

# Changing EU Energy Legislation: Practical Scenarios for Strengthening the EU-Russia Energy Partnership

Institute of World Economy and International Relations

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## Energy Roundtable Summary Document



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## **Roundtable Discussion**

The EU-Russia energy roundtable discussion held at the Institute of World Economy and International Relations (IMEMO) on February 26, 2010, brought together a significant number of well known experts and policy makers engaged in the EU-Russia energy relationship in order to assess some of the challenges which presently exist in this sphere. Some of these challenges are summarised below. The objectives of the seminar organisers were to create an environment in which experts and policy makers could openly and candidly discuss the challenges standing before the EU-Russia energy relationship. The roundtable was also attended by a large number of participants from academia, government, energy companies and the diplomatic community.

## **Conceptual Background**

### **The Challenge for the EU-Russia Energy Partnership**

The energy trade between Russia and the countries of the European Union (EU) is of fundamental significance for the energy security and economic well being of each party. Russia is the EU's largest supplier of natural gas, a significant oil supplier to the 27 country-strong EU bloc, while the Union is Russia's core energy export market, particularly for natural gas. This relationship is unlikely to be altered in the near term.

Despite the close proximity of the EU-Russia energy relationship, however, the legal and political basis underpinning this relationship, particularly with regards to the gas trade, has proven itself inadequate in assuring the energy security of the parties. The Energy Charter Treaty (ECT), for example, has not been able to prevent costly transit disputes between Russia and Ukraine, and has been unable to develop into a steadfast confidence building instrument promoting the energy security of its predominantly European and former-Soviet Republic member states. Brussels and Moscow have been employing their formal institutions of Energy Dialogue more as a means of defusing crisis, as opposed to working towards a common position on energy security. Some voices perceive elements of the European Commission's Third Energy Package as being detrimental to Russian interests, whilst Ukraine's ongoing negotiations for accession to the EU-sponsored Energy Community Treaty aims to incorporate Ukraine into the framework of EU energy legislation – a development looked upon with some level of scepticism in Russia.

With Russia's recent announcement of its intention "of not becoming a member" of the Energy Charter Treaty, and while negotiations over a new EU-Russia Partnership and Cooperation Agreement remain in their very early stages, much political and institutional uncertainty clouds the future of the EU-Russia energy relationship. Whilst in April of last year Russia announced a conceptual initiative advocating for a new legal solution to the present incongruence between energy producers, consumers and transit states inherent in the Energy Charter process, the parameters and scope of such efforts remain unclear.

This likewise puts under question Ukraine's future as the key transit corridor for Russian gas to Europe, given that Kiev is likely to become part of EU energy legislation (once it accedes to the Energy Community Treaty) quicker than a legally binding multilateral solution for transit disputes is found. This could have major implications on Ukraine's future role as a transit state. Russia, in the meantime, appears set to bypass Ukraine altogether, envisaging that a new multiparty transit agreement is unlikely. Moscow is therefore likely to move forward with its own transit avoidance projects, predominantly the Nord Stream and South Stream gas pipelines. In the meantime, as Europe struggles through another cold winter, one begs to ask the question: how secure are our energy supplies?

## Agenda

### Changing EU Energy Legislation and the Brussels-Moscow Relationship: The Key Aspects

- Implementing the 3<sup>rd</sup> gas and electricity directive: implications for Russia
- Ukraine's accession to the Energy Community Treaty: implications for all parties
- The nature of the EU-Russia energy relationship beyond the Energy Charter process: what, if any, changes can be expected?
- A new Russian conceptual framework for energy security: producer and consumer interests taken on equal footing
- The basis for an effective energy dialogue through a new Partnership and Cooperation Agreement (PCA): the key elements

### Intended Practicalities Towards the Strengthening of Transit Regimes through Third Countries

- Is a gas transit consortium a possible solution for the management of gas transportation infrastructure in third countries?
- What is the likelihood for a new EU-Russia transit agreement outside of the Energy Charter framework? Is such an agreement necessary ?
- Can an external early warning crisis prevention instrument emerge out of strategic discussions in view of modernising the Energy Charter?
- Rehabilitating gas transport infrastructure through privatisation: the pros and cons of proposed management and ownership reform of Ukraine's gas transport operator

#### Moderator:

##### **Prof Nodari Simonia**

*Director, Centre for Energy Studies, Russian Academy of Sciences*

#### Speakers:

##### **Vladimir Feigin**

*Principal Director, Head of Energy Department,  
Institute of Energy and Finance*

##### **Dr Andrei Konoplyanik**

*Former-Deputy Secretary General,  
Energy Charter Secretariat*

##### **Konstantin Simonov**

*Director General,  
Russian National Energy Security Foundation*

##### **Tatiana Mitrova**

*Head, Centre for International Energy Market  
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##### **Prof Anatoly Zolotukhin**

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##### **Michael Webb**

*Deputy Head,  
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##### **Dr Urban Rusnak**

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*Former-Senior Adviser, Energy Charter Secretariat*

## Introduction

The roundtable was opened by the distinguished Russian academic, **Professor Nodari Simonia**, who stressed the following:

- While energy relations between Russia and the EU have become unnecessarily politicised, we need to depart from any confrontational moments which have existed in the past. Taking into account that we now have a new (European) Commission and new (European) Parliament in Brussels, this approach needs to be reflected in the new rounds of negotiations between Brussels and Moscow in their mutual efforts to reinforce attempts to establish a more balanced institutional framework for their energy partnership.
- The change of government in Ukraine as a result of the latest presidential elections could create conditions which are more favourable for arriving at more acceptable solutions in Russia's energy cooperation with Ukraine, assuming that both sides approach future rounds of negotiations seriously and professionally.

Following the opening remarks from the Chair, a number of esteemed Russian energy experts took the floor with a series of interventions. Some of the key points emphasised included the following:

### Interventions by Russian speakers:

#### i. Energy Charter Treaty and Process

- Despite the widespread perception within Russia that the ECT is hostile to Russian national interests in the energy sector, there are both benefits and disadvantages for Russia contained in the ECT. In principle, Article 7 of the Treaty (the transit provisions) is of benefit to Russia, since (theoretically speaking) it compels Ukraine to ensure freedom of transit of Russian gas bound for Europe. If this were to work efficiently, it would help enhance Russia as a reliable energy partner to the Europeans since the Treaty would work to reduce the scope of transit disputes taking place between Russia and Ukraine. Article 7, however, is also inimical to Russian interests since it would likewise oblige Russia to act as a transit state for west bound Central Asian gas, which Russia has preferred to buy at the border entry points and resell as part of the Russian gas supply to Europe.
- The important question for Russia is not just the facet of the Treaty itself, but also how Russian energy diplomacy engages the Treaty as an instrument of international energy governance. This is linked to Russia's ability to negotiate the process of its energy dialogue with the EU, taking into account that the EU has started to move away from unconditional endorsement of the ECT given that elements of the latter may contradict the development of the EU's own external energy strategy and efforts to promulgate a new set of rules for the EU internal energy market (for gas and electricity).

- Overall, the narrow level of knowledge which exists in Russia about the Energy Charter remains, for the most part, negative and this is something difficult to change (one of the speakers later commented that he did not know why the speakers appeared so determined to focus on the ECT given that the Treaty has for such a long time been a “dead letter” in Russia)
- January 2009 (and the failure of the Energy Charter to even give the impression that it is taking even the most meagre of steps to facilitate a resolution of the Russia-Ukraine gas dispute) is a stain that simply cannot be removed from the Charter process and how it is viewed in Russia
- The ECT is essentially about the provision of energy security. Russian gas can play a major role on the European energy market if the relationship between supplier and consumer can be played out in a mutually beneficial manner. As it stands at the moment, the relationship is yet to be fine tuned to its most effective level. The ECT, in this context, can play both a positive and a negative role.

### **Reforming the Charter**

- The so called modernisation of the ECT is bound to be an ongoing process that should be used by all non-EU players to coordinate positions and define interpretation of the relevant clauses in a manner acceptable to all parties. We see this process lasting in to the next 2-3 years at least.
- As already implied above, both the discussion about Russia’s Conceptual Approach for energy security (April 2009) and the reform of the Energy Charter is predicated on the necessity to focus on the development/strengthening of crisis prevention mechanisms. It should also reflect contemporary challenges and balance of power in the international energy markets. The reform process is predicated by the debate over whether to modernise the ECT or to “re-invent” a new document altogether. The EU position is that the ECT cannot be fully excluded from the emergence of new institutional arrangements for energy security. If the Russian government is more drawn to the argument that a new document is necessary and that the ECT should be altogether scrapped, then this could be the reason as to why Russia has decided to withdraw from provisional application of the Treaty.
- Most experts concede that the Charter and the Conceptual Approach are by and large based on the same principles. Yet there is still no commonly accepted institutional basis for the EU-Russia energy relationship. So how do we move forward towards something that both sides could work with?
- The current ECT, as an integrated document is rather vague in some of its provisions and fairly demanding in others. This has led to the exclusion of some core, would-be partners of the Charter from either joining or ratifying the Treaty, including the USA, Norway, Australia, Canada and the OPEC members
- It is evident that not all ECT signatories are in full agreement over the text (of the ECT), nor do they accept all of the provisions of the Treaty. Yet the Treaty is binding on all of its members. Can a more flexible approach be the way forward?

- Such an approach could be proposed through a combination of the **Concept Plus** (ie, a universally accepted agreement on the principle of cooperation in the energy sphere based on the G-8 2006 St.Petersburg Declaration, which would be a legally binding document. The document would envisage the creation of an “energy club”, where members of the agreement would also be members of the Club, which could be derived from the experience of the WTO) and/or the **ECT Plus/Minus** (ie, a new system of binding documents, sectoral in their orientation, which would allow members of the Club to join into the parts of the process deemed relevant to them. The sections [sectors] which members join would be legally binding. Sections which they do not join, would not be applicable to them. This gives members flexibility to join into those parts of the process which are most relevant to them, ie, transit, energy efficiency, other)
- This still leaves us with a number of open questions, including with respect to how existing ECT members would become participants of the “Energy Club” and how membership to the Club would affect their ECT status.
- This process would seemingly involve a major overhaul of the Charter – are the parties ready for this? We hence return to a discussion leading us into debate about reform of the Charter Vs its termination and replacement with new instruments

## **ii. The European Commission’s Third Energy Package**

- With the adoption of the Third Directive on Gas and Electricity (Third Package), we have entered into a new era with regards to the organisational arrangements for the “energy space” of the greater European (and even Eurasian) institutional energy environment. Interconnected and unified energy infrastructure is the key aspect of this new environment. Geographically, this means that from Lisbon to the Sahara, and further afield to Central Asia and even China, a basis will exist for the entire pipeline system of this broad region to operate in unison.
- With adoption of the above mentioned document, the institutional structure of the market has changed. Vertically Integrated Companies (VIC) have up to now been the basic elements of the market, providing for market capitalization, competitive power increase and larger scale project realisation. VICs dominated the energy markets of both continental Europe and the former-Soviet Republics. The adoption of the Third Package, however, implies the non-reversible task of de-segmentation of the VICs, where the so called “Scale Effect” is to be substituted with the competition effect. This will also involve a fundamental change in the economic model upon which the market is based.
- However, in saying all of the above, we also have to note that there is scope for the emergence of multiple inconsistencies in the process of alteration of market rules, which should be ironed out in order to coordinate with other European rules/documents as well as with bi-lateral agreements within EU and with non-EU countries. At this stage it is highly unclear as to how these inconsistencies would be resolved.

- We should further note that major alterations in market rules could likewise result in the alteration of the economic incentives and investment policies of the main suppliers to this market (ie, Russia, Algeria) due to (the perception of) increased risk of non-effective investments. The energy market regulations which the EU is developing within the framework of the Third Package are still themselves very raw in form. Furthermore, it is not clear as to how these regulations will impact existing aspects of legislation regulating the energy relationship in wider Europe (including the ECT). The uncertainty creates the risk of ineffective energy investment decisions
- The manner in which the European regulators are engaging themselves in the task of market rules alteration is exacerbating the risks to investment on the one hand, but (due to its flexibility) is also creating a process in which such risks could be mitigated on the other (by adopting new codes and guidelines, particularly those drawn up by the European Commission)
- When discussing the aforementioned subject matter it should be again emphasised that the core issues relate to the creation of an institutional environment for the energy markets of wider Europe, with an institutional value chain reaching far beyond the EU (ie, into Eurasia and North Africa). Given this trend, the EU is compelling companies from countries outside of the EU but wishing to work with its energy markets, to accept EU internal market rules (including the main clauses for unbundling and vertical de-integration of energy companies for the development of competition and transparency)
- A large part of the debate about the nature of the EU-Russia energy partnership revolves around the question of the EU internal gas market. We still do not have a clear understanding of the full implication of what the EU is trying to achieve and the jury is still out with respect to the experience with competition in the case of a number of national energy markets. As we know, there is substantial resistance to the Third Package within (some parts of) the EU and we should ask ourselves that if companies like ENI (Italy) are forced to unbundle, to whom will they sell their assets? Not to their daughter companies?
- From our perspective, the philosophy behind the Third Package is quite obvious: to reach gas-to-gas competition within the EU based on clear and equal market rules for all players. It is assumed that this goal would be achieved by the development of new energy infrastructure (new underground storages and new pipelines), the 20:20:20 objectives and other Package components, with a reduction in the price of gas paid by the consumer being the final outcome.
- However, the emergence of such a competitive environment in Europe is still clouded in a degree of uncertainty. The market conditions and the technologies required for these circumstances are still to be created

- Further, the Third Package concept may be quite feasible, but appears to assume large volumes of easily accessible gas supplies at the EU borders. Conditions could be less favourable in the event of lesser available gas supplies. An assumption could be made that the EU's adoption of the Third Package is the result of an over-optimistic future gas supply evaluation. It is not an anti-Russian measure due to the substantial volumes of gas available in Russia in the period 2015-2020, when it is envisaged that scalable shale gas extraction could commence (it should be recalled that the Package is primarily directed against the EU based national champions, rather than against Gazprom or other national champions outside of the EU)
- This could be a largely positive development for Gazprom since it would not necessarily burden the company's aspirations to access the end user (energy consumer) in Europe due to the fact that a liberal market has already been created in order to achieve this purpose (and assuming that a political lobby against Russian interests would not be in place in the EU)
- This assumption will be workable if the EU will be consistent in its approach to market development (unlike the experience with the Groningen System, which saw the emergence of inconsistencies), and that endorsement of the spot price approach will not revert back to basket prices based contracts.
- While many of the emerging changes such as those taking place in the EU internal energy markets are dynamic, there is still a strong degree of scepticism that (dynamic) changes are indeed taking place. This is less true of the developments within the EU than of the fact that Russia and the EU are at two "opposite ends of the spectrum" when it comes to the use of technologies and their respective conceptual approaches towards energy policy making

### **iii. A new EU-Russia Partnership and Cooperation Agreement (PCA)**

- The new PCA is in a very early stage of negotiations and it will take an unrealistically long period to arrive at a common position, let alone a binding agreement

### **iv. Ukraine and the Energy Community Treaty**

- It is felt that Ukraine provides a positive environment in which to practice the rules of the Third Package since we will have to figure in Ukraine as the main transit route for Russian gas to the EU for at least 20 years. The (energy markets) liberalisation experiment which could take place in Ukraine could be of interest (and benefit) for both Russia and the EU.
- Will liberalisation of the Ukrainian gas market give Russia greater access to the Ukrainian gas transportation network? If movements in this direction is to develop, who will take on the existing debts of Naftogas and Ukraine ?



Interventions by a number of European speakers followed:

## **Interventions by European speakers:**

### **i. The EU-Russia energy partnership**

- This relationship is predominantly characterised by its interdependence and should be viewed more as a “game” rather than a “battlefield”. A repeat of the January 2009 gas crisis is in nobody’s interest and everything should be done to ensure that it will not repeat itself.
- In this context, the energy infrastructures linking the EU and Russia should be safe, secure and fully utilised and the assistance that the EU is rendering to Ukraine to modernize its gas transit system is a major contribution to these efforts. A practical result of such efforts is the crisis prevention early warning mechanism that was signed between Russia and the EU in November 2008.
- The EU is basing its actions on the premise that Russia and EU are likely to remain important partners for the foreseeable future, therefore when the EU promotes the diversification of gas delivery routes and sources of gas to Europe, it is not doing so in order to reduce EU dependence on Russia but rather to insure the EU would have access to additional gas volumes in the years to come (this is why the EU endorses both the Nord Stream and the Nabucco gas pipeline projects as priority contributions to the extension of the EU energy network system).
- To further ensure its energy security, the EU has introduced its 20:20:20 strategy, which means 20% more energy efficiency, a 20% increase in the share of renewables in EU energy consumption and a 20% reduction in CO2 emissions.

### **ii. The European Commission’s Third Energy Package**

- It should be understood that the unbundling of energy companies means effectively separating energy production and sale from energy transmission (distribution). This will help to avoid the anticompetitive nature and excessive reliance on vertically integrated companies. It will eliminate scope for conflict of interests and promote investment. In brief, it will make the (European gas and electricity) market more transparent and less discriminatory – a level playing field for all countries within the EU market. These rules would apply to all companies operating in the EU market (both EU companies and those from non-EU countries but having investments in the EU market, including Gazprom).
- The unbundling of energy companies is to be completed by March 2011 (applicable only to gas and electricity) and the provisions will be applicable as of March 2012. The European Commission will provide guidelines on how to interpret the Package and how it should be applied when necessary.

- It is appreciated that there have been certain apprehensions in Russia about the application of this Package. However, even when these changes will be in place, the EU Market will nevertheless remain much more open and more accessible for foreign investments than the Russian market. However the EU recognises such concerns on the Russian side and is ready to address them.

### **iii. Energy Charter Treaty and Process**

- While the EU carefully notes the Conceptual Approach by Russian president Medvedev with regards to a new multilateral framework for energy security, the EU is concerned that (all parties should accept that) the ECT remains an (the) important basis multilateral cooperation in the energy sphere. What has been so carefully built up over the years should not be undermined. The EU, however, acknowledges that the ECT is far from perfect. A review of the process has been under way during 2009 and this presents an adequate framework within which to discuss the proposals on energy security proposed by president Medvedev.

### **Reforming the Charter**

- When it comes to the Energy Charter, both process and Treaty, as an example of an instrument of energy governance applicable to the global energy markets, despite the honourable ambitions of its founders and the wide acceptance of the principles of the Energy Charter Declaration of 1991, the Charter experience has come to symbolise many of the Don'ts, rather than the Do's, of an effective and smooth-flowing energy relationship between key producer-consumer-transit partners

### **1. What are the main (strategic/political) problems with the Charter?**

- i/ Despite the fact that ECT is in effect the only multilateral, legally binding investor protection instrument in the international energy sector, with 51 member countries, hardly anyone knew about the ECT before 2009, and certainly not before the gas crisis of January 2006. Mainstream knowledge – let alone understanding – of the Charter remains limited to a very narrow circle of persons in the international energy business even today. An instrument designed to build investor confidence in the high risk and very capital intensive energy sector can hardly perform the task of promoting energy security if hardly anyone knows about it.
- ii/ In recent years, the focus of the political messaging of the EU and the Charter Secretariat (which receives the majority of its budget from the EU) was on the need to have Russia ratify the Treaty (particularly after the 2006 gas crisis). A convincing case for Russian ratification was never made, however, just a “one stop shop” ratification approach as a panacea for the cooling of energy relations between Moscow and Brussels. This continued policy of “bashing against a brick wall” was counter productive in the end, as no effort was made to take into account the Russian position or change the negative public opinion about the Charter within Russia (with the exception of former IEA Executive Director, Claud Mandil, no senior European energy policy decision maker was prepared to call on the EU to relax Brussels’ drive

- iii/. Instead of trying to make a genuine case for Russian ratification of the ECT, the executive leadership of the Charter Secretariat instead invested much time and much of its budget on expansion of the ECT to obscure countries like Afghanistan, Pakistan, to a lesser degree Jordan, and more recently Syria and Egypt. Neither were there any efforts/initiatives working towards the pursuit of effective solutions to the deadlocked Transit Protocol Negotiations or work to resolve/recommend some of the structural weaknesses in the ECT (ie, weakness of Article 7 on Transit elaborate on some of the ambiguities inherent in the ECT and Charter Process, which have prevented the major energy producers from either joining or ratifying the ECT: Key problem is that there are no fully fledged producer countries, especially on the oil side, which are ratifying members of the ECT). The Charter Secretariat tried to divert attention from these inherent weaknesses by instead presenting the ECT as a relevant global instrument for the promotion of energy security, comparable to the IEA and others, which it never was.
- iv/. While there are only limited circles within the Russian energy establishment which are familiar with the Charter, sentiment towards it is largely negative. No effort was made by the Charter Secretariat, either with or without the support of the EU, to improve this, or develop a strategy towards changing public opinion about the Charter within Russia, either by engaging a professional communications firm or other. A basis for a fully fledged relationship with Russia was never developed as a result, despite the presence of senior Russian officials on the Charter Conference such as Deputy Energy Minister of the Russian Federation, Anatoly Yanovsky. This allowed Russian public opinion to brush off the Charter as an irrelevant and irritating EU-driven instrument, particularly after January 2009 – a development which was clearly reflected by the fact that Russia did not even inform the Charter Secretariat of its decision to withdraw from provisional application of the ECT last summer. (The Charter Secretariat informed itself of the Russian decision through the internet, further creating an atmosphere of major uncertainty within the organisation)

## **2. The Charter's loss of relevance and the Russian position**

- The January 2009 gas crisis left the Charter badly exposed and demonstrated both the ECT's inherent weaknesses and the lack of leadership from which both the Charter Secretariat and the Charter process suffer. The actions of the Charter Secretariat in response to the crisis were limited to short website statements informing the disputing parties of the dispute resolution options available to them under Article 7 of the Treaty. These were, of course, never going to have any influence on the resolution of the crisis. The public hearing over the gas crisis in the European Parliament on January 8, 2009, should have led to at least the cross questioning of the Secretary General (or at least the Director of Trade and Transit) of the Secretariat about the options available to work towards the resolution of the crisis under the ECT, but nothing of the sort happened. Neither did the leadership of Secretariat show

- All of this reflects poor strategic choice at the level of the Secretariat (or lack of consultation within the Secretariat leadership) and failure of the Secretariat executive leadership to coordinate its work with (as well as win the confidence and trust of) the key partners of the Charter Process (ie, Russia and the EU)
- The result is that after the last Russia-Ukraine gas crisis in particular, the Charter seems to have totally lost any relevance to its original objectives (ie, confidence building measure, promoting energy security for all of its members, etc) and appears to be more a process struggling for its survival than anything else. This is underscored by Russia's decision to withdraw from (provisional application of) the Charter last summer, and the comments from its political elite, reflecting the fact that the country is not in any way bound by the ECT
- While many in Europe state that Russia's decision to leave the Charter is a "shame" and demonstrates that Moscow is not a serious partner within the context of international treaty regimes, Russia's actions reflect the total loss of relevance of the Charter from the producer perspective, exposing the structural weaknesses and ambiguities of the ECT and the Charter process. The following extract from a recent article in the highly influential Foreign Affairs journal, further underscores the Charter's loss of relevance amongst contemporary institutions of global governance in the energy sector:

Beyond these specialised (energy governance) institutions (such as the International Energy Agency, the International Energy Forum, and the International Atomic Energy Agency) is a landscape of wreckage. Europe's Energy Charter Treaty has had no practical impact on energy markets, despite its bold vision for integrating the energy systems of eastern and western Europe. One problem is that the Treaty violates the first rule of effective institution building: it alienates the most important player. Russia, Europe's pivotal energy supplier, sees no benefit in subjecting itself to oversight by an intrusive Western institution and so has ensured the treaty's irrelevance.<sup>1</sup>

### **Major uncertainties lie ahead (for the future of the Charter Process)**

The last Energy Charter Conference, in Rome at the end of 2009, has left the Charter Process in a state of major and endemic uncertainty.

No one knows exactly where we are with:

- Russia's position towards the Charter, whether it has left or not (Ukraine, for example, raised the question of whether Russia still remains in the Charter process during the (Energy Charter) Ad Hoc Strategy Group meeting in Brussels in February this year. The Secretary General of the Charter Secretariat could not adequately answer this question, responding that "Russia is currently in a process of deliberation about its participation in the Charter". At the same meeting, Switzerland proposed to make a separate "association agreement" with Russia within the context of the Charter

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<sup>1</sup> David G. Victor and Linda Yueh; "The New Energy Order: Managing Insecurities in the Twenty-first Century", *Foreign Affairs* (January/February 2010), p.67.

Process). This however underscores the fact that the Secretariat has never been able to develop an effective working relationship with Russia (despite the appointment of a respected Russian diplomat to the position of Deputy Secretary General of the Charter Secretariat in summer 2008) and there was always much ambiguity about Russia's position towards the Process to begin with (especially after mid-2006)

- What will emerge from the Russian Conceptual Approach to Energy Security of April 2009? Will this develop into a fully fledged legal instrument/treaty of international standing? Or will this merge with the discussions of the so called need to modernise the Energy Charter for which Russia has long been calling?

At a joint session of the EU-Russia Parliamentary Cooperation Committee at the European Parliament in January 2010, three different perspectives about the Charter emerged from three different actors (the European Commission, the Charter Secretariat, and the Russian State Duma), further underscoring the state of uncertainty over the ECT and the process which underscores it:

1. The European Commission: Welcomes the Russian Conceptual Approach of April 2009 but this initiative should not undermine or disrupt existing legal instruments promoting global governance in the energy sector, predominantly but not exclusively the ECT. This alludes to the fact that the Commission is likely to stand by the ECT for the time being although signs of some political compromise with Russia at the political level are becoming more apparent (ie, acknowledging that the "ECT is not a perfect document" and that Russia is within its right in refusing to endorse it)
2. The Charter Secretariat represented by the Secretary General: Calls for the Energy Charter to be modernised and calls on Russia to take a leading role in this process, as without such modernisation we could be witnessing the "death knell" of the Energy Charter (The Secretary General stated publically that he felt that the Charter will die unless it is modernised). The Secretariat, however, has been careful to avoid any acknowledgement of the fact that Russia has announced that it is withdrawing from (provisional application of) the Charter, would like to scrap the whole process and build something totally new on the basis of the original principles of the Energy Charter

It is worth mentioning that the Rome Charter Conference documents hardly make any mention of the fact that Russia is withdrawing from (provisional application of) the ECT. Instead, the forum documents highlighted the fact that the Hashemite Kingdom of Jordan has been invited to become a member of the ECT and that China participated in the Conference in its capacity as an observer of the Treaty. The Energy Charter Ad Hoc Strategy Group report coming out of the Rome conference made a one line acknowledgement of Russia's decision to pull out, but made no further comment. This is little more than a game of diplomatic charades and reflects either the stake holders aim to buy time or slowly putt of the pain (and embarrassment) of the inevitable (ie, to close the Process)

3. The Russian Duma Deputies' position: Reflected the opinion that "we live in new times, old instruments do not work" and in fact significantly undermine our energy security (ie, the Charter failing to prove itself a useful instrument during the last 3 Russia-Ukraine gas disputes). In response to this scenario, a

## **Reforming the Charter: the way ahead**

Two possible directions for a forward looking round of negotiations (between the EU and Russia) are suggested:

1. Close the Charter, disband the Secretariat and replace with something new, which more realistically reflects the balance of power in today's global energy order. Not an easy and possibly not a realistic option.
2. Compromise between Moscow and Brussels: Restructure the Charter Process by significantly changing the mandate of the Secretariat, essentially restructuring it into an early warning crisis prevention instrument, serving the interests of all of its member states.

The Charter secretariat under the current ECT regime is unable to work either towards the prevention or resolution of disputes, particularly in the sphere of energy transit. If this orientation would be pursued, the Charter Secretariat would act much more as a Strategic Think Tank and research laboratory (liberating the great expertise which exists within the Secretariat specifically for these purposes) as opposed to pursuing obscure objectives such as bringing in distant countries into the Charter process.

Further, given that the Secretariat's/EU's pursuit of Russian ratification has largely alienated Russia from the Charter, and politicised the energy relationship between Brussels and Moscow, the negative political symbolism which has become stored (accumulated) within the Charter needs to be divested. In order to do this, an adequate first step could be to disband the office of the Secretary General and replace the tradition of EU "energy diplomats" governing the Secretariat. This sub-institution within the Charter process should be replaced with a rotating Director-Generalship, off about 2 years per term, starting with a figure nominated from the leading Russian energy experts, as opposed to political figures. This post would initially be supported by an EU Deputy-Director for the initial two years, then revering back to an EU Director General and a Russian Deputy-Director. Under the new leadership, the Secretariat's mandate would predominantly be focused on research into crisis prevention in the energy sector, together with administering the process and pro-actively interpreting the Treaty, which would all be conducted in a spirit of much greater transparency and accountability than exists within the Secretariat at present.

### **iv. A new EU-Russia Partnership and Cooperation Agreement (PCA)**

- In parallel to some of the dialogue aspects of the EU-Russia energy partnership, the two parties are also in the process of negotiating a new framework agreement for EU – Russia relations. This agreement is to replace an existing Partnership and Cooperation Agreement (PCA) which has existed since 1994. As far as the EU is concerned, this new agreement must contain important and substantive provisions on energy security. It should be based on mutual benefit and the principles of the ECT, which were endorsed at G8 St.Petersburg Summit. The provisions on energy security contained in the

- However, negotiations on the new agreement have thus far not proceeded with any haste, which is the result of some uncertainty in the broader process of Russian accession to the WTO. Further, for the EU, it would be largely impossible to ratify a new agreement unless it contained a significant provision on energy.

#### **v. A central European perspective on energy security**

- The Russia-Ukraine-EU gas crisis of January 2009 had led to a fundamental re-evaluation of the concept of energy security in Central Europe, particularly in countries like Slovakia, which depend on Russia for 98% of its oil supplies and 100% of its gas and nuclear fuel supplies – all of which enter into Slovakia via Ukraine. This makes Russia and Ukraine strategic partners for countries such as Slovakia. The energy security of countries such as Slovakia is based on energy infrastructure solutions dating back to the 1970s, which do not fit the current economic and political requirements of these countries (as EU and NATO members).
- Prior to January 2009, the Slovak political leadership was not overly concerned about the above mentioned circumstances and largely saw Russia and Ukraine as reliable partners. This has changed drastically since January 2009. Slovakia and Central Eastern Europe (CEE) as a whole now seek new energy security solutions, which include a combination of new bilateral agreements with Russia (and Ukraine) and leverage over the process of the EU-Russia energy partnership from the Brussels level.
- The CEE is also seeking a regional approach towards energy security, taking into account the structural differences in the dependency on energy supplies from the eastern partners. At a high level meeting of the Visegrad (countries) Group (Slovakia, Czech Republic, Poland and Hungary) which took place in Budapest on February 24, 2010, delegates stressed that that the regional circumstances of Central and South-East Europe countries should to be taken into (greater) consideration by Brussels within the context of the formulation of EU-wide energy security strategies.
- There are no easy solutions to the energy security dilemmas of the CEE countries at present. The CEE remains tied to Russia and Ukraine for its energy supplies due to the position of existing energy infrastructure, and there are no easy, workable options for diversification. While the CEE is hopeful of stable energy supplies in the future, it will continue seeking a reliable back up strategy to be used in the event of a repeat of crises such as those taking place in early 2009. There is generally broad support for Ukraine's accession to the Energy Community Treaty from this region, as a key step increasing the likelihood of better transparency and reliability of energy deliveries.

- The above measures also need to extend to the oil sector, since countries like Slovakia all too often face the risk of becoming hostage to energy disputes taking place within the former-Soviet Union. We recently witnessed oil supplies to Slovakia being suspended due to a dispute between Kazakhstan (as a supplier) and Russian and Ukraine transit operators. Disputes of this nature seem to be beyond the influence of either the EU or of commensurate investor protection treaty regimes.

#### **vi. Ukraine and the Energy Community Treaty**

- The accession of Ukraine to the Energy Community Treaty would be a further step towards openness. Such accession would require Ukraine to reform its existing gas laws so that its markets comply with EU's *acquis communautaire*. It would also mean that the unbundling provisions apply to Ukraine and would likewise oblige Ukraine to guarantee non-discriminatory access to gas pipelines.

There were also interventions by speakers from Ukraine:

#### **Interventions by speakers from Ukraine:**

**Ukraine** feels somewhat left out of discussions relating to the context of the EU-Russia energy relationship. Ukraine feels that it has always adequately invited Russian participation into the modernisation of its gas transportation network, but has instead failed to receive a clear response from Russia towards such invitations. Ukraine feels that the EU-Russia energy partnership should reflect a triangular relationship to likewise include Ukraine, particularly since Kiev feels that the Ukrainian corridor is by far the most cost efficient route through which to transport Russian gas to European consumers.

#### **Despite the challenges: a word of gratitude and hope**

The Round Table organisers are grateful to all speakers, guests and the moderator, Professor Nodari Simonia, for their vivid and productive participation in this meeting. While the discussions in the Round Table were at times quite lively, speakers were unable to reach a breakthrough in finding a way to overcome the differences and misunderstandings that have been accumulated in the EU-Russia energy partnership over many years. This further reflects a situation of continuing uncertainty in the EU-Russia energy relationship at both political and expert levels. Most of the speakers reflected a sense of optimism and anticipation of change (in the EU-Russia relationship), however, as it was felt by many that there was simply no other way but to move towards the scenario of a balanced, negotiated agreement in order to keep European demand and Russian supply interests equally afloat.