

A role for the Energy Charter in a new Russia-EU Partnership Agreement

By André Mernier

Negotiations between Russia and the European Union on a New Partnership Agreement to super-cede the Russia-EU Partnership and Cooperation Agreement (PCA) of the 1990s will some day resume. While both parties aim to conclude an agreement which will provide a strengthened legal basis and binding commitments covering all areas of their relationship, energy will remain at the core of the agenda. This should not come as a surprise, since Russia is the EU block's primary energy supplier and energy demand within the EU will continue to rise in the foreseeable future. A highly inter-dependant, albeit at times testing, consumer-supplier relationship now exists between the two sides. The challenge facing the negotiators of the New Agreement will be to make this relationship durable in the long term in order to ensure their mutual energy security. To do this, they will need to structure the relationship through appropriate legal and political instruments so that Russia-EU energy relations will develop as a genuine factor of cooperation, as opposed to a factor of tension.

At first glance, it appears that such instruments are readily available for Russia and the EU to strengthen their energy ties. The Energy Charter Treaty (ECT), a legally binding multilateral agreement which both Russia and the EU signed in 1994, provides the foundation for all aspects of cross border relations in the energy sector.¹ It covers investment, trade, transit, energy efficiency and provides for international arbitration in the event of disputes between its members. There seems little doubt that both Moscow and Brussels endorsed the ECT as the basis for their energy cooperation when the last PCA was being negotiated. Article 65 of that agreement, which applied to energy, made explicit reference to the principles of the Energy Charter at the very outset of the text.

Facts and fallacies

Despite both the originality of the Energy Charter concept in facilitating East-West cooperation in the energy sector, together with the political support enjoyed by the ECT in the initial phases of its development, Russia has yet to ratify the Treaty. This has created confusion about Russia's role in the Treaty and raised questions as to whether Russia is even a member of the ECT. The situation is compounded by the largely ill-informed assertions that ratification of the ECT will require Russia to provide mandatory third party access to its energy infrastructure and open up its energy reserves to foreign investment. Even more critical voices, including those expressing their views in the spring edition of *Europe's World*, argue that "Russia will not implement (ratify) a treaty that it considers a humiliation because it was written to favour consumers who saw themselves as the winners of the Cold War".

None of this type of speculative, emotionally charged discussion does justice to Russia's realistic relationship with the ECT and the fundamental role that the Treaty can continue playing in the New Agreement between Russia and the EU. Considering a number of key facts in the inter-linkage between the Russia, the EU, the PCA and the ECT may be instructive in this sense. Fact number one.

¹ The Energy Charter Treaty of 1994 is a legally binding extension of the principles contained in the European Energy Charter of 1991, a non-binding political declaration and precursor to the ECT. The ECT came into full legal force in 1998, upon its ratification by the 30th member state.

Although Russia has yet to ratify the Treaty, it applies the Treaty on a provisional basis, which means that it has agreed to apply the Treaty's provisions to the extent that they are consistent with Russia's constitution, laws and regulations. While only a handful of ECT members such as Norway and Australia have yet to ratify or apply the Treaty provisionally, Russia's provisional application represents a considerable degree of commitment to the Treaty's binding provisions.

Fact number two. It is true to say that Russia's formal ratification of the Treaty would further consolidate on the relationship between the EU, Russia and other ECT member states. However, the absence of Russian ratification does not interrupt the technical work of the Treaty, nor the Energy Charter process – in which Russia is one of the most active participants. Formal ratification tomorrow would not lead to a different state of affairs for Russia with respect to its ongoing relationship with the Charter process and its obligations under the Treaty.

Fact number three. We should mention at this point that the EU, Russia and all of the other ECT members would not have signed the Treaty and continued to be active in the Charter process had they not accepted the principles contained in the Energy Charter declaration. I refer to universally applicable concepts such as open and competitive energy markets, non-discrimination, recognition of state sovereignty over resources, creating the conditions to stimulate investment flows, consideration of the environment and efficient use of energy. These principles work to the benefit of all parties which is why the great majority of ECT members have seen fit to ratify the Treaty. This includes the European Communities and all of their member states.

Finally, it should be added that the ECT member states, despite the best efforts of Russia, the EU and others, have yet to complete negotiations on new instruments intended to improve upon the Treaty's provisions on transit. While this gives the impression that the work of the Charter process needs to be expanded, it also reinforces the urgency to resolve certain aspects of cross border energy relations – particularly energy transit – within a multilateral as opposed to a bilateral forum setting. It is hardly surprising, therefore, that negotiations on the Energy Charter draft protocol on transit have recently returned to the multilateral level. The Energy Charter process, as the primary international energy institution where Russia is an active member, remains the most adequate framework for energy producers and consumers to iron out any differences they may have in how energy should be transited across borders.

A common denominator for shared principles within competing interests

In the field of energy, it is natural for Russia and the EU to be both competitors and partners. Europe remains the largest single customer for Russian energy exports, on which Russia is no less dependent than Europe relies on Russian energy supplies. Although this creates inter-dependence, it should likewise be accepted that the strategic interests of consumers and producers are not always going to be in convergence. Furthermore, diversification of energy supplies and markets has traditionally been a central tenet of sound energy policies. The prospect of competitive interests – be they with

respect to the price of energy or over the direction which export routes should take – is therefore likely.

We should also note that, as was recently underscored by European Energy Commissioner, Andris Piebalgs, the EU and Russia employ two different types of legislations to organize their respective domestic energy markets. This applies particularly to the gas sectors, where the EU internal gas market endorses the fully liberalized model where as the Russian gas sector is largely vertically integrated. This too can create certain strains since the level of compromise that has to be reached extends beyond the supplier-consumer market based relationship, and includes two distinct institutional approaches of managing domestic energy markets.

This backdrop to the Russia-EU bilateral energy relationship creates a rather challenging playing field for negotiators of a future New Agreement. However, the fact that both sides have embraced the principles contained in the Energy Charter – demonstrated by signing the ECT – implies that the common denominator that binds Russia and the EU in the energy sector is stronger than any competing interests which may exist. This common denominator is the Energy Charter, the core principles of which are just as applicable today as they were when the Charter process was emerging during the 1990s. It is the primary functioning instrument of international law which is available to both Russia and the EU through which to institutionalize their energy relations within the framework of a New Partnership Agreement. There are three key aspects to the ECT and the Charter process which both the Russian and EU negotiators should take into account when designing the energy provisions of the New Agreement.

First, the ECT and the principles of the Energy Charter are based on the guiding philosophy of sanctity of domestic energy policies. Effectively this means that members of the ECT are free to determine the structure of their energy markets (be they fully liberalized or vertically integrated), execute domestic energy policies in a sovereign manner, and determine the degree to which they desire to open up their energy sectors to foreign investment. ECT member countries exercise full sovereignty over the development of their national energy resources and are not obliged to provide mandatory third party access to their energy infrastructure. The starting point for any effective cross border energy relationship is offering due respect for alternative models of market organization.

Second, the Energy Charter aims to maintain a balance between the interests of the key stakeholders along the entire energy value chain. This applies particularly to the need for providing an equilibrium between consumers and producers, simultaneously to paying due attention to the interests of transit states. Whilst it has already been mentioned that the interests of energy producers and

consumers are not always going to converge, a balanced framework for their energy trade is essential. Such structures, however, should be based on principles shared by both sides. The 51 member countries of the ECT include a good mix of producers, consumers and transit states and the Charter process remains the key international energy forum in which these stakeholders can reconcile their differences. In this context the Charter's role is unique: no other international energy organisation provides a common platform for the development and implementation of binding disciplines among these diverse groups of stakeholders.

Finally, and perhaps its most notable contribution, the ECT aims to create a level playing field for all of its members, based on a common set of rules and practices acceptable to all. Nowhere is this more important than in the energy sector, where a fine line exists between commercial and political decision making, and where the sheer size of investments together with ecological considerations brings with it exposure to enormous risks. With respect to the Russia-EU energy relationship and a New Partnership Agreement, the fact that intensive interdependence juxtaposes two highly distinct organisational approaches to domestic energy markets, elevates the ECT to the closest instrument we have in forging a 'common energy space' underpinning an effective Russia-EU bilateral energy trade.

The founders of the Energy Charter concept intended for it to work in a neutral manner, based on common principles to create the foundation for effective cross border energy relationships in Euro-Asia. The negotiators of the ECT designed its instruments to reflect this neutrality and placed it within a binding inter-governmental framework of 'soft-law'. The Energy Charter process, which is based on the provisions of the Treaty, incorporates the necessary flexibility to give the relationship truly durable character, reducing risks and promoting trade and investment along the way. Taken together, the instruments and experience of the Energy Charter provide the most practical and the most realistic platform for the ongoing evolution of the Russia-EU energy relationship. The Energy Charter should form the soul of any bilateral energy deal within the framework of a New Partnership Agreement between the EU and Russia, ensuring that the playing field between remains level, rather than challenging.

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