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From Russia-EU Summit to multilateral transit agreement: A Road Ahead
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From Russia-EU Summit to multilateral transit agreement: a road ahead

Dr. A.Konoplyanik

Russia-EU Summit took place in Moscow on May 21st. Energy agenda between the two parties is always at the top of the list, and it was present there this time as well, in the course of bilateral negotiations on Russia accession to WTO.

In 2003 the St Petersburg Summit established development of cooperative policy ‘spaces’ between the European Union and Russia as a major priority for their bilateral relationship. Development of such common spaces will most effectively progress in the areas where interdependence of both parties is crucial. Energy is such an area. Russia is already a major energy supplier to Europe. Over time, the European Union will become increasingly dependent on energy imports from Russia, particularly of natural gas. Russia – even at a time of high prices for its energy exports – needs huge investment in order to maintain and develop effectively its energy resources and increase efficiency of energy utilization. This investment will come mostly from international capital markets – either through Russian or international energy companies.

Common policy ‘spaces’ require common rules, or at least compatible approaches to regulation, based on the principles of transparency, non-discrimination, be oriented towards market solutions and, finally, reflect balance of interests of the contracting parties adequate to the current state of development of their energy markets. This is precisely the role of the Energy Charter Treaty (ECT), which has been signed not only by Russia and the member states of the EU, but also by twenty five other countries of Europe and Asia. The Energy Charter Treaty represents *one of the few* sets of common rules that bind the EU and Russia together. But so far, in fact, ECT is *the only* piece of EU’s *acquis communautaire* (AC) – the rules governing the operation of the European Union – to which not only Russia (this country has yet to ratify the Treaty, although it does apply ECT rules provisionally and participates actively in the Energy Charter process as a whole), but all the countries of Eastern Europe, the Caspian and of Central Asia (another group of prospective energy suppliers to Europe) subscribe.

Nonetheless, for the purposes of any ‘common energy space’, the Treaty represents a foundation of essential common rules (or: minimum standard rules) that are necessary for the construction of an integrated energy relationship between Russia and the EU within the broader geographical area – within emerging Eurasian energy market. Establishment of the common ‘rules of the game’ at that broader energy space is the aim of the Energy Charter Process. It is clear that two processes need to be complimentary to each other. And they already are complimentary and interdependent – since the EU AC in energy sphere is just going further than ECT in terms of energy markets liberalization (see Chart). But those further liberalised rules of the EU AC related to energy markets (i.e. Gas and Electricity Directives I and II) applies only within the expanding EU territory.

The multilateral approach of the Energy Charter rests on the complimentary interests of producer, transit, and consumer countries to agree those common ‘rules of the game’,

based on the 'minimum standard' principle, for investment, trade and transit, energy efficiency and related environmental issues in the energy sector. 'Minimum standard' principle means that each individual ECT member-country can imply the more liberal regulations of their domestic energy markets (when/if the state of development of the market in this country, firstly the availability and adequate density of energy infrastructure within its territory, would technically and economically allow to implement more liberal rules). Energy Charter also recognises that there are some specific issues in the energy sector, particularly the issue of cross-border energy flows, which cannot be regulated adequately through bilateral channels alone and the Energy Charter represents the most developed multilateral mechanism in existence which can tackle this strategic question in detail. It is hard to underestimate the importance for the future of European (and in a broader terms – Eurasian) energy markets of the issue of energy transit. It will not be possible to develop the energy resources of Russia, and also those in the Caspian and Central Asia, unless there is a reliable and binding perspective on the use of existing or future pipeline networks bringing their energy resources to the quite distant markets in Europe and Asia.

Important issues in the energy sector, incl. those related to transit, have been discussed for some time in the negotiations over Russian accession to the World Trade Organisation (WTO). At the May's 21st Moscow Summit the bilateral discussions between the EU and Russia on Russia's accession to WTO has been concluded. But it seems that the transit-related issues were not clearly settled. No official statements on the transit issues have been presented to public. But it seems that EU is confident that GATT Art.V 'Freedom of Transit' covers the grid-bound energy transit issues, while Russia is quite of an opposite opinion. So though RUF-EU bilateral WTO-related negotiations are finished, it looks like transit issue between the two parties still stays in the 'grey' zone.

However, on questions of transit our member states – including of course the EU and Russia – have already developed a multilateral instrument in the Energy Charter. This instrument - Transit Protocol - represents the most developed multilateral mechanism in existence which establishes in detailed legally binding form the general principles of the multilateral trading system regarding transit in the energy sector.

The Transit Protocol would clarify, for the first time under international law, some key concepts that would facilitate energy transit. Transit Protocol would implement in practice the principle of 'freedom of transit' in the energy sector which is just proclaimed in the GATT Art.V. It would oblige network operators to hold negotiations in good faith on access to available capacity in the pipeline networks (definition of the transit available capacity is given, taking into consideration the realities of the current energy markets, when in some ECT states energy companies might be involved in production and at the same time holds the ownership to the transportation grids). Protocol also specifies that the tariffs paid for transit should be non-discriminatory, cost-based and provide reasonable rate of return. It would also expressly prohibit the illegal taking of energy resources in transit, etc. (see Table).

I would argue that this instrument, in its current form, reflects a solution to transit issues that is realistic, balanced, and protects the legitimate interests of both the European Union and of Russia (including those of Gazprom) – as well as those of the other member states of the Charter constituency. I do not think that Russia and EU can today go further on transit issues in WTO negotiations compared to the provisional agreement that they have reached in the Energy Charter Transit Protocol negotiations, since the latter adequately reflects the current state of development of the energy markets both in the EU and in Russia, as well as in other ECT area (see Chart). As such, I would consider that the draft Transit Protocol represents the basis for a sustainable compromise.

I do not believe that there remain any insurmountable issues in the text of the draft Transit Protocol, as it stands at the moment. On the three issues that remain outstanding and which have prevented the finalisation of negotiations up to this point, these can be clarified in bilateral consultations between Russia and EU in the form of joint declarations or understandings. The basis for this statement is that we now face with Transit Protocol a unique situation when legal demands of the EU's *acquis* adequately corresponds to the valid economic interests of Russia and Gasprom (which definitely always stands behind the position of Russia).

Given that all the other member states of the Energy Charter have indicated their willingness to proceed with the Protocol's adoption, it would therefore be highly appropriate for the Russian Federation and the European Union to renew their political commitment to finalising these negotiations by the end of 2004. Finalisation of their bilateral WTO negotiations has put an end to the situation when those two processes were overlapping which, in turn, has led in December 2003 to the temporary suspension of the Transit Protocol negotiations. The leadership of the Energy Charter has recently addressed to both Russia and EU with corresponding proposals on resuming the Transit Protocol finalisation process.

Finalisation of Transit Protocol would promote a long-standing objective of the Charter's member states, that is, to promote Russian ratification of the Energy Charter Treaty. During parliamentary hearings on this issue in 2001, the Russian State Duma made its consideration of ECT ratification contingent on the finalisation of the Transit Protocol negotiations. So in the 'best case' scenario Russian Government will have an opportunity to present Transit Protocol to the State Duma (if negotiations on the Protocol are successfully finished at December 2004 Energy Charter Conference) even at early 2005.

By reducing the risks associated with energy investment and cross-border energy flows, full implementation of the Energy Charter Treaty and its protocols would enhance Russia's ability to compete successfully with other energy-producing states on international energy and capital markets. It would also represent a major step forward in securing a firm legal foundation for energy cooperation across Eurasia, promoting both Europe's security of supply and further integration of Russia into the world economic system.

Draft text of Transit Protocol is available at www.encharter.org under Transit section.

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