication to others of Russian intention to ratify in the future, it simultaneously enabled Russia to undertake a variety of stalling tactics while still keeping the overall Energy Charter process ticking over.

In 1996 the Russian Government submitted the ECT to the Russian Duma for the purposes of ratification; many within Russia however, had already raised key objections. While the 1997 Duma Report (written by the Committee on Economic Policy) acknowledged that the ECT would attract foreign investments, it also provided

5. The five countries that have not ratified the ECT are Australia, Iceland, Norway, Belarus (applies the ECT provisionally) and Russia (applied it provisionally until October 2009).

6. Signatories who did not accept to apply the ECT provisionally are listed in Annex PA of the ECT.

a slew of legal reasons against ratifying the ECT.[7] Aside from concerns related to trade–related investment measures, compensations for losses (primarily those arising from civil disturbance and war), and the non–discriminatory nature of Russian–sourced uranium, the central anxieties revolved around investment and transit.

The Committee asserted first that prohibitions and restrictions on foreign investment in Russian federal law were necessarily narrower than those set out in the ECT. The Committee believed that the investment provisions of the ECT were more permissive in granting foreign investors and investment wider and more liberal treatment than under Russian law. The Committee thus feared that Russia would be vulnerable for legal actions by foreign investors under the investment dispute settlement mechanism of the ECT as set out in its Article 26. The Committee expressed further concerns over Article 7(6) ECT that prohibits the interruption or reduction of energy supplies. From the Russian perspective, if established energy carriers like Gazprom were to build new pipelines (e.g. in transiting Kazakh gas or Turkmen oil to Europe) and in so doing encountered shortfalls or incur disputes, then supplies could indeed be interrupted and Russia in breach of this obligation. However, this view is an incorrect interpretation, as the obligation of Article 7 (6) is solely upon the transit country not to interrupt or reduce transiting.

The unspoken third issue was simple timing. Russia preferred to expedite their WTO membership first, and then tackle ECT obligations. Ratifying the ECT would perforce require Russia to desist from levying different charges, tariffs and regulations on the gas and oil for their different consumers and instead set a single rate, which in turn could reduce ability to negotiate tariff rates with the WTO. In 2001, the Duma referred the ECT to the Russian Security Council for further analysis; ratification was again turned down.

Gazprom Opposition

Whilst these issues were expressed by the Duma and indeed the real culprit of behind these objections (Gazprom) as legal problems, it can be argued that the real issue at hand were the business anxieties harboured by Gazprom itself – an emergent player during the ECT negotiating period. While the objectives of Gazprom generally mirror the ambitions of the Russian state, despite exerting significant power on both the executive and the legislative branches of the State as a state–owned business, its goals are not necessarily synonymous with those of the Russian Federation. This is a complicating factor that is generally overlooked. Gazprom chief officers may appear to articulate Russian interests, but in many ways they frequently dominate, and are even at odds with the views of government ministers in determining foreign energy policy. A good example was the ceding of delegating authority by the Russian foreign delegation to Gazprom negotiators during the 2002–2004 Transit Protocol negotiations. There are therefore a variety of interesting rifts between the central

7. These concerns were raised by Russia in a variety of European and Russian fora, including the Energy Charter Secretariat and the Council of Europe's Parliamentary Assembly (1997 Ordinary Session, Third Part, 23–27 June 1997, Official Report of Debates: 811).

government who (at least until the Yukos cases) viewed the ratification of the ECT as a positive economic step, and ongoing opposition from Gazprom (and to a lesser extent Rosneft and Transneft), who persistently claimed that ratification would be damaging to 'Russian' interests.

Whilst the Duma's concern was the permissive nature of investor provisions to which the state could be held accountable, Gazprom regarded the ECT as dangerously open–ended due its provisions on the issue of third–party access. ECT ratification would in Gazprom's view require it to grant access to a third party to their pipeline system wherever there was available capacity (which is generally abundant) thereby diminishing its dominant position in European energy markets. Such claims however are based on incorrect readings of the ECT's provisions, which specifically exclude mandatory third party access to pipeline systems.[8] Under the ECT, no ECT Contracting Party is constrained in terms of either mandatory or negotiated third party access.

EU–Russia energy relations were worsened by gas spats in 2006 and 2009, protracted wrangling in the context of the ECT, stasis in the EU–Russia Energy Dialogue, and the 2005 Yukos arbitration claim. By 2009, EU–Russia energy relations had reached a low point, starting with criticism from Russian leaders of the entire Charter process. In April 2009, while on a state visit to Finland, former Russian President Medvedev presented a blunt choice: improve the ECT or replace it with a new one. The blueprint, the 'Conceptual Approach to the New Legal Framework for Energy Cooperation', was published on the President's official website. 9 On 29 June, Deputy Prime Minister Sechin announced that a political decision on withdrawal had been taken; followed on 30 July by the signing of the Russian Federation's Government Ordinance (N 1055–p) authorising Russia's provisional application of the ECT. Thus on 24 August, by a letter signed by former Russian Prime Minister Putin, Russia informed the ECT depositary (according to Article 45b(3–a) that it was terminating its provisional application of the ECT. It is suggested here that both the reason and the timing for this somewhat bizarre and unconsidered action is not hard to ascertain.

Yukos and Provisional Application

The Arbitral Tribunal's decision that it has jurisdiction to entertain the investors' claims in the three Yukos cases came one month after Russia's termination of its PA of the ECT. The following section briefly explores the connection between the Yukos arbitration claims and Russia's legally ineffective but politically damaging decision.

Established as a joint stock company in Russia in 1993, the Yukos Oil Corporation emerged from the collapse of the USSR to become the largest oil company in the Russian Federation.[10] Yukos has three major shareholders: Hulley Enterprises Ltd

8. The ECT is silent on negotiated third party access (hence the need to negotiate an additional treaty, the Transit Protocol). When mandatory third party access does takes place, is it naturally negotiated and contracted separately between a supplier and the owner of the infrastructure.

9. See: http://archive.kremlin.ru/eng/text/docs/2009/04/215305.shtml.

10. The majority of Yukos shares were owned by companies organized under the laws of Cyprus,

(organized under the laws of Cyprus), Yukos Universal Ltd (laws of Isle of Man), and Veteran Petroleum Ltd (Cyprus). The disputes between the Parties (July 2003 – August 2006) involved various measures taken by the Russian Federation against Yukos, which led to its total bankruptcy, and consequently allegedly adversely affected the Claimants' investments in Yukos. The three Yukos shareholders subsequently initiated arbitration proceedings against the Russian Federation on 3 February 2005.[11] Simply put, the claimants alleged that the Russian Federation measures had expropriated their assets (investments) in Yukos. Consequently, the Claimants are seeking damages for breach in the region of $33.1 billion USD. The preliminary question was whether Russia could be a party to an arbitration claim by virtue of it having applying the ECT provisionally but not having ratified it.

The Arbitral Tribunal unanimously ruled on 30 November 2009 that it has jurisdiction over the claimants' claims, and thus Russia was indeed subject to the obligations of the ECT even under the status of 'Provisional Application'. The 2009 Yukos findings dealt a knock–out blow to Russian interpretation of PA. In finding that Russia can be sued for breach of ECT obligations, the Yukos–related claims effectively proved that PA is as robust a legal concept as ratification. Few experts at the time appeared to understand that while treaty ratification sees its provision subsumed into domestic law, Provisional Application (PA) creates a binding effect at the level of international rather than domestic law; thus Russia is currently being successfully sued internationally on the basis of PA, as stipulated in the ECT.

As the Yukos claims gained traction from 2005 onwards, senior Russian politicians arguably countenanced the idea of attempting to sidestep investment obligations by shrugging off Russian provisional application of the ETC. At present, the Arbitral Tribunal is examining the merits of the Claimants' claims (Albert and Rothkopf, 2009). Russian termination of the PA from this perspective appears to be something of a last–ditch escape route away from ECT obligations. Not only is there no immediate escape, termination of PA does not release the Russian state from future obligations (Gaillard, 2009). Thus all investments by investors from other ECT contracting parties are currently covered for the next 20 years under Article 45 (3) (b) ECT, from the time of notification of withdrawal: 2029.

There is arguably a retaliatory, even panic–stricken aspect to Russia's withdrawal of its PA from the ECT. Viewed however from a long–term perspective beginning with its initial misgivings with the ECT, Russian discontent with investment and transit provisions provided a more strategic convincing reason. From this stance, Medvedev's blueprint is probably the watershed moment, not the Yukos case. Strategically, Russia is still very much in the Energy Charter game. Russia still remains a signatory of the ECT, may attend all negotiations and other meetings, and

Malta, Isle of Man. However the companies organized under laws of other countries, were themselves owned by the principal two Yukos share holders, including Michael Khodorovsky.

11. See, Hulley Enterprises Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 226, UNCITRAL (Energy Charter Treaty); Yukos Universal Limited (Isle of Man) v. The Russian Federation, PCA Case No. AA 227, UNCITRAL (Energy Charter Treaty); Petroleum Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 228, UNCITRAL (Energy Charter Treaty). All the jurisdictional awards can be found in http://italaw.com/chronological_list.htm.

thus retains the power to craft the organisation's energy policies. It is unlikely that any legally binding agreements (e.g. the presently abandoned Transit Protocol) will now emerge from the ECT, precisely because Russia still has the power to steer the negotiations without having to comply with the legal obligations of the ECT or any subsequent agreement.

Strange Bedfellows

Russia may have lost at least the first stage of the Yukos arbitration claims, but it may have gained an odd degree of sympathy, most ironically from the European Union. While the EU and Russia remain fiercely at odds over a variety of market mechanisms (e.g. unbundling and third party access), the two find themselves loosely arraigned together against the ECT, though for very different reasons. Russian views of the ECT is of an instrument based on extreme capitalist liberal principles, effectively sponsored by the EU, that bestows private entities and companies alike broad protection in a sector that is politically very sensitive and increasingly dominated by national (public) power.

For its part, the EU arguably appears to be, for various reasons, less and less enthusiastic with the Energy Charter process. Evidence for this is threefold. First, the regular opposition by EU negotiators to a host of major and minor aspects of the Energy Charter progress throughout the 2000, including torpedoing the Transit Protocol (or at least failing to come to its rescue). Second, the construction by the EU of a host of policy alternatives that may be seen to circumvent or duplicate some of the Energy Charter's objectives and principles. These include the European Energy Community, the expansion of DG Energy, widening the scope of 'European energy policy' within successive treaties whilst lessening the competence of Member States over key aspects of energy (e.g. investment), adding in a host of energy provisions to public and foreign policy structures, including the European Neighbourhood Policy (Sikorski, 2009). The critical mass of such actions cannot help but presage the EU's emergence as the dominant European energy actor. The issue is not ambition. The energy world is intensely political, and striving for authority comes with the territory. What is objectionable is that the EU's strivings are generally undertaken with a lack of clarity regarding its own energy endgame.

Third, the spate of arbitration claims involving national energy companies of Member States suing another Member State for alleged breaches of the ECT.[12] Simply put, with its supposed ability to trump EU law (if real or imagined conflict arises), the ECT may be seen as a thorn in the side of the European Commission's legislative initiative and future objectives. Despite the EU (as a REIO) and each of its MS having ratified the ECT on the understanding that there was no conflict between EU law and

12. A recent case involves Hungary, who allegedly implemented a Commission's Decision on State aid, thus terminating Power Purchase Agreements it concluded with Electrabel, a Belgian company. Consequently Hungary has been taken arbitration for an alleged breach of the ECT. Other cases in point include AES Summit Generation Limited and AES–Tisza Erömü Kft v. The Republic of Hungary, ICSID Case No. ARB/07/22 (ECT), decided in favour of Hungary; and Electrabel S.A. v. Republic of Hungary (ICSID Case No. ARB/07/19), still pending.

the ECT, the ECT appears to provide an unhappy and ambiguous dimension to the evolving EU and its Member States energy policies.

Contemporary EU-Russian Relations

Despite the drama attached to a major energy state withdrawing from the most extensive energy treaty, for a number of reasons, very little comment arose in either the press or the political sphere. Perhaps for politics, as in diplomacy, bad news is bad for business and the less said the better. More likely, given the complicated nature of PA, the procedure and implications of withdrawal, few people were confident enough to comment in intelligent detail. Ultimately, Russian withdrawal merely highlighted the stalemate that has largely existed between the EU and Russia on energy matters since the ECT itself was first negotiated. The two are simply different (albeit interdependent) sides of the same coin: buyer and supplier, incomplete market and imperfect monopoly.

Pan–European energy markets and energy policy today exist asymmetrically, with 'sovereign state monopolies' on the one hand and regulated open market entities on the other' (Clingendael, 2009: 3) Even absent Russia, the ECT vision of 'energy sector cooperation and economic integration through investment promotion and protection, market opening and non–discriminatory treatment of energy trade and capital flows' cannot operate in a lop–sided world where producers and consumers alike (both Russian and European) 'apply asymmetric measures in the same interconnected value chain' (*ibid*).

The ball is between courts. The EU has its Third Energy Package (2009), described by Commission President Barroso as legislation designed to improve the internal gas and electricity market by establishing a 'transparent, rule–based framework for all investors and all operators [...] ensur[ing] full effective network access and a proper function of open integrated markets", principally via unbundling, which if applied by European and Russia companies would ensure "more predictable investment'.[13] (Press Statements, Russia–EU Summit, 2011) The Third Energy Package makes two striking additions: third party access (TPA) and unbundling. The TPA requirements is that operators of transmission networks 'must allow any electricity or gas supplier non–discriminatory access to the transmission network to supply customers', which themselves will be regulated by national regulatory authorities. Unbundling aims to prevent companies involved in the transmission, production and/or supply of energy 'from using their privileged position as operators of a transmission network to prevent or obstruct access'. The Commission must therefore induce Member States and persuade non–EU others that the Third Package is the route to regulatory order.[14]

13. With the aim of creating a single EU gas and electricity market, March 2011 was the deadline for MS to transpose into national law the five aspects of the Third Energy Package (adopted in July 2009): two Directives on common rules for the internal market in gas (2009/73/EC) and electricity 2009/72/EC; three Regulations on conditions for access to the natural gas transmission networks ((EC) No 715/2009), conditions for access to the network for cross–border exchange of electricity (EC) No 714/2009), and one on the establishment of the Agency for the Cooperation of Energy Regulators ACER ((EC) No 713/2009).

14. Three forms of unbundling are envisaged: Ownership Unbundling (OU), the Independent System

Equally, Russia has its Conceptual Approach, who principles are largely derived from the Energy Charter Treaty, and proposes altering the legal basis of existing energy policy to fit with the demands of evolving markets. The onus is thus on the next Russian President to persuade energy partners of the merits of a new legal architecture, and more importantly that energy investment in Russia remains protected to high international standards.

Revisiting the ECT

Where, if anywhere, can the two work together? There are three possible policy venues. First, within a reconstructed Strategic Framework that picks up the post–PCA, post Common Spaces landscape and makes it more workable. This forum should set out the broad political guidelines. However, given that the majority of security of supply, and security of demand arrangements are constructed by a combination of 'private' energy actors and national energy companies, rather than inter–governmental agreements, a second option is a renewed EU–Russia Energy Dialogue that is categorically multi–actor, cross–sector, and consciously tilted towards including the cost–benefit ethos that drives the business sector (along with key regulatory actors). Despite its lacklustre performance (or perhaps because of it), the Energy Dialogue is still relatively free of political rancour, and is therefore something of a neutral forum in which to kick–start a new framework. Third, the Energy Charter process itself, as a forum to build on the current gaps in the treaty (Konoplyanik, 2009), explored below.

In addition to these three policy venues, there are three instruments by which to tackle the post–withdrawal situation. First, the ECT itself. Whilst criticizing the ECT is now something of a cottage industry, a viable revisit could include:

- clarifying the scope of Article 7 (3) dealing with non–discrimination treatment between transit and local transport networks;
- clarifying the conciliation mechanism which applies to interruption and reduction of existing flows of energy (Article 7 (6 & 7);
- clarifying contentious investment provisions, e.g. the penultimate sentence of Article 10 (1) dealing with treatment of investment required by international law and (Article 13) expropriation;
- clarifying third party access;
- Article 24 on Exceptions from obligations.

All such clarifications can perhaps be dealt with, first via Article 34 (Energy Charter Conference), which deals with the functioning of the Energy Charter conference, permitting Signatories to 'facilitate and promote market–oriented reforms and modernization of energy sectors', as well as authorizing "the negotiation of Declarations" (used by Contracting Parties to clarify issues, and which have interpretive

Operator (ISO) and the Independent Transmission Operator (ITO).

force). In addition, Article 33 (1) wherein the Charter Conference "may authorize the negotiation of a number of Energy Charter Protocols or Declarations in order to pursue the objectives and principles of the Charter." Lastly, Article 42 (Amendment), allowing any Contracting Party to propose amendments to the text.

The salient question however is the following: what exists in the investment provisions of the ECT that actually requires amendments? Given the inalienable principles upon which the ECT's investment obligations are based (non discrimination, observation of investment contractual obligations, fair and equitable treatment, and expropriation), it is unsurprising that no party has yet made a truly persuasive case to amend them. It seems inconceivable that any such obligations could be questioned except via political objectives specifically designed to restrict the investment dispute settlement provisions of the treaty. This however would remove the main teeth of the treaty, leaving investors with watered down protections.

Second, the tools afforded by the TFEU (Lisbon). However, due to the ambiguities thrown up by the TFEU, these tools are in need of dire refinement. The EU now has competence (albeit ambiguous) over foreign direct investment issues. (Braun 2011) The question therefore is determining the entity that can be held liable for breaches of an international investment treaty? The EU, or its Member States, given that both are separately parties to the ECT.

Third, a new negotiating mandate for the European Commission. Converting the resolution of the 2009 Second Strategic Energy Review to speak with a single voice toward third country producers, the European Council in 2011 examined the idea of mandating the European Commission (independent of Member States) to negotiate gas agreements with external suppliers, such as Eurasian suppliers like Turkmenistan and Azerbaijan, to renewed sources in post–revolution Libya and Iraq.

Dozens of large European energy companies and hundreds of smaller ones (all with differing degrees of public ownership) are repeatedly corralled, regulated, petitioned, legislated to amend, expand, limit their activities to support both policy whims of a given government and market demands of the moment. No one actor speaks for all. Endowing the European Commission with the power to scrutinize all EU energy contracts and to negotiate contracts independently could transform the institution into the most powerful energy actor in Europe, possibly making it a ready sparring partner for Gazprom, on political, market and eventually environmental issues.

Concluding Observations

EU–Russia relations are cordial but not exactly progressive. Each side now has a leitmotif recited reliably at high–level summits. Press statements ending discussions for the new EU–Russia Agreement are a good example, described by in late 2010 Barroso as an 'ambitious agreement, with substantive provisions in all key areas, including trade, investment and energy', geared to ensure 'a rule–based business environment in Russia'. Medvedev responded by highlighting the need to 'improve the regulatory framework [...] because a number of previously adopted decisions in the EU do not seem to us to promote a reconciliation of our positions'. Medvedev

suggested that a new regulatory framework could operate 'on the basis of the Energy Charter, but not on the basis of its current version'. Medvedev would of course prefer his version, 'which has been supplemented and amended, taking into account Russia's suggestions and suggestions by several other fuel–supplying nations.' If agreed to, Medvedev promised that 'everything will be done to give gas supply operations a good legislative format.' (Press Statements, Russia–EU Summit, Brussels, 7.12.2010).

However, the language and the sense of Medvedev's statement are out of joint. Using the Russian termination of its PA of the ECT as evidence, one could arguably assume that Medvedev is seeking a radical reduction of the rights of investors to sue a sovereign state. This indeed would be a step backwards and would have a negative impact on energy investments in general. The Russian termination of the PA has proved once and for all that Russia not only misunderstood the implications of joining a multilateral energy legal framework, but also has signalled its unwillingness as yet to cooperate with its energy partners in creating a regional energy market, regardless of what end of the pipeline they are. One might speculate that any other regime with elements of reciprocity will not ultimately get the Russians on board.

Is the Commission decoding Russian signals? At the conclusion of the June 2011 Nizhny Novgorod Russia–EU Summit, hard on the heels of a statement about the need for unbundling, Barroso declared the EU 'ready to find pragmatic solutions to specific issues' (Press Statements, Russia–EU Summit, Nizhny Novgorod, 9–10 June, 2011). This is a good start, but might not be enough. At the political level, the most optimistic outcome given the current situation could combine key elements of the Commission's Third Energy Package with an agreement from Gazprom that conforms to aspects of unbundling within the European market, and which avoid undue trade, transit and investment barriers (at least in the gas sector). Medvedev himself stated the Third Package to be 'mutually advantageous'. However, whilst it may seem easier in the short–term to construct *ad hoc* sector–specific agreements, the overwhelming need for a mutually acceptable, multilateral transit and investment regime for energy is arguably best addressed in a treaty. Despite the 20–year guarantee on present investments afforded by the ECT, the perceived governance failure in Russia in terms of managing its legacy production, its poor quality infrastructure and reactive, even retaliatory responses to the EU's growing arsenal of energy governance tools continues to keep Russian energy governance underdeveloped. This result is that "lack of an adequate response to this governance failure undermines Russia's ability to attract investment and technology, and negatively impacts on the energy security of all stakeholders." (Clingendael, 2009: 3)

In sum, what the above analysis suggests is that states are simply not ready to subject their energy policies to regulatory legal frameworks; they prefer politics instead. Indeed, this may partially explain recent events in Argentina and Ecuador.

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Annex I

Main Origin of Primary Energy Imports, EU–27, 2001–2009 (% of extra EU–27 Imports). Available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Energy_production_and_imports#Further_Eurostat_information.

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Hard Coal									
Russia	11.5	13.1	13.5	18.7	24.1	25.4	25.1	26.3	30.2
Colombia	12.5	12.6	12.5	12.1	12.1	12.0	13.0	12.5	17.6
South Africa	27.0	31.4	31.5	26.6	25.7	24.3	20.8	17.1	16.0
United States	11.2	8.2	7.0	7.5	7.8	8.0	9.3	14.3	13.7
Australia	16.3	16.9	17.0	15.3	13.5	12.4	13.5	12.0	7.6
Indonisia	5.7	6.7	7.1	7.0	7.4	9.7	7.9	7.4	7.1
Ukraine	1.6	2.0	1.3	2.0	2.1	1.6	1.7	2.2	1.6
Canada	3.8	3.2	2.9	2.5	3.3	2.8	3.1	2.7	1.4
Norway	0.9	1.0	1.2	0.6	0.6	0.3	0.6	0.6	0.8
Others	9.7	5.0	6.0	7.8	3.5	3.7	5.0	4.8	3.9
Crude Oil									
Russia	25.5	29.2	31.1	32.2	32.5	33.4	33.2	31.4	33.1
Norway	20.1	19.4	19.2	18.8	16.9	15.5	15.1	15.1	15.2
Libya	8.2	7.5	8.4	8.8	8.8	9.2	9.8	9.9	9.0
Saudi Arabia	10.8	10.1	11.3	11.3	10.6	9.1	7.2	6.9	5.7
Kazakhstan	1.6	2.4	2.7	3.4	4.5	4.6	4.6	4.8	5.4
Iran	5.9	4.9	6.4	6.3	6.1	6.2	6.2	5.4	4.7
Nigeria	4.8	3.5	4.3	2.6	3.2	3.6	2.7	4.0	4.5
Azerbaijan	0.9	1.0	1.0	0.9	1.3	2.2	3.0	3.2	4.0
Iraq	3.8	3.0	1.6	2.2	2.1	2.9	3.4	3.3	3.8
Others	18.3	18.8	14.2	13.4	14.0	13.2	14.7	16.1	14.6
Natural Gas									
Russia	47.7	45.0	45.1	43.8	40.6	39.3	38.4	37.6	34.2
Norway	22.8	26.2	25.5	25.0	24.4	25.5	28.2	28.9	30.7
Algeria	21.2	21.2	20.0	18.2	18.0	16.4	15.4	14.7	14.1
Qatar	0.3	0.9	0.7	1.4	1.6	1.8	2.2	2.2	4.6
Libya	0.4	0.3	0.3	0.4	1.7	2.5	3.0	2.9	2.9
Nigeria	2.3	2.2	3.1	3.7	3.5	4.3	4.7	4.0	2.4
Trinidad & Tobago	0.3	0.2	0.0	0.0	0.2	1.3	0.8	1.6	2.2
Egypt	0.0	0.0	0.0	0.0	1.6	2.5	1.8	1.7	2.1
Oman	0.4	0.4	0.2	0.5	0.6	0.3	0.1	0.1	0.4
Others	4.6	3.7	5.1	7.0	7.8	6.1	5.4	6.3	6.4