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**Research Report**

## Taking Medvedev at his Word: The Russian president's proposal for an international energy accord and the Energy Charter Treaty

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## Taking Medvedev at his Word

### The Russian President's Proposal for an International Energy Accord and the Energy Charter Treaty

Kirsten Westphal

In February 2009, the Russian president presented his concept for an international framework agreement in the energy sector. Yet up to now, the proposal has passed largely without comment. This is partly related to the 2009 Russian-Ukrainian gas conflict, after which the document was seen as a further attempt to undermine the Energy Charter Treaty. Then in July 2009, the Russian government decided to withdraw from the Energy Charter Treaty. At the present stage, Europe should take Medvedev at his word. Now more than ever, his proposal should be used as a catalyst to flesh out the details of a global energy treaty that goes beyond existing documents such as the 2008 G8 Declaration on Global Energy Security.

During his official visit to Helsinki on April 20, 2009, Russian president Dmitry Medvedev put forward a document with the cumbersome title "Conceptual Approach to the New Legal Foundation for International Cooperation in Energy (Goals and Principles)." There are good reasons why this proposal has scarcely been discussed in Europe. Russia has been calling for negotiations on a new energy treaty since 2000. These efforts have been viewed mainly as a tactical maneuver by Moscow aimed at justifying the country's rejection of the Energy Charter Treaty. The Russian cabinet then decided on July 30, 2009, to refrain from participation in the Energy Charter Treaty.

### The Energy Charter Treaty

With the European Energy Charter of 1991 and the legally binding Energy Charter Treaty of 1994 (in force since 1998), there exists an international set of basic rules for energy cooperation.

In the Charter and in the Treaty, the signatories agreed on the following goals and principles: to build open and efficient energy markets subject to the laws of the market; to establish favorable conditions for foreign and private investments; and to adhere to the principle of nondiscrimination in the area of investments and trade, as well as the principle of free transit without regard for country of origin, country of destination, or ownership. The guiding principle of sustainable development is also enshrined in the Treaty.

The Treaty itself rests on the four pillars of investment protection (Section III), trade (Section II), transit (Art. 7) and dispute settlement provisions (Section V). State sovereignty over natural resources is also emphasized (Art. 18). Moreover, there is an additional protocol on energy efficiency and environmental aspects. Essentially, the Treaty has introduced rules and principles of the WTO such as non-discrimination and the most-favored nation clause into international energy cooperation. Section VII also outlines a conference process that would enable the contractual partners to negotiate annexes, changes, and additional protocols. This process, with its sub-working groups, has already proven itself as a forum for cooperation—for example, in the area of energy efficiency.

Fifty-one countries plus the European Communities and Euratom are taking part in the Energy Charter process. They include the EU member states, Switzerland, Turkey, the CIS countries, and Japan. Five countries (Australia, Iceland, Norway, Belarus, and Russia) have not yet ratified the treaty.

Without doubt it is a weakness that the major Arab energy producers, as well as the US, Canada, Indonesia, Venezuela, and Nigeria are only observers. The main point of critique of producer countries like Norway is that the Treaty favors foreign investors (and thus the gas consuming countries), giving them sweeping rights, while the producer countries see their own sovereign rights as being infringed upon. Thus, a need for further discussion of these issues and expansion of the process still exists.

Since Russia did not file any declaration to the contrary at the time when the Treaty was signed in 1994, it is subject to provisional application under Art. 45 of the Treaty. Russia, however, has called this point increasingly into question. Its reasons are complex.

### **Russia in the Energy Charter Process**

As Europe's most important energy supplier, Russia has played a key role in the

conference process since the very beginning. At the end of the 1990s, the question of transit (both the rules contained in the Treaty as well as the Transit Protocol as an annex to the Treaty) has become a crucial point of contention for Moscow, making resolution of this issue a condition for ratification. Particularly disputed is Article 7 of the Treaty, which establishes the principle of free transit, irrespective of country of origin, destination, or ownership.

Points of contention in the Transit Protocol include the "right of first refusal, the clause on regional economic integration" (REIO), and the transit tariffs. The "right of first refusal" that Gazprom wants to push through would entail that exporters whose transit contracts are about to expire would have priority over competitors in concluding new contracts for the same transport volume. In the case of the REIO clause, the controversy revolves around the EU's demand to be recognized as an economically integrated region and therefore to be able to choose to implement not the rules of the Energy Charter Treaty within its territory for transport but instead the stricter rules of the EU single market. This would affect Russia on the Jamal-Europe Pipeline and the section that runs through Poland to the extent that transit contracts would be for shorter intervals than the existing supply contracts.

Russia has kept negotiations on hold for more than ten years, in recent times due to the combination of a politics of symbolism and substantive issues. But the fact that Gazprom lobbied from the very beginning against ratification while other Russian energy firms were strongly in favor of the Treaty has played a much more decisive role. Gazprom fears the loss of its strategically important position as the narrow gateway to Central Asian gas. Its strong position as a gas supplier to Europe is based on the purchase of Central Asian gas—depending on European demand. The decisive point here is that Gazprom buys and resells Central Asian gas instead of simply providing transit services.

Russia has been the target of international criticism since 2002 due to the YUKOS affair in particular. As a result, the Permanent Court of Arbitration in The Hague is now deliberating on the question of whether and to what extent Russia is bound to the Energy Charter Treaty under provisional application. The background is the expropriation of YUKOS shareholders, and the amount in question is between 28 and 50 billion US dollars.

One of the reasons for the Russian maneuverings may be found in the process itself. During the conflict with Ukraine, Russia occasionally made use of highly nuanced legal arguments in justifying the stoppage of gas supplies to Ukraine based on national law and prevailing customs regulations, while simultaneously complaining at length about the alleged ineffectuality of the Treaty. The crucial point is that provisional application of the Energy Charter Treaty is terminated whenever its provisions violate the prevailing national law and constitution. Over time, the Russian argumentation had shifted to claiming that Art. 45 does not apply to Russia. Thus, the letter with which Russia formally terminated provisional application (which the country claims was never actually practiced) on October 19, 2009, seems all the more surprising. How this legal “double step” will be assessed by the Permanent Court of Arbitration in The Hague remains to be seen.

Of international significance, however, is Russia’s clear withdrawal from the Energy Charter Treaty, which is evidence that the country will no longer ratify the Treaty in its existing form. Annoyance over the fact that Medvedev’s proposal has scarcely been discussed internationally may have been one factor in this.

### **Medvedev’s Proposal**

For the aforementioned reasons, Medvedev’s proposal can scarcely be viewed in isolation from the Energy Charter process. It may seem strange at first that Moscow is

now demanding a legally binding framework for energy cooperation. After all, Russia has tended to profit from the status quo up to now and from the state of uncertainty around the Energy Charter Treaty and its Transit Protocol. Medvedev’s concept is also just the most recent in a series of similar statements: already in February 2009, Putin argued for opening negotiations on a new framework for international energy security in his opening address at the World Economic Forum in Davos. Furthermore, the speaker of the energy committee of the Duma, Jazev, was quoted in the Russian press proposing a corporate energy forum, the realization of which would reinforce existing asymmetries between commercially oriented and state-dominated companies.

According to the Russian president, the document that he presented in April without prior diplomatic consultations in Helsinki is intended to “de facto replace the Energy Charter.” It first describes the goals, then over two pages details the central principles of a new legal basis for global energy cooperation. Annex 1 contains the elements of a transit agreement (one page) and Annex 2 a list of raw materials for energy production and energy products that should be included in the framework.

Medvedev argues that the current bilateral and multilateral agreements are inadequate to prevent and overcome conflict situations. What is called for at present, he says, is the “development of a new, universal, legally binding document” covering all of the major export, import, and transit countries. Another notable feature of this document is the statement that sustainable energy security is indivisible and that all of the actors in the energy sector should therefore share equal responsibility for ensuring energy security at the global level.

The wording is vague and relatively unspecific throughout. The concept proposed also clearly reflects the ambiguity of Russian energy policy in recent years, which attempts to maintain energy supply security while making the sustainability of

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demand a guiding principle. Here, the objectives are clearly to stabilize price levels, earnings, and revenues from energy exports. The question is obviously how to apply this principle given the uncertainties of demand trends in the current recession. There is already discussion internationally on how to create more transparency and foster a more intensive exchange of information between producers and consumers regarding prognoses and investment programs. In the gas sector, there are also long-term contracts with take-or-pay clauses. The proposal to engage in dispute settlement primarily on a diplomatic level (and optionally with reference to UN trade regulations) is significantly weaker than the comparable, although—on the point of investments—still-disputed provisions of the Energy Charter Treaty. This demonstrates the sovereign and far-reaching role that the Russian energy sector intends for the state. Furthermore, the proposal envisions the exchange of assets between companies as a means of ensuring access to markets and infrastructure. This reflects the rational business strategy of Gazprom to become active along the entire supply chain. What is lacking here, however, is any indication of the reciprocity of the rules, that is, their applicability to the Russian market as well, which would be obligatory under the principle of universal applicability.

If one chooses not to dismiss the whole matter from the outset as a tactical and domestic policy maneuver but instead to read Medvedev's proposal favorably, then one can conclude that overall the document is in accord with the basic principles of the Energy Charter and that many of the points are already formulated in legally binding terms in the Energy Charter Treaty. Furthermore, Annex 2 is also a copy of the Annex EM of the Energy Charter Treaty.

## Conclusion

On October 19, 2009, Russia's withdrawal from the Energy Charter Treaty will become official. Russia will then be just an observer

in the process. Although the safeguarding provisions for investments will still apply under provisional application to investments made beforehand for another 20 years, the lack of an internationally legally binding framework will become a matter of paramount concern. There are a host of reasons to take the Russian president at his word. Germany, as a close energy partner of Russia, should not waste this opportunity to constructively integrate Russia into a process of negotiation in order to achieve an internationally binding legal framework. Russia, on the other hand, needs to fill the concept with life and formulate it in precise legal terms. It could turn out that in many respects, the result is not far from the spirit and legal principles of the Energy Charter Treaty. There are good arguments for embedding this process in the framework of the Energy Charter Treaty, not least of these being the imperative of preventing forum-hopping. Medvedev's presidential speaker cited this framework explicitly as an option.

Russia's initiative contains an important point: the key countries need to come to the table. The point in time is auspicious since public sentiment seems to have shifted in favor of more intense regulation in the energy sector and greater cooperation in the field of technology and knowledge transfer, on the question of price volatility, and on the aim of increased compliance with the climate regime. In order to win over important producer and consumer countries, intensive diplomatic efforts are necessary that could also be undertaken, for example, in the framework of the G8 and G20. The result should be an international, legally binding framework: an "Energy Charter Plus" that takes the interests of the energy producers and transit countries more strongly into account in a number of areas and includes modifications of several points that are already under discussion.