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"EU-Russia Energy Relations : the Role of International Law from Energy Investment and Transit Perspective"

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Abstract

Since the establishment of the official relations between the EC and the USSR, the Russian-European energy relations have largely evolved as a result of numerous changes regarding both partners: the Soviet Union disintegrated, allowing Russia to emerge as an international actor, and the EC gave birth to the EU. As to their energy interactions, e.g. natural gas supplies, over the last 30 years Russia has been a reliable supplier of gas to the European market. Lately, the relationship between these two trading partners has degraded. Recent legal developments demonstrate that in the energy investment and transit field both the EU and Russia tend to implement restrictive instruments and separate unfriendly actions. Furthermore, up-to-date rise in business activity, and consequently in business disputes, between Russian and foreign parties, on the one hand, and the latest energy crises, on the other hand, have further harmed this cooperation that should be based on a mutual reliance rather than the panic over loosing supplies or loosing markets. International law which is currently in force does not always adequately contribute to enhancing such mutual reliance. Namely, in terms of international law, the existing mechanisms, such as the EU-Russia Energy Dialogue and Partnership and Cooperation Agreement (PCA), are supposed to create the legal basis for EU-Russia energy cooperation. However, each of them has significant flaws with regards to both its binding force and the interests and objectives of both partners. In this context, the main binding instruments of international law that could generally apply to EU-Russia energy trade-related issues are the ECT and the GATT/WTO rules. So far, since October 2009 Russia is no longer a party to the ECT, and it is not yet a member of the WTO. Consequently, the biggest current practical problem to resolve in the context of this study is what are the best tangible alternatives to frame and enhance EU-Russia energy cooperation, especially with regards to investment and transit issues. Notably, the stakes for both partners should be taken into account, as well as some mutual concessions are needed to be done. While Russia is bound by the ECT until 2019 to investments made in its territory prior to 2009, and although Russia is expected to join WTO around 2012, this research aims to determine the best up-to-date options for regulating EU-Russia energy relations with strong focus on investment and transit. Also, the study highlights the potential shortcomings of the prospective legal framework, and proposes some drafting solutions to remedy those shortcomings.

Key words : Denial of benefits ; Energy Charter Treaty ; Energy Dialogue ; European Union ; Foreign investment ; Gas supply ; GATT ; International commercial arbitration ; International investment arbitration ; International transit disputes ; Lisbon Treaty ; Partnership and Cooperation Agreement ; Provisional application ; Russia ; Security of energy supply ; Third party access to energy network..

Résumé

Depuis l'établissement des relations officielles entre la CE et l'URSS, les relations énergétiques russo-européennes ont largement évolué en raison des nombreux changements en ce qui concerne les deux partenaires: l'Union soviétique s'est désintégrée, permettant à la Russie d'émerger en tant qu'acteur international, et la CE a donné naissance à l'Union européenne. Concernant leurs opérations énergétiques, comme, par exemple, les approvisionnements en gaz naturel, au cours des 30 dernières années la Russie a été un fournisseur fiable de gaz sur le marché européen. Toutefois, dernièrement les relations entre ces deux partenaires commerciaux se sont dégradées. Les développements juridiques récents démontrent que dans le domaine de l'énergie, notamment de l'investissement et du transit, l'UE aussi bien que la Russie tendent à mettre en œuvre des instruments restrictifs et des actions contradictoires. De surcroît, la croissance actuelle des échanges commerciaux, et par conséquent des litiges commerciaux, entre les parties russes et étrangères, d'une part, et les crises gazières récentes, d'autre part, ont principalement nui à cette coopération, qui devrait être fondée sur la confiance mutuelle, plutôt que sur la crainte de perdre approvisionnement ou marché énergétique. Le droit international actuellement en vigueur ne permet toujours pas de renforcer cette confiance mutuelle de manière adéquate. A savoir, en termes de droit international, les mécanismes existants, tels que le Dialogue Energétique UE-Russie et l'Accord de partenariat et de coopération (APC), sont censés créer la base juridique pour la coopération énergétique UE-Russie. Cependant, chacun d'eux a des lacunes importantes en ce qui concerne à la fois la force obligatoire, les intérêts et les objectifs des deux partenaires. Dans ce contexte, les principaux instruments contraignants du droit international qui pourraient s'appliquer au commerce énergétique UE-Russie de manière générale, sont le Traité sur la Charte de l'Energie (TCE) et les règles GATT / OMC. Pourtant, depuis octobre 2009, la Russie n'est plus partie au TCE, et elle n'est pas encore membre de l'OMC. Par conséquent, le plus grand problème actuel à résoudre dans le cadre de cette étude est de savoirquelles sont aujourd'hui les meilleures alternatives concrètes pour encadrer et renforcer la coopération énergétique UE-Russie, particulièrement en ce qui concerne les questions d'investissement et de transit. Notamment, les enjeux des deux partenaires doivent être pris en compte, ainsi que des concessions mutuelles sont nécessaires. Alors que la Russie est liée par le TCE jusqu'en 2019 à des investissements effectués sur son territoire avant 2009, et bien que la Russie doive rejoindre l'OMC autour de 2012, ce travail vise à déterminer, déjà aujourd'hui, les meilleures options tangibles pour réglementer les relations énergétiques UE-Russie. En outre, l'étude met en évidence les éventuelles lacunes du cadre juridique considéré, et envisage quelques propositions rédigées afin de remédier à ces lacunes.

Mots-clés: L'accès des tiers au réseau énergétique; l'Accord de partenariat et de coopération; L'application provisoire; L'approvisionnement en gaz; L'arbitrage commercial international; L'arbitrage international d'investissements; Le Dialogue Energétique; Différends internationaux en matière de transit; GATT; Les investissements étrangers ; Refus d'accorder des avantages; la Russie; La sécurité d'approvisionnement énergétique; Le Traité de Lisbonne; Le Traité sur la Charte de l'Energie; L'Union européenne.

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The views expressed in this study belong to the author and do not necessarily reflect the opinion of any government, institution or firm mentioned.

SUMMARY

INTRODUCTION

As the title indicates, this study focuses on energy issues. But what *is* energy? From the scientific standpoint, energy represents the ability to produce action; it can take different forms. For example: heat energy, muscular energy, mechanical energy, chemical energy and electrical energy; and energy is capable of being transformed from one to another of its many forms. A geologist would add that energy comes from different natural sources: wood, coal, oil, gas, wind, solar radiation, waterfalls, the internal heat of the Earth, uranium; a non-renewable energy resource is an energy resource that is not replaced or is replaced only very slowly by natural processes; a renewable energy resource is the opposite. In today's discussions about energy, a political scientist would first enunciate such key notions as "proven resources" and "cross-border energy supply". An economist would tell you that energy is a broad scientific subject area which includes topics related to the supply and demand of energy in societies.[1] In hearing the word "energy", an international lawyer would primarily think about related principles of international law, namely sovereignty over natural resources and freedom of transit. That is, energy is a multifaceted issue that clearly brings solutions to a multitude of different matters in a number of sectors, but also implies a large and diverse set of problems.

Professor Cartou noticed that:

> "La gravité de la crise a montré la véritable nature du problème de l'énergie. L'énergie c'est plus que la puissance, c'est la vie même qui en dépend: sans soleil tout vie cesse, sans énergie il n'y a plus ni industrie, ni agriculture, ni transports. Dans ces conditions, celui qui détient l'énergie, exerce sur celui qui en dépend un pouvoir absolu…" [2]

The puzzling part is that this statement is not dated of 2009 but of 1983, and refers not to recent Russia-Ukraine gas crises, but to those related to the Arab oil embargo. After 30 years, *the problem of regulation* between energy suppliers and energy consumers comes and goes in four corners of the Earth, but never seems to disappear completely. The problem is far from new.

Indeed, the international community was conscious about both real and potential difficulties proper to the energy-related issues well before the two petroleum crises of 1970s. That is, multilateral efforts to discipline energy issues started in 1947 by drafting the Havana Charter for an International Trade Organisation (ITO). The text contained a far-reaching chapter - Chapter VI - on inter-governmental agreement to address the issues facing trade and investment in energy, regulating production or quantitative control of exports or imports of primary commodities and regulation of prices, developing natural resources while protecting them from needless exhaustion, and more. In particular, its art.55 read in full as follows (emphasis added):

> "The Members recognize that the conditions under which some primary commodities are produced, exchanged and consumed are such that international trade in these commodities may be affected by *special difficulties* such as the *tendency towards persistent disequilibrium between production and consumption*, the accumulation of burdensome stocks and pronounced fluctuations in prices. *These special difficulties may have serious adverse effects on the interests of producers and consumers, as well as widespread repercussions jeopardizing the general policy of economic expansion*. The Members recognize that such difficulties may, at times, necessitate *special treatment of the international trade in such commodities through inter-governmental agreement*."[3]

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[1] Sickles, Robin (2008). Definition of "Energy economics" in *The New Palgrave Dictionary of Economics*, 2nd Edition.

[2] [The severity of the crisis has revealed the true nature of the energy problem. The energy is more than power, life itself depends on it: any life ends without sun; without energy there is neither industry nor agriculture nor transportation. Under these conditions, those who possess energy wield an absolute influence over those who depend on such energy]. Original translation. Cartou, Louis (1983). "La politique de l'énergie [Energy policy]", *Revue Trimestrielle de Droit Européen*, 1983 (pp.523-545), p.524.

[3] Art.55, Havana Charter. The full text of the Havana Charter is available on: http://www.wto.org/english/docs_e/legal_e/prewto_legal_e.htm#other , retrieved on March 3, 2010.

In addition, another project's point which is of particular interest for the present study is that its art.33 laid down the principle of freedom of transit, including transit of energy.

The Havana Charter was never ratified by the United States (US) and the ITO project was abandoned by the international community. For four next decades the General Agreement on Tariffs and Trade (GATT) became virtually the sole legal base of international trade related issues, though most of energy-related Havana Charter provisions were not included in the GATT and for several reasons, one of them being that energy exporting states were not founding members of the GATT. Moreover, today many of the most important fossil fuels exporters and transit countries are still outside of the World Trade Organisation (WTO), though several important states for that matter (e.g., Algeria, Azerbaijan, Iran, Iraq, the Russian Federation) are now in the accession process.

Regarding the GATT Tokyo and Uruguay Rounds,[4] the two petroleum crisis of the 1970s pressed some developed countries such as the US to address energy trade-related matters. However, these issues, being closely linked with the international law principle of state sovereignty over natural resources,[5] became an apple of discord between the GATT members, consequently undermining the efforts of the Uruguay Round to negotiate specific provisions associated with trade in energy goods and services. Today, notwithstanding the actual absence of specific rules dealing with trade in energy, some WTO provisions apply to trade and investment in general and thus could be applied to energy products and services.

Beyond the WTO, the past two decades have seen both radical restructuring and liberalisation of energy markets and an outburst and development of multilateral, regional and bilateral agreements either entirely (Energy Charter Treaty) or partially (United Nations Convention on Climate Change, North American Free Trade Agreement, Southern Common Market, Association of Southeast Asian Nations Free Trade Area, etc.) concerning energy matters. In this respect, one of the main objectives of the Energy Charter Treaty (ECT; the Treaty) for example is providing vigorous energy provisions, and promoting transparency and efficiency in the operation of energy markets, but leaving it up to governments to define the structure of their national energy sector. On the other hand, regarding energy transit for instance, the most well-known regional trade agreement (RTA) - the Treaty of Rome – is currently making up the European Union (EU) common position on this particular issue through a number of directives, regulations and other instruments. Detailed directives, which are in force within the EU, aim at respecting energy transit obligations among member states. (Interestingly, dissimilar to the international law where the transit is made dependant on the crossing of the territory of a third state, the EU directives stress the infrastructure itself.) Finally, bilateral investment treaties (BITs) set out standards of treatment for foreign direct investment (FDI), including energy-related investment, and like the Association of Southeast Asian Nations Free Trade Area (ASEAN FTA) and the ECT, establish frameworks for settling disputes where the host state fails to fulfil those obligations. Therefore, related developments in international investment arbitration awards under the ECT and some RTAs, FTAs, and BITs are of crucial relevance for both development of international energy law and possible solutions of the problem of regulation between energy producers and energy consumers.

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[4] In fact, gradual market liberalisation is one of the fundamental principles of the trading system as laid down by the GATT and then resumed by the WTO, created in 1995; it deems that trade agreements do not end but must evolve over time. Continuing negotiations is a guarantee given by a GATT member state at the moment when it signed the GATT agreement. Thus, since the beginning of the GATT system, there were nine GATT trade rounds including the actual Doha Round. Tokyo (1973-1979) and Uruguay (1986-1994) rounds are respectively the seventh and the eighth GATT trade rounds.

[5] The general principle of international law of permanent state's sovereignty over natural resources was established through the UN General Assembly resolutions 523 (VI) of January 12, 1952; 626 (VII) of December 21, 1952; 1515 (XV) of December 15, 1960; and 1803 (XVII) of December 14, 1962. Moreover, UN Resolution 3201 (S-VI) of May 1, 1974, entitled "Declaration on the Establishment of a New International Economic Order" stated in its Article 4(e) that a state had the right to nationalise its resources and could not be subject to economic, political or other coercion to prevent the exercise of that right.

EU-Russia Energy Relations: the Problem

The subject of regulation of relations between energy producers and energy consumers is manifold, although all its facets are quite interconnected. Theoretically, a need in energy is expressed through energy demand, which could be satisfied by the supply of the quantity of energy matching that demand. Energy supply has to be stable. This requires a certain degree of security of energy supply. (The security of energy supply depends to a great extent on the security of energy transit.) If such security could not be guaranteed anymore by the existent energy suppliers and/or by the existent systems of energy supply, and given that energy demand should be satisfied anyway, the diversification of energy sources and/or the modification of the actual energy supply regime are needed. Hence, new energy investments are required. Consequently, an efficient *legal framework* governing relations between energy suppliers and energy consumers is necessary to cover all those links.

In practice, energy - and hydrocarbons in particular - is transported over increasingly large distances from producers to consumers. Notably, natural gas requires special loading and transportation. Thus it is transported via pipelines which often cross national borders of different states. Bilateral disputes over energy transit can quickly become multilateral because of today's both global character and quantitative importance of using of natural gas as an energy source.[6]

If any comparable substitute to modern pipeline transportation had existed to minimise the risk of energy supply disruptions, *cross-border transit* would be much less important for energy supply. Conversely, to date different means such as rail (possible only for oil), trucks (for petrochemistry), or tankers (possible for gas, but it must be liquefied before being shipped which is not only very expensive, but also considerable volumes of gas are wasted during the liquefaction process and later during re-gasification) generally imply much longer distances and higher costs. These can lead to the rejection of transportation projects on economic grounds.[7] This is illustrated by pipelines, which to date remain the most important means of transport for natural gas in transit. Since construction costs are high and projects require a long period of negotiation, with each longer or additional pipeline taking a different route through different countries, pipilines are of high strategic importance for a diversifying state. Hence, they can be a very complicated and not always feasible project.[8]

The EU is one of the world's largest energy markets.[9] It imports 50 percent of the energy it consumes, a figure that could rise to 70 percent by 2030.[10] Oil and natural gas represent, respectively, about 42 and 24 percent of the total European[11] final energy consumption.[12] About 33.5 and 44 percent of imported crude

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[6] Traditionally, natural gas has been a seasonal fuel. That is, demand for natural gas was usually higher during the winter, partly because it was used for heat in residential and commercial settings. Stored natural gas plays a vital role in ensuring that any excess supply delivered during the summer months is available to meet the increased demand of the winter months. However, with the recent trend towards natural gas fired electric generation, demand for natural gas during the summer months is now continually increasing all over the world. Indeed, today it is widely used in virtually all sectors, by both upstream and downstream industries, in production of processed and semi processed goods, for housing uses (e.g., heating), for commercial uses, in the transportation sector as well as for electric generation using natural gas. *Source:* http://www.naturalgas.org/index.asp , retrieved on July 30, 2010.

[7] Liesen, Rainer (1998). "Transit under the 1994 Energy Charter Treaty", *On-Line Journal of the Centre for Energy, Petroleum and Mineral Law and Policy* (CEPMLP), Dundee University, Vol. 3-7, 1998. URL: http://www.dundee.ac.uk/cepmlp/journal/html/vol3/article3-7.html , retrieved on May 23, 2010.

[8] *Id.*

[9] The EU and the US together represent the world's largest energy markets. As per 2006 estimates, together two actors consume 37.9 percent of the world energy. The Commission Directorate-General for Energy and Transport website: http://ec.europa.eu/dgs/energy_transport/index_en.html , retrieved on July 30, 2010.

[10] International Energy Agency (2004). *Outlook for European Gas Demand, Supply and Investment to 2030,* available at: http://www.iea.org/work/2004/investment/outlook%20for%20European%20gas%20demand.pdf , retrieved on April 6, 2010.

[11] In this study, the terms "European", "Europe's", etc. refer to the EU-27, unless indicated otherwise.

[12] 2006 estimates. European Commission (2009). *EU energy and transport in figures.* (Statistical pocketbook 2009). Directorate-General for Energy and Transport, *op.cit.*, note 9.

oil and natural gas, respectively, come from the Russian Federation.[13] 80 percent of that Russian gas goes through Ukraine.[14]

As for the Russian Federation (Russia), it currently holds the world's largest natural gas reserves, the second largest coal reserves, and the eighth largest oil reserves. The country is also the world's largest exporter of natural gas and one of the largest oil exporters; its economy is heavily dependent on oil and natural gas exports.[15] As per the International Monetary Fund (IMF) and World Bank estimates, in the past decade the oil and gas sector generated more than 60 percent of Russia's export revenues (64 percent in 2007), and accounted for 30 percent of all FDI in the country.[16] At least 75 percent of FDI comes from the EU member states.[17]

Therefore, the energy relations between such an important producer and exporter as Russia, along with the no less significant consumer and importer as the EU, imply the whole palette of energy-related problems specified above.[18]

The most crucial problems related to *energy consumption* that the EU faces today are *security* and *diversification* of its energy supplies.[19] In applying these problems to energy relations with Russia, the two elements of particular relevance to EU-Russian relations are *energy transit* and *energy investment*. Energy transit is important because natural gas constitutes an important share of EU energy consumption and is also Russia's first export commodity, transported via pipelines crossing different national borders. Energy investment is important because of the need to diversify European energy sources and to Russia's need for foreign investments.

When speaking about energy investment and transit, it is better to treat these two highly strategic issues together on account of numerous—and interconnected—reasons.. They are briefly introduced below.

On the one hand, because of the increasing opening of energy-endowed states and the liberalisation of energy markets during the past two decades, investors have seen new possibilities for investment in many previously unreachable energy reserves. Thus, the success of such investments to a certain degree depends on those investors' capacity to ensure stable and secure energy transit.

An empirical illustration of the correlation between energy transit and energy investment was recently demonstrated through the Russia-Ukraine gas crisis of 2009, when gas transit to Europe was disrupted dramatically[20] The crisis outlined the importance of *secure transit mechanisms* for grid-bound energy investments.

On the other hand, in today's energy-dependent world, securing energy investments is a challenge for producer, consumer and transit countries alike.

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[13] European Commission (2009). *Idem*. See also IEA (2004), *supra*, note 10.
[14] IEA (2004), *id.*
[15] US Energy Information Administration (EIA)(2007). *Country Analysis Briefs: Russia*, URL: http://www.eia.doe.gov/cabs/Russia/Background.html, retrieved on September 16, 2010.
[16] *Id.*
[17] 2008 estimates. European Commission (2009). *Trade - Bilateral relations - Countries: Russia.* (Hereinafter "European Commission (2009) A").
[18] See *supra*, p.3.
[19] Aseeva, Anna (2010). "Re-thinking Europe's Gas Supplies after the 2009 Russia-Ukraine Crisis", *China and Eurasia Quarterly*, Vol. 8 - No. 1, 2010 (pp.127-138), p.127. URL:http://www.chinaeurasia.org/images/stories/isdp-cefq/CEFQ201004/cefq8.1aa127-138.pdf , retrieved on May 13, 2010.
[20] *Infra*, pp.13-14.

Outline of the Study

Returning to Professor Cartou's analysis of European energy policy, he continued the discussion on the related energy crisis[21] as follows (original italics):

> "Dès lors, le problème pour un Etat est de trouver en permanence des moyens d'approvisionnement. (…) Cet approvisionnement doit être garanti en tous temps. Il ne doit pas dépendre des aléas de la conjoncture politique. Des dispositions pour faire face a des menaces brutales d'interruption des fournitures constituent *une politique de crise.*
>
> Mais remédier a des crises subites ne suffit pas. *L'indépendance énergétique* doit être assurée de manière durable: elle est l'un des objectifs de toute politique de l'énergie."[22]

It is worth adding that energy *independence* is better to be framed by efficient legal grounds. Or, better say, legally backed energy independence is something that could be seen – at least for such an important energy importer as the EU – as an objective, but a long-term one. Paradoxically, in today's situation it is the *interdependence* between net energy exporters and net energy importers which is growing.[23] Therefore, multilateral regimes that secure all chains of energy supply, and if not those, then similar bilateral rules, are necessary in order to provide a more balanced and efficient framework for the EU-Russia energy relations.

While the EU crucially needs to secure and diversify its energy supplies - specifically, hydrocarbons – the past and present issues of securing Russian energy deliveries and investing in Russian energy fields are complex. Although this study aims primarily to examine and assess the role of international law in the EU-Russia energy relations, it is impossible to fully understand this legal matter in isolation from the core economic, geopolitical, historical and diplomatic issues of EU-Russia relations in the energy field.

The objectives of the present research are multiple, but its general purpose is to assess current legal options remaining after Russia's withdrawal from the ECT, as well as to envisage the short-term and long-term legal alternatives for EU-Russia energy cooperation. To determine these alternatives, this study will primarily attempt to answer the following research question: *Does the international law which is currently in force mitigate, or simply reproduce, disagreements between the two actors?*

More specifically, through an analysis of the issues of investment and transit of EU energy supply, as well as their European and international regulatory and legal framework and arbitral jurisprudence, the study aims to explore two hypotheses. Namely, that: (1) though in theory current international law seems to constitute an appropriate and sufficient legal framework for EU-Russia energy relations, in practice it does not offer enough avenues for greater cooperation; indeed, thus far it seems simply to reproduce asymmetries between the two parties; and (2) since Russia withdrew from the ECT, it is reasonable to assess new and better alternatives for such cooperation, including a new bilateral Partnership Agreement which contains an energy chapter based on the ECT principles.

The study's analysis applies a methodology that is different in its style and structure from a legal analysis, or a geopolitical study. Instead of following the logic dictated by a single method, it is structured around the most relevant issues of EU-Russia energy cooperation, and uses various types of evidence to come up with possible answers.[24]

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[21] *Supra*, p.1.

[22] [Therefore, the state's issue is to constantly discover means of supply. (...) I.e. the supply must be guaranteed permanently. It should not depend on the vagaries of the political situation. Provisions to address concrete threats of sudden supply disruptions constitute the politics of crisis. But addressing sudden crises is not enough. Energy independence must be ensured in a sustainable manner: it is an objective of any energy policy.] Original translation. Cartou (1983), *op.cit.*, note 2, *id.*

[23] Cf. *infra*, pp.15-18.

[24] This methodology was used by Kalotay, Kalman (2006) in his article "New Members in the European Union and Foreign Direct Investment", Thunderbird International Business Review, Vol. 48(4) (pp.485–513), July–August 2006, published online in *Wiley InterScience* (www.interscience.wiley.com). The annual *World Investment Reports* of UNCTAD and *the World Development Reports* of the World Bank adopt a similar approach.

Chapter I begins with a brief, though more formal introduction to energy security issues. Then, the chapter details the current concerns of EU energy security in light of EU-Russia energy relations. Namely, it focuses on the analysis of the recent gas crises; the EU common energy policy challenges; European and Russian energy policies with regards to the international law; common EU-Russia energy space from the international and bilateral rules perspective; and finally the ECT in general and in particular its investment and transit regimes. The chapter closes with general assessment of energy investment and transit rules in selected regional, bilateral and multilateral agreements.

Chapter II aims at providing legal analysis of energy investment and transit issues between the EU and Russia. The analysis is essentially based on the relevant ECT rules and case law, albeit it addresses a number of other international, regional and bilateral related regulations. On investment, the chapter will describe the general method for access to investment dispute settlement under the ECT, and will address two controversial jurisdictional questions under the Treaty. Specifically, it will address provisional application to matters affecting investments prior to the Treaty's ratification, and it will address a member state's right to deny the benefits to a legal entity or an investment. Further, this chapter will address the freedom of transit principle as well as the transit dispute settlement mechanism under ECT art.7 para.7.

The closing part of the document proposes general conclusions of the research and some policy recommendations. It concludes that international law does not always adequately contribute to enhancing EU-Russia energy cooperation. Since the current law does not do so, the concluding part suggests the best ways possible to enhance such cooperation in the short, medium, and long-term. It also discusses how analysing the shortcomings of EU-Russia energy relations could incidentally improve an international regime of energy transit and investment. Because of the near-impossibility today for the ECT to further frame EU-Russia energy relations, the concluding part suggests the establishment of a new framework, mostly inspired by the ECT, but complimented with some relevant provisions and instruments of other agreements. These other agreements could sometimes offer better wording and/or meaning than the ECT rules. Finally, the conclusions propose several drafting solutions to specific provisions of the prospective framework to remedy the relevant shortcomings highlighted in the course of this study.

CHAPTER I. SECURING AND DIVERSIFYING EU ENERGY SUPPLY: THEORIES, PRACTICES AND POLICIES

Safety and certainty in oil lie in variety and variety alone.
Winston Churchill, 1913

1. Major Issues of Energy Supply and Their Impact on Energy Security

Unequal distribution of non-renewable energy reserves among countries has prompted rivalry over energy resources, particularly in fossil fuels. As a result, rising costs of fossil fuels and environmental concerns have intensified the need of the EU to diversify its energy supply in order to secure it.

The notion of *energy security* covers a broad range of issues, from uninterrupted oil, natural gas and liquefied natural gas (LNG) supplies to the protection of energy infrastructures from terrorist attacks.[25] Historically, the concept was applied to consuming countries but it has evolved in recent years to integrate the responsibility of both consumers and producers. For example, factors such as political instability, the increased cooperation between oil-producing and oil-consuming countries, multinational oil companies' investment in oil-producing countries, uncertainty over available reserves, and the possibility of an oil production peak in some oil producing countries have all raised concerns about the uninterrupted flow of energy by reasonable prices to consumers.[26]

Other definitions of energy security may emphasise more e its economic aspect, namely that a necessary level of energy security exists if the energy sector does not cause major welfare-reducing frictions in the economy at national and global levels.[27] Such a definition is confined to a market-centric approach, which views energy security "as the loss of economic welfare that may occur as a result of a change in the price or availability of energy".[28] The IEA had been continually defining energy security as follows: in 1985 it was viewed as an "adequate supply of energy at a reasonable cost"; ten years later it was stated that "energy security is simply another way of avoiding market distortions"; and in 2002 it was posited that "smoothly functioning international energy markets" will deliver "a secure – adequate, affordable and reliable – supply of energy".[29] The market-centric approach could be completed by quantitative and qualitative aspects, such as the 'translation' of the market-centric definition into short-term (operational) and long-term (adequacy) threats of supply disruptions based on sources of energy supplies, and subsequent transit, storage and delivery, as well as the quantification of these risks, and sustainability of energy security strategies.[30]

Energy security is a major objective of the European Union in order "to ensure its economic development and the well-being of [EU] citizens".[31] Given that the EU is becoming more dependent on the external world to meet its energy demand compared to the actual situation, *import dependency* is set to increase even in the event of a reduction in overall energy demand and with imports remaining at today's level,.[32] As it

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[25] Alhajji, Anas F. (2007). "What Is Energy Security? Definitions and Concepts", *Oil, Gas, and Energy Law (OGEL)* 3 (2008).
[26] *Id.*
[27] Löschel, Andreas, Moslener, Ulf and Dirk T.G. Rübbelke, (2010). *Study: Indicators of energy security in industrialised countries. Energy Policy*, Vol. 38 (4), 2010 (pp.1665-1671).
[28] Bohi, Duglas R. and Michael A. Toman (1996). *The Economics of Energy Security*. Kluwer Academic Publishers, Boston, p.1. In Chester, Lynn (2009). "Conceptualising energy security and making explicit its polysemic nature", *Energy Policy*, Vol.38 (2) , 2010 (pp.887–895), p.889.
[29] Chester (2009), *id.*
[30] *Ibid*., p.890.
[31] European Commission (2008). *Europe's current and future energy position "Demand – resources – investments"*, SEC (2008) 2871, Vol. I, Brussels, 13.11.2008, p.19.
[32] *Id.*

follows from the above definitions, a concept of energy security may consist of both absolute and relative notions.[33] The EU appears to favour both notions, as evidenced by its focus on a market which plays a central role in ensuring, enhancing or attaining energy security.

Since EU-Russia energy relations particularly stress energy supply, in this section energy security is examined from the security of the *supply* perspective. A simple method, generally accepted in measuring energy security,[34] involves assessing whether supplies are affordable (1.1.), available (1.2.), accessible, and acceptable (1.3.).

1.1. Affordable Energy

The economic dimension of energy security deals with *price level* and *market behaviour*. The provision of affordable energy to the consumer depends on the cost of production/generation, transportation/transmission, and distribution. The interruption of supply networks can affect prices and create economic challenges for countries with non-diversified energy sources. Continued price rises and short-term thorns in oil, gas or electricity can generate inflation or recession. Energy (in particular oil and gas) prices are among the most volatile of all commodities.[35]

As to the prospects and near-terms of energy affordability*, price volatility* is expected to continue due to supply concerns in the face of rising demand; the price for oil and most other energies is expected to rise over the next 23 years. However, predictions vary from one source to another. The International Energy Agency (IEA) predicts the price of crude oil to fall from its current high back to USD 47 per barrel early in the next decade, and then rise by about 50 percent before 2030. Others have calculated a price of USD 105 (Goldman Sachs) or even USD 120 (Hamburg Institute of International Economics - HWWA) per barrel in 2030. Gas and coal prices are expected to follow the trend in oil prices. For many renewables, government subsidies will continue to determine price levels.[36]

Given that the actual share of natural gas and oil in the EU final consumption is more than 40 percent and about 25 percent,[37] respectively, and that roughly half of that energy is imported, affordable energy prices represent a critical issue for the security of European energy supplies and, consequently, for its overall energy security. However, as it follows from the above forecasts, energy prices, including those of the EU energy imports, are expected to be fairly volatile for the next 20 years.

More concretely, i.e. regarding the next five years,and relating to Russia's energy exports to Europe, it is likely that Moscow would be able under certain circumstances to set prices (and also volumes) to consumers in the both West and East. Whether such circumstances would be created will depend on Russia's success to feed the Chinese gas market in the next four to five years. As to Russia's successful penetration to the Chinese oil market, the process appears to be already underway.[38]

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[33] "Availability and adequacy of capacity are capable of absolute measurement. Affordability, or the 'reasonableness' of prices, are relative notions with meanings subject to considerable variation. Supranational organisations, governments, policy advisers and commentators generally favour a definition of energy security centred on the absolute notions of market supply and market price. Broader definitions, such as those used by the European Commission, encompass absolute and relative notions. All definitions envisage the market playing a central role in ensuring, enhancing or attaining energy security." Chester (2009), *op.cit*., note 28, p.891.

[34] Frondel, Manuel and Christoph M. Schmidt (2008)."Measuring Energy Security - A Conceptual Note", *Ruhr Economic Papers* 0052, Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Ruhr-Universität Bochum, Universität Dortmund, Universität Duisburg-Essen. See also *Indicators of energy security…, op.cit*., note 27.

[35] See Ilie, Livia, Horobet, Alexandra and Corina Popescu (2007). "Liberalisation and Regulation in the EU Energy Market", Munich Personal RePEc Archive (MPRA), Paper No. 6419, posted on December 21, 2007. URL: http://mpra.ub.uni-muenchen.de/6419/1/MPRA_paper_6419.pdf , retrieved on September 1, 2010.

[36] World Economic Forum (2010). "Future mapping for the global agenda". URL: http://www.scribd.com/doc/36158869/Trend2030-Full , retrieved on September 1, 2010.

[37] See *supr*a, p.4.

[38] Chinese-Russian energy cooperation is out of scope of this paper, hence it will not be developed further in this document. However, since EU energy prices would under certain scenario depend on development of such relations, it deserves several words. That is, Eastern Siberia-Pacific Ocean (ESPO) link has recently been opened; the link is

1.2. Available Energy

Both the quantity and quality of a country's available energy reserves determines its *energy independence*. In turn, the energy independence analysis and prospects are of crucial importance for formulating an effective energy security policy.

Since the US and the EU together were estimated in the middle of the 2000s as world largest energy market,[39] it is worth examining the American example of energy independence strategy. This policy is largely based on building up oil and gas supplies by keeping its proven oil and gas resources underground whilst relying on imports, and building strategic petroleum reserves (SPR)[40] as well as diversifying product and geography sources. The logic behind the strategy is that in order to achieve *petroleum independence*, a nation must reach a state in which its economic and/or foreign policies are little – if at all – affected by the restrictive or directing influence of oil and gas producers.[41] This definition captures the essential idea but it is not measurable. A measurable definition needs to reflect the uncertainty about future petroleum market conditions and include a quantitative statement of how much the potential costs of petroleum dependence must be reduced.[42]

Other measures aiming at energy independence represent the basic tools of *energy efficiency* policies. They are fuel diversification, transformation, substitution, etc.[43] For countries exposed by over-reliance on few energy sources, energy efficiency is generally used as a mean to reduce the dependency on those few sources. The discussion about the fuel diversification represents a certain interest for energy security. Although it will not be developed in this study since diversification mostly concerns renewable and "green" energy sources, while this research primary focuses on fossil fuels.

1.3. Accessible and Acceptable Energy

Cross-border investments (1.3.1) and *institutional energy cooperation* (1.3.2.) enhance favourable climate for the development and maintenance of accessible and acceptable energy supplies.

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expected to send over 300, 000 barrels of oil per day to China as starters, and to achieve 1,6 million barrels per day over the next few years. Chinese state oil giant CNPC has actually invested USD 25 billion into the project with its Russian counterpart Rosneft in return for a 20 year supply agreement. It is expected that increasing Russian oil exports to China would be followed by Russian gas flows. Moreover, if Russia succeeds to link Sakhalin and East Siberian gas reserves with Western Siberian fields, this would give to Moscow the choice of LNG or pipeline exports, alongside far greater flexibility to feed Atlantic Basin (Western) or Pacific Basin (Eastern) gas markets. In this case, diversifying supplies to Asia offers Russia what all energy producers want: leverage over competing consumers in the East and West. "Keep Asia keen, treat Europe mean". For more details, see Hulbert, Matthew (2010). "Russian Arbitrage: pipedream or Eastern Promise", September 21, 2010, *European Energy Review*. URL: http://www.europeanenergyreview.eu/index.php?id=2357, retrieved on September 21, 2010.

[39] *Supra*, note 9.

[40] « Since the Arab oil embargo of the early 1970s, the United States has spent nearly $50 billion (in today's dollars) to build and maintain a huge strategic stockpile of crude oil. Stored in underground salt domes along the coasts of Louisiana and Texas, the U.S. Strategic Petroleum Reserve (SPR) now holds more than 700 million barrels of oil. (…) With the price of crude oil likely to continue to rise above $100 per barrel, the venture could cost between $70 billion and $100 billion. Congress has authorized [in 2007] boosting the SPR to one billion barrels … After the military resources spent to keep oil supplies flowing reliably from the Persian Gulf and other significant oil-producing regions, the SPR is the United States' costliest investment in energy security. The theory behind the effort is that a well-coordinated system of oil stocks can buffer the country against foreign and domestic shocks to the world oil market. Strategic reserves allow governments to relieve the pressure of unexpected interruptions in oil supplies by releasing some of their stocks on the market… » Victor, David G. and Sarah Eskreis-Winkler (2008). "In the Tank -Making the Most of Strategic Oil Reserves", *Foreign Affairs*, July/August 2008 (ESSAY). URL: http://www.foreignaffairs.com/print/64450 , retrieved on March 3, 2010.

[41] Greene, David L. and Paul N. Leiby (2007). "Oil Independence: Realistic Goal or Empty Slogan?", *Oak Ridge National Laboratory*, March 2007. URL: http://lugar.senate.gov/energy/links/commentary/08_greene_full.cfm , retrieved on February 28, 2010.

[42] *Id.*

[43] IEA (2010). *IEA Views*. URL: http://www.iea.org/journalists/infocus.asp#effi , retrieved on September 1, 2010.

1.3.1. Energy Security via Cross-border Investments

In the context of the global financial crisis, European general short and medium term concerns such as energy supply and investment insecurity are expected to increase sharply after 2010.[44] [45] The cost of gas is likely to rise after 2010 since high cost greenfield projects are needed; regulatory changes and impact of competition on contracting practices and project risk growth are expected; technology and cost developments are anticipated; and geopolitical developments in the Middle East region may affect exports from this area. The composition of European energy supplies, in terms of types of energy as well as geographic sources, is likely to change in coming years. The change will be driven by the EU policies designed to mitigate climate change and enhance energy security. The speed of the change will also be influenced by macroeconomic developments and by advances in technology regarding energy end-use efficiency, carbon capture and sequestration, alternative energy sources, and the discovery and production of hydrocarbons. In addition, how fast those developments will be implemented depends on government policies in the areas of international trade and cross-border investments. Finally, *the developments within the ECT framework and different Energy Dialogues are likely to influence European energy supply and investment*. There are other short and medium term issues in relation to Europe's gas supplies and investment strategy which need to be addressed. First, there are enough of gas supplies from non-Russian sources to meet the EU's growing supply shortfall, but to date the financial cost and geopolitical price to bring for example Latin American oil or African gas into Europe appears controversial. Second, massive energy investment is needed, but it is needed to be implemented in time.

In general, most forecasts[46] anticipate, in the next two decades, a declining but still dominant share for fossil fuels, and an increasing share of renewables from their present relatively minor place in the energy matrix. These changes will have important implications for both energy exporting and energy importing countries.

However, nowadays attaining security of hydrocarbons supply through cross-border investments is of crucial importance for the EU, since it currently relies on Russia for almost a half of its total gas supplies and 80 percent of that gas transits through Ukraine. Of the Union's 27 member states, seven are almost totally dependent on Russian gas.[47]

A row of disagreements between Russia and its neighbours over gas prices has resulted in occasional *cut-offs of gas supplies* to much of Europe for weeks, causing severe shortages for industries and households, and generating growing worries within Europe as to its potential dependency on energy transit through fromer soviet republics.[48] To address its import dependency, the EU has to invest in alternative options, namely in increasing of LNG supplies and developing new gas routes. However, until the entire LNG infrastructure of special landing terminals and the system of long-term contracts and their constant renewal are fully set up, the EU will have to diversify its gas supplies through new - alternative - pipeline projects. In this regard, four main new projects are illustrative of this EU strategy. The first two are the pipeline projects meant to provide more Russian gas through routes avoiding Ukraine and some other states, while the second two are designed to be a major alternative source to Russian gas.[49]

1.3.2. Energy Security through Institutional Cooperation

Energy security is addressed through a number of regional and international cooperation *institutions*, such as IEA and the International Renewable Energy Agency (IRENA), and different international and regional

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[44] This section is based on IEA (2004), *op.cit.*, note 10.
[45] See tables 1-3.
[46] See IEA (2004), *op.cit.*, note 10; European commission (2009), *Europe Energy Outlook 2020*. Hereinafter "European Commission (2009) B")URL:
http://ec.europa.eu/dgs/energy_transport/figures_archive/energy_outlook_2020/index_en.htm , retrieved on March 1, 2010; World Economic Forum (2010), *op.cit.*, note 36.
[47] European Commission (2009) A, *op.cit.*, note 17.
[48] *Infra*, pp.14-15.
[49] *Infra*, pp.16-18.

mechanisms such as PetroCaribe Initiative, the ECT and the EU-Russian Federation Energy Dialogue. The two latter instruments are relevant for this study and are introduced below.

The ECT is a distinctive multilateral treaty dedicated to the energy sector. It was signed in December 1994 and entered into force in April 1998. The declared purpose of the ECT is to "establish[ ] a legal framework (…) to promote long-term cooperation in the energy field (…) in accordance with the objectives and principles of the [European Energy] Charter."[50] The ECT was negotiated in a relatively short period of time - given the significance and extent of the treaty - less than three years, and encompasses a broad range of energy-related issues, namely investment, trade, transit, energy efficiency and related environmental aspects, and dispute settlement mechanisms.[51]

The EU-Russia Energy Dialogue, established at the sixth Summit between the EU and Russia in Paris on October 30, 2000, is a key instrument to further development of the EU-Russia cooperation in the energy sector.[52] The objective of the EU-Russia dialogue is to "provide reliability, security and predictability of energy relations of the free market in the long term" (EU-Russia energy dialogue, 9th progress report, Paris 2008) and to increase confidence and transparency between both partners.[53]

Both the ECT and the EU–Russia Energy Dialogue are institutional mechanisms collectively used by the EU to address energy relations with its mostly eastern suppliers. However, at present the effectiveness of these mechanisms is just starting to be tested and thus remains to be seen.

2. Key Issues of European Energy Security in Light of EU-Russia Energy Relations

Russia is one of the most important trade partners of the EU, and the latter is Russia's first trade partner. On the other hand, a significant quantity of hydrocarbons imported by the EU comes from, or transits trough, Russia. Therefore, a *multilateral regime* or similar *bilateral rules* that will secure all chains of energy supplies flowing from Russia to the EU appear essential for providing a more balanced and efficient framework for the EU-Russia energy relations.

Russian energy exports were meant to be governed in the framework of the ECT. The Treaty was signed by all member states of the EU and by all Commonwealth of Independent States (CIS) countries, Japan, Switzerland, etc. Its most important provisions, especially for the EU-Russia energy cooperation, are the protection of investments against *arbitrary nationalisation*, rules on *trade in energy products*, for which each state agrees to apply the rules based on the WTO related norms, *transit regime,* and *dispute settlement mechanisms*. It is complemented by protocols on energy efficiency and on transit. However, while the ECT has been ratified by most of the signatories, neither Norway nor Belarus or Russia has ratified it. Moreover, Russian authorities have expressly stated their refusal to ratify the ECT that they consider contrary to the interests of producer countries and ineffective at resolving transit disputes. Bound by the mechanism of *provisional application* of the ECT, Russia announced in August 2009 its decision to withdraw from the Treaty. Since then Russia officially promotes the establishment of a new system for regulating international energy cooperation. However, new Russian proposals widely take back the principles contained in the ECT - the Charter that its member states seem being willing to evolve.

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[50] *The Energy Charter Treaty and Related Documents: a Legal Framework on International Energy Cooperation* (hereinafter ECT) available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf , retrieved on September 13, 2010. The European Energy Charter is a nonbinding declaration of political intent to promote East-West cooperation in the energy sector following the collapse of the USSR. It was signed by over fifty states in December 1991. See ECT, *id.*: "AN INTRODUCTION TO THE ENERGY CHARTER TREATY: WHY AN ENERGY CHARTER?", retrieved on October 5, 2010.

[51] Energy Charter Secretariat, *Energy Charter: About the Charter*, available online at http://www.encharter.org/index.php?id=7 , retrieved on May 5, 2010.

[52] European Commission (2010). *EU–Russia Energy Dialogue.* URL: http://ec.europa.eu/energy/international/russia/dialogue/dialogue_en.htm , retrieved on July 15, 2010.

[53] *Id.*

This part first addresses the trade, economic and geopolitical closeness of the two actors (2.1.), and analyses as well the recent gas crises where both Russia and the EU were implied (2.2.). Second, it assesses possibilities, near-term opportunities, and general prospects for the EU to secure its gas supplies (2.3-2.6.). Then it examines both European and Russian energy policies (2.7.-2.8.), and looks at past, present and future ways for regulating energy cooperation between the two actors (2.9.). Finally, it introduces the relevant ECT rules, namely its investment and transit regimes (2.10.).

2.1. The EU and Russia: Close Neighbours

The process of the EU's enlargement is far from being complete, since two new countries joined the EU on January 1st, 2007, while new negotiations have been launched in 2005 with Turkey and Croatia. Beyond the challenge of institutional running of the Union by 27 members and the economic cost of integration, the new borders of the enlarged Europe raise the question of its relations with new neighbours, including Russia. The Gaullist concept (to develop the cooperation with the Soviet Union in order to create the "Europe from the Atlantic to the Urals") had been largely taken back over the last 20 years, revealing the general *européanité* of Russia, affirmed by Russian leaders from Mikhail Gorbachev to Dmitri Medvedev, and confirmed by their European counterparts.

In trade and economic terms, the EU is Russia's first partner and the latter is one of the most important partners of the EU, and in particular, its first energy supplier.[54] Yet in 1999 the EU issued a Common Strategy on Russia, which reaffirmed its intention to reach a free trade agreement and introduced the idea of a *common economic space* without, however, specifying the content of this term. The EU has proposed a "gradual convergence of legislation and standards between Russia and the EU, in line with the Partnership and Cooperation Agreement [PCA], [which] w[ould] facilitate the creation of a common economic space."[55] A decade later the idea of common economic space is still an important pillar for sustainable market growth in Russia and a challenge for the future of European economic integration. Yet it is still an idea and not the reality.

The ongoing cooperation between the two parties is based on specific policy areas. These "common spaces" cover: economic issues and the environment; freedom, security and justice; external security; and research and education, including cultural aspects.[56] Thus, current challenges to *EU-Russia trade and economic cooperation* are numerous and a great number of them turn to some extent on energy relations.

2.2. The Russia-Ukraine Gas Crises: Analysis

The dismantlement of the Soviet Union in 1991 took place when close to 100 percent of manufacturing was state-owned and, consequently, each successor state took over the control of the assets on its own territory. In Russia that resulted in an emergence of such state-owned energy giants as Gazprom for gas, and Rosneft for oil. Notably, the international strategies of such resource-based *state enterprises* in various countries are to some extent influenced by the course of state foreign policy. In Russia this is done partly through the state's controlling share in those companies, which directly affects the composition of their Boards, and partly through informal pressure.[57]

On the other hand, the geographical situation of Ukraine - between the EU and Russia - implies its highly strategic role in *energy transit*. Indeed, it has the second largest network of pipelines in the world after

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[54] European Commission (2007). *The European Union and Russia: Close Neighbours, Global Players, Strategic Partners.* URL: http://ec.europa.eu/external_relations/library/publications/2007_russia_en.pdf , retrieved on May 15, 2010.

[55] European Council (1999). *Stratégie commune sur la Russie [Common strategy on Russia]*, Bulletin UE 6-1999, Conclusions de la présidence (26/38)

[56] *European Union: External Action. Russia* (2010). URL: http://www.eeas.europa.eu/russia/index_en.htm , retrieved on September 7, 2010.

[57] See Kalotay, Kalman (UNCTAD) (2007). "The Rise of Russian Transnational Corporations", *The Geneva Post Quarterly,* Vol. 2, No. 1 (pp. 55-85), May-June 2007, p.63.

Russia. More than 80 percent of Russian gas exports and around 40 percent of Russian oil exports transit through its territory.[58]

Taking into account cross-border political implications of energy transportation, there was always a hypothetical risk that international legal obligations relating to transit can be determined by *political considerations* For example, undermining the flow of gas or oil may be used as a way to *blackmail* either the producer or the consumer state, or even both.[59] A well-known empirical illustration of the asserted risk is the 1993 dispute between Russia and Ukraine over the Black Sea fleet. In August 1993, Russia cut off Ukrainian gas supplies for a few days to pressure negotiations concerning control of the Black Sea fleet; Ukraine responded by siphoning off gas meant for Italy and Germany and thus took advantage of its role as a transit state.[60]

The *recent* Russia-Ukraine gas crises refer to a row of disagreements between Russia's Gazprom and Ukrains's state-owned oil and natural gas monopoly Naftogaz Ukrainy over natural gas prices settled by Gazprom and Naftogaz's debts towards Gazprom. That is, on January 1, 2006, Gazprom stopped subsidising the gas delivered to Ukraine and decided to align its prices with "European" ones. Ukraine obviously did not welcome such "inflation", since it used to buy gas by old "Soviet" prices. These problems implied a crisis between Russia and Ukraine. Ukraine's unwillingness to pay market prices for Russian gas resulted in Russia's decision to cut off the gas on January 1, 2006, which caused disruption in several European countries. The crisis loosened on January 3 of that year, with the Ukrainian government finally accepting such an increase in gas prices.

However, this crisis rebounded in winter 2009, during which Russia again cut gas exports to Ukraine. The showdown ended with the signing of two ten-year contracts (2008-2018): a gas supply contract, which provides alignment with European market prices in 2010, and a transit contract, which provides an increase in transit fees paid by Gazprom in Ukraine.[61] This second crisis will be studied in greater detail below (2.2.1.). Next the ratio of those crises, especially of the most recent one, will be addressed (2.2.2.).

2.2.1. Stakes of the 2009 Russia-Ukraine Gas Crisis

The second "gas war" started on January 1, 2009, when a disruption of Russian gas supplies to consumers inside Ukraine occurred. The latter resulted in a temporary cut-off (January 5-20) of Russian gas transited through Ukraine to 17 European countries, generating growing worries within Europe as to its *potential energy dependency* on Russia and the viability of Ukraine and Russia as EU's energy partners.

Notably, although Ukrainian, Russian and European representatives signed an agreement to resume Russian gas deliveries to Europe on January 12, gas flows to Europe recommenced only on January 20.

Accordingly, in January 2009, the European Parliament and academia discussed the latest "gas war". Members from all sides agreed that Russia and Ukraine had forfeited their status as reliable gas suppliers.[62] Given that this statement was dated January 26, 2009, the puzzling part of the story is why Russia and Ukraine were not on the EU list of unreliable energy suppliers already - i.e. why were they not placed there after the first "gas war" in January 2006? In fact, the problem that Europe faces is that, for the moment, there are very *few alternatives* to buying Russian gas. As mentioned above, the EU imports half of the energy it consumes, and this share is expected to rise to about 70 percent by 2030.[63] About 44 percent of all imported gas comes from Russia. 16 percent comes from Norway and 15 percent from Algeria, while the

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[58] IEA (2006). *Ukraine: Energy Policy Review*. URL: http://www.iea.org/textbase/nppdf/free/2006/ukraine2006.pdf , retrieved on March 1, 2010.
[59] Liesen (1998), *op.cit.*, note 7.
[60] *Id.*
[61] For more details see annex 1.
[62] European Parliament (2009). "Re-thinking Europe's Gas Supplies after the Russia/Ukraine Crisis", January 26, 2009. URL: http://www.europarl.europa.eu/news/public/story_page/051-47101-026-01-05-909-20090126STO47091-2009-26-01-2009/default_en.htm , retrieved on March 1, 2010.
[63] *Supra*, p.3.

rest comes from Libya, Nigeria and Central Asia. 80 percent of that Russian gas goes through Ukraine.[64] The situation especially worsened in 2008 after the Russia-Georgia conflict. The latter affected the traffic of the Baku-Tbilisi-Ceyhan (BTC) pipeline, running through Georgia from Azerbaijan to Turkey. The South Caucasus pipeline, Baku-Tbilisi-Erzurum (BTE), which runs from Azerbaijan through Georgia, still sends very limited quantities of gas to Europe. Meanwhile the Nabucco pipeline, which is supposed to transport approximately 31 billion cubic meters of gas annually from the Caspian Sea to Europe in 2020, is still in its pre-construction phase.[65]

2.2.2. Two Possible Explanations of the Gas Crises[66]

There could be two general explanations for Russia's behaviour during the two crises, especially during the second one. The first is the "commercial" interpretation, which views the conflict as a *commercial dispute*. According to this explanation, Russia had previously priced its natural gas sales to the former Soviet republics and former Eastern European satellites well below market prices. As Gazprom gradually liberalised and integrated with the market economy, it started to depend increasingly on exports as a means to generate revenue, and less so from the old price-controlled sales. It therefore acquired a strong interest in raising prices for its former political customers up to market levels. But its attempts to raise gas prices to Ukraine were met by Ukrainian refusal to pay its gas bills. Hence, Gazprom did what any commercial entity would do when a customer refuses to pay - it cut the customer off. While the commercial argument may have been relatively credible between 2006 and 2008, more recent developments - particularly the fact that price increases seem to have been concentrated on governments that the Kremlin considered "unfriendly" - make it harder to accept now.

The second explanation is a "strategic" argument. According to this view, Russian behaviour towards Ukraine is *politically motivated*, i.e. it is a kind of censure for the Ukraine's flirtation with the West through its interest in NATO. The Russia-Georgia conflict, which affected the traffic of the BTC pipeline, only strengthens this hypothesis.

The truth is likely to be between the benevolent and malevolent interpretations. In other words, Gazprom appears to behave as any other commercial entity would when faced with a non-paying customer. At the same time, as noted above,[67] one should bear in mind that many resource-based state-owned companies can also be influenced, to some extent, by the course of the state's foreign policy.

2.3. Diversifying EU Gas Supplies

The gas crisis of 2009 may seem far-away, but within the EU, the discussion on how to *prevent* - and if not, how to *prepare for* - the next crisis is intense.

Notably, unlike oil, gas is difficult to store - it is mainly transported in pipelines. In addition, to date Europe's gas pipeline roads are closely linked with Russia. Until the development of LNG supplies, the EU will have to diversify its gas supplies through new - alternative - pipeline projects. Indeed, several alternatives of gas pipeline projects were addressed by the European Parliament in January 2009, namely, *South Stream*, *Nabucco*, and *Nabucco light* . (See box 1.)[68]

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[64] IEA (2004), *op.cit.*, note 10.
[65] For the routes of the mentioned pipelines, see map 1.
[66] This part is based on Aseeva (2010), *op.cit.*, note 19, pp.128-129.
[67] *Supra*, p.12.
[68] *Source*: Aseeva (2010), *op.cit.*, note 19.

Box 1: Projected routes of South Stream, Nabucco and Nabucco light pipelines

South Stream

This project was launched in 2007 by the Italian company ENI, Gazprom, and prospectively EdF (France). Due to latest updates on pipeline's official website, it is nowadays designed to transport 63 billion cubic meters of Russian gas annually to Europe. An estimated cost of the project is EUR15 billion. Several optional gas pipeline routes are addressed. The projected pipeline is supposed to carry gas from the Russian coast of the Black Sea to Romania, Bulgaria, and Greece and from there on either a south-western route into southern Italy or on a north-western route into Hungary, continuing on to Austria or northern Italy.

Nabucco

The most impressive examples of Russian "divide and rule" tactics can be seen in the Caspian region through the Nabucco, BTC and BTE Pipelines. Nabucco pipeline project aims to transport some 31 billion cubic meters of Caspian and Middle East gas to Austria, across the Turkish-Georgian and the Turkish-Iranian borders. The gas would be transported via Turkey, Bulgaria, Romania and Hungary. Europe aims to diversify its energy sector through Nabucco by bringing non-Russian gas that avoids politically sensitive transit corridors in Ukraine. According to the project's official website, its approximate cost is EUR7.9 billion. Yet, apparently the reluctance of the private sector to finance the project, on the one hand, and the August 2008 conflict between Georgia and Russia, on the other, create a funding problem for Nabucco. The shortfall is large enough to make the future of the project doubtful. According to the final agreement signed on September 6, 2010 between the European Bank for Reconstruction and Development (EBRD), the European Invesment Bank (EIB) and the WB via its institution IFC, the project would be granted with a loan of about EUR 4 billion. The final investment decision is likely to be made in 2011 – it largely depends on whether the market shows the project will sell enough 20-year transport contracts. In this context, it is probable that private investors are at present reluctant to finance the project, not because of the instability of the relevant regions or the uncertain legal status of the Caspian Sea as presumed by Prof. Riley, but for a very practical reason: no pipeline can be financed without "throughput agreements" – which are agreements that oblige the shipper to pay debt service on the line regardless of how much it is used. The problem is that to date there is not enough gas supply to keep the pipeline filled and to make it economical to operate. In short, in addition to the lack of financing, the pipeline does not appear to have enough upstream gas sources.

Nabucco light

This project is supposed to involve the use of the existing South Caucasus Pipeline (SCP) and Turkish pipeline systems to deliver Central Asian gas to the EU. By extending the pipelines' Turkish-Greek Interconnector to Italy and improving the transit capacity of the pipelines, it is expected that more Central Asian gas could be carried into Europe. According to Prof. Riley, this project's probable advantages are that it would likely bring Central Asian gas to Europe more quickly; it would probably be cheaper to implement than building the Nabucco pipeline; and it could be developed to a greater degree in tandem with emergent gas supplies. The counterargument to these presumed merits is that it is still too early to evaluate whether Nabucco Light is truly the "cheaper route option" posited by European academics and MEPs with relation to the 2009 crisis and possible options to prepare for the next "gas war". At present the project is still in the planning phase. The costs of transit through Turkey and Greece, along with corresponding contractual guarantees, would need to be negotiated first before a proper assessment could be made with regards to its viability.

However, in long-term perspective, the LNG option appears to be a viable alternative to pipeline supplies. The LNG option consists of the delivery of gas in liquid form, via ship, from a LNG liquefaction plants to LNG re-gasification facilities in Europe.[69] If the LNG will be liquefied in Turkey, this method would

[69] Cook, Linda (Royal Dutch Shell plc) (2005). "The role of LNG in a global gas market". URL: www.shell.com/speeches . See also Lacoste, Romuald (2007). « Les transports maritimes dans la géoéconomie du gaz naturel [Maritime transport in geo-economics of natural gas]» URL : http://fig-st-die.education.fr/actes/actes_2007/lacoste/article.htm ; and City University London (2009). "City University London

require the extension of the SCP gas pipeline to the port of Ceyhan on the Turkish coast.[70] As Riley correctly notes, this solution would be costlier for Europe than Nabucco.[71]

It is worth adding that the LNG option would be even costlier for the EU than South Stream on account of two underlying difficulties. First, there would inevitably be high fixed costs due to the provisioning of a large number of gas carriers and the development of the entire infrastructure of special landing terminals. Second, the system of long-term contracts and their constant renewal would need to be set up. In addition, LNG does not help landlocked middle Europe except as it replaces more distant pipeline movements to Northwest Europe.

However, the LNG option also has its merits. Under certain circumstances, LNG may be even more financially viable than pipeline supply for coastal regions, such as the Mediterranean countries and the Benelux countries.[72] [73] In an optimum economic world, a combination of LNG and pipeline supply would be an ideal solution. In addition, European LNG imports are up substantially and Gazprom's deliveries are way down. Notably, some of Gazprom's customers have gone into take-or-pay obligations.[74] These customers have preferred alternative supplies in a soft market and willing to make cash payments for gas not taken from Gazprom. The fact that Gazprom appears to be willing to ignore take-or-pay obligations in order to maintain the good will of its European customers implies that the above "commercial" interpretation of Russia-Ukraine crisis[75] is not totally unreasonable.

2.4. Assessing EU Gas Import Options

An assessment of the four discussed alternatives leads to the following conclusions. Compared with that of Nabucco, the cost of South Stream is twice as high. In theory, in abandoning the South Stream project, the EU must first choose between providing financial support for Nabucco or for Nabucco Light. As for the LNG option, this solution would be costlier for the EU than either South Stream or Nabucco/Nabucco Light. The main point is that it is unclear what quantities of gas either Nabucco or Nabucco Light could in reality provide to the EU. For example, the existing BTE pipeline transporting Central Asian gas still sends very small quantities of gas to Europe. Thus, the EU is apparently facing the choice between South Stream, which could provide gas in sufficient quantities but mainly from Russia, and Nabucco or Nabucco Light, which would transport perhaps much less gas from Central Asia. On the other hand, one could presume that both Nabucco and Nabucco Light have been treated by the EU simply as bargaining tools for gas supply negotiations with Gazprom.

Notably, if South Stream is realised, it would probably divert in its direction some gas of Central Asia and Azerbaijan, which could significantly reduce expected Caspian supplies for Nabucco or other European projects such as Turkey-Greece-Italy (TGI) pipeline. From this standpoint, Russia could increase its political control in the Caucasus and Central Asia. South Stream could theoretically be used to transport

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Professor Recommends 'Nabucco Lite' Pipeline to the European Parliament," March 12, 2009. URL: http://www.city.ac.uk/news/archive/2009/01_January/21012009_5.html .Retrieved on May 30, 2010.

[70] City University London (2009), *id.*

[71] European Parliament (2009), *op.cit.*, note 62.

[72] Mediterranean Sea with its well developed port infrastructure largely allows for seaborne transport of LNG, which provides far more flexibility in where the gas can be delivered, albeit at a rather higher total cost than for pipeline delivery. In addition, North African gas for instance is relatively cheap to produce, since there are no major climate challenges in Algeria, Libya and Egypt, unlike Siberia or the Norwegian Sea. Algeria is already a major supplier of LNG to the EU. Moreover, the country plans to increase its leading position by nearly doubling its exports up to 2020, namely its LNG export capacity, with new plant meant to bring total capacity to around 35 billion cubic meters annually. *Source:* Kingston Energy Consulting (2004). « North Africa – An Energy Source for Europe? », *Commodities now*, December 2004.

[73] See map 3.

[74] These are specific provisions inserted into a contract binding the buyer to pay for a precise quantity pre-specified in the provision, no matter whether the buyer actually takes the total delivery negotiated.

[75] *Supra*, p.14.

gas from North Africa and/or the Middle East (through swaps[76]), thus depriving the EU of a direct access to additional fields that may be essential for its gas supplies diversification.

On the other hand, the standard scenarios predict that the EU's energy needs would increase by about 20 percent. In this case South Stream will be essential for Europe, even if Nabucco would be also constructed. Conversely, if the natural gas demand in Europe would stagnate or decrease (e.g., due to the development of the LNG supplies), the problem of unutilised spare capacity would affect all pipelines running from the East, including both South Stream and Nabucco.

However, the other problem that could affect the EU gas imports diversification projects is of political order. Notably, among different representatives who frequently try to speak on behalf of a united Europe, everyone seems to stand their ground regarding their own external policies. For example, Italy participates in South Stream while Germany strongly supports the inclusion of Russia in the Nabucco project, contrary to the European Commission's position.

This observation could be confirmed by recent progress on another Russian project that is quickly becoming reality, namely, the Nord Stream gas pipeline. In this case, Gazprom's investments in this project seem to be designed in order to demonstrate to the EU - at Gazprom's charge - that it is a reliable supplier, despite its troubles with Ukraine. Although the Nord Stream option was not considered by MEPs and academia in January 2009 because it was most probably not a coherent alternative for the EU from the solidarity standpoint, it deserves a brief overview.

As per latest updates on pipeline's official website,[77] Nord Stream is a consortium of five shareholders: Russian Gazprom - with a 51 percent stake, as well as German BASF/Wintershall Holding AG and E.ON Ruhrgas AG, Dutch N.V. Nederlandse Gasunie, and French GDF Suez. The pan-European character of the pipeline is highlighted by its status as a project under the EU's trans-European network energy guidelines, a status that was confirmed in 2006.[78] The Nord Stream gas pipeline, which aims to bring Siberian gas directly to Germany bypassing all "problematic" Russian neighbours, was awarded its final building permit on February 12, 2010.[79] The site was officially launched on April 9, 2010. The first pipeline segments were dropped to the sea floor in June 2010, and now the pipeline is expected to run through Russian, Finnish, Swedish, Danish and German waters.

According to latest project updates, Nord Stream will transport up to 55 billion cubic meters of gas each year - enough to supply more than 26 million households. Total investment in the offshore pipeline alone is projected at EUR 7.4 billion, which makes it one of the largest privately-financed offshore gas pipeline projects. The pipeline is supposed to run 1,223 kilometres through the Baltic Sea.[80]

The Nord Stream clearly reflects Germany's support for Russia to bring Russian natural gas across the Baltic Sea directly to Germany. Even the current pro-Western Chancellor Angela Merkel stated: "the Nord Stream and the South Stream are necessary to satisfy Europe's demand for gas. It is essential that

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[76] Swaps - literally "barter", allow countries that lack infrastructure and /or marine equipment, to export natural gas through this option. The principle is the following: a gas exporting company needs a gas operator who will "replace" it. To this end, this gas operator delivers gas of the supplier to the customer situated in the importing country. This gas is not originally exporter's gas, it is a part of a contract of long-term supply for the country of origin of the operator. In exchange for the gas cargo conveyed, i.e. to compensate it, the supplier delivers an equal amount of natural gas to the operator, via the existing gas pipelines between two of them (hence, the existence of a sufficient gas network between the exporter and the operator is the necessary condition). At the end, there is a simple exchange of cargo between the exporter and the operator.

[77] http://www.nord-stream.com/en/ , retrieved on February 12, 2010.

[78] "All Obstacles Cleared for Undersea Baltic Pipe", February 12, 2010, *EurActiv*, URL: http://www.euractiv.com/en/energy/all-obstacles-cleared-sub-sea-baltic-pipe , retrieved on February 14, 2010.

[79] "Final Permit for Nord Stream Pipeline Paves Way for Construction Start in April," Nord Stream AG press release of February 12, 2010.

[80] See map 2.

the projects are supported by all the EU countries".[81] The key littoral states of the Baltic Sea - namely, Finland, Sweden and Denmark, though sceptical about the Nord Stream pipeline - finally signed off on the project on November 5, 2009. Russia granted its permission on December 18, and Germany agreed to allow a section of the pipeline to cross its economic zone on December 28 of the same year.[82]

In fact, Germany, Denmark and Russia will benefit from transit fees, as the pipe runs through their territorial waters. Sweden and Finland will not, as the pipeline runs through their exclusive economic zones, where no transit duties can be imposed according to international law.[83] According to Nord Stream's Managing Director Matthias Warnig, "[t]his is the culmination of four years of intensive studies, consultations and dialogue with the authorities, experts, stakeholders and the public in Finland and other countries through the Baltic Sea region."[84] He adds that, "I would like to thank the authorities and the many stakeholders whose contributions have helped us to find solutions to the many challenges posed by the Baltic Sea ecosystem. Their support has enabled us to develop this key European energy infrastructure project to worldclass safety and environmental standards." He also underlines, "[o]ur project has been made possible by extensive cooperation between many European countries and it will make an important contribution to European energy security."[85] Notably, had the same amount been transported in LNG tankers, 600 tankers a year would have been filled. Therefore, Finland and Sweden will benefit from the Nord Stream pipeline gas transportation system since it is much more secure than import via LNG tankers. Paradoxically, no special permission is needed for LNG tankers, despite the fact that the ecological risks posed by such transport are higher.[86]

2.5. Assessing EU Common Energy Policy Challenges

At the outset, it is worth mentioning that when six European states decided in 1951 to integrate two key *energy* sectors of their economies through creation of a Community, their intention was to replace conflict with cooperation and antagonism with prosperity. Almost sixty years later, energy is still at the top of the political and economic agenda of the EU.[87]

Indeed, in 2000s the energy security has become a crucial policy area for the Europeans. Yet, since the national energy mix and energy policies differ a lot, the EU member states have difficulties agreeing on common priorities and specific measures. Therefore, it appears even more difficult to build and implement a common energy policy. A complete set of European Energy Policy measures (the "energy" package) was adopted in 2007.[88] It is a three-tier strategy for sustainable, competitive and secure energy, i.e. focusing on the sustainability of energy, integrated internal energy market, and security of supply. But while some progress has been made in the field of sustainability, the development of a common energy market and especially the implementation of a common external energy policy to secure supplies remain problematic.[89]

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[81] Quoted from a letter addressed to Jose Manuel Barroso, European Commission President, on Nord Stream website: http://www.nord-stream.com/en/, retrieved on September 1, 2010.
[82] "Final Permit for Nord Stream Pipeline Paves Way for Construction Start in April," Nord Stream AG, *supra*, note 79.
[83] "All obstacles cleared for undersea Baltic pipe", *supra*, note 78.
[84] "Final Permit for Nord Stream Pipeline Paves Way for Construction Start in April," *supra*, note 79.
[85] *Id.*
[86] "All obstacles cleared for undersea Baltic pipe", *supra,* note 78.
[87] Notre Europe (2010). "Towards a European Energy Community", April 2, 2010, *European Energy Review*.URL: http://www.europeanenergyreview.eu/index.php?id=1842, retrieved on April 3, 2010.
[88] European Commission (2006). *Commission Green Paper of 8 March 2006*: "A European strategy for sustainable, competitive and secure energy" [Ref.:COM(2006) 105 final - not published in the Official Journal]. European Council (2007). *Presidency Conclusions (March 8/9, 2007*), at 36 and s. See also European Commission (2007). *Communication from the Commission to the European Council and the European Parliament of 10 January 2007*, "An energy policy for Europe".
[89] For example, sustainable energy policies – e.g. the Directive 2001/77/EC of the European Parliament and of the Council of September 27, 2001 on the promotion of electricity from renewable energy sources in the internal electricity market (RES Directive) – is frustrating integrated internal energy market objectives. I.e. RES-policy is implemented strictly along national lines, and thus largely subsidised. As a result, the internal market is frustrated,

The above EU energy strategy appears to be an essential objective towards a common energy policy. However, there are several major challenges. First, how to create a fully integrated internal energy market since external energy – especially gas - supply sources are at present concentrated in Russia and CIS. Then, there is unfortunately no European unity on energy security. Thus, to date sovereign interests of individual European states appear to have overwhelmed the possibility for a united European security position.

Meanwhile, in early March 2010 the Commission's presented a proposal, which represents the latest Europe's development strategy entitled "EU2020". It sets out an idea of the Europe's social market economy, and how the EU can be turned into a smart, sustainable and inclusive economy providing high levels of employment, productivity, and social cohesion.[90] Concretely, the new strategy comprises three main pillars: new information technologies, inclusive development, and a carbon-restricted economy; and five main objectives, the fifth of which is "energy-climate" package. It is worth mentioning, that, strategy's objectives are *binding on member states*. On the other hand, once again regarding member state sovereignty, a spokesman in the European Parliament recently stated that *strengthening member states' commitment* is crucial if the strategy aims go beyond the lowest common denomination.[91] It could then be deduced from this statement that, to date, states'commitment to the strategy, including its energy-related objectives, is perceived on the European Parliament's level to be insufficient.

The "EU-2020" was published on November 10, 2010, and will be discussed in detail by EU leaders during a summit on energy on February 4, 2011. As some observers noted, despite the message of urgency, the new strategy does not differ substantially from the old one. The main relevant for this study problem of the new strategy is still the same: as the Commission itself notes, "the EU is the level at which energy policy should be developed", while in practice it is often the member states that call the tune.[92]

2.6. EU Energy Policy: an Overview

Aside from political challenges, there have always been challenges of legal nature to the common European energy policy. Notably, before the Treaty of Lisbon entered into force, the *formal base*[93] for the European energy policy was lacking, although numerous *material elements*[94] were already present.

In such a way, energy and energy products represent a special subject in the EU law. In fact, until recently the EU treaties had never truly found energy an appropriately specific place in the EU legislation. However, its *specificity* is significant from both *economic* – energy products are highly "strategic" – and *legal* - regarding monopolies, state enterprises, competition, and tax matters – perspectives.[95]

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one cannot have an integrated market when large, indeed growing parts of that market – namely the renewable energy sectors – are subsidised at a national level in many different ways. Conversely, internal energy market strategy is at odds with RES-policy, since current competitive markets offer insufficient guarantees for long-term investments in large-scale alternative energy sources, such as nuclear power stations, offshore wind parks, etc. Then again, sustainable energy tier of the strategy also hinders security of supply policy, as, by heavily subsidising certain forms of renewable energy, the former is discouraging upstream investment in gas in Russia. Hence, supply security is not balanced with demand security.For detailed analysis see Beckman, Karel (2010). "Academics call for 'full rethink' of EU energy policy" April 21, 2010, European Energy Review, URL: http://www.europeanenergyreview.eu/index.php?id=1885, retrieved on April 21, 2010.

[90] European Commission (2010*). Europe 2020: a strategy for smart, sustainable and inclusive growth*. Ref: COM(2010) 2020. European Council (2010). *Presidency Conclusions (June 17, 2010).* All related texts are avaiable at: http://ec.europa.eu/eu2020/index_en.htm , retrieved on September 21, 2010.

[91] Bullmann, Udo and Frölich Christin (2010). "Putting the European Train back on track", *Eyes on Europe*, Spring 2010 (pp.26-27), p.27.

[92] Belin, Hughes (2010). "The EU's energy strategy: adapting too slowly", November 18, 2010, *European Energy Review*, URL: http://www.europeanenergyreview.eu/index.php?id=2542&zoek=wholly%20inadequate , retrieved on November 18, 2010.

[93] Formal base indicates how a law was created and by whom. A law in its formal meaning must be adopted by a legislative authority - basically, the legislator, but not only - following an ordinary legislative procedure.

[94] Material base indicates the contents of a law. A regulation is a law materially, if it contains general and abstract rules, and could be applied equally to all its beneficiaries and to an indefinite number of situations.

[95] Dubouis, Louis et Claude Blumann (2009). *Droit matériel de l'Union européenne*, 5ème édition Dalloz-Sirey, Paris, p.348.

Indeed, *growth* is the very essence of the EU market integration. The development of exchanges within the system founded on the market economy is supposed to enhance growth. Art.2 of the Treaty establishing the European Economic Community (TEEC), which became art.2 of the Treaty establishing the European Community (TEC), which was in turn taken up by art.3 of the new Treaty on European Union (TEU), binds that the *sustainable development* of Europe is among the primary objectives of the EU. This should be based on *balanced economic growth*, *price stability*, a *highly competitive social market economy*, aiming at full employment and social progress, etc.[96] - in other words, mostly on economic factors. Hence, in order to implement and maintain this system based on growth, the EU needs energy.

Since legislation represents generally a tool for strategic considerations, this part first examines the *legal bases* of the European energy policy (2.6.1.) and then it assesses its *strategic objectives* as laid down by the Union's current legislation (2.6.2.).

2.6.1. Legal Bases of European Energy Policy

The logic of European integration is based on so-called *Schuman method*, that is to say a functionalist method, which supposes that concrete solidarities - i.e. factual solidarities – of members relating to different sectors are expected to lead to conceptual solidarities. In practice, concerning energy, these solidarities deal with political sovereignty, political independence, and political power. Below the basic legal texts, on which the European Communities and the European Union are founded, will be examined.

The Treaty establishing the European Coal and Steel Community (ECSC) laid down in 1951 the common market of coal and steel of its member states, as well as it founded the European competition policy. Notwithstanding the fact that this treaty is basically dedicated to two particular sources of energy, none of its articles addresses energy in general and energy policy in particular.[97]

The Treaty establishing the European Atomic Energy Community (EUROATOM) appeared at the wake of the Suez crisis[98] of 1956. It addresses the nuclear energy. Just as the ECSC, it does not contain any legal base concerning energy policy.[99]

The negotiations on the Treaty establishing the European Economic Community (TEEC) represent in this sense a kind of new stage. That is, during the Messina Conference (June 1-3, 1955) of the Foreign Ministers of the six member states of the ECSC which would lead to the creation of the European Economic Community in 1958, four main objectives were set in the agenda: planning of the development of networks (including electricity ones); developing of the energy economics, i.e. aiming at more abundant and cheaper energy, thus involving the development of gas and electricity exchanges; creation of an organisation framing the pacific development of nuclear energy; and establishment of the common market.[100] Although, the first three objectives – especially the first two of them – were relevant for the recognition to energy an appropriate place in the European legislation, only the fourth conference's point – the common market - was incorporated in the TEEC, thus continuing the European "tradition" of the lack of legislation on energy.

As a result of this legislative absence, the European Communities faced huge difficulties during the two petroleum crises of 1970s. In 1992, the Treaty establishing the European Community replaced the TEEC.

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[96] TEU art. 3 para.3, first sentence. Consolidated version of the Treaty on European Union in Official Journal of the European Union, Vol. 53, March 30, 2010 (Doc. No. C 83).

[97] For details refer to Cartou (1983), *op.cit.*, note 2, p. 525; Dubouis and Blumann (2009), *op.cit.*, note 95, pp. 348-349.

[98] The Suez Crisis (also known as the Tripartite Aggression) was a military conflict fought by Great Britain, France, and Israel against Egypt beginning on October 29, 1956. The attack was the consequence of Egypt's decision of July 26, 1956 to nationalise the Suez Canal. If Israel wanted essentially to reopen the canal to Israeli shipping, and thus to strengthen strategic positions, namely at its southern border with a muslim state, both Great Britain and France aimed first of all that the canal should remain open as an important conduit of oil. "Suez crisis", *The Concise Oxford Dictionary of Politics*. Ed. McLean, Iain and Alistair McMillan. Oxford University Press, 2003.

[99] For details refer to Dubouis and Blumann (2009), *op.cit.*, note 97.

[100] *European navigator*. "Synopsis : The Messina Conference". URL: http://www.ena.lu/messina-conference-020100604.html , retrieved on September 10, 2010.

The TEC devotes new competences to the EC. Its art.2 lays down the main objectives and reads as follows:

> "The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States."[101]

TEC art.3 para.1 (u)[102] binds that in order to achieve the objectives of the art. TCE art.2, the *activities of the Community* shall include *measures* in the spheres of energy, civil protection and tourism. The very limited – and even questionable - effectiveness of this regulation is highlighted by some general observations. First, the term "measures" is quite vague, when it is not made more precise by context, means, clear objectives, etc. Second, the practical question which could arise is why such a strategically important issue as *energy* is regulated at the same paragraph with *tourism*? Last, but not least, this article was never used in practice.

Otherwise, there are some articles in the TCE that indirectly relate to energy matters. First, art. 308 – the so-called "flexibility" clause - which refers to art. 2 in binding that "[i]f action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures."[103] That is, the Council may unanimously adopt a resolution fixing for instance a long-term objective of the European energy policy, indicating main directions of energy production, consumption, etc.[104] The practical application of this article could be observed in, for example, Council Resolution of September 16, 1986 concerning new Community energy policy objectives for 1995 and convergence of the policies of the member states.[105] Other regulations indirectly involving energy are the following. TCE art.93 aims at tax liberalisation amongst EC members. TCE art.95 aims at the correct establishment and functioning of the internal market, and thus liberalisation of trade in energy amongst EC members. TCE art.154 binding that the Community shall contribute to the establishment and development of trans-European networks, including energy infrastructures. TCE art.175 para.2 (c), in referring to TCE art.95, states that the Council may derogate from the ordinary decision-making procedure, thus acting unanimously on a proposal from the Commission and after consulting the European Parliament, the Economic and Social Committee and the Committee of the Regions, and shall adopt measures significantly affecting a member state's choice between different energy sources and the general structure of its energy supply.

Finally, the Treaty of Lisbon gave birth in 2009 to the Treaties on European Union (new TEU) and the Treaty on the Functioning of the European Union (TFUE). Hence, the above mentioned TCE arts.93, 95, 154, 175, and 308 became respectively TFUE arts.113, 114, 170, 192, and 352. Today it appears that the relevant provisions, entering into force with the Treaty of Lisbon, constitute the primary formal and material base related to energy. From the material standpoint, TFUE dedicates an entire title to energy, namely Title XXI (note the quite significant number of the title). That is, at present energy is not any more governed indirectly, i.e. within other titles, such as basis, coordination, or complements, where it figured

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[101] TEC art.2. Consolidated version of the Treaty establishing the European Community in Official Journal of the European Communities, Vol. 33, December 24, 2002 (Doc. No. C325).
[102] Art. 3, TEC, *id.*
[103] Art.308, TEC, *id.*
[104] For more details see Dubouis and Blumann (2009), *op.cit.*, note 95, p.349.
[105] Council Resolution of September 16, 1986 concerning new Community energy policy objectives for 1995 and convergence of the policies of the Member States in Official Journal of the European Communities, September 25, 1986 (Doc. No. C241).

together with industry, civil protection, or tourism. As to the procedure, TFUE art.194 previews co-decision as *modus operandi*.

Last, but not least, an important amendment is introduced by the Treaty of Lisbon to TEC art. 100, the first paragraph of which previously read as follows (emphasis added):

> "Without prejudice to any other procedures provided for in *this Treaty*, the Council, acting by a qualified majority on a proposal from the Commission, may decide upon the measures appropriate to the economic situation, in *particular if severe difficulties arise in the supply of certain products*."[106]

Now, the new wording of this provision became TFUE art. 122. This article specifically mentions that the above measures may be carried out in case of severe supply shortages of "certain products, notably in the area of energy" (bold and emphasis added):

> "Without prejudice to any other procedures provided for in *the Treaties*, the Council, on a proposal from the Commission, may decide, *in a spirit of solidarity between Member States*, upon the measures appropriate to the economic situation, *in particular if severe difficulties arise in the supply of certain products,* ***notably in the area of energy***."[107]

The "products … in the area of energy" could include energy goods, and, most probably energy services – in case if energy equipment is considered as a product in the area of energy as well. [108] The stress put on energy resources in the text of the TFUE witnesses the recently grown attention paid to the problem of the security of energy supply in the EU. On the other hand, it may also be construed as an indicator – though abstract - addressed to exporting and transit countries showing that the EU is ready to act as a single entity in case of threats to security of energy supplies.[109]

2.6.2. Strategic Objectives of European Energy Policy

TFUE art.194 lays down firm legal basis for the European energy policy and is of high strategic importance for both EU and its member states. Its first paragraph establishes four main objectives of the EU energy policy: ensuring the functioning of the energy market; ensuring security of energy supply in the EU; promoting energy efficiency and energy saving and the development of new and renewable forms of energy; and promoting the interconnection of energy networks.[110] These do not mean that the EU did not intervene in the energy field before. However until the TFUE's entry into force, the Union did so on the basis of the *flexibility clause* of the TEC art.308 (became TFUE art.352); that is, unanimously.[111]

Now, once the major issues of EU energy supply, as well as the main challenges to the common EU energy policy and its legal bases, are examined, one can deduce the general strategic objectives of this policy. They are mainly: (1) *respecting of fundamental national energy supply choices of the member states*; (2) increasing energy efficiency; (3) influencing energy prices; (4) opening of national markets of "network energies" between the member states; (5) *developing and interconnecting the energy networks*; (6) *fostering solidarity of member states on energy matters*; and (7) *objectives relating to the external dimension of European energy policy*. Among those points, objectives to increase the energy efficiency, to influence the energy prices, and to open national markets of "network energies" between the member states, refer generally to internal energy guidelines, and thus they have little importance for the present analysis. Therefore, the strategic objectives

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[106] Art. 100 para.1, TEC, *op.cit.*, note 101.
[107] TFUE art. 122 para. 1, Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, in Official Journal of the European Union, Vol. 53, March 30, 2010 (Doc. No. C 83).
[108] Seliverstov (2009), *loc.cit.*, note 177, p.14.
[109] *Id.*
[110] Art.194, TEC, *op.cit.*, note 101.
[111] Priollaud, François-Xavier and David Siritzky (2008). *Le Traité de Lisbonne. Texte et commentaire article par article des nouveaux traités européens (TUE-TFUE*), La Documentation française, Paris, 2008, pp.294-295.

of the EU energy policy relevant for this study appear to be (1), (5), (6), and (7). They reflect both internal and external points pertinent for the subject of this research and will be addressed below.

With regards to the *member states' choice of their energy supply sources*, TFUE art.194 is the most relevant provision for both EU and its member states. In fact, TFUE art.194 para.2 *in fine* lays down that the measures necessary to achieve the objectives in its para.1 shall not affect a member state's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to art.192 para.2 (c). That is to say, this provision explicitly leaves to the EU member countries the choice of their national energy package. Notably, due to art.194 para.2 *in fine*, read together with art.4 para.2 (i)[112] (both TFUE), energy makes entirely part of the EU *shared competences*.[113] Some specialists refer also to *pragmatic competences,* due to the upstream mode of choice.[114] At the same time this explains the liberty of EU members' energy relations with external energy suppliers, including Russia. In practice, each member state participates in its own manner, through its national energy companies, to different energy supply projects that are designed to bring Russian energy to Europe, mainly Nord Stream and South Stream pipeline projects.[115]

Development and interconnection of energy networks is also a very important strategic objective related to the theme of this study. Notably, the EU operates the large number of instruments, regulations and directives making up the EU common position on energy transit. At the internal level, detailed directives within the Union are in force to respect the energy transit obligations among member states.[116] Interestingly,

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[112] TFUE art.4 para 2 (i) reads as follows:
"Shared competence between the Union and the Member States applies in the following principal areas:
(…)
energy;
(…).

[113] The EU differs from traditional international organisations by its model of integration that goes beyond the traditional cooperation between states. Member states have delegated a part of their competences to the European institutions. Thus, alongside the national, regional and local, there is a European authority based on democratic and/or independent institutions, empowered to intervene in a number of areas. The extent of the authority of the EU depends on the areas concerned - if states have decided to transfer the totality of their competences in a field - these means that states can no longer act alone: this is for example the case in commercial, agricultural or monetary policies. This is referred to the EU *exclusive competences*.
Then there is the *principle of subsidiarity*: it aims to ensure the decision-making process in the closest way possible to individual citizens. In its jurisdictional meaning, the principle of subsidiarity establishes that states have transferred a part of their competences to the Union in a manner that they can continue to act alongside the EU. This is called *shared competences*. This is actually the most frequent case of competences in the EU. These mean that the Union will act instead of the states when joint action is considered more effective than that of the states acting separately (as the principle of subsidiarity). This is traditionally the case of such fields as security, although with the Lisbon treaty shared competences have been extended to a number of other areas.
There's also a category of so-called *support skills* (compétences dites d'appui): in this case, the competences mainly remain within the responsibility of member states, but the EU can support their action. This is the case of research or public health areas.

[114] Sauron, Jean-Luc, (2007). *Comprendre le Traité de Lisbonne*, Gualino éditeur, 2007, p. 103. Bourrinet, Jacques (2007). *Droit international et coopération internationale. Mélanges en l'honneur de J.-A. Touscoz,* France Europe Éditions, p.731. Le Baut-Ferrarese, Bernadette (2010). *Presentation « La politique européenne de l'énergie [European energy policy] »* given during the Master Class on European Integration: Energy Law Module, Centre of European Studies (EEC), Lyon III University Law School, July 1-9, 2010.

[115] *Supra,* pp.15-18.

[116] E.g. Council Directive 90/547/EEC on the Transit of Electricity through Transmission Grids; Council Directive 91/296/EEC on the Transit of Natural Gas through Grids and Commission Directive 94/49/EC updating the list of entities covered by Council Directive 91/296/EEC; Access to the Network for Cross-border Exchanges in Electricity (Regulation (EC) No 1228/2003); Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Access to the Natural Gas Transmission Networks (Regulation (EC) No 1775/2005); Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Directive 2005/89/EC of the European Parliament and of the Council concerning Measures to Safeguard Security of Electricity Supply and Infrastructure Investment; "Priority Interconnection Plan" (COM(2006) 846 final);

dissimilar to international law where transit is generally dependant on crossing the territory of a third state, the EU directives put the emphasis on the infrastructure itself; thus, transit rights can be established only relating to certain transmission grids appointed as such, namely gas or electicity. Notably, the EU's current energy infrastructure policy is dedicated in the so-called guidelines for trans-European energy networks (TEN-E), which were established in 2006.[117] The new infrastructure package, which was issued in November 2010, was expected to be more comprehensive and limited to the most crucial issues. Namely, the new infrastructure strategy will have a basis in European law for the first time. I.e., it will be designed in order to best fulfill the four primary objectives of the EU energy policy laid down by the above mentioned TFUE art.194 para.1.[118] Yet, none of these goals can be achieved without large investments in new energy infrastructure.[119] However, at least with respect to natural gas, during the recent European Autumn Gas Conference (EAGC) in Berlin (November 9-10, 2010), European gas industry representatives said it might not have enough cash for those large investments, mostly because of continued saturation in the market and too little political support for gas.[120]

The obligation of member states to respect the policy of development, interconnection, and liberalisation of energy networks within the EU is confirmed in relevant case law of the European Court of Justice (ECJ).[121] Regarding external dimensions of energy networks, namely the common European position on energy transit, the relevant framework is dedicated in European Energy Charter[122] and the Energy Community Treaty.[123] The geopolitical aspects of the EU objectives of development and interconnection of external energy networks are discussed above.[124]

With regards to the *solidarity of member states on energy matters*, in theory it was implicitly consecrated yet in Schuman Declaration of May 9, 1950. However, in practice it seems that for the moment there is unfortunately very little European solidarity on energy security. For instance, taking into account the hypothesis that Nabucco pipeline project is not economically realistic,[125] and if the Germans or Scandinavians believe that it is not, what is their incentive to overlook their own national interests? Thus, today sovereign, namely economic, interests of individual European states appear to prevail over the objective of the European solidarity on energy matters.

As to the *external dimension of EU energy policy*, among the latest strategic instruments to date there are European Parliament resolution of September 17, 2009 on external aspects of energy security[126] and European Parliament legislative resolution on minimum stocks of crude oil and/or petroleum products.[127]

Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

[117] See European Commission (2010). *Energy : Energy Infrastructure*. URL: http://ec.europa.eu/energy/infrastructure/index_en.htm , retrieved on September 30, 2010.

[118] *Id.* See also Belin, Hughes (2010). "Brussels to unveil new energy infrastructure vision", October 5, 2010, *European Energy Review*, URL: http://www.europeanenergyreview.eu/index.php?id=1549&id_referer=2407, retrieved on October 5, 2010.

[119] Belin (2010), *id.*

[120] Nicola, Stefan (2010). "Europe's gas industry deeply divided over the future", November 22, 2010, *European Energy Review,* URL: http://www.europeanenergyreview.eu/index.php?id=2554 , retrieved on November 23, 2010.

[121] See ECJ, *Commission v Kingdom of the Netherlands, Italian Republic, French Republic and Kingdom of Spain* (Cases C-157/94, C-158/94, C-159/94 and C-160/94), EUR-Lex Ref: 61994C0157; *Commission v Republic of Poland* (Case C-223/09), in Official Journal of the European Communities, Vol. 52, September 26, 2009 (Doc. No. C 233).

[122] 98/181/EC, ECSC, Euratom: Council and Commission Decision of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects. EUR-Lex Ref.: 31998D0181.

[123] 2006/500/EC: Council Decision of 29 May 2006 on the conclusion by the European Community of the Energy Community Treaty. EUR-Lex Ref.: 32006D0500.

[124] *Supra*, pp.13-18.

[125] *Id.*

[126] Energy security (Nabucco and Desertec) European Parliament resolution of 17 September 2009 on external aspects of energy security. EUR-Lex Ref.: 52009IP0021(01).

[127] Minimum stocks of crude oil and/or petroleum products * European Parliament legislative resolution of 22 April 2009 on the proposal for a Council directive imposing an obligation on Member States to maintain minimum stocks

However, even the very text of the former resolution outlines the general conclusions on the EU common energy policy challenges, made above in parts 2.3. – 2.6. of this chapter. Namely, on the one hand, energy security constitutes an essential component of the overall security, stability and prosperity of the EU, and a key element for the pursuit of economic and social development in Europe. But on the other hand, there is still no firm and tested basis under the Treaties for energy security. In addition, the lack of a genuine and effective common European external energy security policy undermines the coherence and credibility of the EU's external action. Then, the EU's dependence on energy imports is significant at present and, as things stand, is projected to increase. At the end, several member states are highly dependent on a single supplier of natural gas, and unwarranted disruption to supplies can cause severe problems, as demonstrated during the last Russia-Ukraine gas crisis; and a number of member states do not possess sufficient natural reserves to cope with crises.[128]

Notably, the European Parliament has tried to tackle flaws related to the above challenges to the common EU energy policy. The most recent example of this is Parliament's adoption of the Security of Gas Supply Regulation dated September 21, 2010.[129] The main points of the regulation are the following: inciting the member states and gas companies to be fully prepared in case of supply disruption, through clear and effective emergency plans involving all stakeholders and incorporating fully the EU dimension of any significant disruption in the spirit of solidarity; encouraging member states, together with gas companies, to coordinate their preventive actions and emergency plans at regional and European levels; companies have to invest in the necessary infrastructure and ensure bidirectional flows where needed to secure supplies to all customers and in any case to private households in case of disruption. Once more, since this is a Parliament's regulation, and since it concerns energy, the wording thus says that member states, together with gas companies, are *encouraged* to *coordinate* their actions related to security of gas supply on regional and European levels. Of course, a regulation could only *encourage* and not *bind* member states to undertake such actions. In turn, "coordinate" in the text most likely aims to drive states to harmonise their respective policies, hence, to dedicate them substantially to the common European external energy security policy. Yet again, as an EU observer recently noticed, in a union of sovereign states what is lacking is not so much coercion as political will.[130]

To date it seems that the only realistic hope regarding security of energy supply is the EU's "third package" of legislation adopted in the summer of 2009.[131] In addition, it will come into force on March 3, 2011 and must be transposed into national law in all member states by this time.[132] The latest energy package adopted by the Commission aims to primarily ensure "a truly competitive energy market".[133] This comprises: separating production and supply from transmission networks; facilitating cross-border trade in energy; more effective national regulators; promoting cross-border collaboration and investment; greater market transparency on network operation and supply; and increased solidarity among the EU countries. Althgouh most of those challenges are recurrent in all previous strategic documents cited in above paragraphs of this study, some interesting novelties are introduced in the third package. Those seem to be the very factors of Commission's firm belief that the instrument will succeed where two previous legislative packages have failed. For instance, it seems to be tougher and to forcing gas companies to restructure their businesses and make room for new entrants.

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of crude oil and/or petroleum products (COM(2008)0775 – C6-0511/2008 – 2008/0220(CNS)). EUR-Lex Ref.: 52009AP0226.

[128] European Parliament resolution of September 17, 2009, *op.cit.* note 126, point A and s.

[129] The background for this regulation is the January 2009 gas crisis. Notably, through the European Energy Programme for Recovery cross border infrastructures have benefited EU co-financing amounting to with EUR 1.4 billion. Press releases RAPID (2010). "EU strengthens rules on security of gas supply for citizens", of September 21, 2010. Ref.: IP/10/1151. URL: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1151&format=HTML&aged=0&language=EN&guiLanguage=en , retrieved on September 21, 2010.

[130] "Charlemagne" (2010). "Rules of Brussels club", *The Economist*, Vol.396 No.8699, September 11-17, 2010, p.30.

[131] Regulation (EC) No 713/2009; Regulation (EC) No 714/2009; Regulation (EC) No 715/2009. *Op.cit.*, note 116.

[132] See European Commission (2010). *Energy :Gas and Electricity*. URL: http://ec.europa.eu/energy/gas_electricity/third_legislative_package_en.htm , retrieved on September 30, 2010.

[133] *Id.*

In particular, an interesting for this study third package's development was the so-called "Gazprom clause". It was linked to plans to separate production and transmission channels in the EU's energy firms.[134] The project of the clause was implying the respect of this EU's principle of liberalisation, by all companies, including from third countries. I.e. energy investors outside the EU could not acquire transit and distribution networks within the EU if they did not separate production and transmission channels. Gazprom, which is a monopoly, does not separate production and transmission, and does not seem to do that in near future. However, EU ministers have dismissed the idea of building such a robust shield to protect the EU's energy market from such foreign companies as Gazprom: instead, they were set to follow a softer line, in which a parent company retains ownership of transmission networks, but owned by the same set of shareholders and heavily supervised by a national regulator. It seems that such an outcome was especially wanted and inspired by Germany, which imports 40 percent of its gas from Russia.[135]

To summarise, the first two strategic objectives of the EU energy policy (namely the respect of fundamental national energy supplies choices of the member states, and the development and interconnection of energy networks) seem to have viable chances for success. However, the last two concerned strategic goals (that is, enhanced solidarity of member states on energy matters, and progrees on the external dimension of European energy policy) appear to be more difficult to reach due primarily to the reticence of member states to appropriately mitigate their sovereignty. The consistence of the latter phenomenon with the new wording of the TEC art.100, which became TFUE art.122, remains unclear, and must be tested by the ECJ practice.

2.7. Russian Energy Policy: an Overview

While for the European Union the thorny question of sovereignty appears to be the primary stumbling block to the achievement of a number of strategic energy objectives, in the case of the second protagonist, Russia, sovereignty seems to be the very essence of its energy policy.

According to the IEA,[136] Russia holds the world's largest natural *gas* reserves (and 20 percent of global gas production - behind the US), the second largest *coal* reserves (estimated at 173 billion tonnes, between the US with 267 billion tonnes and China with 126 billion tonnes), and the eighth largest *oil* reserves (12 percent of world's oil production - behind Saudi Arabia). Russia is also the world's largest exporter of natural gas, the second largest oil exporter and the third largest energy consumer. In addition to huge reserves of the "energy of the past" i.e. coal, and the "energy of the present" i.e. hydrocarbons, Russia possess around 10 percent of the world's proven *uranium* reserves – the "energy of the future", estimated at approximately 5, 500 thousand tonnes - and assumes around eight percent of the world's uranium production, i.e. roughly 3,400 tonnes (2007 estimates).[137]

In 2007, Russia's real gross domestic product (GDP) grew by approximately 8.1 percent, surpassing average growth rates in all other G8 countries, and marking the country's seventh consecutive year of economic expansion.[138] Russia's economic growth over the past ten years has been driven primarily by energy exports, given the increase in Russian oil production and relatively high world oil prices during the period. According to IMF and World Bank estimates, the oil and gas sector generated more than 60 percent of Russia's export revenues (64 percent in 2007), and accounted for 30 percent of all FDI in the country.[139]

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[134] Goldirova, Renata (2008). "EU weakens 'Gazprom clause' on foreign energy investors", October 13, 2008, EUobserver, URL: http://euobserver.com/9/26914 , retrieved on September 30, 2010.
[135] *Id.*
[136] EIA (2007), *op.cit.*, note 15.
[137] Sénat (France) (2009). *Rapport d'information No.182*, session ordinaire 2009-2010 [Information report No. 183, ordinary session 2009-2010], p.12.
[138] *Id.*
[139] *Supra,* p.3.

In sum, the country is the *third largest world energy producer* (with the 1,185 billion tonnes of oil equivalent (toe) [140] production in 2005, it is just behind China – 1,641 toe, and the US - 1,190 toe). It is also the *third largest world energy consumer* (with 647 million toe, it is behind the US – 2,340 billion toe and China – 1,717 toe).[141] Therefore, its primary economic objectives include ensuring the sustainability of its dynamic economic growth by elaborating on a long-term energy strategy, and further promoting its non-oil and gas energy sectors where Russia may have comparative advantages.

On the other hand, there is a complex issue of regaining control of the energy sector by Russian authorities. Russia is not a unique state for which energy is among primary strategic issues. What are then the specific strategic energy policies which Russia implements? Notably, the prices at which it sells the energy - primarily natural gas – in national market are very low. Such pricing behaviour appears to be purely political, in that it is unprofitable economically, but at the same time, it favours national producers who use a lot of energy in their industries, like for instance producers of highly processed goods.

For a quite long time period, until the demise of the USSR, the state had collective ownership over means of production, and so the state completely controlled energy exploration and production. Right after the USSR's dismantlement, the policy changed. Under the first Russian president, Boris Yeltsin, a policy of privatisation in the energy field, driven in a particularly opaque manner, took place on the country level. The Russian tycoons (or "oligarchs") have become the beneficiaries of privatisation in energy field.

Since 2003, the second Russian president, Vladimir Putin, has stopped the referred privatisation policy in a relatively similar – abrupt and opaque – manner, that his predecessor had been implementing that privatisation..In this regard, one of the most striking illustrations of Putin's nationalisation policy has been the case of the petroleum company Yukos where its leaders, first of all Mikhail Khodorkovsky, were the subject of censure.

Today, the state controls about 87 percent of gas production and 30 percent of oil production in Russia.[142] However, in recent years the state has undertaken a major power sector reform leading to the disappearance of the monopoly RAO UES (electricity) and the resale of its power plants to public and private Russian and foreign investors.[143]

Thus, the current energy policy in Russia is characterised first of all by the *concept of sovereignty* (2.7.1.), as well as its near-term objectives are conditioned by Russia's *energy strategies* (2.7.2.).

2.7.1. The Interplay of Energy and Sovereignty

> "The concept of sovereignty is central to a State's idea of itself and sense of future direction. The Permanent Court of International Justice established, in one of its early cases, that international law as a system frames the contours of a State's sovereignty, and delimits it. Thus a strongly sovereign State recognises that, whilst international obligations restrain the exercise of sovereign prerogatives, the right to assume international obligations is itself an attribute of State sovereignty."[144]

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[140] For "toe" definition see Energy glossary.
[141] Sénat (France) (2009), *supra*, note 137.
[142] *Id.,* see also Kalotay (2007), *op.cit*., note 57.
[143] Sénat (France) (2009), *supra*, note 137.
[144] As held by the Permanent Court of International Justice in the seminal case of *The SS Wimbledon* (1923), cited in this context in Paulsson, Jan (2009), "El Poder de los Estados para Hacer Promesas Significativas a los Extranjeros" (2009). *TDM Issue* 1, on www.transnational-dispute-management.com. See also his recent post, « Repudiation of International Arbitration Agreements and the Public Interest », February16, 2009, http://kluwerarbitrationblog.com/blog/2009/02/16/repudiation-of-international-arbitration-agreements-and-the-public-interest/ , retrieved on September 10, 2010. For a historical and witty account of *The SS Wimbledon*, see Klabbers, Jan (1998), "Clinching the Concept of Sovereignty: Wimbledon Redux" (1998) 3 Austrian Review of International and European Law 345. In Nappert, Sophie (2010). "EU-Russia Relations in the Energy Field: The Continuing Role of International Law", *IAEE Energy Forum*, 3rd quarter 2010, URL: www.iaee.org/en/publications/newsletterdl.aspx?id=110 , retrieved on October 1, 2010.

Given that Russia's economic growth over the past ten years has been driven above all by energy exports, it could be argued that energy is of high strategic importance for Russia, and it could even be considered as a sector of high *state* importance. This assertion is confirmed by numerous Russian government reactions to different matters related to energy. For example, in 2003 Russia's government explicitly expressed its disagreement regarding the European Neighbourhood Policy directly after publication of the Policy which originally mentioned Russia as a possible *acquis communautaire* recipient country.[145] Then, the two Russia-Ukraine gas crises confirmed this argument. Or else, the very fact that virtually any international petroleum operation of Russian resource-based state enterprises is to some extent influenced by the course of Russian foreign policy[146] bears out that the international strategies of Russia's energy monopolies are closely tied with the core of Russia's sovereignty. (Again, whatever is the extent to what such Russian companies are influenced by the government, in any case, as any commercial entity, they have their own market interests and corporate policies. What is more, one does not have to dream that the European counterparts of those Russian energy giants are completely exempted from political influences on the Union and/or on national levels of their countries of domicile. Yet, the degree of such political influence should turn out lesser than in Russia.)

On the other hand, the "strategic" interpretation of the 2009 Russia-Ukraine gas crisis asserts that Russian behaviour towards Ukraine is politically motivated, i.e. it is a kind of censure for the Ukraine's flirtation with the West through its interest in NATO.[147] Hence, it could be argued that Russia's current energy policy is closely connected with *sovereign* affairs.

2.7.2. Russia's Energy Strategies

A relevant study of OECD distinguishes three critical and interconnected areas of Russia's energy reform: (1) the reform of regulatory institutions, laws, and policies; (2) the reduction or elimination of implicit subsidies; and (3) the introduction of competition into potentially competitive areas, reducing the dominance of Gazprom.[148] The relevant for this study points of Russia's government's current policy in the energy sector generally focuse on two major goals: (1) *increasing investment*; (2) *changing the investment structure*..[149]

Russia's federal policy goals on energy issues were set forth in the Energy Strategy of Russia to 2020 (Energy Strategy 2020), approved by the Decree of the Russian Government No. 1234-p (August 28, 2003).[150] In keeping with the above mentioned goals, the Energy Strategy 2020 emphasised the importance of energy efficiency.[151]

The key points for reform considered by the Energy Strategy 2020 were state price regulation of natural monopolies; separation of natural monopolies and potentially competitive segments; development of wholesale markets for electric power; and structural changes in the gas sector aimed at increased transparency in the activities of Gazprom.[152]

For this analysis, a particularly interesting measure for reform considered by the Energy Strategy 2020 is the *separation of natural monopolies and potentially competing segments*. It is worth mentioning that regarding gas sector in particular, Russia's government aims above all to introduce competition into the supply segment

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[145] *Infra*, p.38.
[146] *Supra*, p.12.
[147] *Supra*, p.14.
[148] OECD (2002). *Economic Survey of the Russian Federation, 2002*, in Selivanova (2008), *loc.cit.* note 234, p.30.
[149] Selivanova (2008), *ibid.,* p. 31.
[150] Энергетическая стратегия России на период до 2020 года (ЭС-2020), Министерство промышленности и торговли Российской Федерации [Energy Strategy of Russian Federation to 2020, The Ministry of Industry and Trade of the Russian Federation]. The full text is available (only in Russian) at: http://www.minprom.gov.ru/docs/strateg/1 ; see also : http://www.energystrategy.ru./projects/es-2020.htm , retrieved on September 11, 2010.
[151] Selivanova (2008), *loc.cit.*, note 234, p.31.
[152] *Id.*

of the sector, namely into the exploitation, exploration, extraction and distribution; conversely, the gas transportation represents a natural monopoly, since according to economies of scale theory, there can be only a few producers, and certain services may justify only one supplier.[153]

Indeed, the crucial obstacle to competition in energy, and especially gas, supply in Russia lies in the *lack of effective access to the pipeline system*. On the other hand, the Energy Strategies aim at introducing competition into sectors such as exploitation or extraction of the supply segment, but not into the transportation system. Interestingly, in Russia by law 15 percent of pipeline capacity is reserved for independent producers.[154] This implies that Gazprom could hypothetically assert a lack of *spare capacity* in gas pipelines which is virtually impossible to verify, and by this means could explain an eventual refusal of access to the transportation pipelines.

The Energy Strategy 2020 also emphasised that the policy of low priced gas and electricity could result in a deficit of resources due to a lack of investments and excessive demand.[155] This policy is cancelled by the Decree of the Russian Government No. 1715-p (November 13, 2009). The same governmental Decree laid down the new policy, namely the Energy Strategy of Russian Federation to 2030 (Energy Strategy 2030). Hence, this is the most recent Russian Energy Strategy paper, although it is taking up the core priorities of the previous policy, but in addition it stresses the modernisation of energy sector in particular, which concerns increasing Russia's energy saving and energy efficiency, especially through energy diversification and the development of renewable energy sources.[156]

The relevant key objectives for reform aimed by the Energy Strategy 2030 are twofold: increase the share of foreign investment in the Russian energy industry to 12 percent;[157] and encourage more active participation of Russian energy companies in foreign projects. The latter could particularly mean to increase access to profitable investment upstream opportunities, and also to energy transportation infrastructure.

Notably, both Energy Strategy 2020, and Energy Strategy 2030 have among their main priorities *the further integration of Russia's energy sector in the global energy system*. That is, Russia actually aims at firlmly establishing itself an equal counterpart with the EU in their energy dialogue.

2.8. EU-Russia Energy Cooperation: History, Options and Prospects

Commodity dialogues between Russia and some European countries is an old tradition. Germany, for instance, has always been open to all sorts of energy collaboration. One reason for this may be the wish to open the country, which is a typical energy importer, to new sources.[158] For example, the *German-Russian Raw Materials Forum* has its roots in the *300-year-old dialogues* between the St. Petersburg State Mining

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[153] For a detailed analysis see Selivanova (2008), *loc.cit*. note 234, p.32.
[154] IEA (2002). *Russia Energy Survey 2002*, at 22. In Selivanova, *ibid*., p.33.
[155] Energy Strategy 2020, *supra*, note 150, at 4.
[156] Энергетическая стратегия России на период до 2030 года (ЭС-2030), Министерство промышленности и торговли Российской Федерации [Energy Strategy of Russian Federation to 2030, The Ministry of Industry and Trade of the Russian Federation]. The full text is available (only in Russian) at: http://www.energystrategy.ru./projects/es-2030.htm , retrieved on September 11, 2010.
[157] In order to implement the strategy, recently declared Valery Yazev (Vice President of the State Duma, Chairman of the Russian Gas Society, and Curator of the German-Russian Raw Materials Forum) and to facilitate foreign investment in raw-material extraction, the Russian government, wants to amend several laws. This includes a law on foreign investment in economic enterprises which, from a Russian perspective, are strategically important in terms of national defense and state security. A presidential decree is now in the making which would strike off 240 enterprises from the list of strategically significant companies. In addition, Yazev pointed out that thirteen oil fields in East Siberia are tax-exempt at the moment. "It is likely that nine more oil fields will be given this privilege in the future." The Russian state is known to be planning a large-scale program for the production, processing and export of energy resources in East Siberia and the Far East of Russia. See Schroeter (2010), *loc.cit*., note 525.
[158] Liesen (1998), *op.cit*., note 7.

Institute and the Freiberg University of Mining and Technology,[159] as well as in the German-Russian discussion forum "Petersburg Dialogue." The two oldest mining schools in the world agreed at the 2006 "Petersburg Dialogue" in Dresden to meet regularly in the future at an independent forum in order to discuss Russian-German cooperation in raw materials.

Aside from bilateral energy relations of separate member states, since the establishment of the official relations between the European Communities (EC) and the Union of the Soviet Socialist Republics (USSR), the Russian-European dialogue has largely evolved as a result of numerous changes regarding both partners: the Soviet Union disintegrated, allowing Russia to emerge as an international actor, and the EC gave birth to the EU. As to energy interactions, e.g. natural gas supplies, over the last 30 years Russia has been a reliable supplier of gas to the European market. Regarding gas trade, Europe-Russia transactions have three main interconnected features: *oil-indexed gas prices*, *long-term* and *take-or-pay* gas sales contracts.[160] Notably, long-term take-or-pay contracts have contributed to the consistant trade relations in the past, in particular by ensuring adequate finance for the large-scale capital investments required, both in production and in the transportation infrastructure.[161]

However, such incidents as the recent gas disputes, Russian private energy companies' nationalisation, and so on, significantly blur the landscape of this cooperation. In addition, subject to regular meetings and intense negotiations, EU-Russia energy cooperation is still complicated to advance, due to the lack of an efficient common project.

A general agreement on cooperation of the two protagonists - the *Partnership and Cooperation Agreement* (PCA) was concluded in 1994. Then Russia and the EU have launched an *"energy dialogue"* (oil, gas and electricity) at the Paris Summit (October 30, 2000). The Summit was generally considered by all observers as marking the real takeoff of the EU-Russia partnership, since for the first time the partners agreed on a topic of high priority for each of them.[162]

At their St. Petersburg Summit in May 2003, the EU and Russia agreed to start working on the creation of four "common spaces", meaning closer cooperation and integration in economics and energy; internal security and justice; foreign and security policy; and education and culture.[163] They agreed on guidelines for the four spaces at the Moscow Russia-EU Summit in May 2005 with the legal framework for these four spaces to be implemented within the *new Partnership Agreement* (PA) replacing the previous PCA, signed in 1994, which was in force until the end of 2007. Energy relations are included in the *road map on the common economic space*[164] which defines the aim of cooperation and necessary actions.[165]

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[159] See German-Russian Raw Materials Forum's official website (in Russian): http://www.rohstoff-forum.org/index.php?home_ru ; also available in German: http://www.rohstoff-forum.org/index.php?home_de , retrieved on September 30, 2010. See also Schroeter (2010), *loc.cit.*, note 525.

[160] See *supra*, pp.15-16.

[161] EU-Russia Energy Dialogue (2001). *Synthesis Report, Brussels/Moscow*, September 2001, p.2. URL. http://ec.europa.eu/energy/international/russia/doc/reports/progress1_en.pdf , retrieved on September 7, 2010.

[162] La Documentation française (2008). *Dossier : La Russie et l'Union européenne.* URL : http://www.ladocumentationfrancaise.fr/dossiers/europe-russie/partenariat-energetique.shtml , retrieved on September 7, 2010.

[163] Konoplyanik, Andrei (2009). "A Common Russia-EU Energy Space (The new EU-Russia Partnership Agreement, acquis communautaire, the Energy Charter and the new Russian initiative)", *Journal of Energy and Natural Resources Law,* Vol. 27, 2009, afl. 2, pp. 258-291.

[164] Russia and the EU first mentioned the idea of a common economic space between the two in their Joint Statement at the EU-Russia Summit held in Moscow on 17 May 2001, in which they stated: "We agree to establish a joint high-level group within the framework of the PCA to elaborate the concept of a common European economic space". URL: http://www.delrus.ec.europa.eu/en/images/pText_pict/239/sum31.doc , retrieved on June 20, 2010.

[165] "The objective of the common economic space is to create an open and integrated market between the EU and Russia. Work on this space will bring down barriers to trade and investment and promote reforms and competitiveness, based on the principles of non-discrimination, transparency and good governance. Among the wide range of actions foreseen in the road map, an EU/Russia regulatory dialogue on industrial products is to be launched, as well as greater co-operation on investment issues, competition and financial services. It is also foreseen to enhance co-operation in the telecommunications, transport and energy fields, on issues such as regulatory

On May 26, 2008 the European Commission finally received a mandate from the EU Council of Ministers to open the next round of negotiations for the new EU-Russia Agreement.[166] At the EU-Russia Summit held in Khanty-Mansiysk (the oil capital of Russia's Western Siberia) at the end of June 2008, the parties have agreed to start negotiations on the new bilateral PA.[167] The first round of negotiations took place on July 4, 2008. Following the conflict in the Caucasus the European Council of September 1, 2008 decided to postpone meetings on the negotiations. At the meeting of EU Foreign Ministers of November 10, 2008 the Commission received an approval to pursue negotiations.[168]

One of the key objectives of the new PA is to harmonise legislation and to develop a legal framework for the creation of a *common EU-Russia economic space*, including energy. The practical issues associated with the preparation of a new PA were further discussed at the next EU-Russia Summit held in Nice (France) on November 14, 2008.[169] It seems that there will be an energy chapter in the new PA, but the structural design of the chapter is still to be discussed. The preceding agreement - PCA - did not include an energy chapter, and so it now seems to be a good moment to outline the principles of such a chapter and if possible, a fully-fledged legal framework for such a common energy space.[170]

This study addresses *several ways* to develop such a *legal energy framework* and this part will examine those avenues from a legal and institutional perspective, taking into account important geopolitical, security, economic, financial, social, historical, and sometimes environmental considerations. The first two instruments discussed below, namely the EU-Russia Energy Dialogue (2.8.1.) and PCA (2.8.2.), represent an already *existing legal basis* for the energy cooperation between the two parties. The second four mechanisms to be discussed, that is new PCA (PA) (2.8.3.), export of "acquis communautaire" (2.8.4.), a kind of "new Energy Charter" proposed by Russia's presidency (2.8.5.), and EU-Russia energy integration through Russia's accession to the WTO (2.8.6.), are *potential options* for energy cooperation. Finally, this part will briefly address the ECT from its past, present and future position with regards to the EU-Russia energy relations (2.8.7.).

2.8.1. Energy Dialogue

As per the European press release "EU-Russia Energy Dialogue", the essence of the latter consists of the following (emphasis added):

> "a. Objectives
> The overall objective of the energy partnership is to enhance the energy security of the European continent by binding Russia and the EU into a closer relationship in which all issues of mutual concern in the energy sector can be addressed while, at the same time, ensuring that the policies of opening and integrating energy markets are pursued. With the

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standardsetting and infrastructure development…". (15th EU-Russia Summit Moscow, 10 May 2005 Press Release, 8799/05 (Presse 110)). URL: http://www.delrus.ec.europa.eu/en/images/pText_pict/465/Press%20release.doc , retrieved on June 20, 2010.

[166] Press releases RAPID (2008). "EU-Russia Summit in Nice on November 14, 2008", of November 14, 2008. Ref.: IP/08/1701. URL: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1701&format=HTML&aged=0&language=EN&guiLanguage=en , retrieved on June 20, 2010.

[167] Joint statement of the EU-Russia summit on the launch of negotiations for a new EU-Russia agreement, Khanty-Mansiysk, June 27, 2008, 11214/08 (Presse 192). URL: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/er/101524.pdf , retrieved on June 20, 2010.

[168] EU-Russia Summit in Nice on 14 November 2008, *op.cit.*, note 166.

[169] See: "EU-Russia Summit" at : http://www.ue2008.fr/PFUE/lang/en/accueil/PFUE-11_2008/PFUE-14.11.2008/sommet_ue-russie , retrieved on June 20, 2010.

[170] See Emerson, Michael, Tassinari, Fabrizio and Marius Vahl. (2006) "A New Agreement between the EU and Russia: Why, what and when?" – *Centre for European Policy Studies (CEPS)* Policy Brief, No 103/May 2006. This CEPS paper is a response to two articles published in Russia in *Global Affairs* (Vol. 4, No. 2, April-June 2006): "Toward a Strategic Alliance" by Bordachev, Timur, and "Russia-EU Quandary 2007" by Arbatova, Natalia (http://www.ceps.be).

strong mutual dependency and common interest in the energy sector, this is clearly a key area of EU-Russia relations.
The energy partnership aims at *improving the investment opportunities in Russia's energy sector in order to upgrade and expand energy production and transportation infrastructure as well as improve their environmental impact, to encourage the ongoing opening up of energy markets, to facilitate the market penetration of more environmentally friendly technologies and energy resources, and to promote energy efficiency and energy savings.*
The Dialogue continues to be a valuable tool for enhancing EU-Russian energy relations providing that there is commitment on both sides and that the Dialogue has the political impetus provided by energy PPC's. It has permitted a good and frank debate at different levels between the EU and Russia and has allowed broad participation and involvement of the various Russian governmental bodies, the Commission, EU member states and International Financial Institutions such as the EIB and EBRD, as well as a wide variety of EU and Russian energy companies.

b. Functioning
The functioning of the EU-Russia energy dialogue is based on several working levels. The Permanent Partnership Council (PPC), comprising the Russian Minister responsible for Energy (...), [the European] Commissioner [for energy] (...), and the Minister responsible for Energy from the current Presidency and the next Presidency. It is up to the EU Presidency to convene an Energy PPC. (...)
At the political level, regular contacts are maintained by the Coordinators of the Energy Dialogue, [European] Commissioner [for energy]and Russian Minister. At working level, regular contacts are maintained between the European Commission and Russian Ministry of Energy officials."[171]

Essentially, the five major themes of mutual interest support the essence of the Dialogue by: ensuring the security of energy supplies of the European continent; developing the vast potential of the Russian economy, in particular Russia's energy resources; realising the opportunities of the pan-European market; addressing challenge of climate change; and framing the conditions for use of nuclear energy.[172]

However, among the primary objectives of the instrument, most of the terms (e.g. "to enhance the energy security ", "improving the investment opportunities ", "to upgrade and expand energy production and transportation infrastructure", "to encourage the ongoing opening up of energy markets", etc.) refer to more secure energy investment in and transit from/through Russia. As a result, they mostly refer to the security of the European energy supply.

As a starting point, the parties recognised that investment decisions related to energy production and transport from Russia to Europe are to be based on long-term contracts of investment in large-scale projects and on sharing risks between producers (exporters) and consumers (importers). Long-term contracts are an essential element for energy security and should continue to ensure energy supply to the European market.[173]

Since then, several tangible results were obtained in the sphere of energy security based on the framework of the Dialogue. First, the EU recognised – in the latest Directive on security of gas supply, namely its Preamble, point 8 - *the significance of the long-term contracts in Europe's energy supply*.[174] Then, those results have

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[171] Press releases RAPID (2009). "EU-Russia Energy Dialogue", of March 19, 2009. Ref.: MEMO/09/121. URL: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/121&format=HTML&language=en , retrieved on September 1, 2010.
[172] EU-Russia Energy Dialogue (2001), *op.cit.*, note 161, p.1.
[173] *Ibid.*, p.2.
[174] Council Directive 2004/67/EC of April 26, 2004 concerning measures to safeguard security of natural gas supply. EUR-Lex Ref.: 32004L0067.

included resolving the question of *destination clauses*[175] which existed in some long-term gas supply contracts, confirming the absence of any EU limit of 30 percent on imports of fossil fuels from a single external source; addressing certain *energy trade issues* in the context of the Russia's accession to the WTO negotiations; and the confirmation of the *supply contracts for nuclear materials* concluded by Russia prior to EU enlargement.[176]

From the *legal angle*, the status of the Energy Dialogue is fairly obvious regarding the international law and current EU-Russia energy negotiations. Indeed, on the one hand, the Dialogue is consistent with the existing legal framework. Nevertheless, on the other hand, its binding character and its operational effectiveness are *limited by its consultative nature*.

Still, some authors assert that in future the Dialogue may serve the purpose of guaranteeing EU energy security within the meaning of the international law.[177] In such a way, in general the level of legal formalisation of the security of energy supplies from Russia to the EU does not adequately correspond to the scale of international relations and the amount of supplies. That is, the enormous volumes of energy involved in the Russia-EU trade require a *solid legal basis*. Therefore, the policy, currently being elaborated by the EU institutions, namely a policy aiming at creating a single European energy market that should embrace all European countries including Russia, could be relevant in this respect. In particular, it is proposed to extend the *basic principles of the EU law* ("acquis communautaire"), particularly the rules of competition, the free movement of goods and services, and the freedom of access to energy infrastructure and to the markets of energy exporting countries. Such measures aim at reducing energy prices and establishing common requirements for producing and consuming countries to reduce the amount of the natural rent received by producers. However, such a legal option could hardly correspond to Russia's interests as a net energy exporter. The reasoning outlining this opinion will be developed further in this document.[178]

From the *strategic perspective*, the Dialogue shows the necessity for the EU to develop a *strategic cooperation* with Russia as its major energy supplier, i.e. Russian energy supplies should be stable and uninterruptible no matter how the bilateral situation between two protagonists and/or the international state of affairs change.

2.8.2. PCA

The Partnership and Cooperation Agreement[179] has been the framework of the EU-Russia relationship for more than a decade. It was signed in 1994 and entered into force on December 1, 1997. The Agreement regulates the political and economic relations between the EU and Russia and is the *legal basis* for the EU's *bilateral trade and investment relations* with Russia. The PCA is a mixed agreement, concluded by the EU and the member states.[180] One of its main objectives is the promotion of trade and investment as well as the development of harmonious economic relations between the parties.[181]

The objectives of the Partnership established by the PCA are the following: to provide an appropriate framework for the political dialogue between the Parties allowing for the development of close relations

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[175] Destination clauses are clauses in long-term commodity supply contracts which bind traders to not resell the commodity outside the countries where they are based. This practice aims at guaranteeing the seller a kind of protection and helps to maintain price differentials across different national markets.

[176] EU-Russia Energy Dialogue (2005), *Sixth Progress Report,* Moscow/Brussels October 2005. URL. http://ec.europa.eu/energy/international/russia/doc/reports/progress6_en.pdf , retrieved on September 7, 2010.

[177] Seliverstov, Sergey (2009). "Energy Security of Russia and the EU: Current Legal Problems", *The Institut Français des Relations Internationales (IFRI)* paper, April 2009, p.11.

[178] See *infra*, p.38.

[179] Agreement on partnership and cooperation establishing a partnership between the European Communities and their Member States, of one part, and the Russian Federation, of the other part. EUR-Lex Ref. : 21997A1128(01).

[180] *Id.*

[181] European Commission (2009). *Trade - Bilateral relations - Countries : Russia.* URL: http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia/ , retrieved on September 1, 2010.

between them in this field; to promote trade and investment and harmonious economic relations between the Parties based on the principles of a market economy and so to foster sustainable development in the Parties; to strengthen political and economic freedoms; to support Russian efforts to consolidate its democracy and to develop its economy and to complete the transition into a market economy; to provide a basis for economic, social, financial and cultural cooperation founded on the principles of mutual advantage, mutual responsibility and mutual support; to promote activities of joint interest; to provide an appropriate framework for the gradual integration of Russia in the wider area of cooperation in Europe; and to create the necessary conditions for the future establishment of a free trade area between the Community and Russia covering substantially all trade in goods between them, as well as conditions for bringing about freedom of establishment of companies, of cross-border trade in services and of capital movements.[182]

PCA art. 65 is dedicated to energy policies of both partners. The main concern of those policies as determined by this regulation is the *cooperation in the area of improvement of the quality and security of energy supply in an economic and environmentally sound manner*. Otherwise, the article refers to cooperation in such areas as the formulation of energy policy, the improvement in management and regulation of the energy sector, the introduction of institutional, legal and fiscal conditions necessary to encourage increased energy trade and investment, the promotion of energy saving, and the modernisation of energy infrastructure, including interconnection of gas supply and electricity networks.[183]

Interestingly, PCA art.65 does *not* refer to the diversification of supplies, which is a common feature of the Agreements on Partnership and Cooperation with other ex-Soviet republics.[184] The provisions of this regulation thus implicitly confirm the role of Russia as the EU key energy supplier.[185]

A suspending condition is contained in PCA art.105 which relates to the application of the ECT and its additional Protocols thereto in matters covered by the PCA. Notably, the provisions of the ECT could substitute the respective norms of the PCA accordingly to art. 105 only upon entry into force of the ECT on the territory of Russian Federation, i.e. upon its ratification by Russia.[186] Therefore, since Russia's withdrawal from the ECT in 2009, this article has essentially lost its general meaning.

The trade liberalisation of the parties as laid down by the PCA is based on the principles contained in the GATT, and also takes into account the establishment of the WTO[187] (PCA, Preamble). Title III of the PCA, namely its articles 10-13, are not only based on GATT fundamental principles, but they also require that the relevant GATT provisions shall be applicable *mutatis mutandis* between the parties. Those principles are, first of all, MFN treatment (GATT art. 1 para.1; PCA art.10 para.1); national treatment (GATT art. III; PCA art.11, paras.1, 2); freedom of transit (GATT art.V para.1; PCA art.12, para.1); and finally, the terms "customs union" and "free trade area", laid down in the PCA art. 10 para.2 (b), are supposed to have the same meaning as those described in the GATT art. XXIV, para.8, and should be created through the procedure indicated in paragraph 10 of the same GATT article. In addition, the following GATT regulations shall be applicable *mutatis mutandis* between the partners: GATT art.III, paras.8, 9 and 10; art. V, paras.2, 3, 4 and 5; art. VII ("Valuation for Customs Purposes"), paras.1, 2, 3, 4 (a), (b) and (d), 5; art.VIII ("Fees and Formalities connected with Importation and Exportation"); art. IX ("Marks of Origin"); and art. X ("Publication and Administration of Trade Regulations").

Interestingly, PCA art. 19[188] contains virtually the same list of exceptions and conditions to be respected in order to invoke those exceptions, that GATT art. XX.[189] Therefore, even though a potential limitation of

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[182] Agreement on partnership and cooperation, *supra*, note 179.
[183] Art. 65, Agreement on partnership and cooperation, *id.*
[184] See e.g. art. 53 of the EU-Kazakhstan PCA; art. 54 of the EU-Kyrgyzstan PCA; art. 61 of the EU-Ukraine PCA. In Seliverstov (2009), *op.cit.* note 177, pp.10-13.
[185] *Id.*
[186] *Id.*
[187] See *infra*, note 220.
[188] PCA art. 19 in full reads as follows:

freedom of transit of energy from Russia into Europe would violate PCA relevant provisions (generally, art. 12, but also art. 11, etc.), it might be acceptable if the restricting measure conforms to the one of PCA art. 19 conditions. Among the listed conditions, it seems that "the protection of natural resources" could be a viable legal basis for appeal in case of a dispute over the obstacles to energy transit from or through Russia into the EU. Since a formal dispute over energy transit under international law had never been raised between the two parties, the relevant GATT/WTO norms application could be taken as an example.

There is a twofold analysis required for measures to be excepted under GATT/WTO standards according to GATT art.XX. First, otherwise inconsistent trade restrictions relevant to the freedom of transit could be excepted under GATT art. XX if they are "necessary" to protect *human, animal, or plant life or health* (art. XX (b)) or if they conserve *exhaustible natural resources* (art.XX(g)). Second, even if the art.XX conditions are met in accordance with one of its paragraphs, the measure must fulfil the requirements of the so-called "chapeau" to art. XX. That is, it should be established that such a restriction is not a means of *arbitrary* or *unjustifiable discrimination* or a *disguised restriction* to trade, as specified in the "chapeau".

To date, there has been little "practical" experience within the WTO regarding transit, namely with GATT art. V.[190] One case relevant for this study failed to bring a panel to apply GATT art. V in February 2002: Slovenia brought to the attention of the Council for Trade in Goods a ban imposed by Croatia on road transit of oil and oil products through Croatian territory which it argued violated art. V, particularly paragraphs 2, 4 and 6 of the regulation. The concern was later extended to also take in additional measures subsequently introduced by Croatia, covering oil and oil products as well as several chemical products (internationally classified as "dangerous goods"), and referring to road transit and international road carriage. Slovenia declared that those measures were in direct conflict with different GATT/WTO provisions, first of all, with art. V. Croatia held that the road transit ban with respect to oil and oil products had been only temporary and that the subsequently introduced measures referred to by Croatia were in conformity with the requirements of art. V. Both parties agreed to hold further consultations on the issue.[191]

"The Agreement shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection o[f] health and life of humans, animals or plants; the protection of natural resources; the protection of national treasures of artistic, historic or archaeological value or the protection of intellectual, industrial and commercial property or rules relating to gold and silver. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between the Parties." Agreement on partnership and cooperation, supra, note 179.

[189] GATT art. XX matching provisions read as follows (emphasis added):

"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(a) necessary to protect public morals;

(b) necessary to protect human, animal or plant life or health;

(c) relating to the importations or exportations of gold or silver;

(…)

(f) imposed for the protection of national treasures of artistic, historic or archaeological value;

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption (…)." GATT full text in WTO Secretariat (2007). *The results of the Uruguay Round of Multilateral trade Negotiations: The Legal Texts*, Cambridge University Press / WTO.

[190] Some disputes arose, in GATT and in WTO, concerning the scope of this obligation, but they were settled between the parties concerned: Austria v Germany in 1989/90, EC v. US in 1996, Slovak Republic - transit of cattle, US v Canada - transit of cattle II, EC v. Chile in 2000). WTO Secretariat (2002). "Article V of the GATT 1994 – Scope and Application", September 10, 2002 (Ref.: G/C/W/408).

[191] *Id.*

Separately, this provision has only recently been applied by a panel in the dispute *Colombia – Indicative Prices and Restrictions on Ports of Entry*.[192] However, this dispute does not concern the transit of energy, but rather concerns the transit of textiles, apparel and footwear. Nor did this dispute use in its reasoning one of the two above mentioned exceptions of GATT art.XX. Conversely, due to specificity of both relevant parts of this provision, it was repeatedly tested through environment-related WTO cases. Therefore, for modelling the applicability of GATT art.XX exceptions, one has to argue from analogy, in examining environment-related WTO norms and case law, since the latter is more advanced in the environmental disputes than in transit ones.

Notably, the requirement "necessary" in art.XX (b) is perceived as more difficult to meet than the condition of "relating to" in art.XX(g).[193] Hence, if a dispute over energy transit occurs under WTO law, it is more likely that the countries seeking to justify limitation of freedom of energy transit would resort to art.XX(g). This "relating to" test requires that there must be a *substantial relationship*[194] between conflicting legislation and the conservation of the exhaustible natural resources. Specifically, "relating to" requires that the "means are...related to the ends"[195] i.e. the limitation should contribute to attaining the goal of the exception invoked. Moreover, the measure must be taken in conjunction with the restrictions on domestic production or consumption.

There are also some other relevant elements that stand out from the WTO case law. Namely, it may be that the "chapeau" demands the concerned state to undertake efforts at an international agreement as a precondition to the fallback of unilateral measures.[196] By analogy, it could mean that Russia has to show that it actively supports the respect of the principle of freedom of transit in international agreement. In addition, any discrimination in the application of the conflicting measure should "relate to the pursuit of the measure."[197]

2.8.3. New PCA (PA)

This option aims at creating a new bilateral EU-Russia PCA (PA), either "on the basis of the Energy Charter principles" or in drafting a totally new agreement. This option has been preferred by Russian authorities,[198] but is also considered as possible avenue for moving forward by some EU officials[199] and even – indirectly – by the EU in general.[200]

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[192] WTO DISPUTE DS366, available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds366_e.htm , retrieved on September 8, 2010.

[193] For detailed analysis of the GATT art.XX application, see Guzman, Andrew T. and Joost Pauwelyn (2009). *International Trade Law,* Aspen Publishers, Kluwer Law International, 2009, pp.339-404. For its application on environment-related measures, see Hufbauer, Gary Clyde, Charnovitz, Steve and Jisun Kim (2009). *Global Warming and the World Trading System.* DC: Peterson Institute for International Economics, 2009; see also International Centre for Trade and Sustainable Development (ICTSD) (2009). "Competitiveness and Climate Policies: Is There a Case for Restrictive Unilateral Trade Measures?" ICTSD Programme on Competitiveness and Sustainable Development, Information Note No. 16, December 2009.

[194] WTO, Appellate Body Report, *United States-Standards for Reformulated and Conventional Gas (*hereinafter "US-Gasoline"), WT/DS2/AB/R, adopted on April 29, 1996, p.19.

[195] WTO, Appellate Body Report, *United States-Import Prohibition of Certain Shrimp and Shrimp Products* (hereinafter "US-Shrimp"), WT/DS58/AB/R, adopted on October 12, 1998, para 14.

[196] *US-Gasoline*, GATT Panel Report, paras. 27-28.

[197] WTO, Appellate Body Report, *Brazil — Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/, adopted on December 3, 2007, para. 93.

[198] See, for instance, the following statement of Valery Yazev, Deputy Chairman of the Russian State Duma, to the press early April 2008, which reflects his long-standing views. "My view of the situation is that it is impossible to modify the Energy Charter to the extent which could make it possible for the State Duma to ratify it. A different, seriously thought-through document is required," told Yazev. "Russia and Europe, being strategic partners in the field of energy, have to start developing new institutions capable of coordinating inter alia the functioning of the forming global energy market," added the Vice-speaker. (Press service of the Deputy Chairman of the RF State Duma V.A. Yazev. Press-release, 09.04.2008) in Konoplyanik, (2009), *op.cit.,* note 163.

However, as some authors assert, this avenue could present a fundamental difficulty.[201] Indeed, it would be more difficult to negotiate a new EU-Russia legally-binding treaty today than it was in early 1990s when the former PCA 1994 was negotiated. This is due to the following technical, legal, political and operational reasons.[202]

Technically it would be difficult on account that although nominally "bilateral", in reality the PA would be a *multilateral* treaty with 29 members (the 27 member-states plus the EU as a whole plus Russia) since it would need to include at least some derogations from the *acquis* (see below). In 1994 when the PCA was signed there were only 15 EU member states.

Legal complexity lies in the fact that in the early 1990s the EU-Russia PCA was negotiated mostly on the basis of the then existing *acquis,* which was much less liberalised then today. Today, obviously the "liberalisation gap" between the EU and Russian legal systems has increased, and with it the scope of potential derogations from the *acquis* did, which might be needed to reach a compromise. This makes the task much more difficult legally.

It would be also difficult *politically* to implement the PA. That is, today the window of political opportunity is much narrower than it was in early 1990s after the fall of the Berlin Wall, the end of the Cold War, and the dissolution of the Council for Mutual Economic Assistance[203] (COMECON) and the USSR. The euphoria and expectation of changes on both sides were so high that they most likely opened a broad window of political opportunity for negotiations aimed at creating common rules of the game and a level playing field, particularly in energy, in a broader Europe. Today this window has most probably narrowed dramatically, though one hopes only temporarily.

Operational intricacy might be due to the fact that it took almost six years for the delegations of two protagonists to negotiate and discuss informally at the expert level the three open issues in the draft Energy Charter Protocol on Transit, and finally the results were below the expectations of both parties.[204] In this context, comparing to the above protocol, the PA being a broader treaty to be finalised and ratified, it seems that one could expect an even longer negotiation phase with unpredictable outcomes.

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[199] This was, for instance, mentioned by some speakers at the 2008 Annual Conference of the French Institute of International Relations (IFRI) "The External Energy Policy of the European Union", held on 31st January - 1st February 2008 in Palais d'Egmont, Brussels, Belgium.

[200] "The new Agreement will cover results-orientated political co-operation, the perspective of deep economic integration, a level playing field for energy relations based on the principles of the Energy Charter… The new agreement will build upon the current four Common Spaces." EU-Russia Summit in Nice on November 14, 2008, *op.cit*., note 166.

[201] Andoura, Sami and Marius Vahl (2006). "A New Agreement Between Russia And The European Union", The EU-Russia Review, Issue 2, pp. 5-11; Konoplyanik, (2009), *op.cit*., note 163.

[202] Konoplyanik, (2009), *id.*

[203] COMECON (1949–1991), was an economic organisation with countries of the Eastern Bloc along with a number of communist states elsewhere in the world as its members. It was the Eastern Bloc's version of the Organisation for European Economic Co-operation (OECD) implemented in western Europe.

[204] Russia has linked the ratification of the ECT to negotiations on an Energy Charter Transit Protocol (ECTP) which would have amplified and strengthened ECT provisions on energy transit issues in order to diminish some specific operational risks that continue to affect energy transit flows. Negotiations on the text of the ECTP began in early 2000. During the meeting of the Energy Charter Conference on December 10, 2003 it became clear that an unanimous decision could not be achieved on the basis of the compromise text. A complicating factor was that energy issues, including transit, were also a thorny subject of the bilateral agenda for the EU and Russia in the context of Russian negotiations for accession to the WTO. The Protocol negotiations were temporarily suspended. The suspension was lifted in 2004 after Russia and the EU reached agreement on the terms of Russian WTO accession. Further bilateral consultations between the EU and Russia have been taking place since the autumn of 2004. Accordingly, in December 2006 Russia indicated that the ratification of the ECT was unlikely due to the provisions requiring third-party access to Russia's pipelines.

2.8.4. Export of "Acquis Communautaire"

This option (clearly preferred by the EU),[205] is to export the EU's emerging *acquis communautaire* (i.e. the common internal legislation of the enlarging EU) to the countries outside the EU.

The approach of direct expansion of the *acquis* area through enlargement of the EU or through multilateral treaties based on implementation of the EU law in full or in relation to a particular segment of economic activity (e.g. energy in the case of the EU-SEE Energy Community Treaty) may be envisaged for some transit states and a few energy producing states within the spectrum of energy supply chains running to the EU. But as EU's energy dependence grows, especially in gas, one can expect that key gas exporters, especially those that are part of the integrated Eurasian (EU plus non-EU) gas supply system based on fixed infrastructure, would prefer to remain outside the EU legal regulation area.

For instance, the then Russian Deputy Prime-Minister Victor Khristenko expressed his concerns regarding the European Neighbourhood Policy in a letter to the then CEC Trans-European Networks Director General Francois Lamoreaux immediately after publication of the Policy which originally mentioned Russia as a possible *acquis* recipient country.[206] Right after this letter Russia was excluded from the Policy and therefore disqualified as a potential recipient of the EU energy *acquis*. As some experts observe, it is quite difficult to imagine Iran (one of the most likely key future direct gas suppliers to the EU through fixed infrastructure) or other Islamic gas producers adopting EU *acquis* in general, and in particular EU energy *acquis*.[207]

2.8.5. "New Energy Charter"

As it was noted by Nappert, " [t]he energy policies of the Russian Federation (…), as well as the role they are made to play in its international relations, are the subject of worldwide publicity (...). Russia's gas pricing disputes with the Ukraine (…) provide recent examples."[208]

Indeed, third country observers, independent experts, members from all sides of the European Parliament, Ukrainian authorities, top-level Russian officials – all of them were actively involved in the gas crises debates. As to the reactions of the latter authorities to the January 2009 gas crisis, as of the very month they have started to suggest that the ECT should be reviewed; by April 2009 those suggestions resulted in a proposal no less than a "new Energy Charter".[209]

Some observers see the latter as an alternative treaty (though broadly worded and in the form of a statement of principles),[210] while others argue that it could hardly be seen as an alternative on account that it simply represents a set of questions, unanswered – or until today, wrongly answered - by the ECT, especially regarding its transit mechanisms; and that the only important innovative element it contains is a

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[205] Konoplyanik, (2009), *op.cit.*, note 163.

[206] European Commission (2003). Communication from the Commission to the Council and the European Parliament "Wider Europe - Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours", Brussels, March 11, 2003, COM(2003) 104 final. URL : http://ec.europa.eu/world/enp/pdf/com03_104_en.pdf , retrieved on September 9, 2010. In Konoplyanik, (2009), *id.*

[207] Konoplyanik, (2009), *id.*

[208] Nappert (2010)., *op.cit.*, note 144.

[209] A few weeks after the January crisis, President Medvedev proposed a "new Energy Charter". In his March 1, 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. See infra Belyi (2009), note 200; Dvorkovitch (2009), note 493. On April 20, 2009 he tabled an "alternative" to the ECT: the "Conceptual Approach to the New Legal Framework for Energy Cooperation" (see *infra,* note 512).

[210] Belyi , Andrei V. (2009). "A Russian Perspective on the Energy Charter Treaty (ARI)" June 16, 2009, published by The Elcano Royal Institute.

system of international commissions authorised to resolve extraordinary situations related to energy transit.[211]

The following sections of the proposal set aside all the legal and other comparisons between the actual ECT and the proposed alternative by the Russian government; instead, they concentrate on a wider but concise description of the proposed initiative.

Accordingly, the main issues covered by the Russian proposal are *sovereignty over natural resources*; *ensuring non-discriminatory access to markets*; and *transparency, access to technologies, and exchange of information.* In geopolitical terms, Russia proposed to extend the ECT to other countries, including the US and some producing countries, and to cover a broader scope of energy sources, such as the nuclear energy.

But the main added value – or at least as it seems to be perceived as such by its authors – of the new Russian concept is the transit regime. Once again, Russia calls for the reform of the transit dispute settlement mechanism, but this time the Russian proposal could actually bring the investment debate back to the table of negotiations.[212] The suggestion introduces the idea of non-discrimination at the *pre-investment phase*: "non-discriminatory investment promotion and protection, including *new investments* in all energy chains".[213] In fact, Russia has reintroduced the issue of the ECT Supplementary Treaty ten years after the first attempt; unfortunately, the current proposal does not elaborate further on this topic.[214] However, in general terms it could be expected that "non-discriminatory investment promotion and protection, including *new investments* in all energy chains" should refer to the *soft law obligations* such as national treatment and MFN principles.

On the other hand, the point could be arguable whether the new rules on non-discrimination at the pre-investment phase would be effective regarding transit security and dispute settlement. Indeed, regarding the original Treaty, its regime for the making of *new investments* is probably one of the least satisfactory components because it is hedged with numerous words such as "endeavour" and "encourage."[215] On the other hand, regardless of this weakness, the driving force of the Treaty as appears from the recent cases under the ECT is to provide a non-discriminatory regime for investment in petroleum, either national or most-favoured nation treatment, whichever is most favourable (ECT art.10). Again, disputes arising under this "pre-investment" regime may be submitted for arbitration by the signatory states, but not by the individuals or companies concerned (ECT art. 27).[216] [217]

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[211] "Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)", proposed by Russia, cannot be seriously considered as an alternative to the ECT and related documents, but (…) it may be accepted by the international community as a proposal on future improvement of the Energy Charter process, the latter being a single universal mechanism of legal regulation in the international energy sector. On the one hand, the promulgated document does not contain any suggestions as to its conceptual novelty or principle difference from the provisions of the Energy Charter documents. These proposals should be viewed not as an alternative, but rather as a list of questions, offered to the Energy Charter international community with the aim to analyze the efficiency of the multi-facet directions of its activity. This will allow a reduction to the negative effects of declarations and proposals made by the Russian party and will turn the discussion of the matter into something constructive and positive. (…) It would also be quite reasonable to propose to the Charter community a transit agreement, indicated in the "Conceptual Approach…", aimed at preventing such crises as the Russia-Ukraine dispute in January, as part of the complex Russian initiative on adaptation of the Energy Charter to the new challenges and risks of the international energy markets development. It should be noted that this draft agreement on transit crises prevention was prepared by Gazprom's experts explicitly as a document supplementing ECT and draft Transit Protocol, rather than substituting them. There is only one innovative element in the text of this agreement, but it is an important one – a system of international commissions authorized to resolve extraordinary situations, connected with transit, if a threat of their occurrence should arise." Konoplyanik (2009), *op.cit.*, note 163. pp. 38-39.

[212] Belyi (2009), supra, note 210.

[213] *Id.*

[214] *Id.*

[215] Andrews-Speed, Philip (1999). "The politics of petroleum and the Energy Charter Treaty as an effective investment regime", *Journal of Energy Finance and Development*, Vol.4, 1999 (pp.117–135), p.121.

[216] *Id.*

[217] See *infra*, pp.67-68.

Actually, the Russian conceptual approach does not introduce any "revolutionary" changes to the ECT and it could be in line with the five-year reviews of the Energy Charter Secretariat.[218] In any case, the chances to fill the gap created after Russia's withdrawal from the ECT with the "new Energy Charter" are slim, [219] because, above all, Russia's new project presented by the President Medvedev in 2009 was rejected by Europeans. While it proposes a set of interesting ideas, at its present stage it is too broad and short to become a new treaty.

2.8.6. WTO

This avenue is supposed to use the GATT/WTO trade-related rules[220] in applying them on trade in energy and energy services between the EU and the Russian Federation. For doing so, Russia needs to adhere to the WTO. This approach may be practical in spite of Russian concerns and its continuoulsy changing position on WTO accession.

Notwithstanding the actual absence of specific rules dealing with energy and natural resource-related matters, WTO provisions apply to trade and investment in general and thus could be applied to energy products and services. Yet while it seems to be a sound alternative, it would become feasible only with Russia's accession to the WTO. To date the Russian Federation is not a WTO member, but it is negotiating its accession as a developed country; the EU (until November 30, 2009 known officially in the WTO as the European Communities) has been a WTO member since January 1, 1995; the 27 member states of the EU are also WTO members in their own right.

Notably, energy issues were a thorny subject of the bilateral agenda for the EU and Russia in the context of Russian accession to the WTO.[221] In fact, that bilateral agenda was closely linked with the Russia's ratification of the ECT. The Protocol on Transit[222] negotiations was temporarily suspended. The suspension was lifted in 2004 after Russia and the EU reached agreement on the terms of Russia's WTO accession. Further bilateral consultations between the EU and Russia have been taking place since the autumn of 2004.

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[218] Andrei V. Belyi and Sophie Nappert (2009). "A New Energy Charter: Myth or Reality?", *Oil, Gas, Energy Law Intelligence*, (Vol.2.1, April 2009). Available at: http://cceis.ru/data/image/art2.pdf , retrieved on May 25, 2010

[219] See Konoplyanik (2009), *op.cit*., note 163.

[220] From 1948 to 1994, the GATT provided the rules for much of world trade and presided over periods that saw some of the highest growth rates in international commerce. Since GATT's creation in 1947-48 there have been eight rounds of trade negotiations. A ninth round, under the Doha Development Agenda (DDA), is now underway.
The fundamental principles of the trading system as laid down by the GATT and then resumed by the WTO, created in 1995, are the following:
Gradual market liberalisation. Trade agreements do not end but must evolve over time. Continuing negotiations is an obligation made by a GATT member state at the moment when it signed the GATT agreement.
Most-favoured-nation principle (MFN). Under the GATT/WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other members. This principle is first article of the GATT, which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article II), although in each agreement the principle is handled slightly differently. Some exceptions are allowed. In principle, under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to service providers from all other WTO members. MFN applies to all services, but some special temporary exemptions have been allowed.
National treatment principle. Imported and locally-produced goods should be treated equally - at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. This principle of "national treatment" (giving others the same treatment as one's own nationals) is also found in all main WTO agreements (e.g., GATT Article III, GATS Article XVII), although once again the principle is handled slightly differently in each of these agreements.
For details refer to the "Principles of the trading system", on the WTO official website. URL: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm , retrieved on May 5, 2010.

[221] European Commission (2007), *op.cit.,* note 54.

[222] See *supra,* note 204.

Today it is worth assessing the potential advantages and disadvantages of such an option. Its *prospective advantages* for Russia are the following. First, Russia's WTO membership might help tie the hands of special interest groups, especially in oil-and-gas and natural resources sectors. It might also confer a legal advantage for individual citizens, because by tying the hands of the Russian government, trade multilateralisation could provide a defence for Russian citizens against some potential arbitrary actions of the governemnt.[223] It would also boost the creation of economies of scale by reducing transaction and information costs, and by transferring technologies. In addition, it has to be taken into account that energy represents more than 60 percent of Russia's export revenue, hence its economy is highly dependent on world energy prices. The latter are in turn dependent upon a number of different factors. In that the oil prices today are basically determined by traders on spot markets, and thus are subject to constant trading. Consequently, in order to be less dependent upon hardly predictable economic factors governing energy markets, it is necessary for Russia to diversify its exports. WTO accession should therefore promote economic development in Russia by opening export markets for Russian industrialised goods.

For the EU the main advantage would be that Russia will liberalise its commerce, and if correctly negotiated, also liberalise its trade in energy products and services, especially the coal, nuclear, and hydrocarbons sectors. The latter represents both a crucial and growing need for the EU. Then, under the GATT non-discrimination principles, Russia will be obliged to equalise domestic and export energy prices. Otherwise its downstream industries, mainly electricity, heat, and semi-processed goods producers, get very cheap energy for their production, which fosters competition of the EU producers that pay the "export" prices for Russia's energy which today are much higher than domestic ones. In addition, the WTO Dispute Settlement Mechanism (DSM) is virtually the sole international dispute resolution system which does not require the respondent's consent for the procedure. This means that under the WTO rules the EU could, for example, hold Russia responsible if another "gas war" occurs.

The *probable disadvantages* which may drive Russia not to accede to the WTO are the following. One is the "single undertaking" principle, where a member cannot choose GATT/WTO rules *à la carte*, but rather it must adhere to the totality of the agreements. In combination with the WTO's DSM, it may make commitments too politically expensive, such as under certain unexpected extreme conditions when it becomes vital for a WTO member to renounce certain commitments, and DSM sanctioned retaliation may harm powerful interest groups. Hence, this fear could divert an important energy exporter such as Russia from accession. Instead, undertaking the same commitments in RTAs could be "safer" since it is easier to renegotiate commitments bilaterally.[224] When countries such as Russia cannot predict with confidence exactly which exporting nations will benefit (and by how much) from a particular liberalisation commitment, such as the liberalisation of energy sector, it seems difficult - if not impossible - to use the concession as leverage to win a matching concession.

2.8.7. ECT

In the beginning, the Treaty was essentially aimed at the former Soviet Union and Eastern Europe, and tracked along the following stages. The Charter of Paris was signed between the two former ideological blocks in 1990. It is often seen as a starting point for the "New Europe",[225] which stressed in particular Europe's new image which was related to the "security community". Similarly, there have also been several attempts to settle a multilateral regime in energy investment, trade and transit. In particular, the European Energy Charter declaration was signed in 1991. Historically, the 1991 Energy Charter sets out objectives of international energy cooperation, including the promotion and protection of investments.

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[223] See Baldwin, Richard and Theresa Carpenter (2009). "Why not in the WTO? The erosion of WTO centricity in trade liberalisation", p.6. Background paper prepared for the Inaugural Conference of Thinking Ahead on International Trade (TAIT): *Challenges Facing the World Trade System*, organised by the Centre for Trade and Economic Integration (CTEI) at the Graduate Institute of International and Development Studies (IHEID), Geneva, in collaboration with the Economic Research and Statistics Division of the Secretariat of the World Trade Organization. Held at the WTO, September 17-18, 2009.

[224] *Ibid*., p.9.

[225] The Organisation for Security and Cooperation in Europe (OSCE) (1990). *The Charter of Paris*. The full text is available on: www.osce.org/item/4047.html , retrieved on September 10, 2010.

This was followed by multilateral negotiations aimed at the creation of an international energy regime. Those three-year negotiations resulted in a sector-specific, legally binding international instrument covering energy trade, transit and investments – in short, the ECT.

At its creation, the Treaty was limited geographically on account of the US and Canada's withdrawal.[226] In addition, many energy producing countries, including Saudi Arabia, Iran and Venezuela, obtained observer status without signing the ECT.[227] Hence, the ECT was mainly intended to integrate the energy sectors of the Soviet Union and Europe in the wake of the dismantlement of the former. At that time, following the declaration on European Energy Charter[228] and taking into account the lack of experience in the former Soviet Union regarding trade and investment negotiations, the provisions of the ECT were principally instigated by the EU member states.[229] As for the decade and a half of provisional application of the ECT to the Europe-Russia energy cooperation, an expert notes that "[t]he underlying purpose of the ECT is to ensure Western European states security of supply of energy (notably natural gas from Russia) in exchange for obligations respecting border treatment of exports and investments."[230]

Interestingly, while articulating *openness to foreign investment* and granting a set of protective rights for investors, including a dispute settlement mechanism, the ECT stresses the parties' irrevocable right, namely *state sovereignty over natural resources*:

> "Each state continues to hold in particular the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, [and] the optimalisation of their recovery and the rate at which they may be depleted or otherwise exploited[.]"[231]

ECT provisions are based on the GATT/WTO pillars of non-discrimination, national treatment, prohibition of export and import restrictions and access to markets on an open and transparent basis. These cover: (1) *protection of foreign investments*, based on the extension of national treatment or most-favoured nation treatment (whichever is more favourable); (2) *free trade in energy* through non-discriminatory conditions for trade in energy materials, products and energy-related equipment; (3) *freedom of transit* through pipelines and grids; (4) *promotion of energy efficiency* and minimising the environmental impact of energy production and use; and (5) *resolution of disputes* between participating states, and - in the case of investments - between investors and host states.[232]

Taking into account that regarding energy, the EU values most the security of its energy supplies through protected diversification of sources and a safe energy transit, and Russia claims the respect of its sovereignty over natural resources, the ECT appears to be the best option for framing the EU-Russia energy relations, especially concerning energy investment and transit. However, after Russia's formal notification of August 20, 2009, that it is not intending to become a contracting party to the ECT, and once all the formal delays are expired, Russia does not apply the ECT provisionally anymore. Indeed, ECT art.45 para.3 provides that a signatory may at any time terminate its provisional application by written notification of its intention not to become a contracting party to the Treaty.[233] In accordance with ECT art.45 para.3 (a), this resulted in Russia's termination of its provisional application of the ECT precisely on

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[226] Energy Charter Secretariat, *Energy Charter: About the Charter*, URL: http:// www.encharter.org/index.php?id=7 , retrieved on September 10, 2010.
[227] *Id.*
[228] *Id.*
[229] Craig Bamberger, Jan Linehan and Thomas W. Wälde (2007). "The Energy Charter Treaty", p. 149. In Roggenkamp, Martha et al. (Eds.) (2007). *Energy Law in Europe*, 2nd edition, 2007, Oxford University Press , New York , 2007
[230] Herman (2009), *loc.cit.*, note 281, p.3.
[231] Art .18 para. 3, ECT, *op.cit.* note 50.
[232] Wälde, Thomas W. And Andrei Konoplyanik (2006). "Energy Charter Treaty and its Role in International Energy", 24 (2006) *Journal of Energy & Natural Resources Law* 523, at 529. In Herman (2009), *loc.cit.*, note 281, p. 3.
[233] Art .45 para. 3 8a), ECT, *op.cit.*, note 50.

October 18, 2009, i.e. upon expiration of 60 calendar days from the date on which the notification was received by the Depository.

2.9. ECT and beyond: Energy Investment and Transit-related Ambiguities in European and Russian Relevant Legislation

Historically, once the Soviet Union broke up, Western – and particularly European - investors had seen new, supposedly bright, opportunities for investment in many previously inaccessible oil and gas reserves. In practice, however, the success of such investment initiatives to a certain extent depended on those investors' capacity to ensure freedom of energy transit. Indeed, the latter openings for energy FDI in post-soviet Russia appear complicated to operate. For example, the state-owned energy monopolies Gazprom and Rosneft seem to be granted with an informal Kremlin shield when snubbing Western partners from the access to the most prominent oil and gas fields, as well as pipelines.[234] Another current problem for foreign business partners in Russia is the so-called "Yukos-esque" type of nationalisation.[235] Following Russia's "helped" dismantlement of the Yukos Oil Company (Yukos), at the time when it became a private Russian petroleum business and one of the world's largest non-state petroleum companies,[236] in 2007 Russia nationalised again the Sakhalin II liquefied natural gas project in a similar manner.[237] Hence, there exists a certain risk for other foreign investors in Russia with further nationalisation and consolidation in the energy sector.

The fact that the EU and Russia did not find common ground on Energy Charter Transit Protocol, coupled by Russia's last year withdrawal from the ECT, significantly complicates today's cooperation of the two parties on energy investment and transit matters. Yet, had the two protagonists achieved an accord on the ECTP, or even had Russia stayed within the ECT, there would have been some ambiguities anyway with both EU and Russia's investment and transit regulations in relation with WTO and/or ECT law. In this regard, the following part first addresses Russia's ECT provisional application and its termination (2.9.1.), and then examines existing and potential inconsistencies of relevant legislation of both parties with regards to international law (2.9.2.).

2.9.1. Russia's Provisional Application

The total number of parties to the ECT is 53. Of these 53, by 2009 all had ratified the Treaty except for five: Australia, Belarus, Iceland, Norway, and the Russian Federation.[238] Of these five, Belarus and the Russian Federation have accepted provisional application of the Treaty, which meant that – pending ratification – they agreed to apply the ECT to the extent that it was consistent with their own constitutions, laws and regulations.

From the investment regime's perspective with regards to Russia's provisional application, ECT art.45 para.3 provides that a signatory may at any time terminate its provisional application by written

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[234] Kramer, Andrew E. (2006). "Gazprom and Rosneft to cooperate on new gas fields", *The New York Times*, November 28, 2006. See also Selivanova, Julia (2008). *Energy Dual Pricing in WTO Law: Analysis and Prospects in the Context of Russia's Accession to the WTO*, London, Cameron May, 2008.

[235] Niebruegge, Alex M. (2007). "Provisional Application of the Energy Charter Treaty: The Yukos Arbitration and the Future Place of Provisional Application in International Law", *Chicago Journal of International Law*, Vol. 8 No. 1 (pp.355-376), p. 356.

[236] Yukos was a publicly-traded joint stock corporation organised under the laws of the Russian Federation in 1993 as part of the privatisation and consolidation of state-owned energy assets following the collapse of the Soviet Union. The Russian Government, initially retaining all shares in the privatised Yukos, sold off its stake in the company through a series of auctions in 1995 and 1996. The principal purchaser was a group of investors of a Gibraltar-based holding company, Menatep (factually led by Mikhail Khodorkovsky and Platon Lebedev). Prior to the Russian actions preceding the re-nationalisation of the company, Menatep and its subsidiaries held approximately 51 percent of Yukos' equity capital. Yukos official website, "Yukos: About Us", URL: http://www.yukos.com/About_us/History.asp , retrieved on April 9, 2010.

[237] Reed, Stanley (2006). "Journey to Extreme Oil", *Business Week* 74, 74–76 (May 15, 2006). In Niebruegge, *supra,* note 235.

[238] See ECT "Members and Observers", URL: http://www.encharter.org/index.php?id=61&L=0 , retrieved on October 1, 2010.

notification of its intention not to become a contracting party to the Treaty.[239] However, the provisions of Part III of the ECT, concerning investment promotion and protection, and Part V, concerning dispute settlement, continue to apply to investments made in the terminating state during the period of provisional application for 20 years following the effective date of termination.[240] This means that all foreign investments recognised as such under the ECT law and made prior to Russia's withdrawal from the Treaty are protected under the ECT through October 18, 2019.

As for the transit regime under the provisional application, Russia has linked the ratification of the ECT to negotiations on the Transit Protocol which would have amplified and strengthened ECT provisions on energy transit issues in order to diminish some specific operational risks that continue to affect energy transit flows.[241] Negotiations on the text of the ECTP began in early 2000. During the meeting of the Energy Charter Conference on December 10, 2003 it became clear that a unanimous decision could not be achieved on the basis of the compromise text. Then, following tensions linked to the EU-Russia bilateral agenda in the context of Russia's negotiations for accession to the WTO of 2004,[242] in December 2006 Russia indicated that *the ratification of the ECT was unlikely due to the provisions requiring third-party access to Russia's pipelines*. Thus, actually the main flaw of the ECT as it was perceived by Russia is ECT art.7, which lays down the Treaty's transit regime.

2.9.2. Current and Prospective Incompatibilities of European and Russian Relevant Legislation with International Law

Russia withdrew from the ECT and to date is reticent to join the WTO. But the ECT and/or WTO norms could continue to serve as basis to the prospective establishment of an energy regulatory framework between two parties. Therefore, it would be useful to analyse whether the current legislation of both protagonists comply with the core ECT and WTO principles. Both Russia and the EU have several ambiguities to address in regard of some of those rules and principles.

As it was stated above, energy and trans-European networks - together with the internal market regulation and the environment - are governed by the *shared competences* between the EU and the member states.[243] The very essence of the European common market – competition rules and the four freedoms of movement – is confirmed by the basic provisions of the TFEU. However, a number of amendments brought by the Lisbon Treaty to the TEC, thus transforming it to the TFEU, enable the Union to undertake the restrictive measures in relation to the third countries. Indeed, in accordance with TFUE art.64 para.3, "the Council, acting in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries."[244] In other words, it could be argued that this provision can be used to restrict the investments of companies from the third countries, including their energy investments.

Moreover, ongoing proceedings before the ECJ concerning the compatibility of BITs of EU member states with EU law, several arbitral proceedings of investors versus EU member states based on BITs between EU member states and/or concerning substantive legal problems that are somehow related to EU law (e.g. *Eastern Sugar*[245]) take place. Insufficient attention, however, has so far been paid to the relationship between EU law and the ECT with regard to the specific situation of a possible arbitral proceeding of an EU national versus an EU member state. As the ECT is a plurilateral treaty that has been concluded as a so-called *mixed agreement* by the EU and all its member states, the questions that arise are to a large extent different than in the *Eastern Sugar* situation.[246]

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[239] Art .45 para. 3 8a), ECT, *op.cit.*, note 50.
[240] Art. 45 para.3 (b), ECT, *id.*
[241] This section is based on European Commission (2007), *op.cit.*, note 54.
[242] See *supra,* p.41.
[243] See *supra,* pp.20-22.
[244] Art. 64 para 3, TFUE, *op.cit.*, note 107.
[245] Cf. i*nfra*, note 253.
[246] See Seliverstov (2009), *op.cit.*, note 177, p.13. See also Nappert, Sophie (2009), « Le droit dérivé et les investissements », in Kessedjian, Catherine and Charles Leben (2009), *Le droit européen et l'investissement*, Panthéon

The recent ECJ jurisprudence could give some relief to these alarms. Notably, in its decision of March 3, 2009 in the cases brought by the European Commission against Austria and Sweden respectively,[247] and against Finland on November 19, 2009,[248] the ECJ examined certain BITs pre-dating the accession of these countries to the EU, which contained wording conferring *unrestricted freedom of transfer of capital* and *profits for investments* covered by the BITs.[249] Whilst *free movement of capital* is a fundamental principle of EU law, TEC arts.57, 59 and 60 (TFEU arts.64, 66, and 75) give the Council powers to impose exchange controls for certain limited or temporary purposes. The Council has never exercised these powers. However, if it were to do so, the unrestricted freedom of transfer clauses in the relevant BITs would make it difficult or impossible for Austria, Sweden or Finland to comply with their obligation to cooperate with the Council. In this respect, the Commission takes the view that there is a "hypothetical conflict" between the BITs and the EU law. The ECJ agreed and ordered Austria, Sweden and Finland to renegotiate the relevant BITs or to denounce them. Although these cases arose in the context of bilateral treaties, a similar freedom of transfer provision is found at art.14 of the ECT.
Notably, new TUE art.32 (former TUE art.16) requires that (emphasis added):

> "(...) Before undertaking any action on the international scene or entering into *any commitment which could affect the Union's interests*, each Member State shall consult the others within the European Council or the Council. Member States shall ensure, through the convergence of their actions, that the Union is able to assert its interests and values on the international scene. *Member States shall show mutual solidarity*."

In practice, with regard to energy policies, the principle of *mutual solidarity* could imply restrictions on the unilateral actions of the member states on the global scene. Some unilateral actions and initiatives may qualify as undermining the solidarity requirements. However, the wording of the provision does not offer any *binding criteria* which would establish the cases when the proposed action would "affect the Union's interests", i.e. in which cases a member state should use the consultative procedure within the Council.[250] In addition, the limits for the harmonisation of actions of the member states and the result of the consultations within the Council are not clear. That is, should it be formalised as an approval or interdiction of actions, or should it be formalised as a general guideline of the international policy?[251] Consequently, if the answer to the previous question is far from clear, and if a member state were to step away from the recommendations of the Council, the effects are not clear either.[252]

Aside from some hypothetical conflicts of the EU legislation with international law, and the potential complication of energy relations between Russia and individual EU member states, recent investor-state case law confirms some of the doubts. It also outlines concrete challenges presented to the EU as a party to international treaties along some of its member states, and in its dealings with other state parties. These challenges give rise to avenues which newly-acceded EU member states are starting to invoke in defence of nvestor-state claims: that is, a BIT dispute settlement mechanism violates the above mentioned principle of *mutual trust and solidarity* between member states, laid down by the new TEU art.16;[253] the inconsistency between BIT protection and EU law;[254] and in the ECT context, claims by EU nationals against other member states.[255]

Assas, Paris, 2009; Tietje, Christian (2008), "The Applicability of the Energy Charter Treaty in ICSID Arbitration of EU Nationals vs. EU Member States", draft in *TDM*, September 2008, in Nappert (2010), *op.cit.*, note 144.

[247] ECJ, *Commission v Republic of Austria* (Case C-205/06), EUR-Lex Ref: 62006J0205; ECJ, *Commission v Kingdom of Sweden,* (Case C-249-06), EUR-Lex Ref: 62006J0249; Decisions of the Court, 3 March 2009.

[248] ECJ, *Commission v Republic of Finland* (Case C-118/07), EUR-Lex Ref : 62007J0118.

[249] This section is based on Nappert (2010), *op.cit.*, note 144.

[250] Seliverstov (2009), *op.cit.*, note 177, p.15.

[251] *Id.*

[252] *Id.*

[253] Notably in ECJ, *Eastern Sugar BV v The Czech Republic*, Partial Award, 27 March 2007. URL: http://ita.lawuvic.ca/documents/EasternSugar.pdf , in Nappert (2010), *op.cit.*, note 144.

[254] ICSID, *Micula and others v Romania*, Case No. ARB/05/20, Decision on Jurisdiction and Admissibility, September 24, 2008. URL: http://ita.law.uvic.ca/documents/Miculav.RomaniaJurisdiction.pdf , in Nappert (2010), id.

[255] Stockholm Chamber of Commerce (SCC), *Mercuria Energy Group Limited v Republic of Poland*, claim registered on July 24, 2008, IAReporter, Vol.1, No.8, August 26, 2008, URL: http://www.iareporter.com ; ICSID, *Electrabel S.A. v*

As for Russia, the latest modifications of the Russian legislation in force cast doubt on the viability of the protection of foreign investments, including investments in energy fields on Russian territory. In this regard, Russia, for example, is not yet a WTO member, but it already has some specific regulations regarding control and restrictions of foreign investments in the strategic sectors of the Russian economy, such as Federal Law N 57-FZ[256] of April 29, 2008 (Law 57-FZ) and the Federal Law N 58-FZ[257] of April 29, 2008 (Law 58-FZ).

Law 57-FZ sets up the *ex-ante* approval requirement for transactions resulting in the *establishment of control of a foreign investor* over the companies doing business in the *strategic sectors of Russian economy*, including energy.[258] The notion of "control" is construed very widely for such transactions; the definition includes not only the possession of 50-plus percent of voting shares, but also the variety of indirect mechanisms of control in the best traditions of the European competition law. However, the approval for the transactions should be given by the government commission. In order to receive such approval, the transaction needs the prior consent of the designated authority and the Federal Security Service (FSB). This mechanism works in parallel with the already existing merger control mechanisms provided by Russian competition law. However, taking into account Russia's sovereignty conundrum regarding energy matters, the underlying reasons for the introduction of additional instruments for this strategic sector may be the intention to introduce a regulatory mechanism of a purely political nature aimed at controlling the foreign business.[259]

The most relevant part of Law 58-FZ for this analysis relates to the *legal regime of the subsoil* in general and the subsoil parcels on the continental shelf in particular by introducing amendments to the Federal Law on Subsoil and the Federal Law on Continental Shelf. With the Law 58-FZ into force, the license to use the subsoil parcels of federal significance on the continental shelf may only be granted to the Russian legal entities that fill the following criteria. Specifically, they must have at least five years of experience with Russian continental shelf exploration/production, and they must have at least 50 percent participation of the Russian Federation. *De facto,* this means that for the moment Gazprom and Rosneft, or their subsidiaries, are virtually the sole potential beneficiaries of licenses to use subsoil parcels on the continental shelf.[260]

Even if this recent legislation were to be justified by GATT art. XX (g)[261] (and it would be difficult to invoke it without restrictions on domestic production or consumption), it clearly contradicts the investment provisions of the ECT, especially the non-discrimination and national treatment clauses. Indeed, ECT provisions are based on the GATT/WTO pillars of non-discrimination, national treatment,

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Republic of Hungary, Case No. ARB/07/19, URL: http://www.worldbank.org/icsid; ICSID , *AES Summit Generation Limited and AES-Tisza Erömü Kft.v Republic of Hungary*, Case No. ARB/07/22, URL: http://www.worldbank.org/icsid. In the cases against Hungary, the European Commission has applied for *amicus curiae* participation, arguing that the long-term power purchase agreements at issue, which guarantee a return on investment, violate EU competition law.

[256] Федеральный закон от 29 апреля 2008 года N 57-ФЗ г. Москва « О порядке осуществления иностранных инвестиций в хозяйственные общества, имеющие стратегическое значение для обеспечения обороны страны и безопасности государства [Federal Law of the Russian Federation "On the order of making the foreign investments in the companies having strategic importance for defence and security of the country"]". Published on the Rossiiskaya Gazeta's website on May 7, 2008. The full text is available (only in Russian) at: http://www.rg.ru/2008/05/07/investicii-fz-dok.html, retrieved on September 20, 2010.

[257] Федеральный закон Российской Федерации от 29 апреля 2008 г. N 58-ФЗ г. Москва "О внесении изменений в отдельные законодательные акты Российской Федерации и признании утратившими силу отдельных положений законодательных актов Российской Федерации в связи с принятием Федерального закона "О порядке осуществления иностранных инвестиций в хозяйственные общества, имеющие стратегическое значение для обеспечения обороны страны и безопасности государства" [Federal Law of the Russian Federation "On making amendments to certain legal acts in relation to the enactment of the Federal Law "]". Published on the Rossiiskaya Gazeta's website on May 7, 2008. The full text is available (only in Russian) at: http://www.rg.ru/2008/05/07/izmenenia-investicii-dok.html , retrieved on September 20, 2010.

[258] See Seliverstov (2009), *op.cit.*, note 177; Nappert (2010), *op.cit.*, note 144.

[259] *Id.*

[260] *Id.*

[261] See *supra*, p.35.

prohibition of export and import restrictions, and access to markets on an open and transparent basis. However, it represents a more robust instrument than GATT/WTO rules regarding foreign investment.[262]

That is, with regards to the ECT, the next incompatibility refers directly to international contracts, which basically include different types of provisions to protect foreign partners to Russian businesses. These are primarily *arbitration clauses*,[263] and *enforcement of arbitration awards* abroad.[264]

In this regard, the 2008 Federal Law N108-FZ[265], which amends as of July 2, 2008 the 2005 Federal Law N115-FZ [266] (broadly used in the energy sector), represents another tension with international law. While the original wording of the 2005 law (Law 115-FZ) allowed disputes between a grantor (the state) and a concessionaire to be resolved through international arbitration, wherever located, the amended wording appears to subject it to a Russian seat.[267] Law 115-FZ art. 17 states that these disputes may be heard "in accordance with the legislation of the Russian Federation in courts, arbitration courts, [and] arbitral tribunals of the Russian Federation."[268] These restrictions appear to require that disputes not be heard by way of institutional or *ad hoc* arbitration outside Russian boundaries.[269]

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[262] For details see *supra,* p.42.

[263] Arbitration clauses are clauses contained in international contracts that bind the parties to resolve their potential disputes through an arbitration process (the latter is maybe preferred to the state justice by international partners, since arbitration represents a private impartial justice of an international arbitral tribunal, consisting of independent expert(s), often seated in a third country for purposes of neutrality). Although such a clause may or may not specify that arbitration occurs within a specific jurisdiction, it always requires the parties to a type of resolution outside of the courts, and is therefore considered a kind of forum selection clause. This is especially valuable in the investor-state disputes resolution, where investors are dealing directly with a state or state entity (as is the case in the natural resources sector) and do not want to submit to that state's courts; in turn, the concerned state would not submit it to the courts of another state. See Jacquet, Jean-Michel, Delebecque, Philippe et Sabine Corneloup (2007). *Droit du commerce international*, Dalloz, Paris, pp.751-760. For an explicit but concise explanation in English, see Moses, Margaret S. (2008). *The Principles and Practice of International Commercial Arbitration*, Cambridge University Press, 2008, p.17.

[264] An arbitration award is a statement on the merits by an arbitration tribunal in an arbitration, and is an equivalent of a judgment in a court of law. International arbitration is above all popular as a means of resolution of commercial and investor-state disputes, on account of the fact that, in international economic relations, it is often easier to enforce an arbitration award in a foreign country than it is to enforce a judgment of the court. Under the international instrument called the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York" Convention), an award rendered in a contracting state can normally be enforced in any other contracting state, only subject to certain, limited defences. I.e., the "New York" Convention is establishing – in its art.V - a list of restricted, mandatory bases on which a state court may refuse to recognise and enforce an award issued in another country. See Jacquet, Delebecque, and Corneloup (2007), *id*; Moses, (2008), *ibid.*, pp.202-219.
To date the "New York" Convention counts 144 parties including Russia. See UNCITRAL, 1958 - Convention on the Recognition and Enforcement of Foreign Arbitral Awards - the "New York" Convention: Status. URL: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html , retrieved on September 20, 2010.

[265] Федеральный закон Российской Федерации от 21 июля 2005 г. N 115-ФЗ "О концессионных соглашениях [Federal Law of the Russian Federation "On Concession Agreements"]". Published on the Rossiiskaya Gazeta's website on July 26, 2005. The full text is available (only in Russian) at: http://www.rg.ru/2005/07/26/koncessii-dok.html , retrieved on September 20, 2010.

[266] Федеральный закон Российской Федерации от 30 июня 2008 года N 108-ФЗ "О внесении изменений в Федеральный закон "О концессионных соглашениях" и отдельные законодательные акты Российской Федерации [Federal Law of the Russian Federation "On making amendments to the Federal Law "On Concession Agreements" and to certain legal acts in relation to the enactment of the Federal Law "]". Published on the Rossiiskaya Gazeta's website on July 2, 2008. The full text is available (only in Russian) at: http://www.rg.ru/2008/07/02/soglasheniya-dok.html, retrieved on September 20, 2010.

[267] See Hertzfeld, Jeffrey and Mikhail K. Ivanov (2008), "Disputes Regarding Immoveable Property (Real Estate) in the Russian Federation: The Competence of Arbitral Tribunals", *SCC Newsletter* 2/2008. In Nappert (2010), *op.cit.*, note 144.

[268] *Id.*

[269] *Id.*

3. Energy Investment and Transit Issues in Selected Regional, Bilateral and Multilateral Agreements

This part looks at energy investment and transit issues contained in the relevant regulations outside the framework of EU-Russia energy relations. Albeit the fact that those do not relate directly to Europe-Russia energy cooperation, in order to better understand current situation as well as to envisage prospects for further cooperation between the two parties, it would be useful to consider some of such relevant texts and instruments.[270]

In such a way, energy-related rules in general and/or investment and transit-related mechanisms in particular, will be examined first in selected regional agreements (3.1.). Then the system of standards of treatment for FDI and frameworks for settling investor-state disputes, including energy investments, as laid down by BITs will be addressed (3.2.). Finally, this study will synthesise the energy investment- and transit-related framework contained in multilateral agreements – mainly the GATT/WTO (3.3.).

3.1. Regional Instruments

3.1.1. APEC

Asia-Pacific Economic Cooperation (APEC) was established in 1989 – it is the first forum for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region.[271] APEC is the only intergovernmental alliance in the world operating on the basis of non-binding commitments, open dialogue and equal respect for the views of all participants. Unlike the WTO or other multilateral trade bodies, APEC has no treaty obligations required of its participants. Decisions made within APEC are reached by consensus and commitments are undertaken on a voluntary basis. APEC has 21 members - "Member Economies".[272] Its main purpose is to further enhance economic growth and prosperity for the region and to strengthen the Asia-Pacific community.

In 1994 APEC introduced *Non-Binding Investment Principles*, and in 2002 it introduced the APEC Investment Transparency Standards. After submitting a request, in 2007, the APEC Investment Experts group received a report on *Identifying Core Elements in Investment Agreements in the APEC region*, based on 28 bilateral and plurilateral investment agreements. The inventory of agreements was conducted per country. Provisions were analysed, and elements of convergence identified.

However, the APEC instruments mentioned above represent a soft-law approach, enhancing cooperation between its members, but do not enforce legally binding mechanisms, including those for energy matters.

3.1.2. ASEAN FTA and ACFTA

The Association of Southeast Asian Nations Free Trade Area[273] (ASEAN FTA) is a trade bloc agreement by the Association of Southeast Asian Nations supporting local manufacturing in all ASEAN countries. The AFTA agreement was signed on in 1992 in Singapore. When the AFTA agreement was originally signed, ASEAN had six members, namely, Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. Vietnam joined in 1995, Laos and Myanmar in 1997 and Cambodia in 1999. AFTA now comprises ten countries of ASEAN. The AFTA generally aims at increasing ASEAN's *trade liberalisation*

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[270] See annex 2 for the synthesis.

[271] This section is based on "About APEC" on the APEC official website: http://www.apec.org/apec/about_apec.html , retrieved on May 1, 2010.

[272] Australia; Brunei Darussalam; Canada; Chile; People's Republic of China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; The Republic of the Philippines; The Russian Federation; Singapore; Chinese Taipei; Thailand; United States of America; Viet Nam. *Id.*

[273] AFTA & FTAs (ASEAN Secretariat) official website: http://www.aseansec.org/4920.htm , retrieved on May 1, 2010.

through the elimination, within ASEAN members, *of tariffs and non-tariff barriers*, *and attracting more FDI* to ASEAN states.[274]

The key instrument for achieving those objectives is the Common Effective Preferential Tariff (CEPT) mechanism establishing a schedule for phased scheme aiming to increase the region's competitiveness.[275]

Notably, the ASEAN Comprehensive Investment Agreement (ACIA) (2009) is one of the most advanced and ambitious regional investment tools to date.[276] It has not yet entered into force, though it was implemented incrementally: first in 1987 with the ASEAN Agreement for the Promotion and Protection of Investments between certain members of ASEAN (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand); then in 1998 with the Framework Agreement on the ASEAN Investment Area. Ultimately, ACIA will actually replace both agreements.[277]

ACIA applies to ASEAN investors and ASEAN-based foreign investors. The agreement has four pillars: *liberalisation, protection, facilitation, and promotion of investments* (ACIA art. 1). Due to its "freshness", ACIA is essentially based best international practices, and it is thus expected to be more comprehensive than its two predecessors, and, more generally, more comprehensive that most international investment agreements. It includes substantive protection provisions (art.11-15) as well as pre-establishment national treatment (art. 5) and MFN provisions with a positive list approach (art. 6).

It also has a more advanced dispute settlement mechanism.[278] In parallel, ASEAN also concluded several free trade agreements which include an investment chapter with a pre-establishment national treatment provision (with Australia and New Zealand, China, India, Japan, South Korea).[279]

In addition, ASEAN FTA, namely one of its subsidiary agreements, the Framework Agreement on Enhancing ASEAN Economic Cooperation[280] (Framework Agreement, Singapore, 1992), includes commitments among members to *enhance cooperation in energy*:[281]

> "B. Cooperation in Industry, Minerals and Energy:
>
> 1. Member States agree to increase investments, industrial linkages and complementarity by adopting new and innovative measures, as well as strengthening existing arrangements in ASEAN.
> 2. Member States shall provide flexibility for new forms of industrial cooperation. ASEAN shall strengthen cooperation in the development of the minerals sector.
> 3. Member States shall enhance cooperation in the field of energy, including energy planning, exchange of information, transfer of technology, research and development, manpower training, conservation and efficiency, and the exploration, production and supply of energy resources."

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[274] *Id.*
[275] *Id.*
[276] ACIA full text is available on: http://www.aseansec.org/documents/FINAL-SIGNED-ACIA.pdf , retrieved on September 9, 2010. See also Wernert, Sophie (OECD) (2010). "Analysis of Regional Investment Frameworks Worldwide". Presentation for the meeting of Working Group 1 MENA-OECD Investment Programme, February 15-16, 2010, Amman, Jordan. See also (ASEAN Secretariat) official website, *supra*, note 273.
[277] ACIA Preamble, *id.*
[278] See Section B of the ACIA.
[279] Wernert (2010), *supra*, note 276.
[280] Framework Agreement on Enhancing ASEAN Economic Cooperation full text is available on: http://www.aseansec.org/12374.htm , retrieved on September 9, 2010.
[281] Herman, Lawrence L. (2009). "Beyond the WTO: Regional and bilateral rules affecting energy and energy investments ", p.2; background paper prepared for the Conference *Global Challenges at the Intersection of Trade, Energy and the Environment*, organised by the CTEI at the IHEID, Geneva, in collaboration with the WTO, October 22-23, 2009.

The Framework Agreement is a soft set of commitments, falling short of hard legal rules. However, they are useful for prescribing standards of regional cooperation in energy that could serve as models in future international examination of energy issues.[282]

Finally, the ASEAN FTA transit provisions apply to trade in goods and to road, rail and air transit, without any special reference to energy goods *per se*.

Regarding the ASEAN-China Free Trade Agreement (ACFTA), in November 2004, at the 10th ASEAN Summit in Vientiane, Lao PDR, the Economic Ministers of ASEAN and China signed the Agreement on Trade in Goods (TIG) of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China .[283] This ACFTA in goods was completed by services and investments. ACFTA, the third biggest free trade area besides the EU and the NAFTA, is an agreement among the ten member states of ASEAN and China. It is predicted that the establishment of the ACFTA will create an economic region with 1.7 billion consumers, a regional GDP of about USD 2 trillion and a total trade volume estimated at USD 1,23 trillion. The removal of trade barriers between ASEAN and China is expected to result in lower costs of production through economies of scale, expanded intra-regional trade and increased economic efficiency. As of January 1, 2010, it has become fully effective in introducing zero tariffs on 6 682 tariff posts in 17 sectors, including 12 in manufacturing and 5 in agriculture, mining and maritime sectors. By signing a FTA with China, ASEAN expects to improve its bargaining position in the international arena. Indeed, as China's economy lacks of natural resources, the demand for ASEAN exports might still increase in the near future. In any respect, ACFTA could be seen as a bulwark against potential hostile behaviour from China towards the Southeast Asian region.

3.1.3. MERCOSUR

Among key RTAs is the Mercado Común del Sur or the Southern Common Market (MERCUSOR), sub regional integration agreement formed by the Treaty of Asuncion in 1991, involving Brazil, Argentina, Uruguay and Paraguay, with Chile and Bolivia holding special associated status. It is now a *customs union* (all members have the same tariffs to the outside world) and is *moving toward becoming a full common market*. In this sense it aspires to regional integration like the EU, rather than a free trade area like NAFTA. [284]

This agreement contains investment-specific provisions, namely in its Colonia Protocol for the Reciprocal Promotion and Protection of Mercosur Investments (1994) [Argentina, Brazil, Paraguay, Uruguay].[285] This protocol contains the definitions of investment and investors, binding obligations in terms of standard of treatment, MFN, transfer of funds, expropriation and compensation, etc., and a mechanism of dispute settlement between investors from a party and a host state from another party under International Centre for Settlement of Investment Disputes (ICSID) or United Nations Commission on International Trade Law (UNCITRAL) rules.

On the other hand, several resolutions of the Grupo Mercado Común and decisions of the Consejo de Mercado Común deal with issues such as pesticides, energy policies and transport of hazardous

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[282] See Herman (2009), *id.;* Wernert (2010), *op.cit.*, note 276.

[283] This section is based on AFTA & FTAs, (ASEAN Secretariat), *op.cit.,* note 273, then follow the hyperlink ASEAN - China Free Trade Area . See also Lim, Ivan and Philipp Kauppert (2010). "Facing a Political Lock-In Situation with the ACFTA. Which options for Indonesia?"*Report of Friedrich Ebert Stiftung Foundation – Indonesia*, March 2010. URL: http://library.fes.de/pdf-files/bueros/indonesien/07101-20100325.pdf , retrieved on September 20, 2010.

[284] International Institute for Sustainable Development (IISD) (2000). *"Mercosur" in Environmental aspects of regional trade agreements*. URL: http://www.iisd.org/trade/handbook/7_3.htm ; Argentour.com : http://www.argentour.com/en/argentina_economy/mercosur.php ; see also MERCOSUR official website (only in Spanish or Portuguese): http://www.mercosur.int/msweb/Portal%20Intermediario/ . Retrieved on September 9, 2010.

[285] Wernert (2010), *op.cit.*, note 276.

products.[286] In addition, meetings of the four countries-members' environment ministers laid down a foundation for cooperation in the sub region on these issues.[287]

However, it does not contain sector-specific rules, namely concerning energy. Nevertheless, since it is now a customs union, both tariffs and non-tariff barriers (NTBs) are reduced within MERCOSUR. Therefore, supposedly MERCUSOR guarantees that energy goods and services flow among the parties without restriction.

3.1.4. EFTA and CARICOM

The European Free Trade Association[288] (EFTA) is a free trade organisation that was established in 1960 by the Stockholm Convention as a trade bloc-alternative for European states who were either unable to, or chose not to, join the then-European Economic Community (EEC) which has now become the EU. The Stockholm Convention was subsequently replaced in 2001 by the Vaduz Convention. The latter provides for the *liberalisation of trade* among the member states. Nowadays EFTA comprises the four remaining European country-members that are outside of the EU; namely Iceland, Norway, Switzerland, and Liechtenstein.

The Caribbean Community[289] (CARICOM), is an organisation of 15 Caribbean nations and dependencies, established by the Treaty of Chaguaramas in 1973 in Chaguaramas, Trinidad and Tobago. It is promoting *equitable economic integration and cooperation* among its members, and coordinating foreign policy. It is operating as a regional single market for many of its members (Caricom Single Market) and handling regional trade disputes.

In 2001, the heads of governments of CARICOM member-states signed a Revised Treaty of Chaguaramas thus clearing the way for the transformation of the idea for a Common Market aspect of CARICOM into instead a Caribbean (CARICOM) Single Market and Economy. Part of the revised treaty among member states includes the establishment and implementation of the Caribbean Court of Justice.

That is, both of these regional instruments are similar to the MERCOSUR in matters relevant for this study. Indeed, first, both the EFTA and the CARICOM are RTAs that follow similar approaches that the MERCOSUR does. Second, both agreements apply tariff preferences and GATT-based MFN non-discrimination rules across the board to all goods, including energy.[290] Third, neither EFTA nor CARICOM address specific sectors or industries. Likewise, there are no specific energy transit provisions in MERCUSOR or EFTA.

3.1.5. EU-Chile FTA

The EU-Chile Free Trade Area (EU-Chile FTA) is a recent (2002) and quite comprehensive agreement.[291] It covers all the areas of EU-Chile trade relations, going well beyond WTO commitments: the agreement eliminates barriers to trade and establishes clear, stable and transparent rules for exporters, importers and investors.[292] It creates a *free trade area* in goods, services and government procurement, liberalises investment and capital flows and strengthens the protection of intellectual property rights.[293]

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[286] IISD (2000), *supra,* note 284.
[287] *Id.*
[288] EFTA official website: http://www.efta.int/ , retrieved on May 1, 2010.
[289] Caribbean Community (CARICOM) secretariat official website: http://www.caricom.org/ , retrieved on May 1, 2010.
[290] EFTA official website; CARICOM secretariat official website; Wernert (2010), *op.cit*., note 276.
[291] EU-Chile FTA, Official Journal of the European Communities, Vol. 45, December 30, 2002 (Doc. No. L352).
[292] European Commission (2008). *Trade - Bilateral relations - Countries : Chile.*
[293] *Id.*

The agreement created an Association Committee and also Special Committees that meet once a year to assess further possibilities for widening bilateral trade and investment. The EU-Chile FTA foresees that both parties will further liberalise trade in agricultural goods and services in the future. Both parties are interested in improving market access for their products and services. Discussions on the protection of Geographical Indications will also be important part of the further deepening of the FTA.[294]

Notably, its art.22 ("Cooperation on energy") aims at *consolidating economic relations* in key sectors such as hydroelectricity, oil and gas, renewable energy, energy-saving technology and rural electrification. In particular, its para.2 (f) says that the assistance for Chilean institutions dealing with energy matters and the formulation of energy policy is one of the key objectives of such cooperation. It appears that this regulation expresses avenues towards the above mentioned export of the EU's energy *acquis communautaire*.[295]

3.1.6. NAFTA

The North American Free Trade Agreement (NAFTA) is a treaty between Canada, Mexico, and the US that was designed to foster greater trade between the three countries. NAFTA and its parallel agreements on the environment and labour issues came into force on January 1, 1994.[296]

Just like MERCOSUR, NAFTA encloses legally enforceable – and far-reaching - rules on the definitions of investment and investors; binding obligations in terms of standard of treatment, MFN, transfer of funds, expropriation and compensation, etc.; and a mechanism of investor-state dispute settlement under ICSID or UNCITRAL rules.

NAFTA Chapter VI ("Energy and Basic Petrochemicals") contains a series of GATT-inspired legal obligations for the treatment of *trade in energy and basic petrochemical goods and cross-border trade in services associated with such goods*. Namely, export restrictions are permitted in accordance with GATT art. XI and XX, but subject to stipulation that guarantees a proportion of supply to importing NAFTA members. In terms of *internal energy regulatory measures*, GATT non-discrimination requirements apply. Energy and basic petrochemicals are defined by reference to the Harmonised System of Tariff Classification (HSTC). While not specifically stated, it is generally admitted that the purpose of NAFTA Chapter VI is to move the three parties *toward a single North American energy market*.[297]

Regarding energy transit, although the NAFTA applies GATT to trade in energy goods, it contains nothing beyond GATT art.V in terms of transit of energy.

3.1.7. EU-South Korea FTA

The Free Trade Agreement between the EU and the Republic of Korea (EU-South Korea FTA[298]) is the first of the new generation of FTAs launched in 2007 as part of the "Global Europe" initiative. These agreements, based on solid economic criteria, are designed to represent a stepping stone for future liberalisation as they are also tackling issues, which are not ready for multilateral discussion and are going beyond the market opening that can be achieved in the WTO context. It has been signed by both parties on October 6, 2010 in Brussels.[299] One of its main distinctive features relevant for this research is that it

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[294] *Id.*
[295] See *supra*, pp.37-38.
[296] NAFTA official website : http://www.nafta-sec-alena.org/en/view.aspx , retrieved on May 2, 2010.
[297] Herman (2009), *op.cit.*, note 281, p.3.
[298] European Commission (2010). *Trade - Bilateral relations - Countries : Korea*. URL: http://trade.ec.europa.eu/doclib/press/index.cfm?id=443&serie=273&langId=en
[299] "EU-SOUTH KOREA FREE TRADE AGREEMENT: A QUICK READING GUIDE OCTOBER 2010", URL: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145203.pdf , retrieved on October 10, 2010.

contains a comprehensive dispute settlement chapter (Chapter 14) which combines features of both investment arbitration and the WTO DSU.[300]

Indeed, the *procedures* laid down by EU-Korea FTA Chapter 14 appear analogous to investment arbitration involving States. There are provisions for the request for arbitration,[301] establishment of an arbitral panel,[302] rules of procedure for arbitration,[303] rules of conduct for arbitrators,[304] etc. On the other hand, concerning *remedies*, the Chapter 14 arbitration rules are taking up the WTO relevant provisions. A non-complying party may offer compensation for a violation, or failing that, be subject to retaliation (countermeasures).[305] Notably, the testablished recognition and enforcement matters of arbitral awards under the "New York" Convention[306] are irrelevant in this context.

3.2. BITs

BITs, sometimes called international investment agreements (IIAs) or foreign investment protection agreements (FIPAs), set up standards of treatment for FDI and, like the ECT and the NAFTA, create frameworks for settling disputes where the host state fails to fulfil its obligations under ICSID or UNCITRAL rules.[307]

Whether designed as FIPAs, IIAs or BITs, these treaties ensure that foreign energy sector investors will not be discriminated with regards to similarly situated domestic investors or other foreign investors; that they will not have their investments expropriated without prompt and adequate compensation; and that they will not be subject to less than a minimum standard of treatment, often referred to as the *fair and equitable treatment,* and *full protection and security* standards. (These are provisions ensuring the foreign investors to be treated under the same conditions that are applied to domestic investors and/or third country investors).[308] Many follow the NAFTA and ECT, although other bilateral models are current, including those based on one developed within the OECD.[309]

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[300] See EU-South Korea FTA, Chapter 14, URL: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145187.pdf , retrieved on October 10, 2010.
[301] Art. 14.4, *id.*
[302] Art. 14.5, *id.*
[303] EU-South Korea FTA, Annex 14-B, URL: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145189.pdf , retrieved on October 10, 2010.
[304] EU-South Korea FTA, Annex 14-C, URL: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145190.pdf , retrieved on October 10, 2010.
[305] Art. 14.11, EU-South Korea FTA, Chapter 14, *op.cit.*, note 300.
[306] See *supra,* note 264.
[307] Herman (2009), *op.cit.*, note 281, p.6.
[308] The concept of "fair and equitable treatment" - and the related notion of "full protection and security" - is a presumptively absolute standard, unlike "national treatment" and "MFN." It is a standard whose content and measurement are to be considered independent of treatment of host state nationals or third-country nationals. It is a legal principle, not *ex aequo et bono*. In a general sense, three different, overlapping approaches may be noted. First, "customary international law" and the concept of a"minimum standard of treatment" of aliens. Second, a broader international law standard, including protections in treaties and general principles including those informed by domestic laws and harmonisation of domestic concepts. Third, an autonomous concept in respective treaties, without any necessary link to customary international law, but based on specific treaty wording, textual context, negotiating history, plain meaning, and indications of party intent. The conceot is largely a post-World War Two development, however it can be traced back to Neer v. Mexico (US-Mexico General Claims Commission, 1926). It later obtained mention in the Havana Charter (1948), various Friendship, Commerce and Navigation Treaties (1950s), the Abs-Shawcross Draft Convention (1959), the OECD Draft Convention (1967), and the Draft UN Code of Conduct on Transnational Corporations (1983). In the OECD Study (1984), the principle was found to be part of international law including all sources, and thus not limited to a minimum standard in customary international law, and to include general principles and treaties and other conventional obligations. In Kreindler, Richard H. (2006). "Fair and Equitable Treatment – A Comparative International Law Approach" *Transnational Dispute Management*, Vol.

As in the case of the multilateral treaties, these terms are sometimes linked to the phrase, "in accordance with customary international law", which implies reference to an objective, external standard. Whatever the formulation, the effect is to guarantee a legally enforceable basis, ensuring that host state treatment will not fall below minimum standards, whether those are grounded in the treaty itself or externally referenced to customary international law.[310]

For example, the US Model Bilateral Investment Treaty (2004) and a number of recently-concluded US FTAs provide that, "[e]ach Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security." [311]

Germany's Model Bilateral Investment Treaty comprises in its part VI requirement of fair and equitable treatment and full protection and security principles, i.e. a host state's obligation to give foreign investments fair and equitable treatment and full protection and security under international law;. It also requires compensation in the event of expropriation and/or nationalisation.[312]

Canada's model FIPA uses similar words that link fair and equitable treatment of an investment to a minimum standard or "floor" level of treatment below which state actions cannot fall. Specifically, "FIPAs seek to ensure that foreign investors will not be treated worse than similarly situated domestic investors or other foreign investors; they will not have their investments expropriated without prompt and adequate compensation; and, in any case, they will not be subject to treatment lower than the minimum standard established in customary international law."[313]

3.3. Multilateral (WTO) Agreements on Energy[314]

On the topic of investment, there are three main areas of work in the WTO on trade and investment. A Working Group established in 1996 conducts analytical work on the relationship between trade and investment. The Agreement on Trade-Related Investment Measures (TRIMS), one of the Multilateral Agreements on Trade in Goods, prohibits trade-related investment measures, such as local content requirements, that are inconsistent with basic provisions of GATT 1994. The GATS addresses foreign investment in services as one of four modes of supply of services. However, TRIMS, which applies to trade in goods, does not protect investment *per se*. Returning to GATS, it covers all measures that affect trade in services, apparently including services related to trade in energy, as well as and energy services.

The following GATS rules could be relevant for issues related to energy investment and transit: the MFN principle (art. II); general rules on monopolies and exclusive services suppliers (art. VIII); obligations of market access and national treatment (art. XVI and XVII) that apply through inscription of specific commitments under the GATS; and domestic regulation (art. VI) relevant for energy services when the supply of services depends on the right of access to infrastructure (e.g., gas pipelines, electricity grids, gas storage facilities, LNG terminals).

3, issue 3, June 2006, pp.1-3. See also Hird, Rachel A. (2009), "Thomas Wälde and Fair and Equitable Treatment", Journal of Energy & Natural Resources Law 27, in Herman (2009), *op.cit.,* note 281, p.11.

[309] For a useful summary of the contents and the terms of BITs, see: UNCTAD, Investment Agreements On-Line, www.unctadxi.org. In Herman (2009), *id.*

[310] *Id.*

[311] OECD (2004), Herman (2009), *ibid.*, p.12.

[312] Malik, Mahnaz (2006). "Time for a Change: Germany's Bilateral Investment Treaty. Programme and Development Policy", in *Dialogue on Globalization*, No. 27/ November 2006, p. 13.

[313] Canada's Foreign Investment Promotion and Protection Agreements (FIPAs): Canada's FIPA Program. URL: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/index.aspx , retrieved on September 9, 2010.

[314] This part is based on Marceau, Gabrielle (2009), "The WTO in the emerging energy governance debate"; Cossy, Mireille (2009), "Energy Transport and Transit in the WTO"; Herman (2009), *op.cit.*, note 281.; all are background papers prepared for the Conference *Global Challenges at the Intersection of Trade, Energy and the Environment*, organised by the CTEI at the IHEID, Geneva, in collaboration with the WTO, October 22-23, 2009.

Third, some government actions regarding energy transit and investment, such as pipeline supply and import or export restrictions, could be justified by far under art.XX(g) of the GATT addressing an exception relating to the conservation of exhaustible natural resources; it is possible that the provision could be used in order to justify a discrimination of foreign investment, if the latter would be shown as a contribution to exhaustion of natural non-renewable resources. In addition, as natural resources are very often under direct or indirect governmental control, the coverage and the reach of the WTO's plurilateral Agreement on Government Procurement**,** which at the moment only applies to a fraction of the WTO members, should be expanded. For the same reasons, the WTO's rules on state-trading enterprises would need to be further developed in line with regulations inserted in recent accession protocols.

The GATT transit provisions for movement of hard goods are contained in GATT art.V, which allows the state of transit to apply reasonable charges and regulations "having regard to the conditions of the traffic", provided that "all charges, regulations and formalities in connection with transit" are applied on an MFN basis. The provisions prevent one WTO member from interfering with freedom of transit of energy goods from another member "via the routes most convenient for international transit". This regulation contains no national treatment requirement, however, and, as worded, means that energy goods in transit can be subject to a range of measures that are more burdensome than those applicable to local goods. Moreover, the MFN obligation concerns only "charges, regulations and formalities in connection with transit" and leaves open the possibility of discriminatory measures respecting *grid and distribution* access.

However, there may be a point where these are fully restrictive and interfere with the right of transit. In the case of environmentally sensitive energy goods, for example, the right of the state of transit to control and regulate environmental concerns could prevail over the primary right of the sending state to freedom of transit. The extent of the right for states of transit remains unclear and it seems that limits on such a right are being determined by each state since the right concerns national security.[315]

4. Concluding Remarks

So far, energy issues remain at the forefront of trade and economic relations between the EU and Russia, and the last "gas war" has been a shock to the EU-Russia energy partnership. However, these events also offered a fresh opportunity to look at EU-Russia energy relations, to explore practical ways to resolve energy supply crises together, and thereby further cooperation. After all, the EU needs a reliable gas supplier and Russia needs reliable gas markets for export.

Remarkably, not only has Europe's dependence on Russian for gas imports been the subject of increasing political concern after the gas conflicts between Russia and Ukraine in 2006 and 2009, but so has the future impact of Russian unreliability on the European gas market. In short, the episodes directly affected the strategy for gas imports for the European Union.

In spite of their shared understanding of what constitutes energy supply security – stable and uninterruptible energy flows at affordable prices – Russia and the EU find themselves in *strategically* different situations. Russia is an energy exporter and the EU is an energy importer. Therefore, the energy well-being of the EU is to a certain extent dependent on Russian energy sources. The other side of the coin is that energy suppliers are basically interested in retaining the markets, while consumers are interested in acceptable prices. In this respect, aside geopolitical and purely security reasoning, from the *economic standpoint of some privete actors*, it could be argued that paradoxically the latest "gas war" brought not only problems, but also some tangible benefits. Namely, in January 2009, the time when the Russia-Ukraine dispute started, gas prices reached their peak. Incidentally, at that moment the disruption of gas supplies was even profitable for some EU gas companies – it allowed them to use the gas accumulated in

[315] See, by analogy, ICJ, *Gabcikovo-Nagymaros (Hungary v. Slovakia)*, award of September 29, 1997. A state may refer to environmental considerations in an indirect way, namely in the context of an emergency or a state of necessity, etc. That is, in the above mentioned case the ICJ had recognised that in some extreme cases environmental protection could indeed be considered as an essential interest of the state.

storage facilities instead of purchasing it at maximum prices. Thus, when the prices dropped, it made both suppliers and consumers to take a calmer look at their own interests. [316]

However, from the *general economic perspective*, due to the recent irregularity of Russia as an EU energy supplier, it could be supposed that Russian contract volumes and prices would decline significantly. To date they already do so to a small extent,[317] and it is not completely unreasonable to suppose that this is – at least partly – a result of Russia's unpredictability as an energy supplier. Therefore, not only Europe but also Russia would suffer if Russia's unreliability worsens. For Europe, buying gas from more reliable suppliers at a price premium turns out to be generally more attractive than building strategic gas storage capacity. However, this second alternative should not be neglected. In an optimum *strategic* scenario for securing and diversifying EU's energy sources, both options should be combined.

Historically, Russia and the EU have always been "natural" partners in energy sector. Russia has been a consistent supplier of energy into Europe for decades, despite periods of internal pressures. Equally, the EU is today the primary market for Russian energy exports. Therefore, it appears that the energy sector could serve as a "test" field for *enforceable bilateral cooperation between the two partners* generally speaking, and/or for implementation of *common sector-specific economic spaces* between them. If this is done, it could create a virtuous circle, when other sectors relevant to EU-Russia mutual interests would be successfully integrated. Moreover, an *advanced* development of an EU-Russia strategic partnership could be in this case one of the most positive side-effects of establishing an EU-Russia enforceable energy regulatory framework.

With regards to EU common energy policy challenges and the diversification of European energy supplies, and keeping in mind the Treaty of Lisbon principle of mutual solidarity between EU members, the following assumption could be advanced. In order to succeed in energy negotiations, the EU member states - which presently retain a high degree of sovereignty over their energy policies - must finally accept some mitigation of their sovereignty. Otherwise, the individual weight of each EU member country will not withstand the gathering Russian energy weight.

The above assertion could be illustrated empirically by the fact that some coercion was necessary to bring the three Scandinavian EU-members to agree to the Nord Stream pipeline, thus reinforcing the assumption that for the moment, there is unfortunately no European solidarity on energy security. A similar observation made of the Nord Stream development, in relation to the South Stream project, is that Russia seems to prefer avoiding gas transit routes through countries with "unfriendly" governments. The Nord Stream pipeline route notably bypasses Ukraine, Belarus, the Baltic States and Poland.

The two pipelines generally considered as Europe's alternative options, namely Nabucco and South Stream, reveal another geopolitical issue, specifically the strategic energy bargaining between the EU and Russia, with Turkey in the middle as an additional complicating factor. In other words, Turkey also actively seeks to secure gas imports for its growing domestic demand. Turkey agreed to join the South Stream project in August 2009[318] – essentially a month after its signature of an agreement on the Nabucco project.

As to the future of EU-Russia trade and economic integration, the "gas wars" have prompted at least one positive development: the EU now seeks a balanced energy dialogue with Russia and lobbies for the renewal of the PCA - this time with a larger scope so as to include energy relations.

However, before a higher level of trust is reached between the two parties, the EU needs to hedge its bets. Hence, from the short- and medium-term perspectives, the EU may have to consider establishing a

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[316] Romanova, Tatiana (2010). "Energy Security Without Panic", July 7, 2010, *Россия в глобальной политике [Russia in Global Affairs*], URL: http://eng.globalaffairs.ru/print/number/Energy_Security_Without_Panic-14900 , retrieved on September 1, 2010.

[317] See Åslund, Anders (2010). "Gazprom in crisis: a chance for reform", April 26, 2010, *European Energy Review*, URL: http://www.europeanenergyreview.eu/index.php?id=1898, retrieved on April 30, 2010.

[318] See South Stream official website: http://south-stream.info/?L=1, retrieved on September 11, 2010.

strategic gas reserve based on the US strategic petroleum reserve (SPR) model, which would amortise gas supply shortages and could even serve as a dissuasive tool against possible future cut-offs. The extent to which the EU should invest in strategic gas storage capacity to mitigate the effects of potential Russian unreliability, as well as some other related economic forecasts, still needs to be finalised, but the evidence is clear that the EU should begin such a strategic store.[319]

Concerning gas prices, the creation of new mechanisms for setting prices between the two partners might be an effective solution. This could reduce financial bubbles and increase market efficiency. The two partners may also increase the number of long-term contracts between suppliers and customers. In this way, reconciliation between European consumers and Russian suppliers could possibly prevent the recovery after global economic crisis from mutating into an energy crisis between them. Finally, the EU and the Russian Federation have to clearly determine the rules of the transit regime by substituting the draft Transit Protocol of the ECT with a specific EU-Russia energy agreement or new multilateral energy regime.

As it was posited, Russia appears to claim that it is an equal partner with its European protagonist in the EU-Russia energy negotiations. However, Russia's demonstrated unreliability as an EU energy supplier, the country's withdrawal from the ECT, and its reluctance to join the WTO, could result in the opposite effect. That is, even if there is not a large risk of Russia becoming marginalised on the European and global energy scene due to its strong position as one of the world's largest energy producers, from a long-term perspective there exists a significant risk that Russia would be marginalised as a *global player*, and in particular with its close neighbour and trade partner – the European Union. Conversely, if it accepts to integrate at least some norms of international law into its energy policies, it would not only cement the foundations for trust which Russia craves, but would also help the country to solve a number of its own internal and external energy-related trade and economic problems. On the other hand, Russia should carefully examine and negotiate such principles of international law to be accepted in its energy policy, in order to bind the country with the norms which would be mutually beneficial for Russia and the EU, as well as for individual citizens of both parties.

The EU has its own legislative problems to address with regards to energy policies. That is, the principle of mutual solidarity enforced by the Lisbon Treaty appears in theory to be comprehensible and strong. However, in practice, and particularly with regards to energy sector, it appears that the EU member states are not ready for the moment to mitigate their sovereignty regarding their energy policies. This is empirically confirmed by different EU country-members' participation in Russian gas pipeline projects, namely Nord Stream and South Stream. In addition, another legislative ambiguity concerns the respective spheres of competence relating to foreign investment of the EU along individual member states, precisely under the ECT.

Therefore, both sides of EU-Russia energy relationship seem to be"worth each other". In particular, with their respective recent investment-related legislation, both the EU and Russia could either divert *a priori* the energy investment inflows, i.e. placing restrictive preconditions to foreign investment, or threaten them after the FDI is made.

In the context of EU-Russia energy dialogues in general, and in particular in light of the recent tensions between two parties, the principle of mutual solidarity casts doubt on the bilateral and multilateral relations between Russia and certain individual member states, such as Germany or Italy. For example, in case of the gas pipeline projects, and the agreements related to them, more attention and even more compliance controls should be addressed to them on behalf of the Europeans. In conclusion, the role and the influence of the Union in EU external relations has increased thanks to the Treaty of Lisbon amendments, amongst others by means of consolidation of the Member States' policies.

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[319] For instance, for a useful and comprehensive economic analysis to what extent Europe should invest in strategic gas reserve capacity to mitigate the effects of potential Russian unreliability, see Morbee, Joris and Stef Proost (2010). "Russian Gas Imports in Europe: How Does Gazprom Reliability Change the Game? ", *The Energy Journal*, Vol. 31, No. 4 of October, 2010 (pp. 79-110).

Regarding the *Energy Dialogue* as a legal basis of the EU-Russia energy relations, by establishing the Dialogue, the partners advanced five major topics of common interest. Those topics included ensuring the security of energy supplies of the European continent; the development potential of the Russian economy, in particular Russia's energy resources; the opportunities of the pan-European market; the challenge of climate change; and the conditions framing the use of nuclear energy. In keeping in mind the major ECT elements, it appears that the Energy Dialogue is taking up the ECT basic principles, and even appears to represent a kind of replacement for the Treaty, which is especially pertinent after Russia's termination of the provisional application of the ECT.

As for the PCA, the EU has repeatedly expressed concerns over the obstacles for the natural gas transit from Middle Asia through the *Russian Unified System of Gas Supply* to the European market.[320] Although these concerns have never resulted in a formal dispute resolution under the rules of international law, the modelling of such a situation prepared in part 2.9.2.of this chapter allows us to make several conclusions. That is, on the one hand, the exception of the PCA art.19, taking up GATT art. XX (g), namely related to the protection of natural resources, may hand out a valid legal basis if Russia is sued under the international law for restrictions on the freedom of transit. In this paradigm, PCA Title III laying down the bilateral trade rules does not fully assure an uninterruptable energy supply to the EU. On the other hand, as it was illustrated above by the analysis of relevant WTO jurisprudence, in order to invoke this natural resource-based exception, Russia needs to demonstrate first its commitment to one or more international instruments dealing with the security and freedom of energy transit.

In terms of international law, the existing mechanisms, such as the Energy Dialogue and PCA, are supposed to create the *legal basis* for EU-Russia energy relations. However, each of them has significant flaws with regards to the objectives of EU energy security policies. Therefore, both of them could provide a *conventional and/or consultative framework* for energy cooperation between the two partners, but none of them could represent a solid legal source for regulation of EU *security* and *diversification* of energy supplies in its relations with Russia.

The ECT appears to be the best option for becoming such a legal framework. Yet, most of the Treaty's provisions - except for investment protection and dispute settlement - do not apply any longer to Russia's energy relations with other ECT parties. *The King is dead* (almost). *Long live the King.* That is, instead of deploring Russia's withdrawal from the ECT, it would be more pragmatic for both partners to envisage and assess near-term opportunities and further prospects for a legal framework of EU-Russia energy cooperation. From the remaining alternatives, the fourth discussed in this chapter option, namely application of the GATT/WTO rules on trade in energy goods and services, seems to present an effective - and feasible - way to create a mutually-beneficial legal framework for EU-Russia energy cooperation. Indeed, it would be based on a multilateral legal foundation which has already been in force for 15 years. Thus, eventually the GATT/WTO option for running EU-Russia energy relations seems the most realistic – if not for today, since Russia still does not adhere to the WTO, then at least for the near-future. However, since the Russian Federation is still not a member of the WTO, until it becomes such, at least one substitutive *upcoming* option should be envisaged.

[320] See Belkin, Paul (2008), "The European Union's Energy Security Challenges", CRS Report for US Congress, Foreign Affairs, Defense, and Trade Division; Seliverstov (2009), *op.cit.* note 177; Locatelli, Catherine (2010), "Europe's gas supplies: diversification with Caspian gas and the "Russian risk" ", *Europe Asia studies*, 62, Vol. 6, 2010 (pp.959-971).

CHAPTER II. LEGAL ANALYSIS OF RELEVANT ENERGY INVESTMENT AND TRANSIT ISSUES UNDER THE ECT LAW

The King is dead. Long live the King.
Traditional proclamation

1. ECT Investment and Transit Regimes: Setting the Scene

At present, energy investment and energy transit through the Russian Federation are not governed by any multilateral agreement; however, until recently it was *formally* governed by the provisions of the ECT. At that time, Russia signed but has so far failed to ratify the ECT. Nevertheless, it has accepted provisional application of the Treaty pending ratification.

The ECT is a distinctive multilateral treaty dedicated to the energy sector. The Treaty covers a number of energy-related matters, namely investment, trade, transit, energy efficiency and related environmental aspects, and dispute settlement mechanisms. However, for purposes of this paper, only a limited number of the Treaty's provisions will be addressed, namely the rules concerning the dispute settlement in the context of recent disagreements between the European private investors, or the EU as a contracting party, on the one hand, and the Russian Federation, on the other hand.

Taking into account that the energy sector is the most capital intensive and unsafe business segment, the ECT is both a unique and very ambitious multilateral treaty. By the latest statistics, over 20 claims were brought to international arbitration[321] under the ECT, four of which either settled or were offered an award.[322]

Some specialists claim that the ECT, together with NAFTA, is one of the most important multilateral treaties providing for the promotion and protection of investments (especially since the decision on jurisdiction of *Plama v Bulgaria* case,[323] which was the first decision rendered in favour of the investor on the basis of the ECT).[324] Other authors present the ECT as an outdated multilateral instrument, especially regarding its transit dispute resolution mechanism.[325] The truth probably lies somewhere in between. This chapter will analyse the advantages of the ECT's transit and investment regimes as well as highlight their potential weaknesses in the context of EU-Russia energy relations.

On investments, the ECT is novel in setting out sector-specific obligations on the part of host states respecting investments related to "Energy Materials and Products." The ECT investor-state provisions are essentially based on the NAFTA Chapter XI. In this way, the relevant part of ECT art. 10 states that (emphasis added):

> "(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, *encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area.* Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties *fair and equitable treatment*. Such Investments shall also enjoy the most constant protection and security and no Contracting

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[321] Arbitration is "a method of dispute resolution involving one or more neutral third parties who are usually agreed to by the disputing parties and whose decision is binding." *Black's Law Dictionary*, p.112, 8th edition, 2004.
[322] UNCTAD (2009), *infra*, note 359, p.34. See also *Energy Charter: Investor-State Disputes*, URL: http://www.encharter.org/index.php?id=213&L=1%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2F%2Findex.php%3Fid%3D7 , retrieved on May 25, 2010.
[323] ICSID, *Plama Consortium Limited v the Republic of Bulgaria*, Case No. ARB/03/24 [C.F. Salans, President, A. J. van den Berg, V.V. Veeder] (Decision on Jurisdiction rendered on February 7, 2005; Award rendered on August 27, 2008).
[324] Gaillard, Emmanuel (2005). "Energy Charter Treaty: International Centre for Settlement Decision", *New York Law Journal*, April 7, 2005, Vol. 233 - NO. 66. See also Wälde and Andrews-Speed (1996), *loc.cit.* note 368.
[325] Belyi (2009), *op.cit.*, note 210.

> Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. *In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations*. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."[326]

ECT art.26 creates investor-state dispute settlement provisions, also modelled on the NAFTA Chapter XI, as follows:

> " (…)
> (2) If such disputes cannot be settled (...) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:
> (...)
> (c) in accordance with the following paragraphs of this Article.
> (...)
> (4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to:
> (a) (i) The International Centre for Settlement of Investment Disputes, (...) if the Contracting Party of the Investor and the Contracting Party party to the dispute are both parties to the ICSID Convention; or
> (ii) The International Centre for Settlement of Investment Disputes, established pursuant to the Convention referred to in subparagraph (a)(i), under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre (hereinafter referred to as the "Additional Facility Rules"), if the Contracting Party of the Investor or the Contracting Party party to the dispute, but not both, is a party to the ICSID Convention;
> (b) a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter referred to as "UNCITRAL"); or
> (c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce."[327]

As for the transit regime, securing more vigorous transit norms than GATT art.V was one of the main objectives of the ECT, a factor of paramount importance given the geographic situation of many Western and Central European States in relation to energy supplier countries.[328] ECT art.7 para.1 requires that each contracting party "shall take the necessary measures to facilitate the Transit of Energy Materials and Products".

ECT art.7 para.2 provides that in respect of the use of "Energy Transport Facilities", each Party shall treat energy materials and products in transit "in no less favourable a manner than its provisions treat such materials and products originating in or destined for its own Area, unless an existing international agreement provides otherwise." The ECT thus creates *positive obligations* on ECT members to authorise and facilitate energy transit, including what has been described as a "soft" obligation to favour the construction of new facilities, to abstain from unwarranted closure of transit facilities (e.g., for political reasons) and to make sure state and private transit operators do not undermine that obligation.[329]

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[326] Art. 10 para.1, ECT, *op.cit*., note 50.
[327] Art.26, ECT, *id.*
[328] Wälde and Konoplyanik (2006), *op.cit*., note 232, p. 543. In Herman (2009), *op.cit*., note 281, p.4.
[329] Konoplyanik and Wälde (2006), *id.* As discussed by the authors, ECT members are aiming to enhance the treaties transit provisions through the conclusion of a Transit Protocol in order to put in place "a regime of commonly accepted operations principles covering transit flows of energy resources, both hydrocarbons and electricity, crossing at least two national boundaries, designed to ensure the security and non-interruption of transit". *Ibid.*, p.544. In Herman (2009), *id.*

Last but not least, regarding dispute settlement, ECT investor who alleges that a host government has breached its investment obligations under ECT Part III may, at its option, have recourse to one of the following arbitral mechanisms: the ICSID; ICSID's Additional Facility Rules; a sole arbitrator or *ad hoc* arbitration tribunal established under the UNCITRAL Rules; and an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce (SCC). In this respect, it is worth mentioning that arbitral tribunals of international commercial and investment arbitration alike, whether institutional or *ad hoc,* are always assembled for resolving a *particular* and *concrete* dispute.. Indeed, they are all assembled in order to resolve a distinctive conflict, and they consist of world experts in a particular field concerned in each separate dispute.[330] They also use all *ad hoc* techniques (e.g., parties' voluntary obligations, intentions, motivations, etc.). Following the previous two statements, it could be supposed that international arbitral tribunals, under ECT including, should more consider legal matters relevant for *each distinctive case*, and less follow prior, i.e. other arbitral tribunals', decisions.[331]

The general objective of the analysis that follows is to examine ECT's investment and transit dispute resolution mechanisms through an assessment of some recent disagreements between the European private investors as well as the EU as a contracting party, and the Russian Federation. First, an overview of respective inward and outward FDI of both parties and related policy particularities will be briefly introduced. Next, the part on investment, in addition to describing the general mechanism for access to investment dispute settlement under the ECT, will address two controversial jurisdictional matters under the Treaty. The first issue concerns the ECT's application to matters affecting investments prior to ratifying the Treaty by a contracting party. The second one concerns a member state's right to deny the benefits of Part III of the ECT to a legal entity or an investment. In addition to the investment dispute settlement mechanism, the ECT proposes a more specific mechanism of transit dispute resolution between contracting parties; this envisages the application of a panel system along the lines of WTO DSU procedures. Thus, the transit section of this study will address the freedom of transit principle as well as the transit dispute settlement mechanism.

2. Respective FDI of the EU and Russia and Their Policy Context

Regarding the EU, at the outset it is worth mentioning that unlike the common (i.e. EU's "foreign") trade policy that falls within the competence of the Union, the FDI policy was traditionally a shared competence between the EU and its member states.[332] Accordingly, both the EU and member states are parties to bilateral and international investment treaties, although their respective influences of decision on FDI differ according to diverse stages. Namely, member states charge the European Commission to negotiate the conditions of market access and liberalisation at the *pre-investment phase* (the latter ensures the respect of the fair and equitable treatment principle[333] by the host states vis-à-vis foreign investments), while they themselves negotiate commitments with respect to the treatment of foreign investors *after* their penetration into the host country, mainly through BIT provisions.

But with Lisbon Treaty things change. One of the most notable impacts of new EU legislation on foreign trade policy lies in its provisions relating to FDI. That is, TFUE art.207 extends the EU common trade policy to FDI, which would from now fall within the Union's competence. Thus, it is expected that

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[330] In Roman Civil law the *jus gentium* (opposite to the *jus civile*) was a flexible and loosely-defined body of law based on international norms. Thus, the officers of those special tribunals applying *jus gentium* to diverse multistate cases, had been essentially creating new substantive law for each case.

[331] It is recognised, and is confirmed by the most notorious specialists in the field, that the "doctrine of the precedent" (*stare decisis*) does not govern international arbitration, as it was valued by the author from the conference given by Gilbert Guillaume (former President of the ICJ) "Le Précédent dans la Justice et l'Arbitrage International [the Precedent in Justice and International Arbitration]", at the IHEID, Geneva, in collaboration with Lalive Lawyers Geneva, June 2, 2010.

[332] See Priollaud and Siritzky (2008), *op.cit.*, note 111, p.304 and s.

[333] See *supra,* note 308.

member states may well lose much of their traditional legal authority to negotiate and/or conclude their own BITs.[334]

Concerning the general situation of FDI in the EU 27, two main and interconnected issues are important. They are *the EU enlargement process* and new European legislation introduced by the *Lisbon Treaty*.

In 2004 the ten new members, as well as more recently the two "latecomers" of 2007, have committed themselves to adopting the totality of EU law, i.e. *acquis communautaire*. Reception of *acquis* implies, on the one hand, an enhancement of the business environment and the attractiveness of accession countries,[335] which logically attracts greater *inward* FDI to those countries. On the other hand, its application (e.g., concerning environmental protection or labour standards) generally augment the cost of doing business in new EU member states.[336] Therefore, the ambiguous impact of the *acquis* on business in general, and on FDI in particular, is the result of a philosophical compromise between a more liberal and a more *dirigiste* interpretation of what a common market means.[337]

With regards the novelties of the Lisbon Treaty, new TUE art. 32 (former TUE art.16), reinforces the obligation of the member states to consult among them (namely, by a compulsory consultation of their partners) before undertaking any action on international scene,[338] and binds them to show mutual solidarity.[339] In practice, recent investor-state jurisprudence confirms some of the doubts and outlines concrete challenges presented to the EU as a party to bilateral and international investment treaties alongside some of its member states, and in its transactions with other state parties. These challenges give rise to avenues in which newly-acceded EU member states, in defence of investor-state claims, are starting to invoke: first of all, a BIT dispute settlement mechanism violates the above mentioned principle of mutual solidarity between member states.[340] Moreover, recent ECJ rulings of 2009, [341] state that BITs pre-dating the accession of the concerned countries to the EU, which contain unrestricted freedom of transfer of capital and profits for investments clauses, could be in a "hypothetical conflict" with the EU law. Indeed, TFEU arts. 64, 66, and 75 give the Council powers to impose exchange controls for certain limited or temporary purposes. However, if the Council were to do so, the unlimited freedom of transfer clauses in the relevant BITs would make it difficult or impossible for concerned members to comply with their obligation to cooperate with the Council. In order to avoid these, ECJ recent rulings suggest renegotiating the relevant BITs or to denounce them.

As to the European *outward* FDI to Russia (accordingly, Russia's *inward* FDI), in particular energy direct investments, at least 75 percent of that FDI comes into Russia from the EU member states.[342] For the next few years, Russia is ranked among the five top FDI destinations in 2010-2012 (after China, India, Brazil and the US), while of four top FDI sources, three are EU member states; namely, France, Germany, and the United Kingdom (UK).[343]

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[334] For a comprehensive analysis, see Vis-Dunbar, Damon (ICTSD)(2009). "Le Traité de Lisbonne : conséquences pour les Accords internationaux d'investissement de l'Europe [The Lisbon Treaty: Implications for International Investment Agreements in Europe]", *ICTSD, Eclairage*, Vol.8, No.9, November 2009. URL : http://ictsd.org/i/news/eclairage/60762/ , retrieved on September 20, 2010.

[335] United Nations Economic Commission for Europe (UNECE) (2001). "Economic growth and foreign direct investment in the transition economies." *Economic Survey of Europe* 2001 No. 1. New York and Geneva: United Nations, United Nations publication, Sales No. E.01.II.E.14, 185-226, in Kalotay (2006), *op.cit*., note 24, p. 492.

[336] Kalotay (2006), *id.*

[337] Tupy, Marian L. (2003). "EU enlargement: costs, benefits, and strategies for Central and Eastern European countries." Policy Analysis No. 489. *Washington, DC: Cato Institute*. http://www.cato.org/pubs/pas/pa489.pdf . In Kalotay (2006), id.

[338] Priollaud and Siritzky (2008), *op.cit*., note 111, p.116.

[339] See *supra,* pp.37-39.

[340] See ECJ, *Eastern Sugar*, *op.cit*., note 253.

[341] ECJ, *Commission v Republic of Austria*; ECJ, *Commission v Kingdom of Sweden*; ECJ, *Commission v Republic of Finland. Op.cit*, notes 247-248.

[342] 2008 statistics. Source: European Commission. *Trade - Bilateral relations - Countries : Russia.*

[343] UNCTAD (2010). *World Investment Report 2010*. Figure I.21., p.25.

To summarise, for EU FDI in the context of the Lisbon Treaty and recent ECJ case law, it appears that *acquis* reception through EU membership resembles a man who gives with his right hand, and then takes part of it back with his left. For instance, investment protection and promotion were always governed by the member states competence. However, with the Treaty of Lisbon modifications, and with the expansive definition of FDI, there exists a real possibility that the Union's authority would be extended on this matter. A decision on jurisdiction and admissibility had been taken already within the ICSID with relation to the inconsistency between BIT protection and EU law.[344]

With respect to the *inward* FDI, the EU imports vast quantities of energy from third states and is also an important importer of capital investment. In this regard, numerous investment protection treaties exist, both between EU member states *inter se* and between EU member states and third states. However, conflicts might take place in the future between new EU legislation and existing and future BITs with third countries. If conflicts arise, they could be resolved through international investment arbitration. When it concerns energy FDI, these could be settled under the ECT investor-state dispute settlement, if the both claimant's and defendant's countries are parties to the Treaty. Unfortunately, Russian investors for instance are not shielded anymore by the ECT investment protection.

Regarding Russia, recent rapid economic growth at home, high commodity prices, and FDI liberalisation in host countries have been feeding a boom in *outward* FDI from Russia. Data from this year (based on 2009 estimates) shows that Russia has the second largest stock of direct investments abroad among the emerging economies (USD 248.9 billion), behind only the special case of Hong Kong (China) (USD 834.1 billion).[345]

Between 1995 and 2007, Russia's *outward* FDI stock was growing more rapidly than the outward FDI stock of the other emerging economies, such as Brazil, China and India.[346] However, as a result of the global financial crisis, a sharp downward revaluation of Russian assets held abroad reduced Russia's lead vis-à-vis other large emerging economies by the end of 2008.[347]

Nevertheless, before the crisis, and especially in the preceding three years (2005-2008), Russian FDI expansion via "Mergers & Acquisitions" (M&A) increased by more than ten times compared with the period from 2001-2004. That is, Russian FDI increased from USD 5.5 billion to USD 56.8 billion. Most of these cross-border purchases were in the primary sector, which accounted for 59 percent of M&As in January 1997–June 2008.[348] Notably, regarding the geographical distribution of acquisitions abroad, the data shows that Russian firms have generally targeted developed country firms, especially in Europe and North America.[349]

The data set on cross-border M&As also allows one to measure the size of *round-tripping transactions* in outward FDI, under which foreign affiliates of Russian firms, typically established in offshore financial centres such as Cyprus, the Netherlands and the British Virgin Islands,[350] invest back to the Russian Federation. Such deals amounted to almost USD 7 billion over January 1997-June 2008, accounting for ten percent of the total FDI.[351] Some 50 to 60 Multinational enterprises (MNEs) account for a large part of Russian assets abroad, with outward FDI among this group dominated by such giants as Evraz, Gazprom, Lukoil, Norilsk Nickel, Rusal, Severstal, etc. The majority of Russian MNEs operate in four

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[344] ICSID, *Micula and others v Romania*, *op.cit*, note 254.
[345] UNCTAD (2010), *op.cit.* note 343, Annex table 2.
[346] See Box figure I.2.1., *ibid.*, p. 7.
[347] UNCTAD, Cross-border Merger & Acquisition database, available at: http://stats.unctad.org/fdi/. In Panibratov, Andrei and Kalman Kalotay (2009). "Russian outward FDI and its policy context", *Columbia FDI Profiles*, Country profiles of inward and outward foreign direct investment issued by the Vale Columbia Center on Sustainable International Investment, No. 1, October 13, 2009.
[348] *Id.*
[349] *Id.*
[350] Russian Federal State Statistics Service (Rosstat) data, available at : www.gks.ru/bgd/free/b04_03/IssWWW.exe/Stg/d02/91inv21.htm . In Panibratov and Kalotay (2009), *id.*
[351] UNCTAD, cross-border M&A database, *op.cit.*, note 347. In Panibratov and Kalotay (2009), *id.*

major industries: oil and gas, metallurgy, finance, and telecommunications. Despite the concentration of outward FDI among a limited number of large MNEs, the total number of Russian firms investing abroad probably exceeds 1,000.[352] Notably, the ten largest announced M&A transactions in January 2005-December 2008 mainly involved Russian resource-based firms (e.g., Norilsk Nickel, Evraz Group, Gazprom, Lukoil).[353]

A large number of those Russian MNEs are motivated by *strategic considerations* rather than by short-term profitability, reflecting the role of state-owned enterprises in the outward FDI. Notably, many of the MNEs headquartered in Russia have become truly global players, as they possess global brand names, management skills and competitive business models, among other traits. –Ranked by foreign assets, Lukoil and Gazprom particularly exhibit these traits.[354]

As it was mentioned in the first chapter of this study,[355] the Russian state has played – and continues to play an important role in the emergence of Russian outward FDI. Indeed, Russian state enterprises are granted a set of advantages on behalf of the Russian state (financial capabilities, access to loans from the central bank, administrative support, etc.) that facilitate the enterprises' internationalisation.[356] In particular, when it comes to companies in the energy sector, the law makes Russian majority ownership mandatory, regardless if this ownership is by the Russian state or by private Russian nationals.[357]

In sum, Russia's outward FDI, regardless of its various bottlenecks, continues to penetrate foreign markets.[358] In particular, Russian *energy* companies are keen to gain access to *downstream assets in European states*, i.e. they aim to sell their goods and provide services to the European final consumers.

Regarding *inward* FDI, inflows to the Russian economy increased again in 2008.[359] However, growing inward FDI implies growing uncertainty with respect to some contractual obligations vis-à-vis investments made in Russia.

Namely, with the most recent amendments of Russian investment-related legislation,[360] the situation is unclear as to arbitration clauses, and enforcement of arbitration awards abroad. It could be argued that this new legislation introduces a requirement that relevant investor-state disputes may not be heard by way of institutional or *ad hoc* arbitration outside Russian boundaries.

Meanwhile, the bulk of FDI in the country continues to be in natural resource-related projects, such as extraction and oil and gas refining. Over time, the ECT increasingly protects such FDI in Russia. Again, if Russia ratified the Treaty, Russian investments abroad would be shielded in the same manner. On the other hand, statistically, a closer look at FDI in the Russian Federation reveals that a substantial proportion of inflows merely reflect the return of offshore capital held by Russian residents in Europe.[361]

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[352] Panibratov and Kalotay (2009), *ibid*., p.2
[353] UNCTAD, cross-border M&A database, Panibratov and Kalotay (2009), *id.*
[354] UNCTAD (2010), *op.cit*., note 343, Box I.2., p. 7.
[355] See *supra*, pp.26-29.
[356] Panibratov and Kalotay (2009), *op.cit*., note 347.
[357] It is mainly governed by the Federal Laws N 57-FZ and N 58-FZ of April 29, see *supra*, p.46.
[358] Russian MNEs, continued to look for strategic assets in developed countries, mainly in downstream energy activities in the oil sector. UNCTAD (2010), *op.cit*., note 343, p. 51.
[359] UNCTAD (2009). *World Investment Report 2009*, Figure II.22.
[360] The wording of Federal Law N108-FZ amending as of July 2, 2008 the Federal Law N115-FZ (2005), the latter being broadly used in the energy sector, appears to subject disputes between a grantor (the state) and a concessionaire to be resolved through to a Russian seat. See *supra*, p47.
[361] For example, nearly half of inward FDI in 2008 was invested in oil production and exploration, according to statistics reported by the central bank, though no new major acquisitions or large investments by foreign firms in the Russian oil industry were reported to have taken place. Since a large share of inflows in 2008 originated in the Netherlands, it is likely that it was mainly Gazprom's financial services affiliate in that country which was channeling money back into the Russian energy industry. In addition, special purpose entities in Cyprus and the British Virgin Islands also appear to have been involved in such investments. UNCTAD (2009), *op.cit*., note 359,., p. 74 (Box II.5.1.). See also Rosstat (2009), *op.cit*., note 350.

Thus, since a considerable amount of natural-resource-based FDI is financed from round-tripping Russian capital, and following the recent *Yukos* rulings regarding the denial of benefits,[362] there may be a chance that in the next 20 years a fraction of claims under the ECT will be brought by Russian residents, who have incorporated their companies in the EU member states, against Russian government.

3. ECT Investment Regime

The most famous energy investment arbitration in history – *Yukos v Russia* case[363] - was until recently pending against Russia in The Hague. In a landmark decision rendered on November 30, 2009, an arbitral tribunal constituted pursuant to the ECT and the UNCITRAL Arbitration Rules, and sitting in The Hague under the auspices of the Permanent Court of Arbitration,[364] ruled that the Russian Federation is bound by the ECT notwithstanding that it was never ratified by the Duma,[365] by virtue of its provisional application of the Treaty.[366] At stake in this dispute are not only three claims esteemed in total at approximately USD100 billion, but also the future effectiveness of *provisional application* as well as the *"denial of benefits" clauses* in the ECT, and other multilateral treaties.

This part starts by introducing the main elements of the ECT investment regime (3.1.) and its major dynamics (3.2.). Then, it continues with an analysis of the ECT investment dispute settlement system in the context of the *Yukos Arbitration,*[367] focusing on obligations that could be imposed on a ECT contracting party by the Treaty's provisional application (3.3.) and the "denial of benefits" (3.4.) clauses, while comparing both those ECT provisions and the referred ruling with other relevant international treaties' provisions and case law.

3.1. Main Elements

The main elements of the Treaty for the promotion and protection of petroleum investments are the following: definitions and basic principles; the investment regime; the treatment and protection of investment; and related measures.[368]

Like any investment treaty, the ECT aims to promote and protect foreign investment. ECT art.1 para.6 defines what *investment* is under the Treaty:

> "(6) "Investment" means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
> (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
> (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other

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[362] See *infra*, pp.79-82.

[363] Majority shareholders of Yukos Oil Company brought three parallel claims under the ECT against the Russian Federation. The shareholders asserted that the Russian Federation wrongfully expropriated Yukos's main production unit, Yuganskneftegas, to offset a significant and phony back tax bill. The Russian Federation, however, argued that it is not bound by the ECT because it had not yet ratified it, but rather applied it provisionally. Gaillard, Emmanuel, Banifatemi, Yas, and Philippe Pinsolle (2010). "Yukos - Landmark Decision on the Energy Charter Treaty ", January 5, 2010, *Shearman & Sterling LLP : Publications*. URL: http://www.shearman.com/Yukos---Landmark-Decision-on-the-Energy-Charter-Treaty-01-05-2010/ , retrieved on April 25, 2010.

[364] The Arbitral Tribunal is composed of L. Yves Fortier, CC, QC (President), Judge Stephen M. Schwebel and Dr. Charles Poncet. The decision referred to here is the Interim Award rendered on November 30, 2009 in each of the three arbitrations initiated by the majority shareholders of former Yukos Oil Company against the Russian Federation: *Hulley Enterprises Limited v The Russian Federation* (PCA Case No. AA 226), *Yukos Universal Limited v The Russian Federation* (PCA Case No. AA 227), *Veteran Petroleum Limited v The Russian Federation* (PCA Case No. AA 228).

[365] The lower chamber of the Parliament in Russia.

[366] *Yukos Arbitration*, *supra*, note 364.

[367] *Id.*

[368] For more details see Thomas W. Wälde and Philip Andrews-Speed (1996). "Will the Energy Charter Treaty help international investors?", *Transnational Corporations* , Vol.5 (3) 1996, pp. 31-59.

debt of a company or business enterprise;
(c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
(d) Intellectual Property;
(e) Returns;
(f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.
A change in the form in which assets are invested does not affect their character as investments and the term "Investment" includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the "Effective Date") provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.
"Investment" refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as "Charter efficiency projects" and so notified to the Secretariat."[369]

An important point of the ECT art.1 is that it expressly extends *protection* to the *investors* (ECT art.1 para.7).

ECT art.2 confirms that the Treaty aims to create "a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits". The substantive provisions of the ECT are all found in Part III (arts. 10-17), and more precisely in arts.10 and 13.

In its relevant provisions, ECT art.10 requires *fair and equitable treatment* (para.1, first sentence); forbids *unreasonable and/or discriminatory treatment*, and binds *most constant protection and security* (para.1, second sentence); and introduces *the minimum standard clause* (para.1, third sentence); includes the *umbrella clause (i.e.* "Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment", para.1, last sentence), requires national treatment (para.7), and MFN treatment (para.8).

Hence, while the regime for the *making of investments* is probably one of the least satisfactory components of the ECT,[370] the provisions for the *treatment and protection of investments* are considerably more robust. Along with a requirement for fair and equitable treatment according to international law, the Treaty binds the contracting parties to respect all obligations agreed to with an investor from another contracting state. Expropriation by the state, when in the public interest, is not prohibited, although the *Hull formula* of prompt, adequate, and effective compensation is invoked (ECT arts.12 and 13).[371] [372]

Finally, ECT arts.26 and 27 lay down respectively the Treaty's investor-state and state-state dispute resolution mechanisms. Notably, under art.26 the investor may choose which of the available arbitration procedures to pursue, *with* or *without* the agreement of the host state. This article applies only to failures to

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[369] Art. 1 para.6, ECT, *op.cit.,* note 50.
[370] Mainly because it is hedged with numerous words such as "endeavour" and "encourage."Despite this weakness, the thrust of the Treaty is to provide a non-discriminatory regime for investment in petroleum, either national or most-favored nation treatment, whichever is most favorable. Notably, disputes arising under this "pre-investment" phase may be submitted for arbitration by the signatory states, but not by the individuals or companies concerned. Andrews-Speed (1999), *op.cit*., note 215, p.121.
[371] *Id.*
[372] ECT art. 13 para.1 contains clause on expropriation and provides that:
"Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation except where such Expropriation is:
a) For a purpose which is in the public interest;
b) Not discriminatory;
c) Carried out under due process of law; and
d) Accompanied by payment of prompt, adequate and effective compensation." Art. 13 para.1, ECT, *op.cit*., note 50.

fulfil obligations on the part of a *host contracting state*. In other words, it does not apply to *foreign investors* that fail to honour their obligations.[373]

The question, whether there exist other investment-related issues, not covered by ECT Part III, and what the actual investment to be protected under the ECT is, will be addressed later in this document, namely in part 4.5. The next paragraphs look at the major dynamics of the ECT investment regime.

3.2. Major Dynamics

This part evaluates investment under the ECT by addressing three issues: (1) the extent of common interest or convergence of interests among the signatory states which may allow the objectives of the Treaty (in relation to petroleum investment) to be achieved; (2) players which are most likely to appear either disinterested or obstructive; and (3) issues that are likely to prove the most controversial. It is based on an old but still comprehensive synthesis from the author's standpoint of the major dynamics within the ECT concerned parties regarding petroleum investments (Box 2).[374] This box deliberately concentrates only on those issues directly relating to petroleum investment, specifically the import and export of petroleum, the import and export of capital and technology, and the requirement for transit.[375]

Box 2: Major Investment Dynamics under the ECT

Signatory States
Interestingly, Andrews-Speed clustered ECT signatories into groups with broadly similar interests with respect to petroleum investment and investment-related issues.

That is, Russia and the Southern republics of the former Soviet Union are net exporters of petroleum and importers of capital and technology. Northwest Europe, specifically the United Kingdom, Norway, and the Netherlands, are net exporters of petroleum, technology, and capital. Japan and the rest of Western Europe import petroleum but export capital and technology, while Central and Eastern Europe import all three.

Thus, in the context of the Treaty, there appears to be a relationship of *interdependency* between Russia and the Southern republics of the former Soviet Union on one hand, and between Japan and Western Europe on the other. In other words, though heavily dependent on US capital and technology in the past, Northwest Europe may now be considered a net exporter of petroleum, capital, and technology, though clearly it still needs markets. Central and Eastern Europe would seem to be in the unenviable position of total dependency. This picture is incomplete because the issue of transit has not been taken into account.

If one considers the above mentioned relationship, including the transit issue, it would imply two questions. *Primo*, does the group of states form a transit route for one or more other signatory states? And, *secundo*, does the group require transit across other signatory states, for either exports or imports? Firstly, Russia, Central and Eastern Europe (CEE), and parts of Western Europe appear to be both transit states and relying on other signatory states for transit. Russia provides northerly export routes to Europe for certain Southern republics of the former Soviet Union exporters, and yet relies on CEE states for transit to Western Europe. The CEE states themselves and some Western European states lie on transit routes from Russia to Western Europe, and in turn rely on these transit routes for petroleum imports. The far Western states of Western Europe, which lie at the end of the pipeline network from Russia, rely on transit but do not provide it. Northwest Europe and Japan neither rely on nor provide transit. The Southern republics of the former USSR states fall into two categories. Those with little or no petroleum resources, such as Armenia and Georgia, are vital transit countries and yet can purchase their petroleum

[373] In such cases, the host state must rely on either national law or on the terms of the investment agreement. Andrews-Speed (1999), *op.cit*., note 215.
[374] This box is constituted on Andrews-Speed (1999), *id*., pp.122-133.
[375] *Id.*

imports either from neighbouring signatory states or from outside the Treaty regime. The central Asian states of significance in this context are the major potential exporters: Kazakhstan, Azerbaijan, Uzbekistan, and Turkmenistan.

On the basis of these considerations, a number of generalisations may be made concerning dependency and convergent interests. Those states that would appear to have *the most to gain from an effective Treaty regime* are Russia, Central and Eastern Europe, and much of Western Europe. An effective regional market for petroleum underpinned by a functional transit network is vital to satisfy their requirements for security of energy supply. This is of particular importance for natural gas. In addition, the transit fees form an important source of income for Central and Eastern European states. At the other extreme, the petroleum exporters of Northwest Europe would appear to have nothing tangible in the petroleum sector to gain from the Treaty save for opportunities to invest capital and sell equipment and services. Their geographical position means that they have a wide range of markets for their petroleum exports.

The petroleum exporting states - Southern republics and Central Asian states - stand to benefit from the implementation of investment provisions of the Treaty in order to attract much needed capital and technology. Their dependence on the transit provisions is not as great because of the range of export routes open to them.

In general, the states upon which the Treaty is most dependent are those upon which other signatory states rely for transit. Where a trade regime is dependent on a single pipeline or network of pipelines, the transit states are in a position of great power, which they are likely to use to their advantage, even if that state also consumes the petroleum in the pipeline. *This strength may be tempered if the transit state is dependent on other signatory states, for example for foreign investment or strategic security*. It is in the interests of both exporters and importers to construct multiple export routes that have an aggregate capacity greater than the production capacity. The Southern republics of the former Soviet Union are evidently in a position to achieve this with potential routes to the north through Russia, to the west to the Mediterranean, to the south to Iran, and to the east to China.

In contrast, the major export routes westwards from Russia depend almost entirely on passage across Ukraine. In this respect, Ukraine is in a relatively strong position to exploit its situation as a transit state for economic or political purposes.

Non-signatory States

In terms of the global setting of the ECT, it is important to identify those states whose interests may be threatened by the Treaty and those who might benefit from joining the regime. That is, the US, while being a non-signatory, is along with Western Europe and Japan a net importer of energy and an exporter of capital and technology. South and East Asia, together with Eastern and Southern Africa, are net importers of petroleum, capital, and technology. Only Canada is alongside northwest Europe as the "self-sufficient" state in terms of petroleum. The Middle East, North and West Africa, and Latin America are all petroleum-exporting states which are net importers of capital and technology.

In this respect, one of the most significant developments in the global petroleum markets is the continuously growing materialisation of regional markets. This results from a gradual shift of interdependencies in the trade of petroleum.

Then, two groups of nations might potentially have a *direct interest* in seeking to join the ECT regime: those Mediterranean states that have not already signed, and the energy-importing states of northeast Asia. To the south, Algeria, Libya, and to a lesser extent Egypt are significant exporters of petroleum. In addition, Tunisia is a transit state for the Algerian gas export line. As the European Union's gas markets are liberalised and as the level of gas exports from Russia rises, the gas-exporting states of North Africa may find their share of the European market under attack. Membership of the Treaty regime should allow them to receive fair market access. Direct benefits in the field of petroleum for non-exporting states in the Southern and Eastern Mediterranean are rather less easy to identify.

The petroleum-importing states of northeast Asia, like those of Europe, wish to gain access to the former

Soviet Union's s petroleum resources. Of those states, only Japan is a signatory state. Notably, the gas and oil reserves of Eastern Siberia can, realistically, only be exported to the outh and east to Northeast Asia. These states also have their eye on central Asia, especially the gas resources. The regulatory issues for these Eastern export routes are likely to be similar to those for the Western routes. On the other hand, the gas markets in the East are less liberalised than those in Europe. Hence, with the latter provisorather than create an entirely new regime for East Asia, the participation of these Northeast Asian states in the ECT may be to the benefit of all parties, including the western oil companies involved.

Of the other non-signatory states, the most significant are the US and the Middle East oil-exporting nations. The US was a party to the European Energy Charter and took part in the negotiations for the Treaty, but it declined to sign. The reasons included a belief that the Treaty was not necessary, the conflict with MFN legislation, and objections from the American states themselves, especially concerning taxation. Regardless of the reasons, the question remains: Does the absence of the US affect the viability of the ECT? In the light of the regionalisation of global petroleum markets, a simple answer might be that *the absence of the US is of little consequence*.

The failure to involve the major petroleum exporting states of the Gulf in the Treaty negotiations is notable, given that energy supply security was the driving force behind the western European initiative.

Given that a diversity of sources is the key to the long-term security of energy supply, Europe has no option but to maintain a working relationship with the Middle Eastern oil exporters. Notably, gas, rather than oil, is likely to be the factor that draws Middle Eastern states to the Treaty regime; for example, they need access to markets once they start to develop their gas reserves systematically. However, they will be unwilling to join unless the Treaty regime has achieved a track record of successful implementation.

State and Private Enterprises
Governments may be concerned with the security of their energy supplies, foreign exchange earnings, and the flow of investment, but it is the energy enterprises themselves that actually develop, transport, and sell the energy. They have a considerable influence on the decision-making process regarding the implementation of the ECT. The Treaty recognises this and allocates to the State responsibility for adherence to the terms of the Treaty by "state and privileged enterprises" (Article 22).

The heart of the strategy for any petroleum company, whether state or private, is to gain access to profitable investment opportunities, either upstream or downstream, and to gain access to energy transportation infrastructure. Conversely, any company that has a privileged national or local status will seek to defend its position. *The most powerful of such privileged entities are those that own and operate transportation infrastructure* because in the absence of an effective regulatory regime, they can deny access to the infrastructure by other companies. Most signatory states, even those in Western Europe, have either given or allowed some of their energy companies to attain a privileged status: for example, Electricite de France, ENEL of Italy, RuhrGas of Germany, Gazprom and Transneft of Russia, MOL of Hungary, and Rompetrol of Romania. Whether fully or partially privatised or wholly state owned, each will continue to use political and economic means to defend its access to resources, transportation, and markets on its "home" territory. The ECT unambiguously gives the home state the responsibility of preventing this behaviour. At the same time, these enterprises are now in the position to invoke the terms of the Treaty to gain access to opportunities and infrastructure in other signatory states. In this regard the Treaty was designed as a symmetrical one, in order to grant companies from the former Soviet Union fair treatment in Europe to the same extent as western companies were supposed to be granted fair treatment there.

Not only are investment conditions less discriminatory and more transparent in the West, but no western nation has applied for transition arrangements under the Treaty.

On the other hand, any large petroleum company will exercise considerable power in its home territory, especially *if the regulatory regime is weak*.

To summarise it with respect to this study's interest, the signatory states that theoretically have a lot of interests *in common* under the Treaty are Russia, Central and Eastern Europe, and much of Western Europe. Indeed, all of them are both transit states and rely on other signatory states for energy transit. On the other hand, Russia itself is an energy exporter, while Central and Eastern Europe, and most of Western Europe are energy importers, which leads to the convergence of their interests. However, in practice, Russia's behaviour relating to gas supplies to Europe, and some of its actions with respect to European investments in Russia, as well as consequent EU's reactions such as development of countervailing strategies, such as Nabucco pipeline project, and new "FDI-unfriendly" legislation, undermine the above theory, and thus some objectives of the Treaty.

With regards to players which are most likely to appear either disinterested or obstructive, the case of the US is relevant and quite understandable. That is, one of the US main concerns was the *pre-investment phase* under the Treaty, which specified that each contracting party was bound to provide fair and equitable treatment during the *constitution* of the investment on its territory, though each party still retained control over such investment. Since the US proposal to cancel this control at the pre-investment stage was rejected, the US did not sign the ECT. Interestingly, the matter of the pre-investment phase was recently re-invoked, this time by Russia.[376] On the other hand, it could be argued that to some extent the US efforts to advance its own energy-related interests on the territory of the former Soviet Union may be pursued without a shield of the ECT. Indeed, the US investors were among top "backers" in Russia's petroleum industry under the president Yeltsin. During president Putin's authority, especially its first mandate, a considerable part of inflows of those US investments was stopped. However, the most recent projections for the period through 2012 predict that the US will remain one of the four main sources of FDI, while the Russian Federation will figure among the top home bases for FDI. Therefore, it is not excluded that investments from the US to Russia including petroleum investments are likely to rise.

Finally, the above synthesis shows that the most controversial concern of petroleum investments under the Treaty is related to s*tate and private enterprises,* some of which are likely to weigh considerably on the decision making process regarding the implementation of the ECT. Empirically, in the case of Russia, it could be argued that significant lobbying on behalf of Russian energy monopolies, primarily Gazprom, has not only influenced Russia's decisions with regards to the ECT advancement process, but has also been one of the main forces driving Russia's withdrawal from the Treaty.[377]

Another important concern, expressed in Box 2 with respect to the subject of this paper, is related to transition arrangements under the ECT, including the provisional application of some signatories.

3.3. Provisional Application of the ECT to Matters affecting Investments prior to the Ratification

Provisional application, established by art.25 of the 1969 Vienna Convention on the Law of Treaties (VCLT) is a recognised - though not universal - facet of international treaty practice. ECT art.45 establishes a specific and detailed provisional application regime. Notably, through 2009, i.e. more than 15 years after its signature, the ECT has not yet been ratified by some of its signatories. This implies an extraordinary state of affairs within the ECT process, as some signatories had continued to apply it provisionally for years. This part looks at the concept of provisional application in general (3.3.1.), and then analyses it through the prism of the most recent and the most significant related arbitration: the *Yukos* case law (3.3.2.).

3.3.1. Stakes of Provisional Application

The main question regarding the provisional application of the ECT that arose in the *Kardassopoulos*[378] and recently *Yukos* cases was whether this provisional application, as defined by ECT art.45, provides a basis for the tribunal's jurisdiction over the merits of the claims of an arbitration. Concluding on the

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[376] See *supra*, pp.39, 61; *infra*, pp. 106, 110-111.
[377] See *infra,* pp.91-92.
[378] ICSID, *Kardassopoulos v Georgia*, Decision on Jurisdiction, Case No. ARB/05/18, (July 6, 2007).

Respondent's arguments that the tribunal lacks jurisdiction and that claimants lack standing in the *Yukos Universal Limited v The Russian Federation,* the court stated that (emphasis added):

> "(a) provisional application of a treaty is a *genuine form of application and provisionally applied treaty provisions may have legal effect*; (b) accordingly, by accepting provisional application of the ECT, Respondent accept[s] the obligations of Parts III and V of the Treaty; (c) in particular, given that the arbitration clause of the ECT was being provisionally applied by Respondent, *Notices of Arbitration filed by qualified investors perfected an agreement to arbitrate which was, and remains, independent of the continued provisional application of the ECT itself*; and (d) on the facts as stipulated, the dispute settlement provisions of the ECT apply to Claimants."[379]

Thus, provisional application especially could be a serious issue if disputes arise out of the time when other members of the ECT provisionally applied it prior to ratification. Therefore, it is essential to firmly determine the multilateral standards for provisional application, not just for the ECT, but also for all current and future multilateral treaties containing provisional application clauses.[380]

In general, states agree to apply multilateral treaties provisionally for several reasons, the most common of which is to resolve urgent international matters.[381] This explanation perfectly fits the case of the ECT, since "[its] roots (…) date back to a political initiative launched in Europe in the early 1990s, at a time when the end of the Cold War offered an unprecedented opportunity to overcome the previous economic divisions on the European continent."[382]

While provisional application is a relatively common practice for treaties demanding immediate enforcement, it is a new development in investment agreements.[383] Generally, the process of concluding a treaty takes place under a three-step procedure of *signature*, *ratification*, and *entry into force*.[384]A multilateral treaty usually provides for states to express their consent to be bound by signature "subject to ratification, acceptance or approval." Once the necessary number of signatories has ratified the treaty, it will definitively enter into force.[385] After the treaty's entry into force, the signatories become parties to the treaty and acquire the full rights and obligations drawn in the agreement.[386] Often, however, there is a significant period of time between the moment of signature and entry into force. *Provisional application* is thus mostly used in order to eliminate this gap in time.[387] It could be best understood as an attempt to solve *collective action problems* created by the gap.[388] Under provisional application of a treaty, signatory states undertake to give effect to the treaty obligations prior to the completion of the domestic ratification

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[379] Professor James Crawford, SC, Energy Charter Treaty Arbitration: Jurisdiction Issues, June 22, 2006 in *Yukos Universal Limited v The Russian Federation* (PCA Case No. AA 227).

[380] Belz, Matthew (2008). "Provisional Application of the Energy Charter Treaty: Kardassopoulos v. Georgia and Improving Provisional Application in Multilateral Treaties," *Emory International Law Review*, Vol.22, 2008 (pp.727-760), p. 732.

[381] Report of the of the International Law Commission on the work of its Eighteenth Session, 4 May - 19 July 1966, Official Records of the General Assembly, Twenty-first Session, Supplement No. 9 (A/6309/Rev.1) at 210, available at http://untreaty.un.org/ilc/documentation/english/a_cn4_191.pdf , retrieved on May 2, 2010. The drafters of the VCLT recognised provisional application as "[o]wing to the urgency of the matters dealt with in the treaty or for other reasons." *Id.*, at 210. In Belz (2008), *id.*

[382] ECT, *op.cit.* note 50, "AN INTRODUCTION TO THE ENERGY CHARTER TREATY: WHY AN ENERGY CHARTER?"

[383] Hutcheon , Andrew and James Spencer (2008). "Provisional Application of the Energy Charter Treaty", *Global Arbitration Review:* THE EUROPEAN & MIDDLE EASTERN ARBITRATION REVIEW (SPECIAL REPORT) 25 (2008).

[384] UN Office of Legal Affairs Treaty Section, *Treaty Handbook*, paras.3.1.-3.4, available at: http://untreaty.un.org/English/TreatyHandbook/hbframeset.htm , retrieved on September 2, 2010.

[385] *Ibid.*, paras. 3.1.3-3.1.4

[386] *Ibid.,* para.3.2

[387] Niebruegge (2007), *op.cit.* note 235, p. 355. See also Thomas W. Wälde (ed.) (1996). *The Energy Charter Treaty: An East-West Gateway for Investment & Trade*. London - The Hague - Boston: Kluwer Law International, 1996, p. 576

[388] Niebruegge (2007), *id.*

procedures, with the intention of acceding to the treaty once domestic ratification has been completed.[389] However, in this instance, the positive legal obligations are not yet firmly recognised in international law – these are still developing in international law, particularly through international arbitration.[390]

Signature of a treaty in and of itself *does not impose a legal duty* on a signatory to ultimately ratify the treaty.[391] Nor, as a general principle of international law, do treaties have legal effect before entry into force.[392] VCLT art.18 provides a limited exception to this principle by obliging signatories to a treaty to avoid acting in a manner that would defeat the object and purpose of the treaty.[393] However, this obligation does not impose *positive* duties on a state to carry out specific provisions of the treaty.[394] Art. 25 of the VCLT states that "[a] treaty or a part of a treaty is applied provisionally pending its entry into force if: (a) the treaty itself so provides; or (b) *the negotiating States have in some other manner so agreed* (emphasis added)".[395] However, it does not define the *essence of provisional application* or the *specific obligations provisional application is designed to impose*.[396] Moreover, the text of this provision leaves broad discretion to the negotiating parties to decide how it will apply the related rule in practice.[397]

ECT art.45 para.1 expressly provides that "[e]ach signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory (...) *to the extent that such provisional application is not inconsistent with its constitution, laws or regulations* (emphasis added)."[398] ECT art.45 para.2 provides that (bold and emphasis added):

> "(a) Notwithstanding paragraph (1) *any signatory may, when signing,* deliver to the Depository a declaration that ***it is not able to accept provisional application***. *The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration.* Any such signatory may at any time withdraw that declaration by written notification to the Depository.
>
> (b) Neither a signatory which makes a declaration in accordance with subparagraph (a) nor Investors of that signatory may claim the benefits of provisional application under paragraph (1).
>
> (c) Notwithstanding subparagraph (a), any signatory making a declaration referred to in subparagraph (a) shall apply Part VII provisionally pending the entry into force of the Treaty for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its laws or regulations."[399]

When exercising this "opting-out" provision of art.45 para.1, a contracting party and its investors have no right to claim the benefits of provisional application of the ECT.[400]

To date, 51 European and Asian countries have signed or acceded to the ECT.[401] All EU states are individual signatories, but the Treaty has also been signed collectively by the European Community -

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[389] UN Treaty Handbook, *op.cit*., note 384, para.3.4 .

[390] "The extent to which provisional application of the Energy Charter Treaty creates firm legal rights and obligations for Russia is not entirely clear under international law. Pending ratification, this question can be settled authoritatively only in the context of relevant cases brought to international arbitration." Speech by Andre Mernier, Secretary General, to the International Conference on Energy Security, Moscow, March 13-14, 2006. URL: http://www.encharter.org/index.php?id=59&id_article=75&L=0 , retrieved on September 2, 2010.

[391] Rogoff, Martin A. (1980). "The International Legal Obligations of Signatories to an Unratified Treaty", *Maine Law Review*, Vol. 32 (263), p.267. In Niebruegge (2007), *op.cit*. note 235, p. 357.

[392] Niebruegge (2007), *ibid*., p. 357. See also Belz (2008), *op.cit*. note 380, p. 729.

[393] Niebruegge (2007), *id.*

[394] *Id.*

[395] *Id.*

[396] *Id.*

[397] *Id.*

[398] Art.45 para.1, ECT, *op.cit*. note 50.

[399] *Id.,* art.45 para.2

[400] Niebruegge, *op.cit*. note 235, p. 360

which became the EU with the Lisbon Treaty's entry into force - and Euratom, so the total number of parties to the ECT is 53.[402]

As of April 20, 2009 Russian government announced its decision not to ratify the ECT, which was officially confirmed on August 20, 2009, when the Russian Federation officially informed the Depository that it did not intend to become a contracting party to the ECT.[403] In accordance with ECT art.45 para.3 (a), such notification resulted in Russia' termination of its provisional application of the Treaty upon expiration of 60 calendar days from the date on which the notification was received by the Depository.[404] Therefore, the last day of Russia's provisional application of the ECT was October 18, 2009.[405] Belarus still applies the Treaty provisionally.[406]

Interestingly, one month after Russia had terminated the ECT provisional application, the PCA in The Hague, which had been considering the *Yukos* case since 2005 under the UNCITRAL rules, has ruled that former Yukos shareholders can move on to the merits phase of their arbitration claim against the Russian government.[407] Yukos' expropriation claim is stated on the ECT's official website as having a value of USD 100 billion.[408] The tribunal decided that Russia is bound by the treaty - this made the meaning of provisional application of the treaty quite certain.[409] A merit phase during which time Russia can challenge the ruling could take up to three years.[410] A judgement would then be pronounced and an award determined. However, if the final decision will confirm the present ruling, it would have a colossal *precedent* value as it will go far beyond this individual case meaning that many other investments made in Russia up to 19 October 2009 will benefit from the ECT protection for 20 more years, i.e. until October 18, 2029.

3.3.2. Yukos Arbitration and Provisional Application of the ECT

Before examining the ruling of the Yukos Interim Award, it is useful to recall the main provisions of the ECT investment regime.

ECT investment dispute settlement is laid down by art.26.[411] The primary jurisdictional question relates to a state's consent to arbitrate.[412] Art.26 para.1 states that it applies to "[d]isputes between a *Contracting Party*

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[401] ECT "Members and Observers", *op.cit.*, note 238.
[402] For details, see *supra*, pp.43-44.
[403] ECT "Members and Observers", *op.cit.,* note 238.
[404] *Id.*
[405] *Id.*
[406] *Id.*
[407] *Yukos Arbitration*, *op.cit.,* note 364.
[408] Ross, Alison (2009). "Tribunal says Yukos case can proceed", November 30, 2009, *Global Arbitration Review,* URL: http://www.globalarbitrationreview.com/news/article/19521/tribunal-says-yukos-case-proceed-/ , retrieved on August 13, 2010.
[409] *Id.*
[410] Gaillard, Banifatemi, Pinsolle (2010), *op.cit.* note 363.
[411] Under the investor-state arbitration provisions, parties are first encouraged to settle any disputes amicably. If a dispute cannot be settled within a period of three months, the investor party has the option to submit the dispute to the courts of the host state, to any previously-agreed-upon dispute settlement procedure, or to an international arbitral tribunal. The ECT requires that both the host state and the investor give their unconditional consent to the submission of a dispute to international arbitration. Investors choosing to submit the dispute to an international arbitral tribunal may submit the dispute to the ICSID, an ad hoc arbitration tribunal established under the Arbitration Rules of the UNCITRAL, or an arbitral proceeding under the Arbitration Institute of the SCC. See the full text of art. 26, ECT, *op.cit.*, note 12.
[412] In discussing whether the parties had consented to submit their dispute to ICSID arbitration, the *Plama* tribunal laid strong emphasis on the protection regime established by the ECT and, in particular, by its arbitration clause contained at art. 26, which provides for a contracting party's unconditional consent to investor-state arbitration: "[…] Article 26 ECT provides to a covered investor an almost unprecedented remedy for its claim against a host state. The ECT has been described, together with NAFTA, as 'the major multilateral treaty pioneering the extensive use of legal methods characteristic of the fledging regulation of the global economy,' of which 'perhaps the most important aspect of the ECT's investment regime is the provision for compulsory arbitration against governments at the option of foreign investors…;' and these same distinguished commentators concluded: 'With a paradigm shift

and an Investor of another Contracting Party (emphasis added)."[413] The second paragraph of the article defines "Contracting Party" as a "state . . . which has consented to be bound by [the] Treaty and for which the Treaty is in force."[414] Provisional application by a signatory, as provided in ECT art.45, expressly applies in the period *before* the ECT has entered into force according to the provisions of art. 44.[415] Thus, such a signatory would not fall within the definition of a "Contracting Party." Therefore, it could be argued that art.26 para.1 would not apply to disputes between an investor and a signatory who has agreed to apply the ECT provisionally, if solely the basis of a *literal reading* is used.[416]

Art.31 of the VCLT provides that a treaty is to be interpreted by the *ordinary meaning* of its terms in context and in light of the treaty's *object* and *purpose (teleological reading)*.[417] Looking at its purpose, the ECT suggests that the term "Contracting Party" in the context of ECT art.26 para.1 should be interpreted to *include signatories who have agreed to provisionally apply the ECT,* but for whom the Treaty has not entered into force.[418]

Hence, following the teleological reading of the scope of ECT, art.26 should include disputes between investors and signatories who have agreed to apply the Treaty provisionally.[419] Such a reading has been supported by the decision on jurisdiction of *Plama* case, to date one of the few ECT arbitrations to have issued an award. In *Plama*, the tribunal found that art.26 of the ECT provisionally applied *from the date of a state's signature* unless that state had declared itself unable to accept provisional application under the art.45 para.2 (a).[420] Under this reading, the Yukos-Russia dispute thus falls within the scope of the investor-state arbitration provisions of the ECT.

The investment definition is laid down by ECT art.1 para.6 as encircling practically "every kind of asset, owned or controlled directly or indirectly by an Investor."[421] Further, the notion of "direct or indirect control" is explained in Understandings number 3 of the ECT as being "control in fact, determined after an examination of the actual circumstances in each situation."[422] The definition of investor under the ECT is provided in art.1 para.7 and includes, with respect to a contracting party, besides natural persons, "company or other organisation organised in accordance with the law applicable in that Contracting Party (...)."[423]

In the *Yukos* case the arbitral tribunal held that the Russian Federation, in signing the ECT in 1994, accepted its provisions on provisional application contained in art.45.[424] The tribunal further held that the

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away from mere protection by the home state of investors and traders to the legal architecture of a liberal global economy, goes a coordinated use of trade and investment law methods to achieve the same objective: a global level playing field for activities in competitive markets.' By any standards, Article 26 is a very important feature of the ECT which is itself a very significant treaty for investors, making another step in their transition from objects to subjects of international law." (*Plama*, *op. cit.* note 323, para.141). In Gaillard (2005), *op.cit.* note 324.

[413] Art.26, ECT, *op.cit.*, note 50.

[414] Art.1 para.2, ECT, *id.*

[415] Art.45 para.1, ECT, *id.*

[416] Niebruegge (2007), *op.cit.*, note 225, p. 367.

[417] Art 31 para.1, VCLT, Treaty Handbook, *op.cit.,* note 364.

[418] As discussed previously, one of the primary goals of the ECT is to mitigate the risk associated with energy-related investments. Without the obligations imposed by the dispute settlement procedures, investors have limited recourse against states violating the treaty guarantees of investment promotion and protection under Part III. The twenty-year continuation period provided by Article 45(3)(b) works to mitigate the risk of this limited legal recourse by ensuring the availability of appropriate fora for dispute resolution. Failing this protection, signatories who have agreed to provisionally apply the ECT would generally be able to escape their treaty obligations by failing to ratify the ECT, while at the same time retaining the benefits of the ECT accrued in the period of provisional application. Such a result would be inconsistent with the principles of reciprocity embodied in the ECT. Niebruegge (2007), op.cit., note 235, p.367.

[419] Niebruegge, *ibid.*, p. 368. See also Gaillard, *op.cit.* note 324.

[420] *Plama*, *op. cit.*, note 323, para.140 , in Gaillard, *id.*

[421] Art.1 para.6, ECT, *op.cit.* note 50.

[422] Energy Charter, Dispute Settlement, URL : http://www.encharter.org , retrieved on April 13, 2010

[423] Art.1 para.7, ECT, *op.cit.* note 50

[424] This section is based on Gaillard, Banifatemi, Pinsolle (2010), *op.cit.* note 363.

provisional application of the Treaty is fully consistent with both Russian law and Russian treaty practice.[425] The binding character of the ECT includes the obligation to arbitrate investment disputes pursuant to its art.26. This ruling is evidently of particular significance for investors in the energy sector in Russia. The tribunal further found, pursuant to art.45 para.3 of the Treaty, that the decision of the Russian Federation to terminate provisional application of the ECT, which became effective on October 19, 2009, had no bearing either in the present case or, for that matter, the investments made in Russia in the field of energy prior to October 19, 2009. In other words, a signatory's decision not to become a party to a treaty entails consequences for the *future* only. As far as investments made *prior* to the effective date of termination, they will continue to be protected for 20 years pursuant to ECT art.45 para.3, i.e. until October 19, 2029.[426]

Yet a very controversial concern regarding provisional application which arises out of the *Yukos* case is whether states that agree to provisional application upon signature *give up* their right to later raise the *domestic law exception* contained in ECT art.45 para.1.

In this regard, Professor Wälde posed the following question (emphasis added):[427]

> "Where the existing legislation of a Treaty signatory so conflicts with the Treaty's substantive provisions as to make that signatory's compliance with the Treaty virtually impossible, *was the signatory under an obligation at the time of signing to declare itself 'not able to accept provisional application', or is it instead entitled to rely on the conditionality language attached to the provisional application commitment?* If a signatory follows the latter course, may its investors - unlike the investors of signatories making a declaration—claim the benefits of provisional application?"[428]

These concerns raise a more general question: may a signatory that provisionally applied or currently provisionally applies the ECT, and further did not declare its inability to accept it at signature, later declare that provisional application conflicts with its domestic law? Or, in contrast, does the signatory waive this right?[429] Alternatively, may a signatory challenge its legal obligations under the Treaty by relying on the domestic law exception in art.45 para.1 *after* accepting provisional application upon signature?[430] Since this relationship is not clear, a state, although not declaring itself incapable to accept provisional application of the ECT upon signature per art.45 para.2, could assert that it nevertheless considers itself excused from provisional application based on the domestic law exception found in art.45 para.1.

In this regard, another author proposed the following drafting solution (see emphasised part, original italics) of ECT art.45 para.1:

> "Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations. *If provisional application is inconsistent with a signatory's constitution, laws or regulations, that signatory must make a declaration upon signature rejecting provisional application pursuant to paragraph (2)(a). If the signatory fails to make this declaration upon signature, the signatory thereafter waives its right to assert that provisional application is inconsistent with its constitution, laws or regulations*".[431]

However, concerning the proposed above solution, it is barely conceivable that the founding fathers of the ECT overlooked such an option. On the contrary, one can imagine that they had rather reasoned as follows. Had they drafted anything similar, some important energy producers including Russia would have

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[425] *Yukos Universal Limited v The Russian Federation*, *op.cit.*, note 364. Tribunals' conclusions, paras.370-392
[426] *Supra*, pp.43-44.
[427] I.e., regarding the textual relation between the ECT arts. 45(1) and 45 (2), not the Yukos ruling.
[428] Wälde, *op.cit.*, note 387, p. 601.
[429] *Id.*
[430] *Id.*
[431] Belz (2008), *op.cit.*, note 380, p.756.

simply refused to sign the Treaty. That is, *primo*, Russia is an important Energy Charter participant.[432] *Secundo*, one of ECT's purposes, apart from the European Energy Charter's official primary intent[433] taken up in the main ECT's objectives, is in practice to *somehow* embrace Russia in *at least* one multilateral treaty in order to bring it in compliance with *some* international trade and investment standards. Then, it could be argued that the ECT drafters intentionally omitted to spell exactly the terms when a signatory could be excused from provisional application. In this case, the recent *Yukos* decision bears out that this presumed intentioned omission of the ECT drafters was a right choice. Indeed, it seems to be perfectly in line with those international efforts designed by the founding fathers of the ECT to somehow bind Russia on investment matters, especially in such strategic field as energy.

On the other hand, the language of ECT art.45 para.1 *tel quel* proposed above would have guaranteed to the investors that a signatory's acceptance of provisional application binds it unconditionally to the rights and obligations of the Treaty upon signature. It would have also bound those signatories from asserting that their domestic law exempted them from provisional application. This, in turn, would have created greater investor confidence - an official primary objective of the ECT.[434]

So far, as any other international regime, the eventual effectiveness of the ECT depends probably more on the convergence of interests of the signatory states and, to a lesser extent, on those of non-signatory states, than on legal niceties and enforcement. Moreover, the problem is that the ECT is possibly much more *politically driven* than any other multilateral treaty comprising investment regimes. Indeed, from the beginning, the Treaty was limited geographically on account of the US and Canada's withdrawal from negotiations, and also on account of the observer status of such important energy producers as Saudi Arabia, Iran and Venezuela.[435] Hence, as it was stated earlier, the ECT was mainly intended to integrate the energy sectors of the former Soviet Union and Europe in the wake of the dismantlement of the former.

Therefore, taking into account the above arguments, it is not impossible - and this hypothesis would be particularly supported by Russia - that the ECT is: (1) a (relatively) EU-driven treaty; and (2) that it was designed by the Europeans to a fairly large extent to embrace Russia in at least one multilateral treaty on international trade and investment (especially taking into account that the energy sector is the most capital intensive and risky business field). Thus, the issues at stake within the ECT are to a certain extent between the EU and Russia. Therefore, maybe the ECT founding fathers intentionally preferred not to be too precise with the wording of ECT art.45 para.1, which exposes investors to some additional risk and especially to the *true initial* burden of proof,[436] but instead preferred to gain Russia among the ECT signatories. Again, if the latter hypothesis is realistic, the protection of investors is round-tripping under ECT art.45 as follows. At first its text intentionally exposes the investors to extra risks, but brings in some important Eastern producers at signature. And then however, as the recent *Yukos* ruling shows, the Treaty effectively protects the investors under this very article.

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[432] "[T]he absence of ratification is not an obstacle to the practical and technical work of the Energy Charter Conference or of the Secretariat. Russia is a valued and active participant in Energy Charter activities, and our day-to-day cooperation is at a high level." Mernier (2006), *op.cit*., note 390.

[433] See Final Act of the European Energy Charter Conference, ECT, *op.cit*., note 50.

[434] See in Mernier's speech, supra, note 412.

[435] See *supra*, pp.41-43.

[436] The burden of proof in arbitration is on the defendant state, i.e. it has to prove that provisional application is incompatible with its domestic law. However, after Kardassopoulos, and to some extent, Plama cases, the true initial burden actually lays on the investor. If an investor is making an investment in a state that is currently applying the ECT provisionally, the investor must now first establish if provisional application is compatible with that state's domestic law. Investors must perform such due diligence because if a dispute arises between the investors and the state in which they are investing, the defendant state will likely declare that provisional application is inconsistent with its domestic law despite accepting it upon signature. Investors with claims arising out of investments made in states while those states provisionally applied the ECT, but which have since ratified the treaty, are no longer safe either. See Hutcheon and Spencer (2008), *op. cit*., note 363, in Belz (2008), *op.cit.,* note 360 , pp.745-746.

Following this hypothesis, had the ECT not been a rather Europe-inspired treaty aiming to secure its energy relations with important energy producers including Russia, the founding fathers of the ECT probably would have adopted different language for ECT art.45 para.1. In this case, the burden would *expressly* have been on the signatory to establish whether provisional application was incompatible with its constitution, laws, or regulations before signature. Thus, there would perhaps be no *Kardassopoulos, Plama* and *Yukos* cases as we know them. Again, on the one hand, the current state of the provisional application terms, involves important *incremental costs* associated with litigating the extent to which provisional application creates firm legal rights and obligations for these signatories. The cited rulings, as they are, bear this out, and indeed entail important costs due to provisional application litigation.[437] This negative effect is however "compensated" by the fact that those cases *tels quels* represent a colossal contribution to the international investment arbitration jurisprudence.

3.4. Denial of Benefits

The second element of the two controversial jurisdictional matters under the ECT invoked above deals with a contracting party's right, under certain circumstances, to deny the benefits of Part III of the Treaty to a legal entity or an investment. The paragraphs that follow first look at the general concept of denial of benefits principle and stakes (3.4.1.), and then analyse these in light of the ECT referred rules and case law (3.4.2.).

3.4.1. Concept of "Denial of Benefits" Clauses

The "denial of benefits" (or "denial of advantages") clause is inserted in investment treaties for at least two purposes: first, to maintain reciprocity or asymmetry with regard to the advantages arising out of the protection offered by investment treaties, and second, to exclude so-called "mailbox companies" [438] from the protection of the treaties.

ECT art.17 lays down the "denial of advantages" rule. Accordingly, each ECT state "reserves the right to deny the advantages" of Part III of the Treaty relating to Investment Promotion and Protectionto "a legal entity if citizens or nationals of a third state own or control such entity and if that entity has *no substantial business activities in the Area of the Contracting Party* in which it is organised (emphasis added)."[439] What are the general considerations behind this "denial of benefits" right?

From the historical perspective of the international investment law, the rationale of the "denial of benefits" clause is to avoid third parties to befrom becoming "free-riders", in other words, to exclude them from claiming the benefits of the Treaty without assuming the obligations therein (such exclusion was specifically directed at "enemy companies").[440] The "denial of benefits" clause is introduced either in the definition part of the treaties or sometimes as a separate article.

For example, the "denial of benefits" clause was included in the 1994 US Model BIT:

> "Each Party reserves the right to deny to a company of the other Party the benefits of this Treaty if nationals of a third country own or control the company and
> a) the denying Party does not maintain normal economic relations with the third country; or

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[437] The *Yukos ad hoc* tribunal pursued more or less the same interpretation of provisional application as the Kardassopoulos and Plama ICSID tribunals, which permitted Russian Federation to declare that provisional application was inconsistent with its domestic law. See Russia's arguments in Yukos Universal Limited v The Russian Federation (PCA Case No. AA 227), paras.247, 256. Those arguments were not retained by the tribunal, however they added unnecessary costs and time for the parties and tribunal, respectively. (See tribunals' conclusions, ibid., paras.370-392).

[438] Mistelis, Loukas A. and Crina Mihaela Baltag (2009). "Denial of Benefits and Article 17 of the Energy Charter Treaty", *Penn State Law Review*, Vol 113:4, January 2009 (pp.1302-1321), p. 1302.

[439] Art.17, ECT, *op.cit.* note 50.

[440] Mistelis and Baltag (2009), *op.cit.*, note 438, *id.*

b) the company has no substantial business activities in the territory of the Party under whose laws it is constituted or organized."[441]

In the 2004 US Model BIT the related clause – curiously, also art. *17* - is more sophisticated, since it aims to be in line with the provisions of the FTAs signed by the US after 1994:

"1. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:
a) does not maintain diplomatic relations with the non-Party; or
b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments.

2. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise."[442]

The explanation for such a wording for both the above Model BITs, a wording which clearly denies the benefits of the treaties, is that unlike FTAs or other multilateral treaties, which contain only limited provisions in respect to investments, BITs exclusively include investment provisions. This difference is perhaps the reason why the FTAs and other treaties limit the applicability of the clause only to the section or chapter regulating the investment related issues.[443] Quite often, these treaties include the investor-state dispute resolution mechanism for protection of investments in the same section or chapter with the "denial of benefits" clause.[444]

However, returning to the ECT, one could notice that in this Treaty's case, the investor-state dispute settlement mechanism is situated in a different part than the "denial of benefits" clause. Specifically, the latter is laid down in Part III ("Investment Promotion and Protection"), art. 17, while the former can be found in Part V ("Dispute Settlement"), in art.26 of the Treaty. Through this unique location, the drafters of the ECT possibly pursued an ambitious aim to make of the Treaty one of the international community's most important multilateral instruments on the promotion and protection of investments, or at least to draw it away from other multilateral treaties containing only limited provisions related to denial of benefits right.

The "denial of benefits" clause can also be found in art.1113 of the NAFTA and will be studied in greater detail further - in the part that follows.

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[441] In a commentary preceding the text of the US-Jordan BIT, concluded based on the 1994 U.S. Model BIT, the US explains that "a non-Party country with which the denying Party does not have normal economic relations" includes, for example, a country upon which the U.S. is applying economic sanctions, such as Cuba. A clarification is provided for the second paragraph of the clause. According to the commentary, "this provision would not generally permit the United States to deny benefits to a company of Jordan that maintains its central administration or principal place of business in the territory of, or has a real and continuous link with, Jordan." The commentary and the text of the Treaty between the Government of the United States of America and the Government of the Hashemite Kingdom of Jordan concerning the Encouragement and Reciprocal Protection of Investment, signed on 2 July 1995, are available at http://www.state.gov/documents/organization/43565.pdf. In Mistelis and Baltag (2009), *ibid.*, p. 1305.

[442] Art.17, 2004 US Model BIT, available at: http://www.state.gov/documents/organization/117601.pdf , retrieved on September 11, 2010.

[443] *Id.*

[444] *Id.*

Last but not least, the "denial of benefits" right was introduced in 2008 by Dolzer and Schreuer as a "method to counteract nationality planning"[445] (that is, where states often oppose investors' nationality planning by inserting certain requirement in the BITs). In such a way, some BITs "require a bond of economic substance between the corporation and the state,"[446] while others insert the "denial of benefits" clause. The authors explain the denial clause as follows:

> "Under such a clause the states reserve the right to deny the benefits of the treaty to a company that does not have an economic connection to the state on whose nationality it relies. The economic connection would consist in control by nationals of the state of nationality or in substantial business activities in that state." [447]

In sum, the general purpose of the "denial of benefits" clause in the international investment regime is to exclude from the protection of related treaties those legal entities and investments which don't have a *substantial* economic link with the denying state.

3.4.2. Denial of Benefits under the ECT Law

ECT art.17 entitled "Non-Application of Part III in Certain Circumstances" addresses the specific situation of denial of benefits, or advantages, as laid down by the text:

> "Each Contracting Party reserves the right to deny the advantages of this Part to:
> (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
> (2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
> (a) does not maintain a diplomatic relationship; or
> (b) adopts or maintains measures that:
> (i) prohibit transactions with Investors of that state; or
> (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments."[448]

Thus, the first paragraph of art.17 aims to provide the contracting states with the right to deny the advantages of Part III to investors whose firms are owned or controlled by citizens or nationals of third countries and don't have a *substantial* economic link with the host state – i.e., so-called "shell companies."[449] In contrast, the second paragraph of this article addresses the right of contracting states to deny such advantages to investors of third countries with which the denying state (a) maintains no diplomatic relationship, or (b) adopts or maintains certain discriminating economic measures.[450]

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[445] Dolzer, Rudolf and Christoph Schreuer (2008). *Principles of International Investment Law*, New York: Oxford University Press, 2008, p. 55. In Mistelis and Baltag (2009), *op.cit.*, note 438, p. 1306.
[446] *Id.*
[447] *Id.*
[448] Art.17, ECT, *op.cit.*, note 50.
[449] "Mailbox" company/ "front" company/ international business corporation, etc.: a company which is created in order to execute certain limited administrative and/or business transactions for the parent company without itself having any economic activity.
[450] The above art.17 of the 2004 US Model BIT contains very similar provisions on "diplomatic relations" (1(a)), "measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments" (1(b)). See *supra*, p.78; note 442.

The wording of the clause invokes similar provisions found in modern BITs and FTAs.[451] Interestingly, NAFTA art.1113, unlike ECT art.17, requires *prior notification* and *consultation* procedures on behalf of the denying state (bold and emphasis added):

> "1. *A Party may deny the benefits of this Chapter* [Chapter XI] *to an investor of another Party that is an enterprise of such Party* and to *investments of such investor* if investors of a non-Party own or control the enterprise and the denying Party:
> a. does not maintain diplomatic relations with the non-Party; or
> b. adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.
> 2. *Subject to* ***prior notification*** *and* ***consultation*** *in accordance with Articles 1803* (Notification and Provision of Information) and *2006* (Consultations), a Party may deny the benefits of this Chapter [Chapter XI] *to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors* of a non-Party own or control the enterprise and the enterprise *has no substantial business activities in the territory of the Party under whose law it is constituted or organized*." [452]

Regarding the relevant case law under the ECT, in both the *Plama* and *Yukos* arbitrations the tribunal ruled that art.17 para.1 did not constitute an *automatic* denial of benefits; rather, it granted a right that must be exercised in order to produce effect.

Plama (emphasis added):

> "In the Tribunal's view, the existence of a 'right' is distinct from the exercise of that right. (…) a Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so. The language of Article 17(1) is unambiguous (…). The Tribunal has also considered whether the requirement for the right's exercise is inconsistent with the ECT's object and purpose. *The exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers*. (…) *By itself, Article 17(1) ECT is at best only half a notice;* without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed."[453]

The tribunal then referred to the notification and consultation procedure provided by NAFTA art.1113 and found that this supports its reading of ECT art.7 para.1.[454]

Yukos (emphasis added):

> "Article 17(1) does not deny *simpliciter* the advantages of Part III of the ECT - as it easily could have been worded to do - to a legal entity if the citizens or nationals of a third State own or control such entity and if that entity has no substantial business in the Contracting Party in which it is organized. *It rather 'reserves the right' of each Contracting Party to deny the*

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[451] See *supr*a, p.78.
[452] Art. 1113, The North American Free Trade Agreement, entered into force on January 1, 1994, available on the Foreign Affairs and International Trade Canada website, URL. http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/texte/index.aspx
[453] *Plama*, *op. cit.* note 303, paras. 155 and 157. Here the issue was whether the denial of benefits under ECT art.17(1) operates automatically and requires no further action from the host state as argued by the respondent, or whether it requires the right to deny to be exercised through positive action taken by the host state as argued by the claimant. The tribunal adopted the latter approach and established that art.17(1) sets forth a reservation of rights mechanism which, to be effective, must be exercised. Gaillard, *op.cit.*, note 324.
[454] Mistelis and Baltag (2009), *op.cit.*, note 438, p. 1319.

> *advantages of that Part to such an entity*. This imports that, to effect denial, the Contracting Party must exercise the right.[455]
>
> To treat denial as retrospective would, in the light of the ECT's 'Purpose,' as set out in Article 2 of the Treaty ('The Treaty establishes a legal framework in order to promote long-term cooperation in the energy field . . .') be incompatible 'with the objectives and principles of the Charter.' Paramount among those objectives and principles is 'Promotion, Protection and Treatment of Investments' as specified by the terms of Article 10 of the Treaty. Retrospective application of a denial of rights would be inconsistent with such promotion and protection and constitute treatment at odds with those terms."[456]
>
> The Treaty clearly distinguishes between a Contracting Party (and a signatory), on the one hand, and a third State, which is a non-Contracting Party, on the other. (...) As a result, the Tribunal concludes that the Russian Federation, for purposes of Article 17 of the ECT, is not a third State."[457]

As one can conclude from the two rulings, *the obligation of the prior notification and consultation procedure on behalf of the denying state* does not seem to be *literally* required under the ECT, though both arbitral tribunals seem to use the teleological element of interpretation in stating that for the *purposes* of the referred rule in the ECT, such requirement must be fulfilled. Indeed, in connection with art.17 of the ECT, Professor Crawford for example emphasises the notification requirement, and observes that tribunals have been clear that notification by the state seeking to deny advantages to investors must be unambiguous.[458] Since the above assertions are presented by some notable specialists in the field, one should be confident in the rightness of those proposals. However, for the sake of a theoretical exercise only, one should assess an opposite alternative.

Indeed, the *Yukos* arbitration tribunal, in relying on *Plama* ruling, held that, in light of the ECT purpose, the application of a denial of advantages may only have prospective effects. In turn, the *Plama* arbitrators, in referring to NAFTA art.1113, ruled that such application must be associated with *publicity* and/or *other* notice *so as to become expressly available to all stakeholders*. Indeed, as said above, the application of art.1113 of the NAFTA is *expressly* subject to prior notification and consultation. Yet, the application of ECT art.17 *is*

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[455] *Yukos Universal Limited v The Russian Federation*, *op.cit.,* note 364, para. 456. Indeed, one of the Russian Federation's allegations in Yukos case was that the claimants were excluded from bringing a claim because they were owned or controlled by Russian citizens or nationals and, as such, fell within the exception contained in ECT art.17 para.1. The Tribunal dismissed the defendant's argument and provided important clarification on the mechanism of the denial of advantages clause. The Tribunal held that the denial of benefits provision in ECT art.17 para.1does not affect the dispute resolution mechanism in the Treaty (which is not comprised in its Part III) and cannot be exercised as to overcome the investors' legitimate expectation of substantive treaty protection under Part III of the Treaty. Confirming the rulings of the Tribunal in the *Plama v Bulgaria* case, the Yukos Tribunal held that ECT art.17 para.1 does not constitute an automatic denial of benefits; rather, it confers a right that must be exercised in order to produce effect. Gaillard, Banifatemi, Pinsolle (2010), *op.cit*., note 363.

[456] *Yukos*…, *ibid.* Tribunals' conclusions, para 458. In confirming the *Plama* decision, the tribunal in the Yukos matter held that when the right to deny advantages of Part III is exercised, it can only be prospective from the date of its put into effect. Indeed, a retrospective application of a denial of benefits clause would be incompatible with the Treaty's objectives of promotion and protection of investments. Gaillard, Banifatemi, Pinsolle (2010), *id.*

[457] *Ibid*., paras. 544 and 546. The tribunal actually introduced an significant element regarding the mechanism of ECT art.17 when it found that a 'third State' under this provision refers to a non-contracting state and therefore does not embrace the state hosting the investment. Id.

[458] Prof. Crawford, *op.cit*., note 399. Prof. Crawford acknowledges the practical difficulty of notifying offshore companies of the exercise of the ECT art.1 right (raise it as an independent issue) but asserts that this is why ECT art.17 para.1 allows states to issue, by clear statement, denials respecting the whole class of investors and potential investors. Though international law provides no formal notice requirements in such a situation, the principle is evident in the depositary requirements under art. 80 of the VCLT. To constitute notice under ECT art.17 para.1, a clear statement by the government of respondent published with an appropriate authority - such as the Energy Charter Secretariat - would be required. Even if the statement in respondent's pleadings was sufficient, the withdrawal from the arbitration clause would have no retroactive effect.

not. So, the theoretical question arises, are actions not required by a rule then not necessarily obligatory? In other words, if ECT art.17 does not require - and it doesn't - any notification and/or consultation, why should a denying state prevent itself from exercising the right which is actually laid down by this very provision? Following this purely hypothetical standpoint, in *Plama* award the tribunal actually held that a contracting party has a *theoretical right* under ECT art.17 para.1 to deny a covered investor the advantages under Part III, but that *in practice* it is *virtually impossible* to exercise this right without prior notification and consultation procedures, the latter being themselves undefined under the ECT.

Still, this theoretical analysis is not completely awkward, since some authors had previously expressed similar concerns.[459] Some observers in particular mentioned, in reaction to another specialist of the *Plama* case suggesting that states should enact "a law containing an abstract and general denial of benefits provision", [460] that it is strange why a state should pass such law when the ECT – which, once ratified, becomes a part of the legislation of the referred state - contains the same abstract provision in art.17.[461] One author sees this proceeding of the tribunal as guidance for contracting states: a prudent state would make a *statement in its official gazette* regarding the exercise of the rights under art.17 of the ECT.[462] Yet, the above solution might be considered as conflicting with ECT art.46 which states that "[n]o reservations may be made to this Treaty".[463]

In sum, it seems that although arbitrators do not have to follow the other tribunals' decisions, they often could be - justifiably - inspired by some brilliant comments of previous arbitral rulings, made by their homologues with regard to general matters of international law. On the other hand, each arbitral tribunal should not forget that it is assembled *à cet effet*, and hence it should be very careful when following this precedent. Therefore, regarding arbitrations under the ECT, an accurate balance should be found between the *ad hoc* character and proceedings of arbitral tribunals, on the one hand, and their probably excessive tendency to apply *stare decisis* with regards to the denial of benefits right, on the other.

Yet, while the case law under the ECT investment dispute settlement regime reinforces some international energy investment rules, to date there is unfortunately no such case law under the ECT transit dispute settlement mechanism. Thus, the next chapter will only address some international energy transit rules and their possible application in the context of EU-Russia energy relations.

3. ECT Transit Regime

Box 3: Premises to ECT art.7

Transit has always been considered a major issue for energy markets, which obviously develop on an *international* basis. Political volatility in transit states primarily menaces the enormous investments typical of energy ventures; from an investor's perspective, energy projects, particularly on East from the EU borders, involve a high political risk. The total absence of a reliable legal framework, in addition to muddled and contradictory laws and regulations, continue to make it difficult, if not impossible, to invest on a long-term basis.[464]

At the outset it is worth reminding that the *principle of freedom of transit* is of course not a concept which emerged along with energy pipelines. Notably, the "ancestry" of this notion dates back to the XVII

[459] See Shore, Laurence (2007). "The jurisdiction problem in Energy Charter Treaty claims", *10IALR*., June 2007, at 63; Chalker, James (2006). "Making the Energy Charter Treaty Too Investor Friendly: Plama Consortium Limited v. the Republic of Bulgaria, 3", *TDM*, December 2006, at 15. In Mistelis and Baltag (2009), *op.cit*., note 438, pp. 1318-1320.

[460] Essig, Holger (2007). "Balancing Investors; Interests and State Sovereignty: The ICSID Decision on Jurisdiction Plama Consortium Ltd. v. Republic of Bulgaria", *Oil, Gas and Energy Law Intelligence*; Volume *5*, issue.2, p.10.

[461] Mistelis and Baltag (2009), *op.cit*, note 438, p. 1320.

[462] Shore (2007), *supra,* note 459, in Mistelis and Baltag (2009), *id.*

[463] *Id.*

[464] Liesen (1998), *op.cit*., note 7.

century when Grotius opined that there was a *general right of transit across the territory of another state in the interests of the community of nations*.[465] During the last century, however, this principle was largely taken up and codified. Notably, the first specific multilateral instrument was the Convention and Statute on Freedom of Transit, concluded by the League of Nations in 1921 (the "Barcelona Convention"),[466] containing a definition of transit and regulating the conditions a member could apply to goods of another member passing through its territory to a third destination.[467] It defined transit as follows: "Persons (...) and goods (...) shall be deemed to be in transit across territory of one of the Contracting States, when the passage across such territory (...) is only a portion of a complete journey, beginning and terminating beyond the frontier of the State across whose territory the transit takes place."[468] The second mechanism was the New York Convention on Transit Trade of Land-locked States, of 1965.[469]

These specific instruments are completed by the GATT. Namely, GATT art. V deals with traffic in transit. It regulates the conditions a member may impose on goods transported through its territory by another party to a foreign destination. Notably, its first paragraph, as well as the last sentence of the second paragraph, are based on the Barcelona Convention.[470] The provision's main objective is to allow for freedom of transit through the territory of each member for carriers to or from the territory of other members.[471] To achieve this freedom, art. V prescribes two main obligations: (1) not to hinder traffic in transit by imposing unnecessary delays or restrictions or by imposing unreasonable charges; and (2) to guarantee MFN treatment to transiting goods of all members.[472] Its first paragraph determines traffic in transit. It defines transit as"(…) across the territory of a contracting party when the passage across such territory, with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes."[473]

Art.V para.2 prescribes freedom of transit. It requires each member to permit free passage through its territory for traffic in transit to or from the territory of another member. Such transit shall be granted "via the routes most convenient for international transit".[474] This is an important restriction, as it means that the *duty to grant free transit does not extend to all routes*.[475]

In addition, according to art.V paras.5 and 6, any transportation or *administrative charges* may only be levied in a *reasonable and non-discriminatory* manner.[476]

The ECT transit regime is laid down in ECT Part II "Commerce", namely art.7. While the ECT's most notable input into international dispute resolution is due to the Treaty's investment arbitration provisions, one should not forget that the ECT also contains provisions on dispute settlement mechanism dedicated

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[465] Lauchterpacht, Elihu (1958-59). "Freedom of Transit in International Law", in Problems of Public and Private International Law, London: Grotius Society: Vol. 4. In Clark, Bryan (1998), "Transit and the Energy Charter Treaty: Rhetoric and Reality", *Web Journal of Current Legal Issues* in association with Blackstone Press Ltd., URL: http://webjcli.ncl.ac.uk/1998/issue5/clark5.html , retrieved on April 23, 2010.

[466] Available at: http://www.jurisint.org/doc/html/ins/en/2000/2000jiinsen159.html , retrieved on September 10, 2010.

[467] WTO Secretariat (2002), *op.cit*., note 190.

[468] Liesen (1998), *op.cit*., note 7.

[469] Available on the University of Oslo Law School website: http://www.jus.uio.no/english/services/library/treaties/09/9-04/land-locked-states.xml , retrieved on September 10, 2010.

[470] WTO Secretariat (2002), *supra*, note 467.

[471] *Id.*

[472] *Id.*

[473] Art. V para.1, GATT, *op.cit*., note 189.

[474] Art. V para.2, GATT, *id.*

[475] *Id.*

[476] Art. V paras.5 and 6, GATT, *op.cit*., note 189.

to energy transit.[477] On the other hand, recent quarrels over the security of energy transit and supply attract growing attention to the Treaty's transit dispute resolution system. Thus, before addressing the means of resolution of transit disputes under the ECT (4.5.), this part aims to look at the contribution which the ECT could theoretically make to strengthening the reliability of transit arrangements in general, by analysing its transit definition, main provisions, and probable flaws (4.1.-4.3.), and then studies whether it improves, or conversely, worsens EU-Russia energy relations (4.4).

4.1. Transit Definition

In 1994 transit was defined in the ECT as follows:

> (a) "Transit" means
> (i) the carriage through the Area of a Contracting Party, or to or from port facilities in its Area for loading or unloading, of Energy Materials and Products originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a Contracting Party; or
> (ii) the carriage through the Area of a Contracting Party of Energy Materials and Products originating in the Area of another Contracting Party and destined for the Area of that other Contracting Party, unless
> the two Contracting Parties concerned decide otherwise and record their decision by a joint entry in Annex N (…)
> (b) "Energy Transport Facilities" consist of high-pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines, and other fixed facilities specifically for handling Energy Materials and Products."[478]

This definition tracks the previous transit definitions of international law, exposed in the box 3. However, the definition of ECT art.7 introduces several aspects proper to the Energy Charter.

Firstly, unlike for example the right to file a complaint under ECT arts.26 or 27, on transit not all states involved in the transit project must be signatories to the Treaty. Beside the transit state, *either* the exporting state or the state of final destination has to be a member *but not both of them.*[479] This, however, concerns transit in general, and not the right to use transit dispute settlement. In order to recourse to the latter, both the potential claimant and the defendant must be ECT contracting parties.[480]

Secondly, as it follows from the above definition, ECT art.7 para.10 (ii) states that transit may involve only two parties. Specifically, "transit" means (…) the carriage through the Area of a Contracting Party of Energy Materials and Products originating in the Area of another Contracting Party and destined for the

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[477] Art. 7 para.7, ECT, *op.cit.*, note 50.
[478] Art.7 para.10, ECT, *id.* Notably, the most comprehensive transit definition with respect to international law in general, as valued by the author, was presented by Liesen in 1998 (emphasis added):
"Transit, in general terms, can be defined as the "passage or carriage of people or goods from one place to another". Instead of "from one place to another" the phrase "through a specific territory" could be used without any change in meaning. In this sense, transit is nothing other than movement of something or someone from point A to point B. In international law, however, the word 'transit' also contains a more political dimension and is understood in a narrower sense, that is to say movement of something or someone by crossing at least two state frontiers. (…)
With respect to this definition, petroleum pipelines (…) are "pipelines which cross another territory to deliver oil and gas to market in a third country".
Therefore, transit in international law always comprises a relevance for the territorial sovereignty of at least one state (the transit state). And this is what makes it critical. The transit state may grant the transit due to its own interests, but it may also decide to deny or limit any transportation through its territory or even to interrupt a formerly permitted transit." Liesen (1998), *op.cit.,* note 7.
[479] Liesen (1998), *id.*
[480] *Id.*

Area of that other Contracting Party, unless the two Contracting Parties concerned decide otherwise and record their decision by a joint entry in Annex N."

Finally, it should be noted that the above wording refers to carrying "through the Area" of a contracting party. The term "area", described in ECT art.1 para.10, includes maritime zones over which a state has sovereign rights according to the international law of the sea.[481]

Notably, for the study's parts that follow these lines, it is important to distinguish between *non-networkbound*[482] and *networkbound*[483] transit means. This distinction between non-networkbound and networkbound transit is particularly relevant for the transit state. Above all, the degree of relevance depends on the *ownership of the means of transport*. A pipeline, for example, owned by a foreign state or entity signifies greater *interference in territorial sovereignty* than a pipeline owned by the transit state. This is why the question of ownership sometimes determines the transit route.[484]

4.2. Relevant Provisions

Provisions related to transit are contained in Part II of the ECT, entitled "Commerce" (arts. 3-9). According to ECT art.3 "International markets", "the Contracting Parties shall work to promote access to international markets on commercial terms, and generally to develop an open and competitive market, for Energy Materials and Products".[485] Thus, energy transit represents a very important issue, since it literally allows energy access to international markets. Moreover, the particular relevance of transit is highlighted due to the location of energy resources, which implies vital economic concerns for land-locked countries, states with undeveloped appropriate port infrastructure, etc. Consequently, ECT art.7 covers a very important issue related to Part II.[486]

Other provisions complete and influence the scope of ECT art.7. First, these are the Understandings of the Final Act of the European Energy Charter Conference n.1(b)(i) ("([t]he provisions of the Treaty do not… oblige any Contracting Party to introduce mandatory third party access; ") and n.8, ("[the applicable legislation would include provisions on environmental protection, land use, safety, or technical standards.").[487]

Next, Declaration n.3 of the Final Act of the European Energy Charter Conference clarifies several points on submarine cables and pipelines:

> "With respect to Article 7
> The European Communities and their Member States and Austria, Norway, Sweden and Finland declare that the provisions of Article 7 are subject to the conventional rules of international law on jurisdiction over submarine cables and pipelines or, where there are no such rules, to general international law.

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[481] *Id.*
[482] Transit transport which accesses and leaves the transit state together with the people or goods being transported: e.g. automobiles, airplanes, ships. In Liesen, *id.*
[483] Transit which remains on the territory of the transit state, i.e. all fixed networks such as cables, wires or pipelines. *Id.*
[484] For example, in 1960s, the Netherlands had been selling natural gas to Italy: the potential transit states Belgium and France refused to concede at least joint ownership of the transport network to the Italian buyer; in the end, it was Germany and Switzerland which decided to grant joint ownership and therefore became transit states for Dutch gas. *Id.*
[485] Art.3, ECT, *op.cit.*, note 50.
[486] Liesen (1998), *op.cit.*, note 7.
[487] See discussion on their analysis and application *infra,* pp.90-93.

> They further declare that Article 7 is not intended to affect the interpretation of existing international law on jurisdiction over submarine cables and pipelines, and cannot be considered as doing so."[488]

This provision is of great relevance for current pipeline politics, since the Nord Stream pipeline is now launched. Thus, if some uncertainties – but not disputes - around Nord Stream arise, this could be applicable. That is, the pipeline runs through Finnish and Swedish waters, among others, and one has to recall that in transit not all states involved in the transit project must be signatories to the ECT in order to apply art.7 provisions, except however provisions related to transit dispute settlement.

4.2.1 Access to Transit

ECT art.7 introduces traditional international law concepts for the treatment of transit requests. Parties are basically aware of such notions as non-discrimination and the prohibition of unreasonable restrictions. Therefore such provisions cannot cause many problems when it comes to interpretation of the Treaty.[489] Also, art.7 imposes a general obligation to grant a transit request, which is expressed by mentioning the "principle of freedom of transit". However, a question arises whether such a principle exists in public international law.[490] And, since the Treaty only refers to such a principle rather than establishes it, the implementation of "freedom of transit" would not be of practical significance.[491]

4.2.2. Conditions of Transit

According to art.7 paras.1 and 3,[492] the ECT introduces *non-discriminatory* and *reasonable* treatment also as conditions for *granting* transit.[493] These mean that access conditions and transit fees must not significantly differ depending on the origin or destination of the product, or on the nationality of the owner of the product or the nationality of the customer.[494]

Notably, in the event that transport capacity is limited, an extreme literal interpretation of art.7 would lead to a situation where the transport company would be obliged to reduce transport for all transactions in order to fulfil the requirements of non-discriminatory treatment.[495] Since this seems impossible due to binding transit agreements, the obligations under ECT art.7 paras.1 and 3, may indirectly force the network company to undertake the necessary investments to establish sufficient transportation facilities.[496]

4.2.3. Non-interference of Transit[497]

Art.7 para.6 provides that a signatory "through whose Area Energy Materials and Products transit shall not, in the event of a dispute over any matter arising from that Transit, interrupt or reduce, permit any entity subject to its control to interrupt or reduce, or require any entity subject to its jurisdiction to interrupt or reduce the existing flow of Energy Materials and Products."[498]

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[488] Declaration n.3 of the Final Act of the European Energy Charter Conference, ECT, *op.cit.*, note 50.
[489] Liesen (1998), *op.cit.*, note 7.
[490] For details see *infra,* p.88.
[491] Liesen (1998), *op.cit.*, note 7.
[492] For details on ECT art.7 para.3, see *infra*, p.90.
[493] Liesen (1998), *op.cit.*, note 7.
[494] *Id.*
[495] *Id.*
[496] *Id.*
[497] This part is based on Liesen (1998), *op.cit.*, note 7.
[498] Art.7 para.6, ECT, *op.cit.*, note 50.

This provision is often referred as "most significant" and "most operationally relevant" and has been considered to be of "self-evident" importance.[499]

However, it could be argued that several uncertainties may arise with this provision. Dr. Liesen, for instance, argues that first of all, ECT art.7 para.6 does not prevent an interruption of or reduction in energy flow by the country of *departure*. He continues that, if for example Russia interrupts its fuel deliveries to Germany because gas supplies are stolen by the transit country (Ukraine, Poland or Belarus), it is not Russia which is breaking the obligation under art.7 para.6 (although it may be breaking other contractual obligations), but the transit country. Germany, therefore, could not sue Russia for the incident under the provisions of the Treaty, although Russia may be fined for non-delivery under the terms of a sales contract.

Further, by insisting on a fact that a transit state shall not "in the event of a dispute over any matter arising from that transit" interrupt or reduce the flow of energy, the provision is limited to conflicts over transit tariffs, which have become very common between former Soviet Union countries during recent years. In the event of a dispute over matters concerning anything other than the transit itself, the transit country would breach its obligations by interrupting fuel deliveries. This interpretation is based on the precise wording of art.7 para.6 and, therefore, cannot be superseded by the overall intention of the Treaty to secure the supply of energy.

Notably, according to Dr. Liesen, an important point of art.7 para.6 is the following: in the event of a conflict over transit issues, the transit state should not be allowed to argue that a dispute other than the transit conflict led to the interruption or reduction of energy flow.

In conclusion, art.7 para.6 does not seem to generally prevent the disruption or reduction of energy flows in transit. The fact, that the provision allows interference of transit "where this is specifically provided for in a contract or other agreement" bears this out. As a rule, transit agreements contain a clause concerning the circumstances under which the transit may legally be interrupted, although most agreements do not provide for the situation if transit tariffs are not paid. Only when interruption or reduction is not stipulated in the transit agreement is art.7 para.6 of relevance.

4.3. What is not Covered by Transit Provisions

ECT art.7 only provides for a general legal framework and does not actually govern contractual agreements. Indeed, it addresses the contracting parties of the Treaty and leaves aside most issues typically addressed in transit agreements.[500] Such practical and important issues as ownership of the infrastructure, transportation routes, applicable legal regimes, construction and licensing, safety and environmental protection, and construction finance are not addressed by ECT art.7.[501] Otherwise, these particular issues--typically dealt with in transit agreements--are not properly addressed in the Treaty's transit regime, but are covered by investment terms.

However, on account of the following logic, only access to transit and non-interference of transit could be the main concerns of ECT art.7. That is, detailed clauses on the contents of bilateral agreements could have never been reached in the course of the ECT negotiations, and, more important, would not make much sense given the wide range of different political and economic interests and abilities of potential transit states.[502]

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[499] See *infra*, pp.92-93.
[500] Liesen (1998), *op.cit.*, note 7.
[501] *Id.*
[502] *Id.*

4.4. EU, Russia and the ECT Transit Regime

The Transit Protocol negotiations were the main focus of the EU-Russia disputes over the ECT, and subsequently the delay in the Transit Protocol negotiations became a political obstacle to the entire Energy Charter process. Then, since the provisional application of the ECT, Russia was persuaded that freedom of transit might have brought about a third-party access for Central Asian producers, it warned against a transit corridor from Central Asia to Europe through Russia, as the latter corridor would result in Russia losing control over the energy flows.[503] However, this assertion is quite controversial in light of the Treaty's relevant provisions. As such, the general principles of the ECT's transit regime will be addressed first (4.4.1.). Moreover, Russia considered (and it still does consider) the transit dispute settlement mechanism as laid down in the ECT art.7 para.7 as flawed and inapplicable, particularly in its relations with Ukraine, which remains the largest transit country from Russia to Europe. Therefore, the transit dispute settlement mechanism under art.7 para.7 will be analysed further in this part (4.4.2.).

4.4.1. ECT art.7: Major Flaw of the ECT?

The ECT's existing transit provisions oblige its parties to facilitate the transit of energy on a non-discriminatory basis consistent with the principle of freedom of transit. [504] This is a critical issue for the collective energy security of the Charter's signatory states, since energy resources are increasingly being transported across multiple national boundaries on their way from producer to consumer. Therefore, in order to enhance Treaty's provisions on transit, the ECT parties agreed to elaborate on a Transit Protocol, where formal negotiations had commenced in early 2000. This item remained under discussion. In general, the Transit Protocol's aim is to develop a regime of commonly-accepted operative principles covering transit flows of energy resources, both hydrocarbons and electricity, and is designed to ensure the security and non-interruption of transit. The Energy Charter Conference approved in 1998 a set of rules of procedure for the conduct of conciliation during disputes over matters of energy transit. The Conference also took positive note in 2003 of the first edition of Model Agreements on Cross-Border Pipelines, prepared on the basis of a mandate from the Conference in 1999.

Now, the practical meaning of the ECT transit regime. It seems that, in early 1990s, all the parties to the ECT negotiations were perfectly aware that the success of any attempt to open up the energy markets in Eastern Europe in general and in the former Soviet Union in particular would surely depend to a great degree on the ability to secure freedom of energy transit.[505] As one author explains, "[i]t is not an exaggeration to say that the success of all western oil and gas investment in the [former Soviet Union] effectively [hung] on the reliable provision of economically viable transit routes from point of production to hard currency markets".[506] This concern is particularly pertinent in the context of the subsisting legal framework and political climate in the CIS countries and, in particular, in the Russian Federation, where transit laws remain largely "non-existent or immature" and many potential transit routes cross "hostile terrain".[507] Indeed, the row of energy transit disagreements, culminated in two Russia-Ukraine gas crises, bears this out.

On the other hand, in addition to geopolitical concerns, a number of economic issues proper to the energy sector amplify worries surrounding transit provisions within this industry. As an observer asserts, "carriage of energy materials, petroleum and especially gas, require[s] costly investments, sometimes as costly or costlier than the investments needed for production".[508]

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[503] Yazev, Valery (2002). "Своей трубы не отдадим ни пяди. Почему Россия отказывается ратифицировать Договор к Энергетической Хартии. [Why Russia refuses to ratify the ECT]», February 1, 2002, *«Труд»[Trud]*. See also Wälde and Andrews-Speed (1996), *op.cit.*, note 368.
[504] This section is based on ECT, "AN INTRODUCTION TO THE ENERGY CHARTER TREATY: Transit".
[505] Clark (1998), *op.cit*, note 465.
[506] Jenkins, David (1996). "An Oil and Gas Industry Perspective", p. 187, in Wälde (ed.) (1996), *op.cit.*, note 387.
[507] Wälde and Andrews-Speed (1996), *op.cit.*, note 368, p. 34. See also Clark (1998), *op.cit.*, note 465.
[508] Fatouros, Arghyrios A. (1998). "Energy Transit and Investment in the Energy Charter Treaty", *Hellenic Journal of International Law,* (Vol.2, 1996, pp. 185-221), p.185. In Clark (1998), *id.* The excessive costs involved and technical expertise required entail a long-term approach which requires the comfort of a stable legal framework within which

Yet, the ECT is a politically driven compromise rather than a deal of universal consensus.[509] Thus, in light of concerns arising from principles of state sovereign interests, some of the main issues supposed to be protected by the Treaty have been diluted to the point to which their efficacy can be questioned.[510] This seems to be the case of some ECT transit rules, and especially its dispute settlement system.

In this regard, several questions exist for specialists in the field. First, given the historically established political nature of the transit issue in the former Soviet Union space, and in particular in Russia, can the rhetoric of the ECT transit provisions be transformed into the reality of freedom of access to a national energy infrastructure (in our case, Russian one)? And, second, are there adequate provisions in the ECT for dispute resolution to protect the security of transit?[511]

Rhetoric aside, on April 20, 2009, one day before the official publishing of its "Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)",[512] , the Russian Presidency declared in Helsinki that "[r]egarding the [ECT], we do not consider ourselves bound by the obligations under this treaty (…) We are not satisfied with the Energy Charter and the documents, comprising the system of the Energy Charter in its present state".[513]

In this context it is worth recalling that Russia linked its ratification of the ECT to negotiations on the Transit Protocol, and that in December 2006 Russia indicated that the ratification of the ECT was unlikely due to the provisions requiring third-party access to Russia's pipelines.[514] Thus, the main flaw of the ECT as perceived by Russia is the ECT art. 7. This was as well largely supported by the Treaty's ratification opponents, and the partisans of the end of its provisional application. Therefore, the next sections look at the development of the ECT's main principles governing energy transit and their assessment regarding Russia's position.

4.4.2. Obligations Concerning Transit: ECT art.7 paras.1-7

ECT art.7 is based on GATT art. V, but aims at representing more robust transit rights than the latter provision, given the geographic situation of many Western and Central European States in relation to energy supplier countries.[515] ECT art.7 para.1 reads as follows (emphasis added):

> "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."[516]

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to develop. Fatouros continues, "[t]his is precisely what the [ECT] seeks to establish, by providing a special sectoral international legal regime for energy". *Id.*

[509] See *supra*, p.76.

[510] Wälde and Andrews-Speed (1996), *op.cit.,* note 368. See also Jenkins, *op.cit.*, note 506.

[511] Jenkins, *id.*

[512] President Dmitry Medvedev (2009). Medvedev, Dmitry (2009). « Концептуальный подход к новой правовой базе международного сотрудничества в сфере энергетики (цели и принципы) [Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles)]", April 21, 2009, *Official website of the President of the Russian Federation.* Available in English at: http://eng.kremlin.ru/text/docs/2009/04/215305.shtml , retrieved on April 30, 2010.

[513] «Ответы помощника Президента Аркадия Дворковича на вопросы журналистов [Arkady Dvorkovitch, the Special Assistant to the President of the Russian Federation, answering journalists]", April 21, 2009, G8 Helsinki Summit, on *Official website of the President of the Russian Federation.* Available (only in Russian) at: http://archive.kremlin.ru/text/docs/2009/04/215309.shtml , retrieved on September 24, 2010.

[514] For details, see note 204.

[515] Wälde and Konoplyanik (2006), *op.cit.*, note 328.

[516] Art.7 para.1, ECT, *op.cit.*, note 50.

While some authors[517] assert that ECT art.7 para.1 is a much stricter regulation than GATT art. V, others[518] argue that the wording of the first paragraph of the article renders its provisions weaker than those enshrined within GATT art.V. The former authors in particular stress that ECT art.7 para.1 "(...) goes considerably beyond the affirmation of the [GATT] principles of freedom of transit and non-discrimination".[519] The rationale of this hypothesis is that parties must take *necessary* measures to "facilitate" free access - a *positive requirement* as opposed to the previously passive requirement merely to *allow* free access.[520] The protagonists of this standpoint assert that taking requisite measures to "facilitate" transit is lower in *normative intensity* than ensuring that there "*shall* be freedom of transit" (GATT art. V).[521] Since then, it remains to be seen how this provision will be interpreted by the contracting parties in practice.

On ECT art. 7 para. 2 an observer noticed that:

> "Article 7(2) builds upon 7(1) and sets out the proposition that [contracting parties] "shall encourage relevant entities" to co-operate in developing, operating, modernising and facilitating the interconnection of energy transport facilities and take measures to mitigate the effects of interruptions in energy supply. These provisions appear at first blush to substantially augment those set out in 7(1). Whilst it is plausible that 7(2) the phrase "shall encourage" articulates a legally binding obligations, these provisions would, however, seem to be "soft" in nature and couched in somewhat opaque language. It seems likely therefore that any actions brought under 7(2) would not be justiciable. This is compounded by the fact that the term "relevant entities" is not defined in this context."[522]

ECT art.7 para.3 requires that in respect to the use of "Energy Transport Facilities", each party shall treat energy materials and products in transit "in no less favourable manner than its provisions treat such materials and products originating in or destined for its own Area, unless an existing international agreement provides otherwise."[523] Consequently, the ECT creates firm obligations on its members to authorise and facilitate energy transit, including what has been described as a "soft" obligation to favour the construction of new facilities, to abstain from unjustifiable closure of transit facilities (e.g., for political reasons), and to make sure state and private transit operators do not challenge that obligation.[524]

Regarding Russia's position, in light of the ECT's transit regime, it could be argued that the Russia's assertion that the ECT provides third-party access to Russia's pipelines lacks ground. The *pros* and *cons* of that Russia's statement are presented below.

In fact, in respect of the ECT, some Russian politicians and energy specialists[525] often expressed fear that in case of direct gas supply contracts between Central Asian producers and European customers, the ECT will bind Russia to grant access to its gas transportation system for cheap Central Asian gas, all at low

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[517] Herman (2009), *op.cit.*, note 281, p.3.
[518] Roggenkamp, Martha (1996). "Transit of Network-bound Energy: the European Experience", p. 109, in Wälde (1996) (ed.), *op.cit.*, note 387.
[519] Fatouros (1998), *op.cit.*, note 508, p. 191.
[520] *Id.*
[521] Clark (1998), *op.cit.* note 465; Roggenkamp, *op.cit.,* note 518, p.509.
[522] Clark (1998), *id.*
[523] Art. 7 para. 3 , ECT, *op.cit.*, note 50.
[524] Wälde and Konoplyanik (2006), *op.cit.*, note 328, p. 543.
[525] Butchnev, Oleg and Maxim Nedzveckyi (2006). "Влияние процессов глобализации на российскую газовую промышленность [The influence of globalisation processes on the Russia'a gas industry]", *Газовый бизнес [Gazovyj Biznes]*, May-June 2006, pp. 40-42 in Belyi (2009), *op.cit.*, note 200. See also arguments of Valery Yazev in Schroeter, Stefan (2010), "Change is in the air", European Energy Review, April 7, 2010, URL: http://www.europeanenergyreview.eu/index.php?id_mailing=60&toegang=072b030ba126b2f4b2374f342be9ed44&id=1848 , retrieved on September 30, 2010.

Russian domestic transportation tariffs.[526] As a result, after its transportation through the territory of Russia, gas from Central Asia will be more competitive than Russian gas on the European market.[527]

The same opponents assert that the terms "facilitate the Transit" (ECT art.7 para.1) are actually unclear, especially regarding transit theft and transit tariffs,[528] which were already a problem in relation with the gas trade with the former Soviet Union.[529] The ECTP was actually designed to clarify the provisions of ECT art.7. The protocol covered the definition of access to pipelines, cost-effectiveness of transit tariffs, definition of available capacity, and transit theft.[530] The ECTP negotiations were the main focus of EU-Russian disputes over the Energy Charter. The Russians asserted that the document should include the "right of first refusal" if a long-term supply contract (i.e., a pure trade transaction) does not match the long-term transit contract (i.e., only access to pipelines), while the EU strongly disagreed with such an arrangement.[531] Instead, the EU wished to see both transit and supply contracts abridged in order to increase competition,[532] one of the most crucial and Commission-followed EU policy areas. Consequently, no agreement was possible and the signing of the Protocol was suspended. Further, given that since 2001 the Russian Parliament has linked the ratification of the ECT to an acceptable Transit agreement within the ECT, the *suspension in the ECTP negotiations* became a *political obstruction* to the entire Energy Charter process.

Next, before assessing Russia's position during its participation in the ECT *vis-à-vis* art.7 provisions, it could be useful to briefly examine whether this article *itself* articulates somehow a *possibility of third-party access to pipelines*. Indeed, ECT art.7 arguably obliges the granting of transit requests by reference to "the principle of freedom of transit".[533] Yet, regardless of the fact that it is well recognised that non-discrimination and the absence of unreasonable transit conditions are features of international transit laws, it is arguable whether there is such an *unfettered principle of international law* as freedom *of access* to transit.[534] In fact, while purely referring in a multilateral agreement to a principle of international law, it does not necessarily mean that such a principle exists.[535]

In addition, had the ECT bound an obligatory third-party access, it would have created immovable obstacles for those transit states who, while facing limited transport facilities and new requests for transit, are compelled to reduce existing transit in order to accommodate the new requests.[536]

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[526] Central Asian gas is actually no longer "cheap" in terms of pricing mechanisms. Over the past years Russia has been buying gas from the Central Asian Republics Turkmenistan, Kazakhstan, and Uzbekistan , then carrying this gas through Russian territory, and selling it to Ukraine. It was a relatively cheap resource but since January 2009 the Central Asian countries introduced European pricing in their relations with Russia. See « Russian Prime Minister Vladimir Putin met with foreign media » , January 8, 2009, Official website of the Government of the Russian Federation, URL: http://www.premier.gov.ru/eng/events/news/2956/ , retrieved on April 25, 2010; see also Aseeva (2010), *op.cit.*, note 19.
In addition, Gazprom itself transits the gas purchased in Central Asia through the territories of Uzbekistan and Kazakhstan and faces corresponding costs and risks. See Konoplyanik, Andrei (2009) – hereinafter Konoplyanik, (2009)bis. "Russian and Central Asian gas in the FSU and continental Europe: evolution of contractual structures and pricing mechanisms". Presentation at the Marine CEMTPP, School of International and Public Affairs, Columbia University, New York, NY, March 3, 2009.
[527] Konoplyanik (2009), *op.cit*, note 163.
[528] See *infra*, pp 97-98.
[529] See Belyi, Andrei V. (2008). "Energy Dimension of Pan European Security and its Impact on the European Union", *Oil, Gas, Energy Law Intelligence*, November 2008, Vol. No.3, 2008.
[530] ECT. *Transit protocol: Background to the Negotiations*. URL: http://www.encharter.org/index.php?id=37 , retrieved on May 22, 2010. The draft text of the Transit Protocol is available at:
http://www.encharter.org/fileadmin/user_upload/document/CC251.pdf , retrieved on September 10, 2010.
[531] Belyi (2009), *op.cit.*, note 210, p. 3.
[532] *Id.*
[533] Clark (1998), *op.cit.,* note 465.
[534] Liesen (1998), *op.cit.*, note 7.
[535] Clark (1998), *supra* note 533.
[536] *Id.*

Hence, the assertion is quite debatable whether the ECT could allow third-party countries to access the transit facilities of a contracting party. Indeed, the Treaty sets forth that "[e]ach Contracting Party shall take the necessary measures to facilitate the Transit of Energy Materials and Products (...)".[537] This above all signifies the *existing transit chains*, not new ones. However it "shall encourage relevant entities to cooperate" in general on matters relating to the transit of energy materials and products.[538] Then, "(...) the Contracting Parties shall not place obstacles in the way of new capacity being established, except as may be otherwise provided in *applicable legislation* which is consistent with paragraph [7](1) (i.e. consistent with freedom of transit and non-discrimination; emphasis added)".[539] Based on ECT interpretative notes (Understandings), namely IV.8, *legislation relative to land use, safety or technical standards or environmental matters* would fall within the domain of this exception.[540] In light of transitional arrangements, "[i]n recognition of the need for time to adapt to the requirements of a market economy, a Contracting Party listed in Annex T may temporarily suspend full compliance with its [transit] obligations (…).[541] And as per Annex T to the ECT, Russia is included in the list of countries applying transitional measures aiming for adaptation to a market economy. In addition to the "applicable legislation" exception to the general proposition, as laid down in art.7 para.4, the fifth paragraph stipulates that (emphasis added):

> "A Contracting Party through whose Area Energy Materials and Products may transit *shall not be obliged to*
>
> (a) *permit* the construction or *modification of Energy Transport Facilities*; or
>
> (b) *permit new or additional Transit* through existing Energy Transport Facilities,
>
> which it demonstrates to the other Contracting Parties concerned *would endanger the security or efficiency of its energy systems, including the security of supply*.
>
> Contracting Parties shall, subject to paragraphs (6) and (7), secure established flows of Energy Materials and Products to, from or between the Areas of other Contracting Parties."

In other words, *the transit state is not bound* by art.7 para.4 if it can demonstrate to other contracting parties that new energy transportation facilities would "endanger the security or efficiency of its energy systems, including the security of supply".[542] On the other hand, art.7 para.5 binds a link with sixth and seventh paragraphs of ECT art.7.

The latter provisions were qualified by some specialists as the most far-reaching and unusual,[543] as well as most operationally relevant[544] of the ECT transit regime. ECT art.7 para.6 stipulates that the transit state "*shall not, in the event of a dispute over any matter* arising from that Transit, *interrupt or reduce,* permit any entity subject to its control to interrupt or reduce, or require any entity subject to its jurisdiction to interrupt or reduce *the existing flow of Energy Materials and Products prior to the conclusion of the dispute resolution mechanism* set out in paragraph (7) (emphasis added)".[545] Thus, some authors state that art.7 para.6 represents certain *insurance for investors,* in the sense that it secures *existing* transit and reduces the *de facto* control of the

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[537] Jenkins (1996), *op.cit.,* note 506.
[538] Clark (1998), *op.cit.*, note 465.
[539] *Id.* On ECT Article 7(4), it should be noted, however, that it is to be read in the light of the somewhat ambiguous provisions of Article 7(9) which state that transit provisions must not be so interpreted as to "oblige any [contracting state] which does not have a certain type of Energy Transport Facilities used for Transit to take any measure under the Article with respect that type of Energy Transport Facilities". Such a [CP] is, however, "obliged to comply with [Article 7 (4)]". At first glance, it appears that Article 7(9) is anathema to 7(4) and quite how this conundrum, clearly a product of the political compromise which has imbued the Treaty provisions, can be resolved is unclear. In an attempt to rationalise this apparent contradiction, some authors suggested that the net effect of the relationship between Articles 7(4) and 7(9) is that transit States may be permitted some discretion as to the particular mode of Energy Transport Facilities to be introduced.
[540] Understandings to the Final Act , ECT, *op.cit.*, note 50.
[541] Art.32 para.1, *id.* See also ECT Annex T.
[542] Clark (1998), *op.cit.*, note 465.
[543] *Id.*
[544] Bamberger, Craig S. (2008). Introduction to the Graham Coop and Clarisse Ribeiro (ed.), *Investment Protection and The Energy Charter Treaty*, Juris Publishing, Huntington, NY, 2008.
[545] Art.7 para.6, ECT, *op.cit.*, note 50.

transiting state over other states' energy exports.[546] However, as other specialists assert, this provision is limited to conflicts over transit tariffs.[547] Still, if a dispute over matters concerning anything other than the transit itself occurs, the transit country would probably have a right to breach its obligations by interrupting fuel deliveries. Nevertheless, it should be noted that this interpretation is based on the literal reading of art.7 para.6.

Returning to the exceptions mentioned above, it appears *prima facie* that by permitting them, the ECT tolerates the fundamental principle of state sovereignty. In addition, for a contracting party applying the ECT provisionally, regarding new transit capacity, *national legislation has priority over the ECT* in case of a conflict of laws[548] ("applicable legislation" exception). And as we know, until recently Russia was a signatory applying the Treaty provisionally. Last but not least, the cited ECT Understanding, namely under 1(b)(i), clearly states that "the provisions of the Treaty do not oblige any Contracting Party to introduce mandatory third party access".[549]

To summarise it in light of Russia's expressed concerns, the ECT's referred provisions stipulate that the generalprinciples of *freedom of transit / transit facilitation* are to be respected but mainly *regarding already existing energy transit chains*. That this respect should be *consistent* with national applicable legislation, as well as with country's *energy security guidelines*. And that full respect of transit obligations could be *temporarily suspended* by countries-economies in transition due to their possible *need for time to adapt to the requirements of a market economy*. Thus, in theory, under the ECT transit regime, Russia is not only not automatically bound to grant third-party access to its pipelines, but it also has the *right to deny new or additional transit* through its energy transportation system. Again, albeit the fact that the text of ECT art. 7 leads quite easily to the latter assumption, within Russia there are many more sceptics toward such a reading[550] than supporters to it.[551]

4.5. Resolution of Transit Disputes under the ECT

In addition to investment dispute resolution mechanisms, the ECT proposes a dispute settlement system specifically dedicated to transit disagreements among parties to the Treaty. Its most original feature is that it comprises a conciliation procedure which could be used prior to and/or instead of adjudication proceedings. This part of the study offers a general overview of the transit dispute resolution mechanism under the ECT (4.5.1.), and further discusses resolving transit disputes related to EU-Russia energy relations (4.5.2.).

4.5.1. General Analysis

ECT art.7 para.7 is the only provision of the Treaty that expressly addresses transit disputes.[552] As it explicitly refers solely to disputes over *existing transit*,[553] one question remains unanswered: what about the obligations set out in the *other* paragraphs of ECT art.7?[554]

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[546] Clark (1998), *op.cit.*, note 465.
[547] See *infra* on this page and p.94.
[548] Konoplyanik (2009), *op.cit.,* note 163, p. 37.
[549] Understanding to the Final Act, (IV).1(b)(i), ECT, *op.cit.*, note 50.
[550] Yazev (2002) and (2008); Butchnev and Nedzveckyi (2006); Belyi (2009).
[551] Konoplyanik (2009).
[552] ECT art. 7 para.7 in full, reads:
The following provisions shall apply to a dispute described in paragraph (6), but only following the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed between the Contracting Parties party to the dispute or between any entity referred to in paragraph (6) and an entity of another Contracting Party to the dispute:
(a) A Contracting Party to the dispute may refer it to the Secretary- General by a notification summarizing the matters in dispute. The Secretary-General shall notify all Contracting Parties of any such referral.
(b) Within 30 days of receipt of such a notification, the Secretary-General, in consultation with the parties to the dispute and the other Contracting Parties concerned, shall appoint a conciliator. Such a conciliator shall have experience in the matters subject to dispute and shall not be a national or citizen of or permanently resident in a party to the dispute or one of the other Contracting Parties concerned.

The answer to this question is very important in case of a conflict between the contracting parties that implies any kind of *unacceptable transit conditions*. Notably, in theory two other ECT articles concerning dispute resolution may be applicable in such a situation, namely ECT art.26 and 27. Regarding this appealing hypothesis, Dr. Liesen explains (emphasis and bold added):

> "Article 26 provides for "disputes between a Contracting Party and an Investor of another Contracting Party (...), which concern an alleged breach of an obligation of a [Contracting Party] under Part III (...)." Part III of the Treaty deals with "Investment promotion and protection", whereas transit matters are covered by Part II which is titled "Commerce". However, *"investment"* as defined in Article 1 [(6)(f)] also includes "*any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector". Since the term* ***"economic activity in the energy sector"*** *explicitly refers to* ***"land transport"*** *(Article1 [(5)])* ***the right to transport energy and energy materials through a contracting party's territory is an "investment" in the sense of the Treaty***. On the other hand, Article 26, although covering all kinds of investments, only relates to obligations under Part III of the Treaty, with the result that the specific transit obligations set out under Article 7 are not included. This conclusion is not mandatory in dogmatic terms but best meets the overall structure of the Treaty with its clear separation of trade respectively investment provisions.
>
> *Article 27 (1), relating to "disputes concerning the application or interpretation of this Treaty", is not limited to specific parts or provisions of the Treaty and thus is theoretically applicable to all disputes related to any transit obligation set out in Article 7.* However, it is arguable whether arbitration under Article 27 also applies to conflicts over existing transit. *Article 7 (7) provides for a specific dispute settlement procedure and could therefore have exclusive priority (lex specialis derogat legis generalis). On the other hand, principles such as the lex specialis rule, although common in national jurisdictions, cannot be used as a general and definitive means of interpretation in international law.* ***In the final analysis, however, it is the unanimous intention of the signatories which is the deciding factor.*** But in so far, neither Article7, nor Article27 indicates the signatories' intention clearly, and no reason can be found why a party to the dispute should not be entitled to choose between the two arbitration methods.
>
> *Should the parties decide in favour of Article 27, the arbitral award will be final and binding [Article 27(3)(b)] and therefore makes a further procedure under Article7(7) unnecessary; if the parties decide on conciliation pursuant to Article7(7), there will be an agreement finally resolving the dispute or an* ***interim decision*** *by the conciliator [Article7(7)(c)];* ***only the latter possibility will open the dispute for additional arbitration under Article 27,*** which is reasonable since the conflict could otherwise remain unsolved.
>
> All in all, the parties to a dispute are free to choose between Articles 7 and 27, *with one exception, however:* ***should the transit state want to interrupt or reduce the existing flow***

(c) The conciliator shall seek the agreement of the parties to the dispute to a resolution thereof or upon a procedure to achieve such resolution. If within 90 days of his appointment he has failed to secure such agreement, he shall recommend a resolution to the dispute or a procedure to achieve such resolution and shall decide the interim tariffs and other terms and conditions to be observed for Transit from a date which he shall specify until the dispute is resolved.

(d) The Contracting Parties undertake to observe and ensure that the entities under their control or jurisdiction observe any interim decision under subparagraph (c) on tariffs, terms and conditions for 12 months following the conciliator's decision or until resolution of the dispute, whichever is earlier.

(e) Notwithstanding subparagraph (b) the Secretary-General may elect not to appoint a conciliator if in his judgement the dispute concerns Transit that is or has been the subject of the dispute resolution procedures set out in subparagraphs (a) to (d) and those proceedings have not resulted in a resolution of the dispute.

(f) The Charter Conference shall adopt standard provisions concerning the conduct of conciliation and the compensation of conciliators.

[553] See *supra*, ECT art. 7 para.6.

[554] Liesen (1998), *op.cit.*, note 7.

of energy materials and products, it is obliged to execute the conciliation procedure of Article7(7) first [Article7(6)]. "[555]

Regarding ECT transit dispute settlement properly speaking, in the case of a dispute, the flow of energy materials or products must not be disrupted. An additional original feature is the provision of a conciliation mechanism for transit disputes that is supposed to be faster than the interstate arbitration procedure provided by ECT art.27, although this latter alternative is also available for the resolution of transit disputes. It is important to note that investors (e.g. private companies) may not take a contracting state to arbitration over a transit dispute.[556] Therefore, the above assertion that ECT art.26 could theoretically be applicable to transit disputes is of particular interest, since it could signify an opportunity for "investors" in the Treaty's meaning to bring a contracting party to arbitration over transit disputes. Another hypothesis deriving from that statement is that contracting states could bring other contracting states to arbitration under ECT art.26, by acting through enterprises. In this case, however, it is not clear how the fact that a contracting party operates through a state-shielded energy company, where it is not a 100 percent owner, or even not a major shareholder, would affect the *qualité d'agir* of such firm. In any case, such situations would be essentially governed by the *rules of attribution* in international law.

As to the applicability of ECT art.7 para.7, it seems that, if they arise, energy transit disagreements between the EU and Russia could be hardly solved by the provision, since the typical disputes to be solved under this article are conflicts over transit tariffs between former Soviet states.[557] So far, here again theory could differ from practice, as it was recently demonstrated by the failure to reconcile Ukraine and Russia under the ECT.[558]

From the procedural standpoint, it should be noted that the procedure of transit dispute settlement under the ECT can only be invoked once all other contractual or previously agreed dispute resolution mechanisms are exhausted. Such mechanisms would include contractual arbitration mechanisms either by virtue of an intergovernmental agreement or protection within a specific pipeline contract.[559] However, it remains unclear at this stage whether ECT art.7 para.7 could be invoked in order to effectively challenge an award determined under a contractual arbitration mechanism.[560]

In fact, as to the procedure, the provision addressed in this part offers some benefits, but also some uncertainties. Above all, it is the first understanding that aims to create an international dispute settlement mechanism regulating disputes over energy transit.

The key advantage of the procedure laid down by ECT art.7 para.7 is that states signatories are bound not to *disturb* and/or to *interrupt* the energy flows through their territory at the time of a dispute. Moreover, the disputing parties may be able to reach a *compromise*, since the conciliation procedure and 12-month period within which the interim award of the conciliator must be adhered to provides a window for such opportunity.

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[555] Liesen (1998), *id.*

[556] Wälde, Thomas W. (1996). "Investment arbitration under the Energy Charter Treaty. From dispute settlement to Treaty implementation", *Arbitration International*, Vol. 12/ 4, (pp. 429–466), 1996.

[557] ECT art.7 para.6 states that the seventh paragraph of the same provision covers "dispute over any matter arising from an existing transit". Referring to the sixth paragraph, no detailed description of the kind of dispute can be found except "an existing transit" of energy materials and products through a contracting state's territory. This provision may thus include all imaginable conflicts about transit matters, with the only limitation that the transit state and, in addition, either the country of destination or departure has to be a signatory to the Treaty. Liesen (1998), *op.cit*. note 7.

[558] *Infra*, pp.98-99.

[559] Wälde (2004), *loc.cit*., note 589.

[560] Furthermore, where redress is available through the transit state's domestic courts, it remains a moot point as to whether recourse must be sought in these fora prior to invoking Article 7(7). Given, however, that such fora exist as a matter of general law and are not "agreed" as such, it has been suggested that as such this question should be answered in the negative. Clark (1998), *op.cit*., note 465.

However, this conciliation procedure creates uncertainties both in theory and in practice. The rhetoric of such ambiguities will follow these lines, while the issue of bottlenecks created by it in practice, namely in Russia's case, will be addressed in the next sub-part.

Some of the main difficulties with the conciliation procedure may derive from the fact that if no consensual agreement can be reached, then the *conciliator*, up to this point a *non-adjudicative neutral*, will start to act in a judicial manner. However, it should be noted that there is a clear distinction between the respective roles of the conciliator and the adjudicator.[561] Indeed, while the essence of *adjudication* is founded on *adherence to legal norms*, *conciliation* is no more than a *quasi-judicial process* based primarily on *optimal convergence of mutual political interests*. The possibility for the success of such non-adjudicative forms of dispute settlement depends to a great extent on the openness and sincerity of the parties to the proceedings, and in particular, information flows to and from the conciliator. The scope for a facilitated settlement may be considerably reduced on account of an underlying trouble that parties to the dispute are actually aware that theoretically sensitive information conferred to the conciliator may be used against them in a subsequent interim award. In such a paradigm, the question remains as to *what will occur* after a 12-month period has lapsed and no agreement has been reached. At this stage it seems that the transit state's obligations cease to exist, including those obligations to adhere to the imposed interim solution and to continue the flow of transit. The options that remain to resolve the dispute at this stage are either to open the general state-investor and/or stat-state dispute resolution procedures under arts. 26 and 27 respectively, or to recommence art.7 para.7 procedures.[562]

However, the relationship between art.7 para.7 procedures, on the one hand, and the ECT's general dispute resolution procedures that can be invoked in relation to new or additional transit, on the other, remains unclear and unexplored. Moreover, the procedures serve to act as a "fall back" position once parties have "exhausted all relevant contractual or other dispute resolution remedies previously agreed between the [parties]..."[563] It remains a controversial point whether or not they can be invoked by one party in the face of an undesirable settlement by arbitration or other agreed contractual mechanisms. In the geographic context of this paper, it is worth mentioning that this inherent uncertainty does not contribute to confidence-building between the Russian government and potential European investors.

4.5.2. Analysis and Prospects of Transit Dispute Resolution under the ECT in Light of Recent Incidents

In theory, following the above analysis of a relationship between the notions of "investment" and "transit" under the ECT, it seems that in case of an inappropriate interruption or reduction of energy flows, ECT signatories could have a choice between different Treaty's provisions as follows. They could choose between ECT transit dispute settlement properly speaking, and transit disputes resolution through investment dispute settlement. In the latter case, claimants have to establish the following pieces of evidence. First, they have to demonstrate that their *right to carry energy and energy materials through a contracting party's territory* is an *investment* as laid down by ECT Article 1.6 (f), namely, *an economic activity in the energy sector*. Then, they have to prove that this investment is subject to a discriminatory treatment, i.e. it is subject to any of alleged breaches of an obligation of a contracting party under ECT Part III conditions (investment protection). Subsequently, the arbitral award under the latter dispute resolution would be binding and final, which could be very interesting for claimants.

In applying these to recent Russia-Ukraine gas disputes, it could be argued that Russia has theoretically had a choice between three options: (1) the ECT transit dispute settlement under art.7; (2) the interstate arbitration procedure under art.27; and (3) a hypothetical possibility that art.26 could be applicable to transit disputes, namely, that a contracting party could sue another contracting party in acting through state enterprises. Each of these options will be discussed in turn.

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[561] This section is based on Clark (1998), *id.*
[562] See reasoning of Liesen (1998), *supra*, pp.94.
[563] Art. 7 para.7, ECT, *op.cit.,* note 50.

The first option could bring a faster solution than the interstate arbitration procedure, particularly thanks to the fact that ECT art.7 contains a provision on the conciliation mechanism for transit disputes. The main disadvantage of this avenue is the quasi-jurisdictional nature of conciliation. Actually, it could be supposed that ECT art.7, proposing a comprehensive procedure largely based on optimal convergence of mutual political interests of the antagonists, aimed to design the key advantage of the Treaty's transit regime. Indeed, in the field of energy transit, which involves even more concerns related to state sovereignty than energy investment, a political compromise might more likely be achieved than an arbitral award would be enforced. Yet, the practice, namely the failure of the ECT transit dispute mechanism to offer effective tools to resolve the latest Russia-Ukraine gas transit crisis, blurs the picture.[564]

The second option, under art.27, is possible under two conditions. First, all parties to a dispute must be states, and, second, the claimant has to establish that its investment, namely, an economic activity in the energy sector (particularly, the right to transport energy through a contracting party's territory), is subject to discriminatory treatment on behalf of the defendant. The advantage of this option is correlated with the theoretical benefit – which appears to be a limitation in practice - of the first option. That is, unlike conciliation, arbitration is based on adherence to legal norms, and its decisions are binding. Russia did not opt for this alternative either for the resolution of its first conflict with Ukraine, or for the second one. Probably Russians did not consider this method simply because it is not expressly dedicated to transit disputes. To this presumption it is worth adding that the situation in both cases was actually the opposite of the one that was supposed to be resolved under this provision. Specifically Russia – the potential claimant – stopped the gas flows through Ukraine – the potential defendant. Therefore, following the logic of the relationship asserted above between notions of "investment" and "transit" under the Treaty, Russia would have factually discriminated against its own investment.

The third option under art.26 theoretically requires Gazprom, not Russia proper, to sue Ukraine as a contracting party. However, the theoretical chances of suing Ukraine for the 2009 gas dispute under ECT art.26 are fairly slim, since this article, while it covers all kinds of investments, only relates to obligations under Part III of the Treaty, with the result that the specific transit obligations set out under art. 7 are not included.[565] Still, this cannot be completely excluded either. In addition to that difficulty, since Russia's government possesses 50 percent plus one share of Gazprom, the company's actions could have been considered as attributable to the Russian Federation as a contracting party, and not to Gazprom as an investor.

If Gazprom could have been considered as an investor under the Treaty, however, it could be supposed that another kind of breach of an obligation of a contracting party under ECT Part III conditions could be invoked in such situation. Namely, Ukraine's unauthorised gas tapping in January 2009, as well as its intention to raise transit tarriffs,[566] could be considered as *the equivalent of an expropriation*, or else, a *tantamount to expropriation*. The latter formulation is dedicated by NAFTA art. 1110 as: "(...) a measure tantamount to nationalization or expropriation of such an investment (...)".[567] The former concept is contained in ECT art. 13, and is called "(…) measures having effect equivalent to nationalization or expropriation". There are four exceptions to an interdiction of those measures, i.e. where such expropriation is: (1) for a purpose which is in the public interest; (2) not discriminatory; (3) carried out under due process of law; and (4) accompanied by payment of prompt, adequate and effective compensation.[568] Therefore, in case of a lack of such justifying bases, Gazprom could theoretically claim that the equivalent of expropriation under the Treaty by Ukraine took place in their 2009 dispute. A related situation had constituted one of claims of a Swedish investor against Republic of Latvia in an ECT

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[564] See *infra*, pp.98-99.
[565] See *supra*, pp.66-67, 85-86.
[566] On January 5, 2009 Moscow accused Kiev in unauthorised gas tapping amounted to 65.3 million cubic meters and called Ukraine to stop that theft and to make up for the stolen amounts. Kiev replied that this gas was required for technical needs of transit (however, under the terms of the transit contract, Ukraine should provide the technical gas out of its own resources). See annex 1.
[567] Art 1110 para.1, NAFTA, *op.cit*., note 296.
[568] Art.13, ECT, *op.cit*, note 50.

case *Nykomb v Latvia*.[569] Notably, in this case, the claimant contended that the contractual obligations breached by the Latvian state amounted to an *indirect* expropriation. Namely, by taking away a part of claimant's income, it was advanced that these actions made the enterprise *not economically viable* and the claimant's investment *worthless*. In arguing from analogy, in Russia-Ukraine case of 2009 crisis, it could be argued that Ukraine *illegitimately took possession of Gazprom's investment*, i.e. transited gas, and raised transit tariffs, which could be qualified as the equivalent of an expropriation under the Treaty. Yet, *primo*, this parallel is not perfect, since in the Swedish-Latvian case the alleged indirect expropriation, non-payment by the defendant of the double tariff, was claimed to take away a *considerable* fraction of claimant's income (which is not the case with the relatively small amounts of tapped by Ukraine gas); and, *secundo*, the above claim of Swedish investor was rejected by the arbitral tribunal.[570] Again, the chances are not that high that the arbitral tribunal would have categorised the related gas theft and/or raised gas transit tariffs as the equivalent of an expropriation. However, it might have been better for Russia to try this option than to stick to the conciliation procedure under the transit dispute settlement.[571]

Empirically, as it was stated above, the main Russian concern about ECT art.7 is that Gazprom was convinced that the freedom of transit also involved third-party access for Central Asian producers.[572] But additionally, prior to Russian withdrawal from the ECT, Gazprom considered the transit dispute settlement mechanism as laid down by art.7 para.7 flawed and not applicable to its relations with Ukraine (as stated, the largest transit country from Russia to Europe).[573]

In particular, according to Gazprom, ECT art.7 para.7 confers a large, discretionary power to the conciliator, who can decide on tariffs and supplies for a period of up to 12 months (art.7 para.7 (c-d)).[574] As it was argued above,whereas the core of arbitration is founded on adherence to legal norms, conciliation is actually a quasi-judicial process based primarily on optimal convergence of mutual political interests. In light of this argumentation the latter Gazprom's argument is not totally unreasonable.

Since then, Gazprom prefers to deal bilaterally both with Central Asian producers as well as with Ukrainian transit obligations. On the other hand, according to ECT art.45, until the last day of the ECT's provisional application on Russian territory, Russia could in fact have used the Treaty's transit dispute settlement mechanism during the 2006 and 2009 "gas wars" with Ukraine. Therefore, the next lines briefly address how the ECT transit mechanisms were used during the two crises respectively, and further, how they could theoretically have been used.

During the first Russia-Ukraine gas dispute (started in December 2005) the ECT Secretariat prepared the conciliatory procedure *in advance* in case the parties would not be able to reach an agreement. In that case an expert, George Verberg, was proposed as a conciliator.[575] Both parties gave preliminary agreement to its acceptability and to the proposed conciliator, though this procedure was not finally used because this possibility was overtaken by the swift conclusion of a bilateral agreement.[576]

However, in the January 2009 crisis the Energy Charter Secretariat *did not even communicate* the name of the proposed conciliator to the parties in dispute until January 9 [577] – i.e., only after the transit to the EU was fully interrupted on January 7. The latter reaction – or, actually, an absence of reaction - of the ECT

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[569] SCC, *Nykomb Synergetics Tech. Holding AB v The Republic of Latvia*, Case No. 118/2001, Award rendered December 16, 2003.
[570] Nykomb, *ibid.*, at 33.
[571] See *infra* on this page and p. 99.
[572] *Supra*, pp.90-91.
[573] See Belyi (2009), *op.cit.,* note 210, p. 3.
[574] See Stern, Jonathan (2004).*Future of Russian Gas and Gazprom,* OIES-Oxford, 2004; Belyi and 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, 2007, nr 3, August), p. 205-224. In Belyi (2009), *id.*
[575] Speech by Andre Mernier (2006), *op.cit.*, note 390.
[576] *Id.*
[577] Energy Charter, "Statements of the Secretary General on the Russia-Ukraine Gas Dispute", January 14, 2010. URL: http://www.encharter.org/index.php?id=21&id_article=167&L=0 , retrieved on May 23, 2010.

Secretariat in such a particular situation gave space for severe Russian critics of the whole essence of the Energy Charter Organisation.[578] Not only has this reaction been lately invoked by Russia as one of the main reasons to withdraw from the ECT, but it could also make other important ECT contracting parties - above all important energy producers and transit states - to reflect on this negative experience.

In fact, such serious crises over international transit of energy as two "gas wars" – and especially the last one - between Russia and Ukraine are of great relevance for ECT art.7 para.7. Indeed,it could be finally tested in practice. The latest Russia-Ukraine gas transit dispute was then a kind of *litmus test* for the ECT transit dispute resolution mechanism, and it appears that it did not work out very well.

Yet, in this regard, an observer notes that first, the latest "gas war" was a moment of truth not for ECT art.7 para.7, but for the Energy Charter Secretariat; second, the ECT transit regime is designed essentially to *prevent* energy transit conflicts, not to solve them; and, third, the actual political leadership of the organisation did not pass through that test.[579] He continues:

> "But this does not mean that the organization as a whole has failed. The inaction (inadequate action) of individuals authorized to act on behalf of the organization need not reflect on the organization as a whole. The international community needs to draw the correct conclusions from this lesson (…). If these conclusions can be drawn then the ECT will be able to fulfil its potential role as the best available legal foundation for the new Russia-EU common energy space and as a level playing field in energy for the emerging Eurasian energy market (…)."[580]

However, as a reaction to an eventual failure of transit dispute resolution between Ukraine and Russia, by April 2009, a "new Energy Charter" was advanced by the Russian presidency,[581] followed by Russia's termination of the Treaty's provisional application.

Some authors see the new Russian proposal as an alternative treaty, while others disagree by arguing that it simply represents a set of questions, unanswered – or until today, wrongly answered - by the ECT, especially regarding its transit mechanisms; and that its only important innovative element is a system of international commissions authorised to resolve extraordinary situations related to energy transit.[582] Though the new energy code was welcomed quite warmly by separate European states (above all, Germany), and even on the Union level, it was not accepted, and is – at least publicly - a draft without details.[583]

Yet, in order to resolve the deep-rooted transit difficulties, in particular on the territories of the former Soviet Union, already in the 1990s some specialists discussed an introduction of an *International Pipeline*

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[578] See *supra*, for example notes 198, 503.

[579] "[ECT contracting parties] may wish to pay more attention to the organizational aspects of the Energy Charter process including the role of the Secretariat and, in particular, the role of the Secretary General. Too much depends on this single person. If that person is not knowledgeable enough in energy, economic, financial, and political issues to foresee the possible and negative consequences of the situation, and/or is not willing to actively participate to prevent negative developments by all available means, then the neutral and potentially effective instrument of the ECT will not be used in time and will lose its efficiency and efficacy. If not used to prevent conflict (and this is the most important role of the ECT aimed at diminishing non-commercial risks throughout cross-border energy value chains) then the organization will act at best as just a monitoring/registering vehicle, that reacts late to the post-effects of the dispute. And by doing so the organization will lose its competitive niche within the international energy environment and will continue to lose the support of member-states." Konoplyanik (2009), *op.cit.*, note 163, p.31.

[580] *Id.*

[581] 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. See supra Belyi (2009), note 210; Dvorkovitch (2009), note 503. On April 20, 2009 Medvedev tabled an "alternative" to the ECT: the "Conceptual Approach to the New Legal Framework for Energy Cooperation" (see *supra,* note 512).

[582] See statement of Konoplyanik (2009), s*upra*, note 211.

[583] Schroeter (2010), *op.cit.*, note 525.

Organisation.[584] Such an organisation could have taken responsibility for the design, construction, financing, operation and maintenance of all pipelines within a given region; and provided a forum as well for the resolution of transit disputes.[585] It is argued that by taking these matters away from the hands of sovereign states and by imposing *common tariff levels*, much of the political and economic deadlock that had affected East-West energy transit through the whole existence of the ECT could have been resduced.[586]

While the accomplishment - though completely uncertain - of the recent Russian proposal of the so-called new Energy Charter is still in progress, the above initiative proposed already 15 years ago unfortunately did not seem to be considered seriously through the 1990s and 2000s at the Energy Charter Conference discussions. Since there is still no International Pipeline Organisation, this initiative could be considered a *lettre morte* within the Energy Charter Organisation, and probably on account of the unwillingness of sovereign states to mitigate their sovereignty, especially on such an important geopolitical and security issue as energy transit.

5. Concluding Remarks

This chapter's general objective was to provide legal analysis of energy investment and transit matters between the EU and Russia under the ECT, and some other pertinent international and regional instruments.

The chapter mainly showed that one of the key efforts of the ECT is the promotion and protection of investments in the energy sector. Another distinctive feature, making the Treaty a unique multilateral regime, is the freedom of transit principle, backed up by a specific dispute resolution mechanism dedicated solely to energy transit. In light of these presumed merits, both of the ECT regimes discussed above seem to be perfectly in line with Treaty's primary purpose, i.e. to secure East-West exchanges in energy field. Indeed, the success of European energy investment initiatives in Russian oil and gas fields to some extent depends on investors' ability to ensure freedom of energy transit. This was supposed to be regulated under the ECT rules.

Regarding the investment regime, in general the ECT provides protection that is similar to that offered by BITs, including such rights as fair and equitable treatment, constant protection and security of investments, prohibition of discrimination, etc. In particular, the Treaty's rules on provisional application to matters affecting investments pending ratification of the Treaty by a contracting party, as well protection of investors from the denial of benefits by a host state, are well reinforced by the arbitral tribunals' rulings in the growing number of cases brought under the ECT investment dispute settlement regime. This means that the latter provides considerable confidence-building among energy investors, although it would probably dissuade those signatories that apply the ECT provisionally from ratifying it, and similarly dissuade non-signatories from signing the Treaty.

In assessing the international effects of the investment provisions discussed in this chapter, and the effects reinforcing them in ECT case law, it is important to resolve the flaws of provisional application and denial of benefits to ensure an efficient framework for international energy cooperation under the ECT. *Vice versa*, the incidence of disputes arising under the Treaty is increasing due to rising awareness among energy investors about the ECT and the existence of dispute settlement mechanisms in international arbitration.[587]

As this chapter illustrated with Russia's example, the Treaty's regulations governing provisional application appear to be well defined and represent a solid legal basis for the protection of investments under the

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[584] Carver, Jeremy (1995), "The Energy Charter and Transit" in Wälde, Thomas W. and Katherine Christie (eds.) (1995). *Energy Charter Treaty : Selected Topics*, Dundee: Centre for Petroleum and Mineral Law and Policy, 1995, p.75. In Clark (1998), *op.cit.* note 465.
[585] *Id.*
[586] This common sense approach was in fact based on the largely successful model of existing European waterway commissions. *Ibid.*, p. 76.
[587] Belz (2008), *op.cit.*, note 380.

ECT. However, it could be argued that the Treaty has less success at clearly defining when the right to deny to investors the benefits of ECT Part III can be exercised by a contracting party. Thus, the referred protection offered to the legal entities and investments by the text of the Treaty itself stands on relatively shaky ground. Indeed, these have particular relevance for a *textual lack* of the notification and consultation requirements related to the exercise of the denial of advantages right. On the one hand, the above case law analysis confirms that the investor dispute settlement mechanism of the ECT is "of considerable value in confidence-building terms" and provides "reassurance for investors that, in the case of a dispute, they will be entitled to have recourse to the above mechanisms in defence of their interests".[588] On the other hand, as one can conclude from the quotes of the related ECT case law, it seems that on matters concerning provisional application and the denial of benefits, each ECT arbitral tribunal tries to track the previous one.[589] This may not be very constructive, especially in the case of an unclear application of the ECT denial of advantages rules. That is, each arbitral tribunal is assembled to resolve a distinctive dispute, and also it should use various *ad hoc* techniques. Yet, the totality of interpretation techniques, as well as previous interpretations of general matters of international law, should of course be considered.

Regarding the ECT transit regime, it is one of the most important issues addressed by the Treaty. The relevant provisions bind parties to facilitate energy transit according to the principles of freedom of transit and so in a non-discriminatory manner. In the case of a dispute, the flow of energy materials or products must not be interrupted. A particular feature is the provision regarding a conciliation mechanism for transit disputes that is intended to be faster than the interstate arbitration procedure provided by the ECT's general dispute settlement procedures, even though this latter alternative is also available for the resolution of transit disputes.

In sum, the ECT provisions on transit appear aimed to gradually reduce transportation risks arising from political or economic tensions between contracting parties. From the security of energy supplies hypothesis, these mean in particular a decrease, and ideally, the elimination of energy transportation risks for both exporters and importers, since both of them depend on the transit state to respect the international legal standards related to transit. Still, the practice shows that, contrary to such international investment standards, it is significantly more difficult to bring transit states to comply with international law. Moreover, it appears more complicated, if not impossible, to hold such states responsible through transit dispute resolution.

In case of the ECT, the legal analysis of this chapter demonstrated that while the Treaty's *investment* dispute settlement mechanism's effectiveness continually grows, its *transit* dispute settlement system remains unfortunately practically ineffective. In this respect, some authors claimed that it is not the mechanism itself which is unsuccessful, but the way it is implemented by individuals – and more specifically, by the Energy Charter Secretariat.

Yet, it could be argued that with such a politically driven issue as cross-border energy transit, the legal obligations of transit states are mostly backed by *political* and *economic* considerations. Another author observed that, prior to discussing the transit provisions of the ECT, it should be borne in mind that freedom of transit has never been an absolute right, nor is it likely to become one.[590] Indeed, the cornerstone of state sovereignty provides an immovable obstacle to asserting the rights of transit. The two make uneasy bedfellows.[591] In this regard, the ECT provision entitled "Transit" actually tries to establish equilibrium between these competing notions. The question of whether or not the ECT transit regime will

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[588] Energy Charter Secretariat, An Introduction to the Energy Charter Treaty, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf , in Belz (2008), *id.*

[589] Indeed, as for example Prof. Wälde observes, it seems that there is a strong pressure on ECT arbitrators to follow other tribunals' decisions, even though the "doctrine of the precedent" (stare decisis) does not govern international arbitration. Wälde, Thomas W. (2004). "Investment Arbitration Under the Energy Charter Treaty: An Overview of Key Issues", *Transnational Dispute Management*, Vol.1, May 2004.

[590] Clark (1998), *op.cit.*, note 465.

[591] *Id.*

succeed still has yet to be answered, but the recent Russia-Ukraine gas transit disputes suggest a negative answer.

Since then, contrary to the whole theory of international legal standards related to energy transit, it is not impossible that in practice exporting states would consider that it is more effective to respond to transit blackmails by political and economic counter-actions. However, such actions could directly or indirectly affect the states of the final destination of the transited energy, and thus do not appear to be sustainable solutions. In this regard, some legal proceedings under the ECT, which would permit suits against a transit state which does not respect its international legal obligations, are possible. Two of them, namely proceedings through ECT arts.26 and 27, were explored in this chapter. Thus, paradoxically, since to date the Treaty's transit dispute settlement mechanism appears ineffective, claimants could try to proceed through the ECT investment dispute resolution, which is more robust. Though this avenue has not yet been tested in practice, it is notionally defensible.

After looking at the EU and Russia through the prism of the above analysis, two general points should be highlighted. First, thanks to recent quarrels between European investors and Russia, as well as Russia-Ukraine gas disputes involving the disruptions of energy supplies to Europe, the ECT could contribute to general progress of both energy transit and investment *international* regimes. On investment, the *Yukos* ruling represents an extremely valuable precedent for future cases under the ECT and other multilateral and bilateral investment treaties. On transit, Russia-Ukraine dispute resolution offers diverse near-term issues to debate, such as the design of the ECT transit dispute resolution; the efficiency of the transit-related conciliation under the Treaty; and even the presumably unsuccessful management of the Treaty's transit regime by the Energy Charter Secretariat. Moreover, the two hypotheses presented in this chapter, regarding how claims over transit could possibly be brought to the ECT investment dispute settlement, offer avenues for prospective debates.

Second, as to EU-Russia energy cooperation in particular, the Treaty's discussed regimes offer a palette of issues. Russia, due to its geographical position, natural resource endowment, external trade, and so on, needs foreign investments, technologies, and reliable export routes. Conversely, as it was stated, Russian energy companies are keen to gain access to downstream assets in EU member states, i.e. they want to sell their goods and provide services to the final consumers. In this regard, until recently Russian companies were in a position to use the ECT investment provisions for promotion and protection of their overseas investments in contracting parties. Now they mostly have to rely on the goodwill of their European partners, and, on occasion, on BITs. (However, the use of the latter means becomes unclear today vis-a-vis EU member states, due to the Treaty of Lisbon novelties).

In addition, of importance to Russia are the principles of non-interruption of transit and the inviolability of transported resources. However, freedom of transit is likely to be contrary to the interests of Gazprom. Moreover, Russia expressed its disappointment with the proceedings of the ECT transit dispute resolution. Last but not least, the emerging market players in the Russian electricity sector, which was gradually liberalised in recent years,[592] are likely to become potential electricity exporters in the European countries. This would imply a need for interconnected electricity network systems, and since the ECT does not govern EU-Russia energy relations any more, such operations would require a new regulatory framework. Either Russian electricity providers would need to respect EU law, which could mean to accept *acquis,* or this new business avenue would amplify the need, and maybe even accelerate the process, of the conclusion of a new EU-Russia PA containing a chapter on energy.

Beyond Gazprom's critics and active lobbying to withdraw from the ECT, and beyond other alternatives, such as PCA and now the prospective PA, between *pros* and *contras* whether Russia actually needed to stay within the ECT, there might have always been grounds of other nature. Namely, diverse stakeholders actively advance the view that Russia did not that need the ECT on account of the following reasons. Russia's petroleum industry is attracting the growing interest of large western multinationals; the

[592] See *supr*a, p.27.

interdependence between Russia and Western Europe for petroleum trade grew up without the Treaty and can continue without it; and Russia lies across a key export route from central Asia to Europe.[593]

In turn, the EU energy needs are likely to continue to grow. Thus, Europeans need to increase and diversify their energy supplies, which will partly result in new energy investments in Russia. In this respect, on the one hand, recent modifications in Russian legislation related to contractual obligations and enforcement of arbitral awards, render it less favourable to foreign investments. On the other hand, Russia's latest energy strategy aims to increase the share of foreign investment in the energy field. Such controversial options for energy investments in Russia are counterbalanced by the fact that the ECT appears to offer vigorous protection for foreign investments. Yet, the last date of Russia's provisional application of the Treaty, i.e. October 19, 2009, should be kept in mind, since only investments made in Russia *before* that date are shielded by the ECT. This means that to date new European energy investments in Russia are not protected by any multilateral instrument.

To summarise, since the Russian Federation does not apply the ECT any more, this would inevitably involve investment and transit-related difficulties not only on a continental but also on an international level. Thus, some alternatives are to be proposed. In this regard, given that the EU-Russia debate over the ECT is over, this could provide an additional basis for further discussions regarding the future bilateral framework in the field of energy, to be discussed under the new EU-Russia PA. Regarding alternatives to the ECT, it is expected that the current debate on energy investment and transit between the EU and Russia will remain extremely dynamic, which could perhaps help to amplify the debate on global energy governance.

[593] Andrews-Speed (1999), *op.cit.*, note 215, p.126.

GENERAL CONCLUSIONS AND POLICY RECOMMENDATIONS

1. Flaws of Current Reulatory Framework of EU-Russia Energy Relations

The position of the EU in energy relations bears out the need for good relations with Russia. Indeed, the EU's position is particularly sensitive: it is a large energy importer, with few transit routes, relies mostly on eastward states for energy transit, and on top of all of this, its energy needs are growing. Consequently, the EU needs Russia to once again begin the process of modernising its energy cooperation. In particular, even though Russia withdrew from the ECT, it still could participate and even positively influence the Energy Charter process. As it follows from this study, not only *could* Russia participate in the Energy Charter process, but it *should* do so.

However, Russia does not appear being more enthusiastic to participate in the Energy Charter than it has been since the conclusion of the ECT. Nevertheless, improved international relations in the field of energy are in the interests of Russia and its economic development. Thus, given the current situation of the energy market, a decrease in oil and gas prices may negatively influence the Russian economy, since the latter is closely tied with the country's petroleum exports. In addition, Russian petroleum giants are eager to gain access to downstream assets in Europe, which count on selling their goods and providing their services to Europeans as final consumers. Then, the country needs more advanced technologies and investments from European partners, since Russia will explore its petroleum fields under ever more difficult geological and climate conditions.[594] Though Russia recently expressed its intention to contribute to the creation of a new international energy order, for the moment its proposals are very general and lack details.[595]

Increasing amounts of all kinds of energy-related transactions between Russia and the EU clearly require a solid international legal basis. An international regulatory framework that intends to secure energy supplies has to take into account the strategic interests of both the EU and Russia. However, the international rules which are currently in force and that could apply to EU-Russia energy relations are in general not designed to either effectively resolve conflicts that may arise between the two parties, or to tangibly enhance their cooperation in the energy field. Moreover, some of them seem to reproduce the asymmetries between Russia and the EU, the former as an energy exporter and capital importer, and the latter as an energy importer and capital exporter.

More specifically, on the EU-Russia Energy Dialogue, this analysis demonstrated that while the Dialogue is coherent with the existing regulatory framework of EU-Russia energy relations, its binding character and its operational effectiveness are limited by its consultative nature. The previous PCA regulated the political and economic relations between the EU and Russia and was the legal basis for the bilateral trade and investment relations of both partners. However, based on GATT rules, the PCA did not address energy *per se*. Now Europe and Russia need to conclude the PCA's successor – a Partnership Agreement, which has to comprise a comprehensive energy chapter. Since the GATT does not contain provisions that address energy sector, this chapter has to be based on ECT rules and principles. Until recently, the ECT itself applied to EU-Russia energy relations.

The ECT was primarily designed by the Europeans to include Russia in at least one multilateral treaty on international trade and investment. Moreover, since the ECT is a unique treaty dedicated to trade and investment in energy, the fact that the energy sector is the most capital intensive and risky business field,

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[594] E.g., in April 2010 Russia and Norway signed off the pact to amicably divide oil and gas interests across a long-disputed Cold War border in the Barents Sea. Gazprom's stake which is now free to explore is huge Shtokman gas discovery on the Russian side, a reservoir that alone holds enough gas to meet the world's entire consumption for a year. See Dyomkin, Denis and Gwladys Fouche (2010). "Russia and Norway strike Arctic sea border deal", April 27, 2010, *Reuters*. URL: http://uk.mobile.reuters.com/mobile/m/FullArticle/p.rdt/eUK/CWORUK/nworldNews_uUKTRE63Q1NG20100427 , retrieved on April 27, 2010.
Also, global climate change brought unprecedented long freezing seasons to Russian North-East regions, where a lot of Russia's oil and gas fields are located.

[595] See *supra*, pp.38-39.

and that Russia is a very special European trading partner, makes the Treaty theoretically the best adaptation of the regulatory framework of EU-Russia energy relations. On investment and transit of energy, the EU values most the security of its energy supplies through protected diversification of sources and a safe route of energy transit. Russia, on the other hand, emphasises its sovereignty over natural resources. As such, the ECT appears to be the best option for governing EU-Russia energy business with regards to investment and transit.

Yet, in practice the stakes come out much more complicated. On investment, recent rulings on the *Yukos* cases confirmed that Russia is bound by the ECT for the next 20 years regarding investment made there during its provisional application of the Treaty. Notably, Russia did not agree with the complainants' arguments in, and was not at all satisfied by the preliminary ruling of, the three related ECT cases. This fact highlights that the ECT, while representing a solid legal framework for the investment exchanges of the contracting parties, including the EU and Russia, does not contribute to the entente and further cooperation of the two antagonists.

But whereas the investment provisions of the Treaty are designed generally to protect investments in *all* ECT member states, and thus challenge *any* contracting party that fails to respect them, Russia including, the transit arrangements within the Energy Charter seem to be designed expressly to regulate energy transit between Russia and the EU. This time it is not the Energy Charter that challenges Russia, but *vice versa*. For instance, the draft of the Transit Protocol was the main focus of EU-Russia quarrels over the ECT. The delay in the Protocol negotiations became a stumbling block to the entire Energy Charter process. Then, during the provisional application of the Treaty, Russia was persuaded that the freedom of transit might have brought about third-party access for Central Asian producers. Consequently it warned against a transit corridor from Central Asia to Europe through Russia, as the latter corridor would result in Russia losing control over energy flows. Finally, the tensions mentioned above resulted in Russia's declaration that it was not satisfied with the Energy Charter in its present state, mostly because of the Charter's transit regime.

Thus, the energy investment and transit-related asymmetries between two partners are unfortunately present on different levels. That is, while the EU-Russia Energy Dialogue and the PCA had not been able to offer an efficient legal basis to EU-Russia energy relations in general, the ECT seems to reproduce disagreements between Russia's government and European private investors – on investments, as well as between the two parties on a governmental level regarding energy transit. The latter issue also involves additional actors, namely the governments of other contracting parties to the ECT, transit states, as well as Energy Charter bodies, such as Energy Charter Secretariat.

Finally, recent legal developments demonstrate that in the energy investment and transit field both Russia and the EU tend to implement restrictive instruments and separate unfriendly actions. During Russia's provisional application of the ECT, the lack of progress on new possible international regulatory frameworks seemed to keep the situation deadlocked. It could be seen from this angle exactly due to the fact that at that time energy investment and transit through Russian territory was formally governed by the ECT, which perhaps made Russia feel the need to "exempt" itself from negotiating seriously other relevant international agreements relevant for trade in energy. Today, energy investments and transit between Russia and the EU are not governed by any multilateral agreement, and this should not be seen as an even greater impasse, but, on the contrary, a moment of impetus. Indeed, such a situation could urge Russia to seriously consider negotiating an agreement which would create a solid legal basis for its external energy relations. In addition, it could drive both Russia and the EU to think more about mutual interests, to make more mutual concessions, or at least, not to continue unfriendly proceedings of the *époque* of the ECT's provisional application on Russian territory.

2. Prospective Solutions for the Future Regulatory Framework of EU-Russia Energy Relations

As it was stated above, if the EU and Russia aspire to finally create an efficient regulatory framework for their energy relations, the stakes for both partners should be taken into account, as well as some mutual concessions are needed to be done.

In doing so, at the outset several important issues have to be taken into account. First, gas pipelines have remained a problematic issue with respect to ensuring security of supply for both the producer, i.e. Russia, who bears loss of income, and the consumer, that is the EU, who undergoes energy supply disruptions. For both of them this implies losses in diverse sectors of their respective economies. As it follows from the analysis of this study, various instruments and actions undertook by the two parties individually in the field of energy transit, create shortcomings which do not match convergent interests of the EU and Russia. Nor do these guarantee the stability and security of energy flows between them. Therefore, in addressing the question of what legal alternatives exist to date for securing energy supply in view of EU-Russia energy *cooperation*, it appears that such alternatives were not yet developed.

Second, in respect to the Treaty of Lisbon, the competence of the EU institutions in the area of the FDI is under a process of expansion. In applying these to the matter of investment protection in EU-Russia energy relations, the expanding Union's competence on inward FDI-related matters could create conflicts in the future. Namely, the Commission's growing *decision-making power* regarding negotiations on *different* phases of investment in BITs with third countries, as well as the Council's related *"police" power*, could affect not only future investment negotiations, but also existent BITs with third countries.[596] If conflicts arise, they could be brought to the appropriate international investment arbitrations. When it concerns energy FDI, these could be settled under the ECT dispute resolution mechanism, if both the claimant's and the defendant's countries are parties to the Treaty. That is, Russian investors for instance could not benefit anymore either from the ECT investment protection, or from its investor-state dispute settlement mechanism.

Third, Russia has its own legislative ambiguities to address regarding its international relations in the field of energy. Aside from some uncertainties relating to contractual provisions and enforcement of arbitral awards, which are brought about with recent legislative modifications,[597] Russia's energy policy papers seem to omit an important issue. Namely, it seems that they do not pay enough attention to transportation. In other words, they aim to introduce competition into branches of energy supply such as exploitation and extraction, but not into the transportation system. On the other hand, as Andrews-Speed noticed, the most powerful of state-privileged entities are those that possess and operate *transportation infrastructure,* because in the absence of an effective regulatory regime, they can deny access to the infrastructure by other companies.[598] This theoretical observation is confirmed empirically, particularly in Russia. That is, it is worth recalling that in Russia by law 15 percent of the pipeline capacity is reserved for independent producers, but Gazprom for example could claim a lack of spare capacity which is quite difficult to verify, and by this means, refuse the access to the transportation pipelines.[599]

Therefore, on the first issue, namely, developing regulatory instruments to foster EU-Russia energy cooperation through securing energy transit, Russia's recent proposal point in the "new Energy Charter" related to *new investments* should be taken into consideration with several details. It should be reminded that Russia suggested to formalise the idea of non-discrimination at the pre-investment phase. The exact wording of this proposal is as follows: "non-discriminatory investment promotion and protection, including new investments in all energy chains". It could be argued that "all energy chains" comprise energy transit. On the other hand, the original text of the ECT contains in respect of the pre-investment phase such words as "encourage" (ECT art.10 para.1) and "endeavour" (ECT art.10 para.2). If the text of ECT art.10 could be incorporated in a new agreement, and such words could be replaced in relevant parts

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[596] For details see *supra,* pp. 61-62.
[597] For details see *supra*, pp.44-48.
[598] Most ECT signatory states, even those in Western Europe, have either given or allowed some of their energy companies to attain a privileged status (Electricite de France, ENEL of Italy, RuhrGas of Germany, Gazprom and Transneft of Russia, MOL of Hungary, and Rompetrol of Romania). Whether fully or partially privatised or wholly state owned, each will continue to use political and economic means to defend its access to resources, transportation, and markets on its "home" territory. The ECT unambiguously gives the home state the responsibility of preventing this behaviour. At the same time, these enterprises are now in the position to invoke the terms of the Treaty to gain access to opportunities and infrastructure in other signatory states. See box 2, namely on p.69.
[599] See *supra*, p.29.

by "guarantee" and "secure", this could constitute more robust protection with regards to a non-discriminatory regime for new investments in petroleum, including transit.

On the second issue, the compliance of European law, including recent modifications with the current and future international agreements in energy investment and transit, remains unclear. This applies equally to the existent EU's obligations under the ECT, and also to possible Union commitments in the context of prospective EU-Russia agreements on energy cooperation. Indeed, in the case when a state adheres to an international treaty, the international law is normally incorporated into this state's legal order, either immediately (monism)[600] or through a transposition/reception process (dualism)[601]. In both cases, if a state ratified an international treaty, the legal rules of the latter prevail over domestic ones. However, these theories could not be applicable with EU law. Indeed, the EU itself was initially founded by an international treaty, i.e. the Treaty of Rome, and from this standpoint it is originally an RTA. However, recent attempts to adopt a constitution of the EU, as well as latest modifications to the Treaty of Lisbon aiming for example to represent the EU as a unity, make things less obvious. The subject of conflicts of laws between international and European law, or, more simply said, treaty conflict, is of great interest but is beyond the scope of this study. However, it would be practical to observe that the Russian Federation has to carefully consider all the provisions of current European law discussed in this paper, when it negotiates a new energy–related EU-Russia agreement, especially in cases of conflict between such agreements and EU law, since there is little chance that the former would prevail over the latter.

Regarding the particular issue of energy transit infrastructures, two correlated observations should be made. First, since transportation is apparently not viewed as a potentially competitive sector, Russian energy policies seem to not going to introduce competition in that sector. In this respect, contrary to its recent steps backward in the field of FDI, in the field of energy monopolies the European legislation provides a constructive example. This cannot be translated into Russian legislation, due to the "legislation gap" with the *acquis*, although in general it would be recommended to Russia to consider some of its points. Namely, since the 1990s the Commission has started advancing policies regarding energy monopolies by segment, including monopolies-suppliers and monopolies-owners of transit infrastructure. More specifically, since the 1990s, numerous directives and regulations are dedicated to the transit of gas and electricity through grids, and concerning common rules for the internal market in gas and electricity.[602] Notably, in the latest related gas regulation ((EC) No 715/2009), namely its art.18, it is stated that gas suppliers have the right of access to transportation infrastructures, but in order to access they have to pay fixed tariffs. Moreover, the directive implies that infrastructure owners have to publish data on tariffs, availability, etc. of the access to their infrastructure, and that such data should be easily available Secondly - and consequently -, the study recommends establishing an international system for determining pipeline spare capacity and non-discriminatory terms of access needs, and to make it easily available for interested parties. It should be done for the sake of effectiveness of interpretation of the current international rules referred to energy transit during arbitral investigations, if transit-related cases arise, as well as of such prospective rules of the EU-Russia energy-related agreements. In addition, a unified international database on pipelines spare capacity, availability, and tariffs per country and/or per company-owner of infrastructure could constitute a practical clarification.

Next, as it results from the first chapter analysis, and more specifically, from the assessment of Russia's current energy strategies,[603] it could be argued that Russia demonstrates an ambition to be considered an equal partner in EU-Russia energy affairs. Through the whole study, the analysis was inviting, among others, to reflect whether, in energy policy the country's withdrawal from a unique international agreement specifically dedicated to energy, i.e. ECT, promoting fundamental principles of international law, really corresponds to Russia's stated above ambition. The answer is: probably not. This is due primarily to the fact that growing Russian outward FDI is not shielded any more by the ECT provisions; nor is it so for

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[600] The theory which does not separate international and internal legal orders, but rather sees them as a unique order.
[601] The theory which separates international and internal legal orders, and requires a transposition of international legal rules into the domestic legal order, and their reception in this order.
[602] See *supra,* note 116.
[603] See *supra*, pp.28-29.

the energy transiting through some countries as Ukraine, which used to exploit its position as a transit state.

Rhetoric aside, the biggest current practical problem to resolve in the context of this study, taking into account that Russia is no longer a party to the ECT and is not yet a member of the WTO, is what are the best remained alternatives to frame and enhance EU-Russia energy cooperation, especially with regards to investment and transit issues. Although Russia is bound until 2019 to investments made in its territory prior to 2009, and although Russia is supposed to join WTO sooner or later, this research aimed to determine the best *tangible* options for regulating EU-Russia energy relations. Also, since the study highlighted the potential shortcomings of the prospective framework, some drafting solutions to remedy those shortcomings will be proposed below.

The most complicated matter lies in the difficulty of promptly converging the interests of both parties. For example, the core of EU market policies is competition. The above mentioned gas and electricity directives reflect the Commission's policy line with regard to energy monopolies, and aim to introduce competition in each energy segment. This is but one example of EU's relevant progrees on competition.

However, today total liberalisation and a clear separation of energy extraction, exploitation, production, and transportation could be hardly envisaged in Russia. That is, while projected reforms aim at introducing competitive elements into the energy supply segment, the hydrocarbons infrastructure system, in particular gas one, constitutes a natural monopoly.[604] Since then, the liberalisation should be considered as a side option, along with today's organisation of the Russian market based on Gazprom's monopoly on transportation.

Therefore, even if a common ground between both parties would be found with regard to freedom of transit, Russia could hardly comply with today's related European competition rules. Indeed, the corporate structure of Russian energy monopolies could not be changed in one day. Again, it is hardly imaginable that this was the case for such energy monopolies of EU member states like GDF Suez, when the competition was introduced in the 1990s to the energy sector.

On the other hand, difficulties such as the inconsistency of Russia's energy-related practices with EU competition rules should not be seen as a bottleneck. On the contrary, this could create the following virtuous circle. If negotiations of the future EU-Russia agreement set a truly motivating balance of interests, Russia would recognise a gradual introduction of some degree of competition to all energy segments. In doing so, Russia could even use some European experience, for instance, concerning integration into competing market such giants as GDF Suez and Electricité de France (France), ENEL (Italy), RuhrGas (Germany), MOL (Hungary), etc. Then, liberalising one of its main trade sectors would be practical for Russia relating to other important issues, for example its accession negotiations to the WTO.

However, one must not mix up two notions related to the competition issues described below. Namely, on the one hand, Russia needs to diversify its exports and expand its industry. A gradual liberalisation would prompt the opening of export markets for Russian products, and bring new technologies to the country. Therefore, introducing some degree of competition in the country's energy sector, and the consequent partial opening of its energy markets, would promote Russia's economic development. On the other hand, recommended gradual liberalisation should not be confused with reception of *acquis communautaire*. That is, competition, free movement of goods and services, freedom of access to the energy infrastructure and to the markets of the energy exporting countries, aim at reducing energy prices and establishing common requirements to reduce the amount of the natural rent received by producers. These do not correspond to Russia's curent interests as an energy exporter.

Last, but not least, since today it appears difficult to converge *supreme* interests of both partners due to underlined in this study differences between European and Russian actual energy markets, Adam Smith's

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[604] See *supra*, p.29.

"invisible hand" of trade transactions[605] could offer an intermediary solution. Namely, discussed divergences of views on top level could not prevent people to trade among them, especially in energy business.[606] Thus, it could be argued that a growing number of business transactions between European and Russian energy companies could create a spillover as follows. Those deals are based on principles of international commerce, and international private law, namely, rules of international commercial contracts, which seem today working better than international law applying on state-state or investor-state energy relations between Europe and Russia. Hence, those private firm-firm deals should - and would – proliferate. Once their volume attains the importance which would go beyond the limit of purely private arrangements, a need for both parties to frame all that on the top public level would occur.

In this regard, the ECT was designed in a manner to meet interests of both private and public stakeholders of energy importers, exporters, and transit countries. But because of the near-impossibility today for the ECT to apply on EU-Russia energy relations, it is suggested to establish a new regulatory framework, which would not only enhance cooperation on the top EU and Russia levels, but also be designed to back energy transactions between separate companies of both parties, once those deals attain a critical level. Therefore, such framework should treat both conventional contract-based arbitrations and investment treaty-based arbitrations.

This study's analysis demonstrates that the best option is an *EU-Russia Partnership Agreement containing a comprehensive chapter on energy*. Numerous recommendations are to be addressed in this regard. First, this chapter should be based on the ECT principles on account of the following considerations. ECT provisions are based on the globally recognised international law principles of non-discrimination, national treatment, prohibition of export and import restrictions and access to markets on an open and transparent basis. These cover FDI, trade, transit, energy efficiency, and dispute resolution. On the other hand, while articulating openness to foreign investment and granting protection of investors, including a dispute settlement mechanism, the ECT stresses the parties' irrevocable right, namely state sovereignty over natural resources. Also, it does not make obligatory third-party access to pipelines of a contracting party. In addition, a contracting party has the right to deny potential new or additional transit through its energy transportation system. The above mentioned merits of the ECT make the latter an international regime which meets the main strategic interests of both the EU and Russia.

Then, though the ECT principles appear to be the best option for framing EU-Russia energy relations, especially on investment and transit, this study's analysis examined several flaws of the Treaty, discussed above.[607] Therefore, the text of the energy chapter should be mainly inspired by the ECT, but complimented with some relevant provisions and instruments of other options and agreements discussed in this study.

For instance, following the Russian President's proposal of a "new energy charter", the issues to highlight and develop in the energy chapter of the PA are the following: sovereignty over natural resources; ensuring non-discriminatory access to markets; and transparency, access to technologies, and exchange of information. In this respect, the EU-Chile FTA[608], and the ASEAN Economic Cooperation Agreement [609] could offer several interesting avenues. Namely, the EU-Chile agreement has created an Association

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[605] "Every individual... neither intends to promote the public interest, nor knows how much he is promoting it... he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it." Smith, Adam (1776). *Recherche sur la nature et les causes de la richesse des nations*, Livre IV, ch. 2, 1776 ; d'après réédition, éd. Flammarion, 1991, p. 456, para. 9.

[606] See *supra*, pp. 63-64.

[607] See *supra,* for instance pp.57-58, 100-103.

[608] See *supra*, pp.51-52.

[609] See *supra*, pp.49-50.

Committee and Special Committees that meet once a year to assess further possibilities for fostering bilateral trade and investment. The ASEAN Economic Cooperation Agreement proposed similar proceedings. EU-Chile FTA art.22 ("Cooperation on energy") aims to consolidate economic relations in key sectors such as hydroelectricity, oil and gas, renewable energy, energy-saving technology and rural electrification. In particular, its para.2 (f) says that the assistance for Chilean institutions dealing with energy matters and the formulation of energy policy is one of the key purposes of such cooperation. If both similar committees are created and analogous provisions are included in an EU-Russia PA's energy chapter, these could complement the ECT basis of a new agreement. These would correspond in particular to the above mentioned points that Russia aspires for, namely transparency, access to technologies, and exchange of information. In addition, these could also contribute to the creation of positive spillovers, such as by introducing some degree of competition to Russia's energy sector, and by some convergence with EU competition rules. Specifically, through such committees and cooperation, Europeans could share their experience of integrating their energy markets, and other information related to competition in the energy sector. In exchange, for instance, Russia could share its expertise in nuclear energy development, which is becoming a crucial energy security issue for the EU.

Next, several drafting solutions should be introduced for the selected energy chapter's clauses of the prospective EU-Russia PA. First, denial of benefits clauses may be drafted differently from that of ECT art.17 to better answer the questions highlighted during the analysis of the *Plama* and *Yukos* cases and identified by some authors.[610] The most controversial issue that arises out of the above rulings and rhetoric concerns whether states, which according to ECT art.17 para.1 deny a covered investor the advantages under Part III, could exercise this right without prior notification and consultation, these activities being undefined under the ECT.

In this respect, a solution to the problem of undefined – or imperfectly defined - application of the right of denial of advantages under the ECT might be a detailed requirement under which benefits could be denied by a contracting party. For example, language in ECT art.17 might have indicated that the denial of benefits by a party to an investor of another party is expressly subject to prior notification and consultation. The following italicised wording, based on NAFTA art.1113, would be recommended for the denial of benefits clause of the new PA.

EU-Russia PA art.__ entitled "Non-Application of Part __ in Certain Circumstances":

> "Each Contracting Party reserves the right to deny the advantages of this Part to:
> (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
> (2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
> (a) does not maintain a diplomatic relationship; or
> (b) adopts or maintains measures that:
> (i) prohibit transactions with Investors of that state; or
> (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments."
> *(3) Subject to prior notification and consultation, a Party may deny the benefits of this Part to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organised."*

If such wording is adopted, there is a chance that in possible arbitrations under the future EU-Russia PA, proceedings of arbitral tribunals with regards the denial of advantages right would be hopefully simplified and maybe accelerated. This would consequently lead to reducing of tribunals costs.

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[610] See *supra*, p.82.

Second, in the promotion, protection and treatment of investments clause (originally ECT art.10) several key words may be replaced to better tackle the issue that Russia has brought back to the table, namely the reform of the transit dispute settlement mechanism through the promotion of non-discrimination at the pre-investment phase.[611] As a result, the first three paragraphs of a provision such as the following, with italicised words, would be recommended for the new agreement.

EU-Russia PA art._ entitled "Promotion, Protection and Treatment of Investments":

> "(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, *secure* and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.
> (2) Each Contracting Party shall *guarantee* to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).
> (3) For the purposes of this Article, "Treatment" means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.
> (…)"

It is expected that such language would constitute in the new PA a more robust non-discriminatory regime of the pre-investment phase, that is, for new investments in petroleum, including transit. Albeit that this topic was invoked by Russia, it could be argued that both partners will benefit from such a clause, since the pre-investment phase of the original Treaty is generally considered as one of the least satisfactory components of the ECT due to such soft law formulations as "encourage" and "endeavour".[612]

Finally, the new PA's equivalent of original ECT art.7 may address not only the contracting parties, but also ownership of the infrastructure, such as gas pipelines, transportation routes, applicable legal regimes, construction and licensing, safety and environmental protection, and construction finance. In such a way, these particular issues typically dealt with in transit agreements could be properly addressed in a new agreement's transit regime, and not, for instance, be covered by investment terms, as in the case of the ECT.[613] These should better answer the needs and expectations of the EU related to the clarifications on access to transit, as well as conditions and non-interference of transit. Last but not least, transit provisions of the prospective energy chapter should somehow consider a clause concerning the circumstances under which the transit may be legally interrupted, comprising situations if transit tariffs are not fully paid.

However, it should be borne in mind that the conclusion of a new EU-Russia PA, with or without an energy chapter, could meet difficulties of a technical, legal, political and operational nature.[614] Although chances to overcome these bottlenecks are real, it would be reasonable to plan alternative solutions.

Thus, the second option could be a sector-specific agreement, i.e. an *EU-Russia Energy Cooperation Agreement*. Namely, it would be a "mini-ECT" between the two actors. In this case it could be drafted following the same logic which was presented earlier in this part for modelling the energy chapter of a new EU-Russia PA. The main advantage of this avenue is that, due to its specificity, the negotiation process of

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[611] See *supra*, p.39, 106
[612] *Id.*
[613] See p.97.
[614] For details on each difficulty, see *supra*, p37.

an "EU-Russia ECT" could encounter those technical, legal, political and operational difficulties, on which negotiations on a general Partnership and Cooperation Agreement could stick.

A possible disadvantage of such an option is that negotiations could be blocked, but this time not because of the growing "liberalisation gap" between the EU and Russian legal systems, but rather because of Russia's numerous derogations from the current *acquis*. This time the issues of the negotiation phase - and even the pre-negotiation phase - might be unpredictable because of the novelties of the Treaty of Lisbon. Namely, unlike the common trade policy which traditionally was the competence of the Union, the energy policy was previously the competence of member states. Now it has become a shared competence (TFUE art.4 para.2 (i)). This of course does not mean that the possible results of such an important shift in the energy-related decision-making will negatively influence future conclusions of energy-specific agreements between the EU and third countries. However, such outcomes remain unclear for the moment.

The third proposed option is the *EU-Russia FTA*. Texts addressed in this study of different RTAs and FTAs could be used as the basis for drafting provisions relevant to energy investment and transit matters. The recommended provisions and instruments of the selected RTAs and FTAs to consult are the following: ASEAN Comprehensive Investment Agreement; Framework Agreement on Enhancing ASEAN Economic Cooperation; Colonia Protocol for the Reciprocal Promotion and Protection of Mercosur Investments; NAFTA Chapter VI; and the recent EU-South Korea FTA, especially with respect of its Chapter 14 combining features of both investment arbitration and the WTO DSU.[615]

This option has its own advantages, the main of which in the context of this analysis is that, as Professor Baldwin recently noticed, it seems to be much easier to reach an agreement, as well as to develop further cooperation on *services* within FTAs rather than within multilateral agreements.[616] It should be reminded that notwithstanding some divergent views (including those of the author) on energy transit definition and classification in international law, to date in international trade it is generally referred as a service.

However, the third avenue is much less likely become reality than the first two on account of one major intricacy. NAFTA, MERCOSUR, and to a lesser extent ASEAN, like most FTAs, are generally moving toward becoming a *full common market*. In case of an EU-Russia FTA, it again means for Russia to accept *acquis communautaire*. As it was asserted above, today the "liberalisation gap" between the two parties' legislations is large enough; in addition, this is not in the current interests of Russia as a net energy exporter.

Alternatively, as it was stated in this study, the operational difficulty today to negotiate a complex, far-reaching, and long treaty between the two parties represent some risk to create a very long negotiation phase, and to have completely unpredictable outcomes. In this case, an alternative to the above mentioned options would be a combination of two of three proposed avenues. Namely, a new PA could be drafted in a *very concise* manner providing a *very general framework*, considerably broader than the one provided by the previous EU-Russia PCA. It must be general and cover only commercial matters between the two sides in order to create room for negotiation and conclusion of the sector-specific agreements. This solution would thus leave to both parties a greater *marge de manoeuvre* in negotiations of each particular sector of cooperation. If both a *short* and *general* PA and a *detailed* EU-Russia Energy Cooperation Agreement are concluded, the two partners will then dispose a broad legal basis covering only general commercial issues plus a sector-specific, fully-fledged legal framework dedicated only to energy-related issues. The difficulties of this twofold alternative that could be met are respectively discussed above regarding a new PA and an "EU-Russia ECT".

In conclusion, in interpreting *a contrario* the Roman maxim S*i Vis Pacem, Para Bellum,* if the EU and Russia are currently undergoing a period of energy disagreements, "gas wars", and restrictive legislation, they will hopefully soon enter into the phase of peace between them.

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[615] For details see annex 2.

[616] "The path ahead for world trade:FTAs and the multilateral trading system in 2020." Roundtable organized on the occasion of the EFTA Ministerial Conference, *under the chairmanship of* H.E. Doris Leuthard, President of the Swiss Confederation, November 22, 2010. Organised by CTEI at the IHEID, Geneva.

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Energy Glossary[*]

Energy Conservation:
Energy conservation is defined as the lowering of energy consumption by reducing energy services. For example, lowering a thermostat's setting during the heating season is classified as energy conservation, because less heating is provided. Because the ratio of energy services to energy consumption is unchanged, energy efficiency does not change in this example.

Energy Dependency:
Energy dependency shows the extent to which a country relies upon imports in order to meet its energy needs. It is calculated using the following formula:
net imports / (gross inland consumption+bunkers)

Energy Efficiency:
Energy efficiency is defined as the ratio of the amount of energy services provided to the amount of energy consumed. Familiar examples of energy services are the heat supplied by a furnace and the light output of a lamp.

Energy Intensity:
Energy intensity gives an indication of the effectiveness with which energy is being used to produce added value. It is defined as the ratio of Gross Inland Consumption of energy to Gross Domestic Product.

Final Energy Consumption (FEC):
Final energy consumption is the energy finally consumed in the transport, industrial, commercial, agricultural, public and household sectors. It excludes deliveries to the energy transformation sector and to the energy industries themselves.
Gross Calorific Value (GC V):

Primary Energy Production:
Primary energy production is the extraction of energy from a natural source. The precise definition depends on the fuel involved:

Solid fuels: Hard coal, lignite
Quantities of fuels extracted or produced, calculated after any operation for removal of inert matter. In general, production includes the quantities consumed by the producer during the production process (e.g. for heating or operation of equipment and auxiliaries) as well
as any quantities supplied to other on-site producers of energy for transformation or other uses.

Crude oil:
Quantities of fuels extracted or produced within national boundaries, including off-shore production. Production includes only marketable production, and excludes any quantities returned to formation. Production includes all crude oil, natural gas liquids (NGL), condensates and oil from shale and tar sands, etc.

Natural gas:
Quantities of dry gas, measured after purification and extraction of natural gas liquids and sulphur. The production includes only marketable production, and excludes any quantities re-injected, vented and flared, and any extraction losses. The production includes all quantities used within the natural gas industry, in gas extraction, pipeline systems and processing plants.

Nuclear heat:
Quantities of heat produced in a reactor. Production is the actual heat produced or the heat calculated on the basis of the gross electricity generated and the thermal efficiency of the nuclear plant.

[**] *Sources :* The Commission Directorate-General for Energy and Transport (2009). "EU Energy and Transport in figures", URL: http://ec.europa.eu/transport/publications/statistics/doc/pocketbook2010_contractor.pdf ; US energy information administration (EIA)(2010). "Annual Energy Outlook 2010 with Projections to 2035", URL: http://www.eia.doe.gov/oiaf/ , retrieved on October 5, 2010.

Hydropower, Wind energy, Solar photovoltaic energy:
Quantities of electricity generated. Production is calculated on the basis of the gross electricity generated and a conversion factor of 3600 kJ/kWh.

Geothermal energy:
Quantities of heat extracted from geothermal fluids. Production is calculated on the basis of the difference between the enthalpy of the fluid produced in the production borehole and that of the fluid disposed of via the re-injection borehole.

Biomass / Wastes:
In the case of municipal solid wastes (MSW), wood, wood wastes and other solid wastes, production is the heat produced after combustion and corresponds to the heat content (NCV) of the fuel. In the case of anaerobic digestion of wet wastes, production is the heat content (NCV) of the biogases produced. The production includes all quantities of gas consumed in the installation for the fermentation processes, and excludes all quantities of flared gases. In the case of biofuels, the production is the heat content (NCV) of the fuel. In the case of biofuels, the production is the heat content (NCV) of the fuel.

Tonne of oil equivalent (toe):
The tonne of oil equivalent is a conventional standardised unit for measuring energy, defined on the basis of a tonne of oil with a net calorific value of 41 868 kilojoules/kg.
1 ktoe = 1 000 toe
1 Mtoe = 1 000 000 toe

Annex 1
2009 Gas Crisis Chronology†

October 2, 2008: Signature of the Memorandum of agreement between Moscow and Kiev to move gradually to market prices.

November 20, 2008: Moscow claims that Kiev has to reimburse its debt to Gazprom estimated at USD 2.4 billion.

November 22, 2008: Gazprom warns to cut off deliveries from 1 January 2009 if an agreement on a new contract is not reached.

December 4, 2008: Russian Prime Minister Vladimir Putin warns to cut gas supplies in case of non-payment by Kiev. Ukrainian President Viktor Yushchenko assures that his country will pay all the deliveries of Russian gas and guarantees the "security" of transit to Europe.

December 30, 2008: Ukraine says to have paid its debt for gas delivered in November and December, namely USD 1.5 billion. It is confirmed by Gazprom. The gas giant has proposed for 2009 a rate of USD 250 per 1,000 cubic meters, a price which is much higher than the price paid by Ukraine in 2008 (USD 179.50), but about half lower than the one paid by European countries. Ukraine suggested the rate of USD 201. Following Ukraine's "haggling", around December 30, Gazprom is now proposing to shift to European prices, namely around USD 450.

December 31, 2008: Ukraine still has the overall debt of USD 2.1 billion to Gazprom. The contract to supply Russian gas to Ukraine ends without a new agreement on pricing policy or the payment of debts that Gazprom claims in Kiev. Gazprom accuses Ukraine of "blackmail", saying it had threatened to seize the Russian gas transiting through its territory to Europe, if Russia was cutting deliveries.

January 1, 2009: Gazprom announces that the supply of Russian gas in Ukraine is cut off as of 7am GMT. Gazprom and Naftogaz nevertheless ensure that supplies to the EU will not be disturbed.

January 5, 2009: Supplies of Russian gas had dropped by 5-30 percent. Moscow accuses Kiev in unauthorised gas tapping amounted to 65.3 million cubic meters and calles Ukraine to stop that theft and to make up for the stolen amounts. Kiev replies that this gas is required for technical needs of transit (however, under the terms of the transit contract, Ukraine should provide the technical gas out of its own resources). Moscow cut the supply by exactly the amount that had been stolen on Ukrainian territory, i.e. 21 million cubic meters. The reductions of Russian gas supplies are felt in seven
European countries: the Czech Republic, Turkey, Poland, Hungary, Romania, Bulgaria, and Greece.

January 7, 2009: No gas is flowing from the Ukrainian territory. Ukraine has completely closed all export pipelines to Europe transiting through its territory.

January 9, 2009: A compromise was negotiated by the Czech Presidency and with presence of Russian, Ukrainian and European observers, to ensure that Ukraine does not siphon pipelines anymore.

January 12, 2009: An agreement signed by Ukrainian, Russian and European representatives, for the resumption of deliveries of Russian gas to Europe via Ukraine.

January 13, 2009: While Russia officially announces that it has reopened the valves supplying gas to Europe, Gazprom announces that Ukraine is blocking Russian gas deliveries to Europe. In fact, at that moment Gazprom persuaded Ukraine to transit gas through a complicated route, which endangers Ukrainian own domestic supply. As a result, the gas does not flow to Europe yet.

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† *Sources:* IEA report "The Ukraine-Russia Gas Dispute" (January 20, 2009); the IEA Secretariat's note *Overview of the Russia - Ukraine gas dispute of January 2009* (March 11, 2009); Russian-American Business (2009). "Ukraine: energy report " URL: http://russianamericanbusiness.org/web_CURRENT/articles/460/1/Ukraine%3A-energy-report , retrieved on March 3, 2010; Government of the Russian Federation (2009). "Russian Prime Minister Vladimir Putin met with foreign media" , January 8, 2009, URL: http://www.premier.gov.ru/eng/events/news/2956/ , retrieved on April 25, 2010.
Synthesis by the author.

January 16, 2009: Russia urges the European energy companies to sign an agreement for the creation of an international gas consortium to provide the Ukrainians with the technical gas they need. Italian ENI, German E. ON Ruhrgas and French GDF Suez sign the consortium agreement.

January 17, 2009: Putin and Tymoshenko, Russian and Ukrainian prime ministers, seem to find a common ground. Ukraine agrees to buy Russian gas at the "European" prices, but with a discount of 20 percent for the year 2009. In return, Ukraine will not increase the transit fees for Russian gas going through its territory for the year 2009.

January 19, 2009: Russia and Ukraine sign an agreement for ten years resuming the supply of Russian gas to Ukraine and Europe.

January 20, 2009: The supply of gas to Europe via Ukraine resumed at 10am Moscow time (7am GMT). Slovakia and Hungary are the first receivers. The new price charged by Gazprom to Ukraine increased from USD 179 to USD 360 per thousand cubic meters.

Annex 2
Multilateral and Regional Trade Agreements, BITs, and energy cooperation‡

Name	Entry into force	Type	Relevant provisions
1. EFTA	1960	FTA	No explicit energy provisions exist in EFTA; however, it applies tariff preferences and GATT-based MFN non-discrimination rules across the board to all goods, including energy
2. CARICOM	1973	FTA	No explicit energy provisions exist in EFTA; however, it applies tariff preferences and GATT-based MFN non-discrimination rules across the board to all goods, including energy
3. APEC	1989	Intergovernmental Alliance / Soft-law approach	Non-Binding Investment Principles APEC Investment Transparency Standards Report "Identifying Core Elements in Investment Agreements in the APEC region"
4. MERCOSUR	1991	RTA	No explicit energy provisions exist in MERCUSOR or its subsidiary treaties; however, it ensures that energy goods and services flow among parties without restriction by reducing tariffs and NTBs Colonia Protocol for the Reciprocal Promotion and Protection of Mercosur Investments (1994) Resolutions of the Grupo Mercado Común and decisions of the Consejo de Mercado Común addressing pesticides, energy policies

‡ Synthesis by the author.

			and transport of hazardous products
5. NAFTA	1992	FTA	Chapter VI "Energy and Basic Petrochemicals" contains a series of GATT-inspired legal obligations for the treatment of trade in energy and basic petrochemical goods and cross-border trade in services associated with such goods While not specifically stated, it is generally admitted that the purpose of NAFTA Chapter VI is to move the three parties toward a single North American energy market. Internal - GATT-inspired - energy regulatory measures, Energy transit, provisions based on GATT; contains nothing beyond GATT art. V in terms of transit of energy
6. AFTA	1992	FTA	Has its own DSU Framework Agreement on Enhancing ASEAN Economic Cooperation bind members to enhance cooperation in energy including energy planning, information exchanges, research and development and the exploration production and supply of energy resources without hard legal rules Common Effective Preferential Tariff (CEPT) mechanism establishing a schedule for phased scheme aiming to increase the

			region's competitive advantage, is the instrument to achieve AFTA's objectives on trade liberalisation through the elimination, within ASEAN members, of tariffs and non-tariff barriers, and attracting more FDI to ASEAN states ASEAN Comprehensive Investment Agreement (ACIA) has four pillars: liberalisation, protection, facilitation, and promotion of investments
7. GATT	1947 (amended in 1994)	Multilateral Agreement	GATT transit provisions for movement of hard goods are contained in the GATT art. V GATT art. XX "General Exceptions", namely (b) and (g) addressing respectively exceptions necessary to protect human, animal or plant life or health, and relating to the conservation of exhaustible natural resources
8. GATS (WTO)	1995	Multilateral Agreement	Covers all measures that affect trade in services, apparently including services related to trade in energy and energy service *per se* Following GATS rules could be relevant for issues related to energy investment and transit: the MFN (art. II); general rules on monopolies and exclusive services suppliers (art. VIII); obligations of market access and national treatment (art. XVI and

			XVII) that apply through inscription of specific commitments under the GATS; domestic regulation (art. VI) relevant for energy services when the supply of services depends on the right of access to infrastructure (e.g., gas pipelines, electricity grids, gas storage facilities, LNG terminals).
9. TRIMS (WTO)	1996	Multilateral Agreement	A Working Group established in 1996 conducts analytical work on the relationship between trade and investment. TRIMS prohibits trade-related investment measures, such as local content requirements, that are inconsistent with basic provisions of GATT 1994 However, TRIMS, which applies to trade in goods, does not protect investment *per se*
10. EU-Chile FTA	2003	FTA	Free trade area in goods, services and government procurement, liberalises investment and capital flows Art.22 "Cooperation on energy" aims at consolidating economic relations in key sectors such as hydroelectricity, oil and gas, renewable energy, energy-saving technology and rural electrification. In particular, its para.2 (f) says that the assistance for Chilean institutions dealing with energy matters and the formulation of energy policy is one of the key objectives of such a

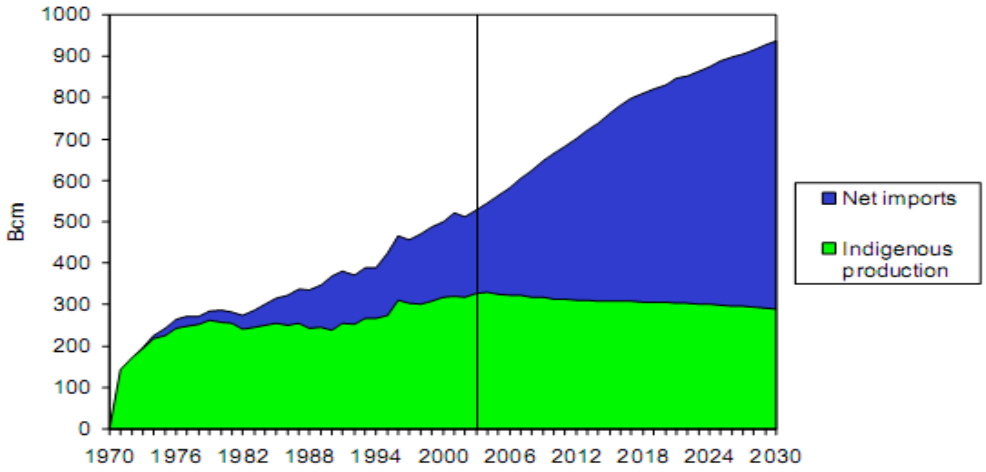
			cooperation
11. ACFTA§	2003	FTA	Has its own DSU No explicit energy provisions exist in MERCUSOR or its subsidiary agreements; however, it ensures that energy goods and services flow among parties without restriction by reducing tariffs and NTBs
12. EU-South Korea FTA	2010	FTA	Has its own DSU (Chapter 14), which combines features of both investment arbitration and the WTO DSU *Procedures* : analogous to investment arbitration involving States. Request for arbitration (art.14.4); establishment of an arbitral panel (art.14.5); rules of procedure for arbitration (Annex 174-B); rules of conduct for arbitrators (Annex 14-C) *Remedies*: are taking up the WTO relevant provisions. A non-complying party may offer compensation for a violation, or failing that, be subject to retaliation, etc. (art.14.11)
13. US Model Bilateral Investment Treaty		BIT-model	Ensures that foreign energy sector investors will not be discriminated with regards to similarly situated domestic investors or other foreign investors; that they will not have their investments expropriated without prompt and adequate compensation; and that they will not be subject to less than a minimum standard of treatment, often referred

§ Here: ASEAN-China Free Trade Agreement.

			to as the fair and equitable treatment, and full protection and security standards
14. Germany's Model Bilateral Investment Treaty		BIT-model	Idem, see "US Model Bilateral Investment Treaty"
15. Canada's Model FIPA		BIT model	Idem, see "US Model Bilateral Investment Treaty"

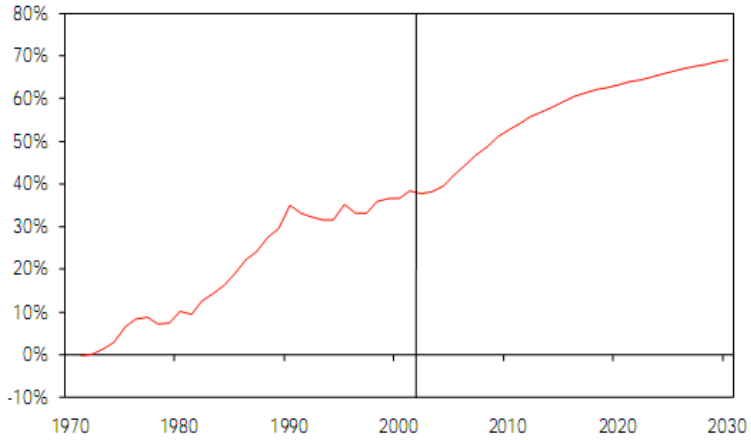
TABLES

Table 1. Natural Gas Supply - Reference Scenario: EU-30



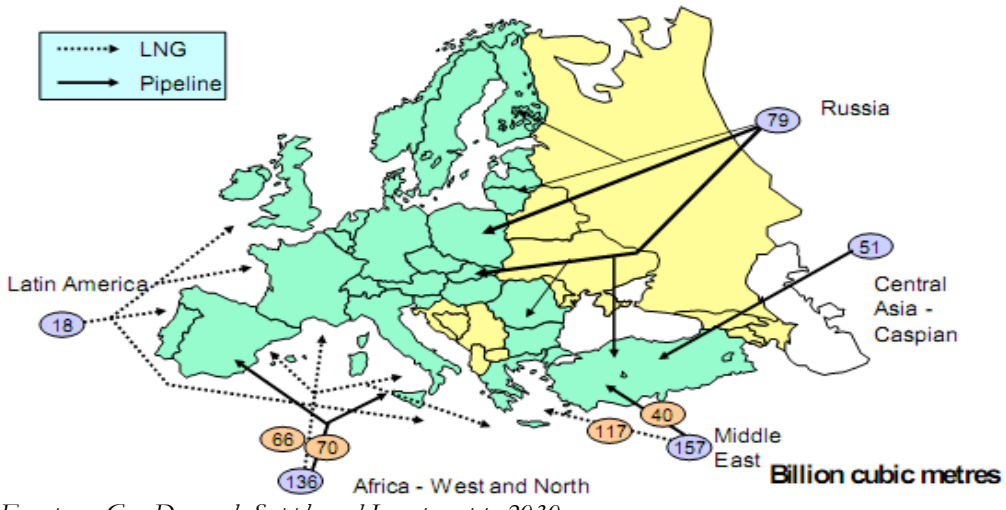
Source : IEA. *Outlook for European Gas Demand, Supply and Investment to 2030*

Table 2. Share of Imports in Natural Gas Supply - Reference Scenario: EU-30



Source : IEA. *Outlook for European Gas Demand, Supply and Investment to 2030*

Table 3. Implications for Supply Infrastructure. Incremental Gas Flows 2002-2030 - Reference Scenario : EU-30



Source : IEA. *Outlook for European Gas Demand, Supply and Investment to 2030*

Map 1. The Caucasus as a Hub of the East-West Energy Corridor

Le Caucase à la croisée des routes énergétiques Est-Ouest

Source : *Questions internationales* (n°37 mai-juin 2009)

Map 2. Projected Routes of Nord Stream, Nabucco and South Stream Pipelines

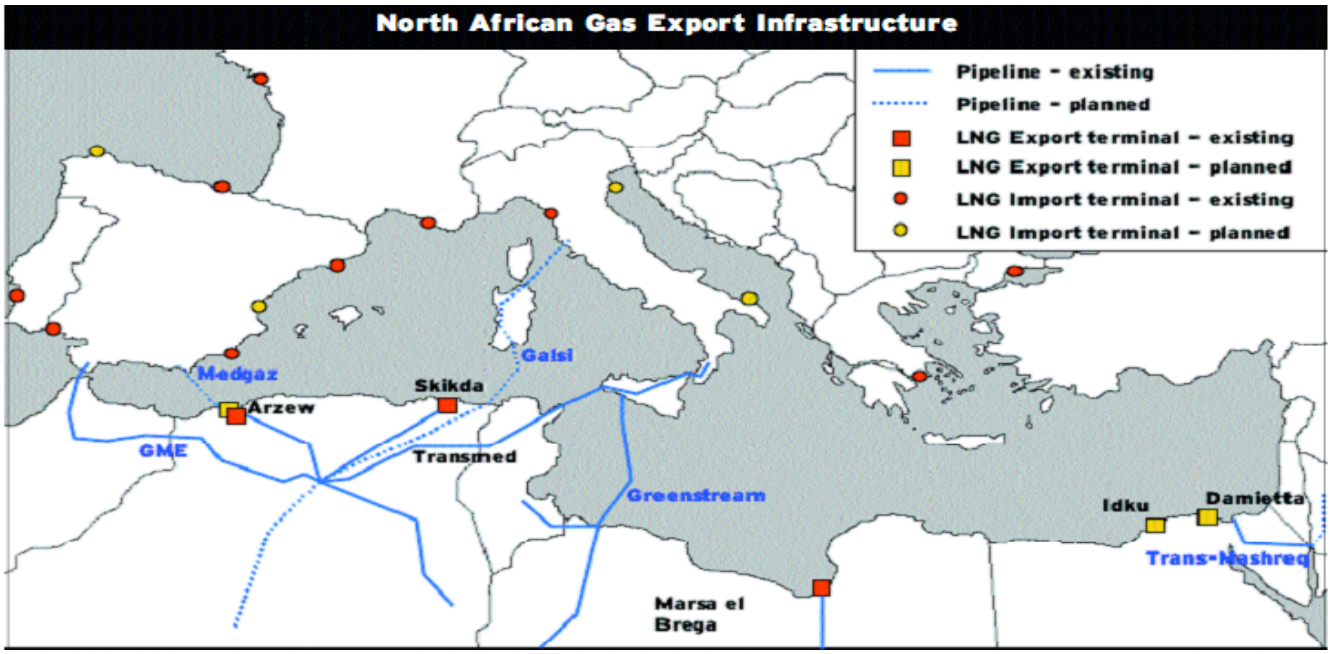
NORTH STREAM:
Connection:
Russia-EU (via Baltic sea)
Transport capacity:
55 billion cubic metres/year
Partners:
Gazprom 51%, BASF/Wintershall 20%, E.ON Ruhrgas 20%, Gasunie 9%
Scheduled for operation:
2 Lines. First scheduled for 2011, second for 2012

SOUTH STREAM:
Connection:
Russia-EU (via Black sea)
Transport capacity:
63 billion cubic meters/year
Partners:
Gazprom 50%, ENI 50%
Scheduled for operation:
End of 2015

NABUCCO:
Connection from:
Caspian region, Middle East,Egypt to EU
Transport capacity:
31 billion cubic meters/year
Partners:
BOTAS, BEH, MOL, OMV, RWE, Transgaz. Each 16,67%
Scheduled for operation:
End of 2015

Source: Europe's Energy Portal " Gas, Electricity & Fuel Prices and Statistics"

Map 3. North African Gas Export Infrastructure



Source: Commodities now, December 2004

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