RUSSIA-THE EUROPEAN UNION RELATION AND THE ENERGY CHARTER TREATY[#]

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Abstract

The transmission of natural gas and electricity through transmission lines is crucial in ensuring the development of competitive energy markets and security of energy supply. As international law on energy transit has yet to be developed, states seek alternative resolution mechanisms to address relevant legal disputes. To what extent these mechanisms suffice to deal with international crises between supplier and consumer states has been an open question. It was Article 7 of 1994 Energy Charter Treaty (ECT) which sought a legal mechanism to address international energy disputes for the first time. Nevertheless, energy crises of 2000s and little use of dispute resolution mechanisms adopted under the Treaty in relation to these crises resulted in criticism on the necessity and effectiveness of the ECT. This paper analyses the critics on the ECT and its priorities with respect to energy transit on the basis of YUKOS case and natural gas crises of 2009.

Keywords: Energy Charter Treaty, Gazprom, EU, YUKOS, Russia, Nabucco, Nord Stream, South Stream, Turkish Stream, Energy Security, Gas Crisis, Energy Transit, Fixed Infrastructure, GATT, WTO, Freedom of Transit.

RUSYA- AVRUPA BİRLİĞİ İLİŞKİLERİ VE ENERJİ ŞARTI

Özet

Doğal gaz ve elektrik enerjisinin iletim hatlarından transit geçişine yönelik hukuki rejimlerin kurulması, ilgili devletler nezdinde enerji tedariğinin güvenliği ve rekabetçi enerji piyasalarının kurulması açısından büyük önem arz etmektedir. Uluslararası hukuk nezdinde enerji transitinin bir çözüme kavuşturulamamış olması, uluslararası hukukun temel aktörleri devletlerin ikili ve çoklu anlaşmalar yoluyla bu soruna eğilmesi neticesini doğurmuş olsa da, bu tür alternatif yolların, uyuşmazlıkların giderilmesi konusundaki başarısızlıkları, tecrübe edilen uluslararası krizler bağlamında açık bir şekilde görünmektedir. 1994 Enerji Şartı Anlaşması, özellikle enerji transitine yönelik olarak bünyesinde bulundurduğu 7. Madde uyarısınca, bu

[#] **Yayın Kuruluna Ulaştığı Tarih:** 05.06.2018
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tür sorunların uluslararası boyutta ilk olarak ele alındığı bir hukuki rejim ön görmüştür. Fakat 2000'li yıllarda ard arda gerçekleşen enerji krizleri ve enerji şartının bu krizlerin önüne geçme konusundaki başarısızlığı, akademik camiada ve üye devletler nezdinde Şartın etkinliği ve gerekliliği konusunda çok ciddi eleştirilerin ortaya çıkmasına neden olmuştur. İş bu çalışma, bu eleştirilerin ortaya çıkmasının nedenleri ve Enerji Şartının enerji alanında ortaya çıkan uyuşmazlıklara ilişkin önceliklerini *YUKOS* davası ve 2009 doğal gaz krizi nezdinde detaylı bir şekilde incelemektedir.

Anahtar Kelimeler: Enerji Şartı, Gazprom, AB, Yukos, Rusya, Nabucco, Kuzey Akım, Güney Akım, Türk Akımı, Energy Güvenliği, Doğal Gaz Krizi, Enerji Transiti, Altyapı, GATT, DTÖ, Transit Serbestisi.

I. INTRODUCTION

Since the dismantling of the Soviet Empire in the late 1980s, energy has been at the centre of the relationship between European Union and Russia. While the former needs great amounts of energy to feed its industry, the latter seeks to deploy its abundant energy resources for both economic and political objectives. As a major resource-endowed country, Russia has lacked of the necessary capital to generate extraction and transportation of its energy efficiently. European Union, on the other hand, was totally dependent on the energy coming from unstable Middle Eastern countries, which tend to use natural resources as leverage against their political opponents. The idea was simple and obvious; exchanging the assets of natural energy resources and high capital to be invested in the energy supply chain, would lead to tremendous commercial activity and interdependence in energy trade which has not been experienced before.

The climate after the collapse of Soviet Union was very persuasive to Western European States to envisage the transformation of newly emerging East European economies into the liberal economies and the establishment of a new framework ensuring a secure access to energy supplies. Russia, once a dominant power of Cold War era as the major component of Soviet Union, was struggling with political and economic crises and seeking to preserve its power over newly independent states. Persuaded by the post-Cold War atmosphere which rendered the newly emerging actors more cooperative, the European Union started to develop new strategies to expands its economic and political periphery over the eastern Europe. The 1994 Energy Charter Treaty was of these strategies and constituted the first multilateral framework governing exclusively energy trade and investment.

The regional scope of the treaty was wide enough to regulate the energy trade between Europe, Russia and other transit and resource-endowed states in Central Asia. The ECT was envisaged to provide the secure supply of the energy originating from producer countries, flowing through transit states and destined to major demand centres and to further improve the energy extraction and production, implementing investment protection. However, given the evidence including conflicts between signatories and the ability of ECT to tackle with these disputes in the last decade, international community was inclined to accept that the context and provisions adopted

under the ECT are far from being an effective in converging all interests and priorities of its signatories on the negotiation table.

Against this background, the paper proceeds as follows. First, it presents the concept of energy governance to show how the characteristics and transportation of energy products differ, when compared to other conventional goods. In this way, it introduces the complexity of energy governance in international law with the conflicting principles of "Trade Liberalization" and "State Sovereignty". Next, the paper discusses "Freedom of Transit" and its implementation within both international law and cross-border energy trade. The transit of energy products is always regarded as a fundamental element for the establishment of secure supply of energy, and the paper presents the conventional approaches to freedom of transit by analysing freedom of transit definitions expressed within the Barcelona Convention on Freedom of Transit, General Agreement on Trade and Tariffs, (GATT) and finally the Energy Charter Treaty. In the third section, the paper addresses the relationship between Russia and European Union to shed light upon the underlying concepts and objectives in the development of Energy Charter Treaty. In so doing, it offers an insight into the energy policies that led states to build a new legal framework governing their trade in energy. After, providing concepts and objectives underlying the development of Energy Charter Treaty, the paper turns to the context of the Treaty and particularly its energy transit provision, Article 7. An interpretation of the article is presented and some of discussions about the effect of the article within the purpose of securing energy trade are included.

In the fifth section, the paper provides a detailed analysis of the tension between Russia and the European Union regarding the ECT. A diverse range of issues is addressed, including external relationships, internal policy struggles within the counterparts, effects of economic and political concerns on the energy trade between them as reflected by the implementation of the ECT. The paper also presents discussions on the strife between the EU member states, the effects of state-owned companies such as Gazprom and Rosneft on Russian energy policy, and the consequences of the colliding principles of nationalization and trade liberalization on energy trade. In this section, the paper also provides a brief review on YUKOS arbitration case to show how investments made by investors from parties of the ECT are protected. Finally, the paper covers the details of 2009 Gas Crisis between Russia, Ukraine and European Union. Addressing also some previous gas crises in the last decade, the paper evaluates why the ECT failed to deal with these crises and to provide an efficient solution for the parties involved.

II. ENERGY GOVERNANCE

Given their unique characteristics, energy products such as electricity, oil and gas are generally perceived and treated differently than other conventional commodities. They are scarce in nature and unevenly distributed across the globe. While some countries in specific regions are blessed with an abundance of natural resources, other countries find themselves importing great amounts of energy products from these resource-endowed countries to sustain their domestic

industry and economic development. Thus, the secure supply of energy products for energy importing countries is essential for economic and social sustainability.[1]

Again, due to their physical nature, transportation of energy products from producer countries to demand centres is of great concern for all parties involved in energy business. Except for crude oil which can be transported by different methods including both pipelines and tankers, transportation of energy goods is exclusively performed through transmission pipelines and grids. Electricity by its very nature can only be transmitted through high or low voltage grids. Transportation of gas through tankers or trucks requires additional processes and costs. In order to transport gas through these methods, gas must be liquefied (LNG) and stored with high technology storage. The efficiency of this process is also highly questionable, because, on the one hand, liquefying the gas also requires additional energy and high technology; on the other hand, there is a considerable volume of gas being lost in the process of liquefaction.[2] Therefore transportation of gas through pipelines without invoking costly and inefficient processes constitutes great value for the parties whose main concern is to access energy supply at reasonable prices.

Apart from limited means of transport for gas and electricity, long distances between producer states and demand centres generate additional international concerns. As mentioned above, natural resources are unevenly distributed across the world and, this ultimately makes transit of energy one of the most important aspects of the access to upstream energy supply.[3] The fact that energy products are transported most efficiently via fixed infrastructures, e.g. grids and pipelines, places emphasis on the need for an international legal framework governing energy trade and in particular energy transit. The significance of transit states in hosting pipelines and grids distinguishes trade and transit in energy from those in other goods. Cross border infrastructure for energy may involve one or multiple state territories in order to reach destination states. For each territory through which pipelines pass, the greater the complexity caused by the inclusion of additional jurisdictions, such as being subject to multiple legal regimes and regulatory institutions is the case.

Even though the nature of these cross border networks over long distances involving multiple sovereign territories and multiple regions has long required a multilateral framework for an effective governance, these cross border networks and energy trade had not been addressed in a multilateral treaty until the adoption of the Energy Charter Treaty in 1994.[4] When, the GATT negotiations started and the system of trade liberalization and the economic globalization were constructed in late 1940s, liberalization and governance of energy trade was not an economic and

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1 Yulia Selivanova, "Challenges for Multilateral Energy Trade Regulation: WTO and Energy Charter," (2010) In *Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona,* p 3.

2 Reiner Liesen, "Transit under the 1994 Energy Charter Treaty," (1999) *J. Energy & Nat. Resources L.,* 17: p 59-60.

3 Nikolay Kaveshnikov, "The issue of energy security in relations between Russia and the European Union," (2010) *European security,* 19: p 588.

4 Julia Selivanova, *WTO and Energy; WTO Rules and Agreements of Relevance to the Energy Sector,* (2010) ICTSD Trade and Sustainable Energy Series Issue Paper No. 1, International Center for Trade and Sustainable Development, Geneva, Switzerland, p VII.

political priority.[5] Energy sectors were generally run by state owned entities mostly at national level, and international energy trade was controlled by few multinational companies.[6] Each legal instrument with respect to energy trade remained at a contractual level and far from constituting general multilateral framework.

As new technological innovation with regards to energy extraction and transit has developed and demand for energy in importing states has drastically risen, the interest in bilateral and regional instruments dealing specifically with cross border fixed infrastructure has also started increasing.[7] Especially, in Europe, the discovery of Groningen Gas field in Netherlands and gas reserves in Norway led to the development of cross border natural gas grids spanning over Europe.[8] This necessitated the arrival of new legal and economic mechanisms designed to govern energy trade on a multilateral basis.

Subject to multiple jurisdictions, energy trade was exposed to high political volatility and risks within transit states which ultimately pose a great threat to enormous investments being made. [9] Conflicting legal norms, regulations across transit states and political instability are the main concerns for investors and parties in terms of making long term investments in transit structures.[10] For example, due to political instability and hostility in the relationships between neighbouring countries, international pipelines in Middle East have never been properly operated since they were built.[11] Many of these pipeline routes have to pass through transit states rife with political instability which render high capital investments on transport networks very questionable.

The fact that the construction and the use of new pipelines and transit facilities constituted permanent occupation of foreign territories also resulted in the emergence of a new tension between the interests of trade liberalization and state sovereignty.[12] Transportation of energy products has crucial legal and political implications as to states' territorial sovereignty. Transit states have been generally reluctant to allow the construction and the use of new or existing transit lines owned and/or managed by foreign nationals and undertakings across their territories. For example, in the late 1960s, a proposal offered to Belgium and France by Netherlands, which had followed highly liberalized economic policies even in a protectionist world trade order, with regards to the construction of a new transport network to sell gas to Italy was refused on the ground that transit states did not want to grant a joint ownership of transport network to an Italian buyer. Germany and Switzerland who consider transit projects as a way of diminishing their energy vulnerability, later allowed joint ownership of the network.[13]

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5 Thomas Cottier, et al., *Energy in WTO law and policy*: (2009) NCCR and World Trade Institute, p 1.

6 Yulia Selivanova, "International Energy Governance: The Role of the Energy Charter," (2012) In *Proceedings of the Annual Meeting* American Society of International Law, p 395.

7 Sergei Vinogradov, "Cross-border pipelines in international law, 14 Nat," (1999) In *Res. & Env*: American Bar Association, p 76.

8 Martha M. Roggenkamp (1994), p 60.

9 Reiner Liesen, (1999), p 57

10 Ibid.

11 Ibid footnote 10.

12 Ibid p. 59

13 Ibid

In the beginning of the 1990s, transport of energy through fixed infrastructure started to be considered with the "Principle of Freedom of Transit". Until then there was no uniformed practice in international law to tackle cross border energy transit which was generally addressed on a contractual, bilateral or regional basis.[14] Initially, several transit cases regarding energy transit were handled in a European framework in connection with the GATT Article V "Freedom of Transit" provision.[15] Later, freedom of transit and energy transit via fixed infrastructure were addressed within respectively European Energy Directives, European Energy Charter and finally the Energy Charter Treaty. Both energy transit and freedom of transit imply a great degree of cooperation between states involved in and the need for a legal framework to materialize and regulate this cooperation.[16] Therefore, the concept of freedom of transit and its application in the context of energy transit is crucial in assessing how the Energy Charter Treaty and particularly Article 7 are set forth to tackle energy transit.

III. FREEDOM OF TRANSIT

A. Development of the Concept

As mentioned above, the importance of energy transit and application of the principle of freedom of transit to energy sector have been subject to an intensive debate within the concept of energy security. The principle of freedom of transit dates back to the idea developed by Grotius in 17th Century, when he asserted "*a general right of transit across the territory of another state in the interests of the community of nations"*.[17] The role played by transit provisions becomes of a greater importance as the commercial transactions between states increase, economic interdependence among states develops.[18]

The first multilateral instrument codifying the principle of freedom of transit is the Convention on Freedom of Transit (Barcelona Convention) promulgated by the League of Nations in Barcelona 1921.[19] Until then, transit was solely invoked when it was in the interest of some certain states or in connection with certain routes.[20] After World War I broke out, the need for an international framework for transit led to the birth of the Barcelona Convention under the auspices of League of Nations.

The Barcelona Convention set out a right for freedom of transit. Accordingly the right arised where: "(p)ersons (…) and goods (…) shall be deemed in transit across territory of one Contracting

14 Vinogradov, S. (1999), p 75

15 In case 266/81, *SIOT v. Ministero delle Finanze* (1983) ECR 731, court stated the relevance of freedom of transit articulated under GATT Article V. within the context of energy transit, even though it is not directly applicable to domestic laws of Europe. For further detail, *see;* Roggenkamp, M. M. (1994) "Implications of GATT and EEC on Networkbound Energy Trade in Europe," *J. Energy & Nat. Resources L.*, 12: p 70.

16 Vinogradov, S. (1999), p 75

17 For detailed analysis of freedom of transit within customary international law *see;* Elihu Lauterpacht, "Freedom of transit in international law," (1958) In *Transactions of the Grotius Society*: British Institute of International and Comparative Law.

18 Martha M. Roggenkamp, "Transit of Networkbound Energy: A New Phenomenon?—Transit Examined from the Barcelona Transit Convention to the Energy charter Treaty," (1995) *World Competition*, 19: p 119.

19 Article 1 of the Barcelona Convention. The text of the convention is *available at* http://www.wipo.int/wipolex/en/other_treaties/details.jsp?treaty_id=304.

20 Roggenkamp, M. M. (1995), p 121.

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".[21] This definition clearly stated that the principle of transit applied to journeys through which crossing of more than one frontiers was needed. States were required to take all necessary measures to establish that goods and facilities were properly in transit.[22]

Even though the Convention was regarded as the first multilateral framework which set forth the right for cross border transit, the legal implications its application would unravel in multilateral context have been ambiguous. Whether the language adopted by the Convention implied an absolute international legal norm for third parties to invoke freedom of transit, whether it prescribed a positive obligation on the part of the contracting states to construct additional facilities in order to make the freedom of transit effective were yet to be answered and have been subject an intensive debate among scholars.

B. Freedom of Transit under GATT

The definition articulated under the Barcelona Convention constituted the basis of many international instruments addressing freedom of transit at multilateral, bilateral or regional level. One such instrument, perhaps the most important one so far, was the General Agreement on Tariffs and Trade, (GATT) of 1947. Article V of GATT provided that "there shall be freedom of transit through territory of each contracting party, via routes most convenient" for international transit, for traffic in transit to or from the territory of other contracting parties".[23] The scope of the Article was derived from the Barcelona Convention. Article V, the first paragraph of which states that all "goods (…) and other means of transport, shall be deemed to be in transit across such territory (…) when the passage is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes". [24]

The reading of Article V provides no exceptions as the scope of goods it addressed. Thus it can be reasonably asserted that GATT applies to all goods including energy products[25]. However, practical experience with Article V is such that only one transit dispute was brought before a World Trade Organization (WTO) dispute resolution body and other conflicts concerning the scope of the Article were settled mostly at bilateral level.[26] As energy trade *de facto* remained outside the scope of the GATT, energy transit has also been treated in the same manner.

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21 Liesen, R. (1999), p 58

22 Roggenkamp, M. M. (1995), p 122.

23 GATT 1994, Article V (2): General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [GATT 1994].

24 Article V (1): GATT (1994).

25 Roggenkamp, M. M. (1995), p 126.

26 Mireille Cossy, "Energy Transport and Transit in WTO," (2010) In *Global Challenges at the Intersection of Trade, Energy and the Environment,* edited by J. Pauwelyn. Geneva: Center for Trade and Economic Integration, p 117.

C. Freedom of Transit under International Treaties

A bifurcated approach is necessary to address the regulation of energy transit in international law. On-land pipelines are fixed infrastructure discussed previously in the context of freedom of transit in the energy sector and fall *de facto* outside any multilateral framework remaining entirely within national jurisdictions of different states.[27] Submarine pipelines, however have legal background within international law. General principle of freedom of the high seas, codified in 1958 Geneva Convention on the High Seas which sets out conclusive right of all states to construct submarine pipelines on High Seas.[28] 1958 General Convention on the Continental Shelf sets out a similar right for all states to lay submarine pipelines on the continental shelf, subject to the right of coastal states to take necessary actions for the exploration and exploitation of their continental shelf and natural resources.[29] Successor of these Geneva Conventions is the 1982 United Nations Convention on Law of The Sea (The 1982 UNCLOS). Requiring the coastal states not to obstruct the construction and the maintenance of submarine pipelines, the 1982 UNCLOS provides a general right to all states to build submarine pipelines on the continental shelf which is again subject to the right of coastal states to take necessary measures regarding exploration, exploitation of the continental shelf and further protection of marine environment.[30]

Compared to submarine pipelines, on-land network, however; lacked of a customary international legal basis until the 1994 Energy Charter Treaty (ECT). The main reason for this was that states have been more reluctant to accept construction of these pipelines over a territory where they have absolute sovereignty rights. Since the establishment of new pipelines constituted a permanent occupation of national territories, sovereignty concerns made the *international law* development of a general framework for on-land energy transit difficult.

After the Arab embargo and global oil crisis, European countries sought to find new energy suppliers and trade routes to sustain the energy need of their domestic industries and reduce their dependence on unstable Middle East countries. The emergence of cooperation between Soviet Union and Europe in the energy sector was the result of this quest. With the collapse of Soviet Union and the end of the cold war, European countries which had become substantially dependent on Russian gas saw a great opportunity to demolish economic divisions with Eastern European countries and to reach Russian and Central Asian gas reserves more easily.[31] Energy Charter Treaty (ECT), which followed, is the main multilateral treaty covering a diverse range issues from energy transit to investment protection over significant geographical scope.

It is essential to note, as earlier that the ECT was built upon the exchange of energy resources and capital investment. Underlying purpose of the Treaty was the provision of energy security to European Union which was greatly dependent on the imported energy. Therefore, in order to understand how issues relating to energy transit are established under ECT, and to what

27 Vinogradov, S. (1999), p 78.
28 Ibid., p 76
29 Ibid.
30 Ibid.
31 Andrei Konoplyanik, & Thomas Wälde, "Energy Charter Treaty and its Role in International Energy," (2006) *Journal of Energy & Natural Resources Law*, 24: p 524.

extend they are effective in resolving disputes pertaining to the energy sector, it is fundamental to address tensions and priorities between the European Union and Russia as the most important players in the context of the negotiation of ECT.

D. Russia-EU relations before the ECT

In 1970s, the world went through a disruptive global energy crisis. During the 1973 war between the Arab States and Israel, oil exporting Arab States imposed an embargo against the United States that decided to provide $2.2 billion military assistance to Israel. As a result, the US started to store millions of barrels of oil and spent great amounts of money to construct and maintain huge oil storage facilities. The safety measures taken by oil importing countries and the instability in the producer regions resulted in a drastic increase in oil prices. The per barrel price of crude oil shifted from $3.00 to almost $11.65 and with the Iranian Revolution in 1979, it reached it's a peak of nearly $40[32]. Shocked by such drastic and sudden changes in the World energy market, international community became more conscious of threats inherent because of the political and economic volatilities of producer regions and the threats to the energy security of energy consuming regions.[33]

In order to gain more security, Europe started reducing its dependence on the crude oil reserves from Middle Eastern countries by seeking new energy suppliers, since the gas reserves in the Netherland, Groningen Field and Norway were insufficient to supply Europe's energy demand.[34] The Soviet Union and later Russia, held the biggest gas reserves in the world but lacked capital investment to develop their indigenous domestic energy production. Though energy trade between Soviet Russia and Europe has been less problematic for a while, in August 1993, Russia cut off Ukrainian gas supplies for the first time to impose a political pressure with regards to the discussions on the control of Black Sea Ports. In return Ukraine started siphoning off the gas flowing through its infrastructure and meant for Italy and Germany. [35]

Russia also employed restrictive measures against the transit of oil from Kazakhstan and other Central Asia states.[36] Ultimately, the necessity of a general framework governing the energy sector and all the parties; (producers, consumers and transit states) was seen as fundamental for international energy trade.

Energy importing European states perceived the collapse of Soviet Union as an unprecedented opportunity to abolish the economic divisions of Eurasian Continent and to materialize the economic transformation of the newly independent East European states into the West European and Atlantic markets.[37] The first proposal was put forward during a meeting of the European Council by Dutch Prime Minister, Ruud Lubbers in Dublin, 1990. By providing the capital investment and technology of extraction and transit of energy resources, Western Europe

32 Hussein Abdallah, "Oil Exports under GATT and the WTO," (2005) *OPEC review*, 29: p 269.
33 Anna Aseeva, "EU-Russia Energy Relations: the Role of International Law from Energy Investment and Transit Perspective," PhD Thesis, (2011), In: University of Geneva, p 1.
34 Reiner Liesen, (1999), p 57.
35 Ibid, *see;* footnote 9.
36 Martha. M., Roggenkamp, (1995), p 119.
37 Andrei Konoplyanik & Thomas Wälde, (2006), p 524.

would have the secure access to the rich energy markets and gas reserves in the former Soviet States.[38]

The result of Lubber's plan was the European Energy Charter which was a non-binding expression of political intent and signed by 49 states and the EU at Hague on 16-17 December 1991.[39] The aims of the Charter were enhancing the security of supply, increasing the efficiency of energy production and transit, and the improvement of security and reduction of environmental concerns, under the principles of 'State Sovereignty', 'Non-discrimination' and 'Free Trade'.[40] This would bring about significant economic integration and the development of a European Energy Market, transforming the dormant Eastern European States into the market economies while promoting interdependence between importer, transit and producer countries in terms of investment in energy sectors.[41]

Nevertheless the European Energy Charter was far from governing the trade between Russia and the EU. The legal framework developed under the Charter lacked an effective compliance system. Rules that were adopted to manage energy trade were not mandatory and there was no structural body that could ensure the compliance of participating states. The systemic inefficiencies with regards to the European Energy Charter paved the way for the adoption of a more expansive and obligatory framework.

E. The Energy Charter Treaty

Unlike the European Energy Charter, the Energy Charter Treaty (ECT) is a legally binding multilateral instrument, signed in Lisbon on 17 December 1991. Balancing the interests of contracting states, the ECT establishes a sectoral legal framework dealing specifically with investment, trade, transit, competition and environmental issues pertinent to energy products.[42] As stated above, while the energy consuming states seek a global regime establishing easier access to foreign supplies, producer countries generally pursue policies to generate utmost benefit from exploiting their natural resources. Before looking at the characteristic of these differences and priorities and the ability of the ECT to deal with these differences in the concept of energy transit, it is necessary to look at the scope of the ECT, and the legal instruments addressing the issues of energy transit.

1- Scope of ECT

The ECT constitutes the first global, multilateral agreement establishing a framework for energy trade. It contains a Preamble, some fifty articles in eight different parts and fourteen annexes governing exclusively energy trade, transit, investment measures, as well as a dispute settlement mechanism.[43] Given its structure, it is generally regarded as the multilateral investment treaty of the

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38 Bryan, Clark, "Transit and the Energy Charter Treaty: Rhetoric and Reality," (1998),*Web Journal of Current Legal Issues*, p 1.

39 Ibid, p 2.

40 Martha M. Roggenkamp, (1995), p 140.

41 Andrei Konoplyanik & Thomas Wälde, (2006), p 525.

42 Bryan Clark, (1998), p 2.

43 Martha M. Roggenkamp, (1995), p 140.

broadest scope, distinguishing itself from all other bilateral and regional treaties. The geographical scope of the Treaty is also broad that all of European states signed and ratified, along with some central Asian energy producer countries.

The purpose of the Treaty as set out in Article 2 and the Preamble is to establish 'a legal framework to promote long-term cooperation in the energy field' and to 'catalyze economic growth by means of measures to liberalize investment and trade in energy'.[44] Provisions are set up in a manner to develop a global energy market by establishing a balance between the interests of different state parties and to overcome objectives of open access to international markets in a competitive environment for energy products.[45] Whether the provisions are really successful in providing these objectives is discussed intensively amongst international community, but it is important, to note that, the ECT is an innovative framework by addressing exclusively energy related objectives and provides a crucial platform for discussion in connection with future legal frameworks on energy.

2- Energy Transit under the ECT

As energy resources is distributed unevenly across different regions of the World, the concept of cross border energy trade cannot be conceived without provisions on the freedom of transit. Apart from the general provisions regulating energy trade, such as on investment and dispute resolution, one of the main contributions that the ECT provided is the introduction of freedom of transit within the context of cross border energy trade. The ECT's transit provision is articulated to put an end or at least to reduce transit risks inherent in the political and economic environment of the contracting parties involved.[46] The provision on energy transit is set out in Article 7(10) of the Treaty, which defines the transit as:

"… the carriage through the area of a Contracting Party, (…) 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."

Regarded as a GATT-Plus provision by some commentators[47], Article 7 is mostly inspired by previous international norms articulating freedom of transit such as the Barcelona Convention and the GATT. One distinction of Article 7 from its predecessors is its explicit mentioning of the transit of energy products.

Whether Article 7 of the ECT goes beyond the practical scope of its predecessors is debated within the international community.[48] Article 7(1) addresses three dimensions of transit: access; conditions; and non-interruption. With respect to access to transmission lines, Article 7(10) of the ECT imposes a general obligation on State parties to grant a request for access to transportation

44 *The Energy Charter Treaty and Related Documents: a Legal Framework on International Energy Cooperation*, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf
45 Reiner Liesen, (1999), p 56.
46 Reiner Liesen, (1999), p 57.
47 Bryan Clark, (1998), p 4.
48 Martha M. Roggenkamp, (1995), p 141.

networks.[49] The extent of this obligation is ambiguous. Even though, freedom of transit refers to a burden of obligation on the part of sovereign states, the article does not mentions regulatory tools or principles designed to ensure access to transit networks by State parties. There is nothing in the Article indicating rights of third parties to access to transportation pipelines or grids. In contrast, Understandings 1 b(i) annexed to the Treaty clearly notes that nothing in the Treaty can be construed as an obligation placed upon Contracting States to introduce mandatory third party access.[50] The concept of "Mandatory Third Party Access" has been introduced as a fundamental component of ensuring access to transportation networks in the Transit Protocol negotiations. However these negotiations were later suspended in 2011 due to strong criticism by producer and transit states leading by Russia, which opposes any implication of third party access, on several economic and (geo)political grounds which are be discussed in detail below[51].

As to conditions, Article 7(4) states that the contracting states should not place any obstacles on the construction of new capacities, in cases where existing capacity is not sufficient for the purposes of transit. Again, this paragraph fails to identify the conditions, under which measures or actions taken by transit States constitute obstacles to the construction of new capacities. Furthermore, the following paragraph, Article 7(5) takes back what Article 7(4) gives. Article 7(5) limits the application of paragraph (4) in conditions, where such services endanger security of supply, or safety of transit states. Due to the lack of an intensive explanation of such conditions, there is nothing in the Article that forbids parties from invoking Article 7(5) and putting obstacles in the way of access to transport facilities. In fact, Russia, a producer as well as an important transit State sees construction of additional pipeline facilities over its territory without its consent as a threat to its national economy and energy security.[52]

With regard to non-interruption dimension, Article 7(6) states that a "contracting party (…) shall not, in the event of a dispute over any matter arising from Transit, interrupt or reduce (…) the existing flow of energy materials and products". Even though, this paragraph is generally regarded as the most important provision in the Treaty, some commentators state that the contribution of the paragraph does not go beyond of a restatement of previous definitions.[53] First, Article 7(6) limites its application only to the transit States, which in turn allows any party other than the transit state to interrupt or reduce existing flow of energy products. Further, Article 7(6) also limits itself by restricting the scope of its application to the matters *arising from transit* which may lead to the interruptions of flow of energy material in the events of disputes over any matter other than transit.[54]

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49 Ibid, p 64.

50 Bryan Clark, (1998), p 9.

51 For the comments on Transit Protocol, see: the Energy Charter's website; https://energycharter.org/what-we-do/trade-and-transit/transit-protocol/

52 There are many scenarios for transit states with different priorities. While some transit states neighboring to resource endowed regions are reluctant to accept new transit routes, others see participating and establishing new transit route projects as a way to reduce their energy vulnerability. For further details on these scenarios *see;* Reiner Liesen, (1999), p 60-61.

53 Martha M. Roggenkamp, (1995), p 142.

54 Reiner Liesen, (1999), p 65.

3- Resolution of Transit Disputes under the ECT

In general, the ECT presents an ambitious dispute settlement mechanism in Articles 26 and 27. The former sets out a state-investor arbitration procedure for disputes between state parties and investors in the energy sector. It is important to note that the scope of Article is limited to disputes arising from Part III of ECT the title of which is "Investment Promotion and Protection". The article focused on investment protection and specifically the protection of investors of contracting parties. Accordingly investors may claim and assert their rights through arbitration from state parties on a equal footing. States cannot take actions against investors with respect to their investment contracts on the basis of their position on state sovereignty and international law.

Since, transit provision is articulated within Part II of ECT under the title of "Commerce, this dispute resolution procedure cannot be applicable to the context of energy transit. Any disputes arising from transit of energy or access to fixed infrastructure are left outside the scope of Article 26 and thus cannot be brought before arbitration panels by legal or natural persons.

Article 27 establishes a State-State arbitration procedure and its scope encompasses the whole treaty. However, the nature of this arbitration process is limited to disputes related to interpretation of the Treaty and does not provide guidance for the investors in energy sector.[55] Any dispute arising from the interpretation of the ECT may be subject to an arbitration procedure as long as parties of these disputes are contracting states.

Apart from general dispute settlement provision articulated in Article 26 and 27, Article 7(7) also sets out a dispute resolution process specific to disputes arising from the transit of energy materials and products. The coverage of this provision is rather limited and applies only to the disputes relating to conditions specified in Article 7(6). In other words, disputes that arise from those other than transit of energy yet intrinsically affect the flow of energy supply through transportations lines remain outside of the scope of Article 7(7)[56]. Article 7(7) also notes that it can only be invoked only after other dispute settlement mechanisms are exhausted by the parties involved. As Article 26, investor-state arbitration procedure is not applicable to transit disputes, Parties are obliged to go before state-state investment arbitration to seek relief before resorting to Article 7(7) procedure.

The effectiveness of the ECT's transit provision has been debated by many commentators. While some assert that Article 7 goes beyond any previous international mechanisms dealing with freedom of transit [57], others contest this view. For example, Bamberger[58] states that despite its elaborate language, Article 7 of the ECT merely paraphrases Article V of GATT. Roggenkamp[59] further states that the language of Article 7 renders its provisions even weaker than those

55 Ibid, p 67.
56 Ibid, p 66.
57 Fatouros, A.A (1998) *Energy Transit and Investment in the Energy Charter Treaty*, internet page at <http://nomos.csd.auth.gr/TELM/Two/Fatouros/fatouros.html>, last updated 23/1/1998, *as cited in;* Bryan Clark, (1998), p 5.
58 Bamberger, C (1995) *The Energy Charter Treaty - a description of its provisions*, International Energy Association, *as cited in;* ibid.
59 Martha M. Roggenkamp, (1995), p 142-143.

established under GATT Article V. It should be noted that though many of its signatories have ratified the ECT, many important states in energy sectors such as Norway, Russia and Belarus, have not yet ratified the Treaty. Apart from the weaknesses within its language, the main problems for the ECT in establishing an effective framework for energy lies in its lack of ability to consolidate all interests of the parties and to incorporate them to a negotiation process. The following section considers this diverse range of state interests pursued in energy trade with a particular focus on relationships and conflicts between the two key players; Russia and European Union.

F. ENERGY AND TENSIONS BETWEEN THE EU AND RUSSIA

1. General

When considering the concept of energy security, many scholars in energy sector tend to offer an identical definition relating to security of supply. Accordingly, energy security means: the access to upstream energy materials at sufficient and reasonable prices for existing and expected energy demands, without the risk of disruptions in supply mechanisms.[60] The definition successfully represents the understanding of energy security from the perspective of energy importing states. It places emphasis on the importance of access to energy supplies and balance between energy supply and demand.

However, the concept of energy security needs a broader definition for the purposes of addressing the interests of every actor in the energy supply chain including importing exporting and transit states. Understanding the concept of energy security from the perspective of each player in energy chain is crucial not only in addressing the energy policies of individual states but also in providing a multilateral legal framework regulating energy sector.

The concept of energy security differs on the basis of priorities of each national policy objective, such as welfare of population, integrity of state institutions or sustainability of domestic economies[61]. Any actions taken by other states or non-state actors which are free from the control of sovereign states can potentially may have adverse effects on states' benefits from energy trade. The perception of energy security in any individual state reflects the mechanisms developed to protect these national priorities against these adverse effects. Transportation and distribution infrastructures as well as extraction and transformation facilities in energy supply chain can be easily subject to these risks, though they are beyond the controls of domestic governments.[62] As will be discussed below, Russo-Ukrainian gas dispute in 2009 Gas Crisis is a good illustration of how disputes between the particular countries can affect entire supply system and the extent to which they endanger the welfare of all states involved. In developing their internal and external energy policy, each State takes into consideration its position in the energy chain and the risks that are inherent to it.

60 Nikolay Kaveshnikov, (2010), p 586.

61 Edward Christie, "Energy Vulnerability and EU-Russia Energy Relations," (2009), *Journal of Contemporary European Research*, 5: p 277.

62 Ibid.

As noted above, energy has an international dimension. Cooperation between States is crucial for uninterrupted flow of energy. Any bilateral dispute on any side of the energy supply chain can easily evolve into a multilateral crisis. This can be easily observed in Eurasian energy tension involving Russia and EU and some transit states. In order to understand this tension and to examine the ECT's dealing with the concerns arising from that tension, it is necessary to examine the scale of energy interdependence and energy trade between these important energy players.

2. The Interdependence

Priorities sought by the EU and Russia the polar opposites of the ECT differ significantly. The European Union is a major energy importer. Natural gas constitutes a major component of its energy consumption portfolio. The majority of gas the EU consumes, comes from Russia. There are significant routes such as Nord Stream pipelines stretching beneath Baltic Sea and Yamal pipeline passing through Russia Belarus Ukraine and Slovakia. Russia also operates as an important transit state for energy resources coming from Central Asian States.

As the second largest energy market in the world after the United States, Europe imports nearly half of the energy it consumes and its demand for energy has been growing drastically. It imports 33.5% of its oil demand and 44% of its natural gas demand from Russian Federation and significant quantities of imported gas has been transported through Ukraine.[63] The European Union is also the main consumer of Russian gas, buying nearly 70% of Russian oil and gas exports, and is the principal investor within the Russian domestic economy and energy sector.[64] Given its location as a major energy importing state, the EU establishes that its energy security policy includes reducing its vulnerability through secure and sufficient supply of energy resources at reasonable prices, from energy exporters.[65] Accordingly, there must be conformity between energy supply and energy demand and the flow of energy needs to be stable. In order to develop a secure supply regime, Europe looks for diversification of energy routes and supplies which further requires additional investments in the energy sector for the construction of new transportation networks.[66]

Energy trade with the European Union is fundamental for the Russian economy. The energy sector generates more than 60% of all Russian export revenues and constitutes 30% of all investments from foreign investors in the economy.[67] The Russian economy is mostly driven by its energy sector, which contributes 25% of gross domestic production and 33% of industrial production. Russia accumulates half of its federal income from energy exports by using its state-owned companies, such as Gazprom for gas and Rosneft for oil and also uses its production and transit infrastructure as a political instrument for increasing its influence on former Soviet states

63 Anna Aseeva, (2011), p 3-4. With the commissioning of Nord stream pipelines, Russia's reliance on Yamal pipelines diminished significantly.

64 Nikolay Kaveshnikov, (2010), p 597.

65 European Commission, 2006. Green paper. A European strategy for sustainable, competitive and secure energy. COM(2006) 105 final, Brussels, p 3, *as cited in;* ibid, p 587.

66 Anna Aseeva, (2011), p 3.

67 Ibid, p 26.

ranging from Central Asia to Eastern Europe.[68] One of the main strategies of Russia is to increase revenue from its energy exports by reaching new downstream resources and developing export diversification. Due to its dependence on Ukraine as a major transit country, Russia has sought alternative transit routes for the purposes of reducing its energy vulnerability and has started to build new pipelines, such as Nord Stream I and expected Nord Stream II and Turkish Stream pipelines.[69]

Energy sector is of high strategic importance for both Russia and the EU and essential for the sustainability of their domestic industry and national welfare. The extent of energy trade reveals that there is a great interdependence between Russia and the EU. Since this commercial activity began, many commentators in the energy field have stressed the importance of a multilateral regime governing the energy sector. The ECT was designed to deal with energy related issues and to further improve the secure flow of energy from producing states to demand centres, it has failed to prevent energy flows from being cut off in the last decade. The 2009 Gas Crisis, in particular, provides an illustration of this. The result of the cut off of energy flow from Russia to Europe through Ukraine, was disastrous for some European States whose domestic industries were highly dependent on imported energy resources, there was no action taken by the EU under the Energy Charter Treaty. In order to understand what happened in the 2009 Gas Crisis and how the ECT failed to address the dispute between the parties involved, along with its underlying reasons, this chapter provides an extensive analysis of energy policies in both European Union and Russia.

3. Energy Policy in the EU

Composed of mostly energy importing countries, the European Union distinguishes it energy policy as "internal" and "external" policy objectives. For the development of a common external energy policy, the European Commission places great emphasis on the creation of a common energy market. After the Single European Act, which entered into force in 1986, several working documents and proposals on an internal energy market were introduced, providing the basis for the development of a common market in the energy sector.[70] Walde and Gunst (2002) assert that liberalization, has so far worked everywhere and so must be considered for the establishment of energy market in Europe.[71] The key to the common internal energy market is understood as structuring of a single liberalized electricity and gas market by introducing high level competition among energy companies.[72]

European Commission introduced several directives on first, price transparency and transit and, second; introductions of the system of third party access, unbundling of management and accounting and freedom in network construction.[73] Unbundling measures which required member states to ensure that their national vertically integrated energy undertakings were dismantled and

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68 Government of RF, 2003. Energeticheskaya strategiya Rossii na period do 2020 goda [Energy strategy of Russia through 2020]. Adopted by the Decree of the Government of RF # 1234-p, p 3, 28 August 2003, *as cited in;* Nikolay Kaveshnikov, p 594.

69 Edward Christie, (2009), p 286.

70 Martha M. Roggenkamp, (1994), p 65.

71 Thomas W. Walde & Andreas J. Gunst, (2002), p 1.

72 Nikolay Kaveshnikov, (2010), p 591.

73 Martha M. Roggenkamp (1994), p 65 footnotes 45-46.

divided into multiple legally and accountably separate entities have been regarded as a direct interference of the Union to the sovereignty of member states over their national territory and thus have been subject to heated objection from member states. Concerns were raised on the concept of third party access which would oblige transmission and distribution companies to offer access to their networks when requested by third parties.

In September 2009, the EU adopted the "Third Package" including provisions to increase the functioning of a single liberalized energy market and providing some of unbundling options and policy proposals for Member States with regards to their national energy transit networks.[74] The package was an ambitious step to further European energy market integration and the creation of a competitive, well-functioning energy sector. To what extent this legal framework has been successful in fulfilling the objectives sought is an open question. Yet it is reasonable to assert that ensuring an homogenous EU-wide policy on energy security has constituted a major threat for the objective of energy market integration the EU's set of legislations were designated to materialize.

The perception of energy security and energy policies vary as does the extent of energy vulnerability. Differences at the level of dependence on imported energy, with Russia as a main trading partner has led member states to pursue a diverse range of energy policies for the purposes of decreasing energy vulnerability. Seven members of European Union are totally dependent on hydrocarbons from Russia.[75] Cut offs in energy flow cause more severe results in these countries. For example, some Baltic states and Bulgaria appeared to be greatly vulnerable, during 2009 Gas crisis, and longer cut offs resulted in deep economic depression and even humanitarian concerns as many people could not afford to heat their households in these countries.[76] Security of energy supply at external policy level has stayed within the competence of member countries which is used by Russia, and especially by its state-owned entity, Gazprom, in pursuing bilateral agreements with its western costumers.[77]

A lack of cooperation among European States can also be seen in the establishment of new energy transit infrastructure projects. Nabucco Pipeline Project was envisaged to introduce an alternative energy transit route for the supplies other than those from Russia.[78] Russia, on the other hand introduced the South Stream Pipeline Project[79] to counter Nabucco. Supporting the inclusion of Russia within the Nabucco project, Germany has been a partner to Russia in the construction of

74 Nikolay Kaveshnikov, (2010), p 592.

75 Of 28 the European Union members, Lithuania, Estonia, Finland, Latvia, Bulgaria and Slovakia are the most dependent States on Russian Gas that the overall dependence rate is nearly 100%. *See,* Anna Aseeva, (2011), p 10.

76 Edward Christie, (2009), p 287.

77 Nikolay Kaveshnikov, (2010), p 594. Nabucco Pipeline project was envisaged to access to gas resources within Khazar basin and to transport these new supplies through a newly built transit route, which would help the EU diversify its energy suppliers. Even though the result was a disappointment on the part of the EU, Nabucco Project served as an inspiration for another project TAP-TANAP which is designated for the same purpose and currently in construction.

78 Anna Aseeva, (2011), p 16.

79 The project was lated abandoned by Russia in 2014 due to the withdrawal of Bulgaria from the project after a significant effort put by the EU to induce Bulgaria to do so. Nevertheless, Russia introduced the Turkish Stream as the successor of the South Stream replacing Bulgaria with Turkey and reviving its policy to access to energy markets in the south of Europe.

another pipeline project, the Nord Stream Pipeline Project, which was developed to transport the Russian Gas across the Baltic Sea directly to Germany without passing through East European transit states. While, Finland, Sweden, Poland and Denmark strongly criticised the commissioning of the project, German Chancellor Angela Merkel supported it, providing that "the Nord Stream and the South Stream projects were necessary to satisfy Europe's demand for gas".[80]

Each member has its own agenda to reduce its energy vulnerability. It is not unusual to see Germany and Italy as partners of Russia in the establishment of these new transit capacities. Both states need high amount of energy to supply their demand, and are eager to reduce their vulnerability and strengthen their position by allowing new transit pipelines across their territory.[81] On the other hand, any additional pipeline project threatens the position of existing transit States, which benefit from their dominance over flow of energy. As the concept of supply diversification leads to increased competition in production level, route diversification results in the competition for transportation of energy resources from produce to consumer countries. The main external goal of the European Union is the secure supply of energy by accessing energy resources at reasonable prices.[82] Consisting of member states with competing energy policies, the EU struggles to ensure conformity in member states lack of which further weakens the Union's position against Russia.

4. Russian Energy Policy

The exploitation and the trade of natural resources are of great importance for Russia to improve its domestic economy and national welfare. Keeping its domestic prices relatively low and subsidizing its national industry, Russia engages in pricing practices differentiating for each energy importer. While, former Soviet Union States can have access to these energy supplies at lower prices, many consumers, mostly EU States are subject to relatively expensive pricing regime.[83] In addition to economic benefits derived from consumer discrimination and market division, there are also political objectives such as increasing its geopolitical influence over former Soviet territories and preserving its place as a global superpower that convey Russia to engage in such pricing policies. After the collapse of Soviet Union, each successor state took control of the former's state entities and institutions on the basis of relevant geographic regions as well as natural resources remaining within their national territories. In Russia, a brief policy of privatization of the energy sector under the government of President Boris Yeltsin was reversed when new President Vladimir Putin assumed office and a new nationalization policy was adopted especially for the Energy Sector.[84] Many of formerly privatized state entities, such as petroleum giant YUKOS Petroleum

80 Letter addressed to Jose Manuel Barosso, European Commission President, on Nord Stream website: http://www.nord-stream.com/en/, *as cited in;* ibid, p 18.

81 Reiner Liesen, (1999), p 62.

82 Nikolay Kaveshnikov, (2010), p 592.

83 Dual pricing practice of Russia is being criticized by its European counterparts asserting that dual pricing is a subsidy and has distortive effects on international trade. Before the Russia's accession to the WTO, issue of energy dual pricing was intensively discussed within the negotiation table. For more information *see;* Julia Selivanova, (2008), *Energy Dual Pricing in WTO Law: Analysis and Prospects in the Context of Russia's Accession to the WTO*: Cameron May.

84 In his 1999 PhD dissertation, Putin asserted that "*the existing socio-economic conditions and also the strategy for Russia's exit from the deep crisis and restoration of its former power on a qualitatively new basis demonstrate that the condition of natural resource complex remains the most important factor in the state's*

Company reverted to the control of the Russian State and the government started collecting all revenues from its domestic energy sector.

To date, almost 90% of gas production and 30% of oil production is under the control of Russian State.[85] As it is noted in *Energy Strategy of Russia 2020*,[86] Russian economy is mostly driven by its energy sector which played a major role in realizing the economic growth Russia experienced in 2000s. However, it is also argued that this strategy damages the regulatory environment and political situation in the country as well.[87] Although, *the Energy Strategy of Russia 2030* states that billions of investments will be needed to meet the growing demand for energy until 2030, with its current structure Russia is already falling behind the expected figures[88]. The lack of competition and the existence of state-owned monopolies constitute major obstacles to further development of the energy sector. In order to attract greater investment to meet its targets, Russia adopted strategies[89], suggesting that the Russian energy sector needs a further integration into the global energy market by introducing competition into the supply segment of the energy sector, particularly in relation to exploitation, exploration and, extraction services.[90]

It is important to note that introducing competition within the upstream segment of energy sector, a strategy on the introduction of competition within the energy transportation segment has not been the case. In terms of external energy policy, Gazprom carrying out a diverse range of upstream and downstream activity enjoys exclusive rights for the transportation and export of natural gas[91] . Any attempt within the country to introduce non-discriminatory third party access to transmission pipelines was repelled by the influence of Gazprom. Signing over long-term, take-or-pay contracts with its consumers, Gazprom tends to refuse every request for access from third parties claiming that there is a lack of capacity in its pipelines. The majority of the company's shares belongs to the Russian state and it is by far the biggest gas production company producing 84% of all gas in the Country.[92] While Russia owns the leading shares of the company, many members of the executive board of the company are also effective in the both Russian government and the parliament. There have been numerous proposals for a reform in the Gazprom to introduce

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development in near term", as cited in; Daniel Behn & Vitaliy Pogoretskyy, "The Tension Between Trade Liberalization and Resource Sovereignty: Russia-EU Energy Relations and the Problem of Natural Gas Dual Pricing," (2011), *Oil, Gas & Energy Law Journal (OGEL)*, 9, footnote 32.

85 Anna Aseeva, (2011), p 27.

86 In the 'Energy Strategy of Russia 2020, it is stated that *the energy sector has a determining influence on the state and prospects of development of the national economy providing for about a quarter of gross domestic product, a third of industrial production and of revenues of the consolidated budget, approximately one half of the federal budget income.* Government of RF, 2003 *Energy Strategy of Russia 2020.* Adopted by the Decree of the Government of RF #1234, p 28, August 2003.

87 Nikolay Kaveshnikov, (2010), p 596.

88 Government of RF, 2009 *Energy Strategy of Russia 2030.* Adopted by the Decree of the Government of RF #1715-p, 13 November 2009, *as cited in;* Ibid.

89 Government of RF, 2003 *Energy Strategy of Russia 2020.* Adopted by the Decree of the Government of RF #1234, p 28, August 2003; Government of RF, 2009 *Energy Strategy of Russia 2030.* Adopted by the Decree of the Government of RF #1715-p, 13 November 2009.

90 Anna Aseeva, (2011), p 29.

91 Edward Christie, (2009), p 275.

92 Vladimer Papava, Sabit Bagirov, Leonid Grigoriev, Wojciech Paczynski, & Marcel Salikhov, "Energy Trade and Cooperation between the EU and CIS Countries," (2009), In: CASE Network Reports, p 36.

more competition into the transportation market of the country, but none of these proposals has been adopted.[93]

Gazprom's position as to the introduction of competition into Russian energy market may reveal its concerns on the ratification of the ECT by Russia. The company argues that provisions of the Treaty contain a threat of future obligations of third party access which will apparently reduce Russia's influence over the regions, in particular in Central Asia, introducing competition between Russian gas and the energy resources from other resource endowed countries. Interested in selling its own reserves, Gazprom is reluctant to grant Third Party Access rights allowing other producer countries such as Turkmenistan and Kazakhstan to transport their energy through fixed infrastructure on Russian territory under the freedom of transit.[94] Gazprom has pursued a policy of purchasing energy products from Central Asian Countries to sell in European Market without granting transit.[95] This trading mechanism has enabled Gazprom to operate as a wholesaler and arbitrage the difference between buying and selling of natural gas. This mechanism also allowed Gazprom to eliminate a possible competition from Central Asian suppliers and increase its dominant position in energy production market. The tension between Russian Government and Gazprom is important for determining Russian external policy. Competition constitutes an essential of Russian domestic energy policy which seeks to attract more investment for supplying its existing and future domestic energy demand as well as energy demand arising from its contractual obligations with its counterparts. Yet the realization of these objectives would be difficult unless new regulatory tools are adopted and implemented to ensure third party access to existing fixed infrastructure.[96]

5. EU-Russia Relations and the ECT

Energy security at international level is a multi-faceted issue including sets of concerns from security of infrastructure to security of supply.[97] The ECT was designated to address all of these concerns, by providing a legal framework governing energy related concerns of contracting parties. It is a treaty that includes binding rules on energy trade, transit and investment, based on the principles of trade liberalization and sovereignty over natural resources.[98] It has a balancing approach to the priorities of its signatories. While importing members provide capital for the investments necessary for the development energy related services, resource-endowed and transit countries guarantee a sufficient and stable flow of energy at reasonable prices. Even though, 53 states including all European Union members and Central Asian States, signed the treaty, along with four other states, Russia so far refrained from ratifying it. Instead, Russia declared that it will

93 Thomas W. Walde & Andreas J. Gunst, (2002), p 16, footnote 64.

94 Reiner Liesen, (1999), p 62.

95 Andrey A Konoplyanik, "Gas Transit in Eurasia: Transit Issues between Russia and the European Union and the Role of the Energy Charter," (2009), *Journal of Energy & Natural Resources Law*, 27, p 464.

96 Nikolay Kaveshnikov, (2010), p 598.

97 Catherine Redgwell, "International energy security", at: Barton, Barry et al. ed., (2005), *Energy Security: managing risk in a dynamic legal and regulatory environment*, Oxford: Oxford University Press, p 17, *cited in;* Wen-chen Shih, "Energy Security, GATT/WTO and Regional Agreements," (2008), In *Society of International Economic Law (SIEL) Inaugural Conference*.

98 Yulia Selivanova, (2010), p 9.

apply the treaty *"provisionally"* unless its provisions deviate from Russian constitution, national law and regulations.[99]

At the moment, the European Union is dependent on energy imported from Russia. Almost all relations with regard to energy reflect this dependency. Both players have their own energy policies and energy security perceptions. While the EU wants Russia to accept energy polices determined by the realities of the free market, Russia sees liberalization of its energy market as a threat to its energy sector and national security and pursues policies that disregard market mechanisms.[100] The EU tries to form a consumer welfare-based energy market and to extend its regulatory structures to countries like Russia which, in turn generates greater competition among producer and transit states.[101] Using the competition among consumers, Russia, on the other hand, focuses on the EU which is its primary export market and seeks to extend its energy exports to reach new customers thereby reducing its vulnerability via new pipeline projects. The EU strongly criticizes the Russian policy of dual pricing in energy market, asserting that the Russian Dual Pricing practice constitutes a direct subsidy for its national sector and has an anti-competitive effect on European Energy market.[102] In contrast, Russia asserts the principle of sovereignty over natural resources in the practice of dual pricing. Furthermore Russia notes that the EU members gain much more revenue than producer states from the taxes built into the prices during the retail sale of imported energy products which further undermine the capacity of producer states to access to the retail market.[103]

However, both players also have problems in determining the course of their internal and external energy policies. The European Union is suffering a lack of cooperation and coordination among its Member States in the development of a common position against Russia. Each State has its own priorities and interests reflecting the extent of its energy vulnerability, although there is a great aspiration to speak in a single voice within the European Commission. Russia, on the other hand struggles to restructure its energy investment and transit sectors due to its earlier nationalization policies transferring assets of private entities to state controlled companies and to internal politics involving the priorities of state-owned energy champions.[104] Russia needs an enormous amount of investment to develop its production and to satisfy its energy demand. This was accepted within the Russian Energy Strategies of 2020 and 2030, and the need for introduction of competition in certain segments of energy sector was envisaged to attract necessary investment.

Another important concern for Russia regarding the ratification of the Treaty was negotiations on the Transit Protocol which would introduce the concept of third party access into the freedom of energy transit under Article 7. All the parties to the negotiations were aware that secure freedom of energy transit was fundamental for reaching to energy supplies and opening up

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99 Anna Aseeva, (2011), p 43.

100 Daniel Behn & Vitaliy Pogoretskyy, "The Tension Between Trade Liberalization and Resource Sovereignty: Russia-EU Energy Relations and the Problem of Natural Gas Dual Pricing," (2011), *Oil, Gas & Energy Law Journal (OGEL)*, 9, p 11.

101 Nikolay Kaveshnikov, (2010), p 598.

102 Daniel Behn & Vitaliy Pogoretskyy, (2011), p 23.

103 Organization of the Petroleum Exporting Countries, (2009), *Who gets what from imported oil* Vienna: OPEC.

104 Nikolay Kaveshnikov, (2010), p 595.

former soviet countries whose energy sector and network facilities were mostly immature.[105] To do so, Transit Protocol Negotiations aimed at developing further commitments to the ECT on transportation of energy resources and non-interruption of transit. Access to Central Asian gas by using Russia's transit infrastructure and, transporting it to the major importer European countries, would result in a decline in the competitiveness of Russian gas in the European Market and threaten Russia's policy of increasing its political influence over former Soviet regions. Any implication of Third Party Access to Russian pipelines for the transportation of energy resources from Central Asian States, would make Russia a gas corridor and further decrease the dependency of Central Asian States upon Russia.

To date, neither the ECT nor the negotiations between contracting parties have offered so much guidance on how contradictions in between states with regard to energy transit can be settled or how convergence of interests might be achieved. While the EU pushed Russia to recognize liberalization of its energy market and third party access to its fixed infrastructure, Russia continuously asserted that the ECT particularly aims at security of energy supply for importing countries and ignores the interests of energy producing and transit States. In order to understand the reasons why Russia cut off its all ties with ECT, and even cancelled its provisional application, we need to analyse the concept of 'Provisional Application' and its consequences for Russia within the well-known *"YUKOS"* case

6. Russia's Provisional Application of the ECT and *YUKOS*

The concept of Provisional Application[106] is articulated in the ECT, Article 45. Article 45 (1) defines the provisional application as a pending ratification of the Treaty between the dates of signature and entry into force. Accordingly, States are obliged to apply the Treaty to the extent that it is consistent with their constitutions, national laws and regulations. States reserve the right to terminate provisional application at any time or, they can make a declaratory statement, while signing the Treaty, noting that they are not able to apply the treaty provisionally. It is necessary to point out that signing the Treaty, Russia did not make such a notification.

Alongside Gazprom-oriented concerns, the Russian government did not want to ratify the Treaty, due to its internal energy policy developed in late 1990s. When President Vladimir Putin assumed the office, a new nationalization process started. The Russian Government commenced a policy of transferring assets of privatized energy companies to state ownership. The nationalization of YUKOS, one of the largest non-state owned companies at that time, demonstrated how this new nationalization policy affected Russia's approach to the ratification of the ECT. The Russian Ministry of Finance presented Yukos with nearly 30 billion USD tax claims and froze its assets so that the company could not pay the taxes. A Russian Court made a declaration of bankruptcy and Mikhail Khodorkovsky, the Chairman of YUKOS, was sentenced to a prison on the basis of fraud.

105 Bryan Clark, (1998), p 3.

106 Provisional Application is a new concept in international law. It is generally understood as a period designed to deal with unexpected or unforeseeable results of concluding treaties. For detailed information *see*; Alex M. Niebruegge,"Provisional Application of the Energy Charter Treaty: The Yukos Arbitration and the Future Place of Provisional Application in International Law", (2007), *Chicago Journal of International Law*, Vol. 8 No. 1 (pp.355-376))

Thereafter, the Russian State-owned petroleum company, Rosneft bought most of the assets of YUKOS at an auction assembled after the decision of bankruptcy. The majority shareholders of YUKOS filed a suit against Russian Federation before an arbitration tribunal under the ECT.[107]

Russia contested the arbitral jurisdiction on the ground that it had never ratified the treaty and that provisional application would not provide a basis for the tribunal's jurisdiction[108]. It is important to note that the concept of provisional application is not fully circumscribed by international law. In general, a provisional application was identified as a legal tool giving legal effect to the treaty obligations within the time period between signature of treaty and its date of entry in to force.[109] However, the signature on the treaty neither imposes a legal obligation to state to ratify the treaty, nor does it impose a positive duty on states to give the provisions a legal effect before the entry into force.[110] The tribunal had to decide whether Russia's provisional application of the ECT imposed a legal duty on Russia to protect investments under the ECT and if so whether the measures by Russia against Yukos violated its obligations in relation to investment protection under the ECT. In September 2009, after Russia terminated its provisional application of the Treaty, the tribunal, relying on Article 45 (3)(b) held that provisional application of the Treaty is enough for the Treaty provisions to have legal effect, and even though, Russia terminated its provisional application later, it was bound by the Treaty provisions on investment protection for twenty years from the date of termination.[111]

The tribunal's ruling clearly shows that the Energy Charter Treaty provisions on investment effectively protect investments and investors, regardless of full ratification of host state. Intensification of state influence over the energy sector is still embraced in Russia since the beginning of re-nationalization policy. According to Russia, the experience of *Yukos* case confirmed the hypothesis that the Energy Charter is an EU-driven Treaty and further protects the interests of consumer states rather than embracing a comprehensive approach.[112] In removing Russia totally from the scope of ECT, the *Yukos* case shows how the Treaty protects investments on energy. Investments are indeed crucial for the regulation of energy, however, as mentioned above, the secure supply of energy is essentially dependent on the provisions protecting transit of energy resources.

While the ECT was successful in resolving disputes on investment protection, it proved to be incompetent to address energy transit disputes. During the last decade, there were some cut offs in transit pipelines and the most important of these cut offs was January 2009 Gas Crisis involving Russia, Ukraine and the European Union that lasted for two weeks and inflicted huge damages on parties involved. Here, the paper analyses this gas crisis that led international community to question ability of ECT to provide secure supply of energy resources.

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107 *Yukos Universal Limited v. The Russian Federation,* https://www.italaw.com/sites/default/files/case-documents/italaw7258.pdf

108 Ibid., paras. 330-338.

109 UN Office of Legal Affairs Treaty Section, *Treaty Handbook*, para. 3.4, available at: https://treaties.un.org/doc/source/publications/THB/English.pdf , retrieved on March 5, 2014.

110 Anna Aseeva, (2011), p 72.

111 *Yukos Universal Limited v. The Russian Federation,* paras. 370-392.

112 Anna Aseeva, (2011), p 76.

G. 2009 Gas Crisis

In the last decade, Europe has experienced many interruptions in energy flows from Russia and especially on the transmission lines passing through Ukraine. Many of them did not last more than a couple days, but were serious enough to attract the attention of consumer states. These disputes provided a good opportunity for the ECT to prove that it is an effective legal framework in dealing with concerns on energy transit before they turn into crises. During 2004 and 2006 Gas disputes between Russia and Ukraine, Europe was urging the disputing parties not to interrupt energy flows pursuant to Article 7(6) which prohibits the contracting parties to *interrupt* or *reduce* the transit of energy resources via fixed infrastructure. Several efforts were made on the parts of the states involved. However, negotiations failed and gas supplies were interrupted for two days in 2004 and three days in 2006. Failing to address the transit issues before they were turning into a transit crisis, the Energy Charter Secretariat emphasised the importance of conciliation procedure articulated under Article 7(7) for resolving the dispute once these gas crises broke out.[113] However the disputes were again settled through bilateral and non-transparent agreements without triggering the conciliation procedure.

The Gas Crisis of January 2009 lasted for two weeks, causing serious damages in local economies, factory shutdowns and economic losses in many European states. The dispute erupted again between Russia and Ukraine due to price disagreements between their state-owned entities, Russian Gazprom and Ukrainian Neftogaz.[114] In January, 2009, Russia stopped the flow of gas to the Ukraine, but the gas meant for European customers continued flowing for a while. Trying to meet its gas demand, Ukraine later started siphoning off the gas meant for other states and Russia cut off all the energy supplies in response. Russia was the main supplier of gas in Europe and Ukraine was then the main gas corridor, transferring 80% of gas from Russia to Europe. Disruption in the middle of winter was devastating for all parties, causing both economic and humanitarian concerns so that in some states with high energy vulnerability, inhabitants were incapable of heating their homes due to the lack of energy and were exposed to harsh winter conditions.[115]

Initially, Europe took a passive position and did not actively participate in the dispute. However, when Russia halted the flows to Europe completely, and severe effects started to be felt in some eastern European States, the EU suggested an initiative for the monitoring of the gas flows through Ukraine with selected experts from both sides of the dispute.[116] Each party blamed the other and no one was ready to shoulder the responsibility for the problem. Finally, on 19 January 2009, the parties agreed to sign a new 10 year transit and supply contract and energy flows from Russia to Europe started again. Distinguishing aspect of this gas crisis was that it was the first time that gas flows from Russia to Europe were completely cut off. There had been reductions and interruptions

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113 Danae Azaria, "Energy Transit under the Energy Charter Treaty and the General Agreement on Tariffs and Trade," (2009), *Journal of energy & natural resources law*, 27, p 583.

114 For detailed information on pricing disagreements *see;* Simon Pirani, Jonathan Stern, & Katya Yafimava, (2009), *The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment*, Oxford Institute for Energy Studies Oxford, pp 14-19.

115 Nikolay Kaveshnikov, (2010), p 600.

116 Simon Pirani, et al., (2009), p 22.

in flows but there has never been a complete stoppage for a relatively long period, which for the first time severely affected the inhabitants in Europe.

There were, of course, economic reasons for the dispute involving the perspectives of parties involved. Ukraine tried to use its dominance over transit routes to Europe as a bargaining tool for its transactions with Russia. It was a reminder that Russia was dependent on Ukraine with a great extent to transport its gas to its European costumers. Any disagreement in energy transit would have financial consequences to Russia which was in fact, the case in 2009 Gas crisis that Russia's losses reached around USD 1.4 billion.[117] Russia, on the other hand, had done what every producer would do against a consumer who did not pay the price for the product it buys and Russia cut off the energy flow going meant for Ukraine.

However, since energy disputes are as much about politics, looking at the crisis from a political standpoint can easily reveal underlying reasons for the dispute in 2009. Russia developed two important pipeline projects, Nord Stream and South Stream Pipeline projects for transit of energy for the purposes of decreasing its dependence on Ukraine. Showing Ukraine as an unreliable partner in the energy supply mechanism, Russia tried to urge its European counterparts to support investments in these new transit projects it had developed.[118] Furthermore, it would be also a punishment to Ukraine, which is a former Soviet State, flirting with Western Europe and abandoning its ties with its former big brother. Russia would tolerate a couple of billions of dollars in revenue for greater political advantage.

The European Union did not participate in solving the dispute until extended flow disruptions directly affected its regional environment. Directly dealing with Gazprom with regards to energy supply and having no contacts with Ukrainian Neftogaz, European States looked at the dispute as a struggle between Slav brothers.[119] The Energy Charter Secretariat, however, has done nothing beyond issuing two statements, one before and one after the eruption of crisis, reminding the parties of the principle of uninterrupted energy transit.[120] The reason why Russia did not bring any claim against Ukraine before an Energy Charter Tribunal is understandable that it was applying the Treaty provisionally without ratification and any action would have consequences for its then on-going *Yukos* case. Even though the disruption of energy transit in the crisis constituted an obvious violation of the ECT, European States did not bring any claims against Ukraine either.[121]

There is no doubt that, the 2004, 2006 and 2009 gas crises and disruptions in energy flow illustrate a complete failure on the part of the ECT. No actions were taken under transit provisions of the Treaty and all of the disputes were resolved at bilateral level. As a legal framework governing energy transit, the ECT failed to prevent upcoming disputes and State parties clearly showed their discontent at the ineffectiveness of its functioning. The ECT was supposed to ensure secure supply of energy products. However, the experience of the last decade points to an ECT that is unable to deliver on its proposed objective.

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117 Nikolay Kaveshnikov, (2010), p 600.
118 Edward Christie, (2009), p 286.
119 Nikolay Kaveshnikov, (2010), p 600.
120 Simon Pirani, et al., (2009), p 16.
121 Nikolay Kaveshnikov, (2010), p 601.

IV. CONCLUSION

Every state needs energy resources for the development of their economy and social welfare. They are fundamental for the progress of national production and domestic industry. However energy resources are different from other commodities. They are unevenly distributed across the globe. In addition energy sector is network-based requiring the construction of fixed infrastructure such as transmission pipelines and grids for an efficient transportation. Such characteristics have constituted major main obstacles to the adoption of a common approach to energy trade by states. This can be seen within WTO as energy resources are not literally excluded from GATT's transit provision, Article 5, the concept of energy trade has remained, *de facto,* outside the WTO framework.

Political and economic instabilities within major energy exporting and transit regions in 1970s and 1980s strongly affected global energy prices and trade, and the international community saw a need for a multilateral framework to provide secure and sustainable access to energy resources. In particular, the climate after the dissolution of the Soviet Union was conceived by the EU as an opportunity to transform their eastern European neighbours into liberal economies and further access to gas reserves in Russia and the Central Asia. The Energy Charter Treaty was the result of this European initiative. The ECT was of great importance for international energy trade as it served as the first multilateral treaty implementing the principle of freedom of transit of energy resources.

Nevertheless, the ECT failed in governing energy relations between Russia and the European Union and in resolving the transit disputes experienced particularly in the last decade. The ratification process was problematic. Russia and five other signatories did not ratify the Treaty and applied it provisionally. Furthermore, in 2009, Russia declared its political intent not to ratify the Treaty and terminated its provisional application.

This paper analysed underlying reasons why the ECT has failed to address the interdependence between Russia and the European Union in energy trade and the convergence of the interests of the parties involved. It contains only the investment protection and energy trade and was developed with a European, importer state perspective. As mentioned in *Yukos* case, while being successful in protecting investments and investors, it failed to provide secure supply of energy resources during the gas crises in 2004, 2006, and 2009.

The urgent need to develop sustainable energy transit policies at multinational level still exists today. Since the ECT has failed to provide that regime, the international community has started to seek the creation of new legal frameworks including detailed provisions governing energy trade. However, introducing a new framework will not be as easy as it was in early 1990s. The current political climate is more complicated and no multilateral framework can be solely built upon the concepts of energy trade and investment protection. For example, one of the most controversial issues in the Energy Charter negotiations on "Transit Protocol" was the introduction of "Third Party Access" for the use of existing transit capacities. Though, it was essential for the establishment of a secure transit regime, the idea was strongly rejected by Russia and the negotiations on the Transit Protocol, seeking to render energy transit provision of ECT effective, failed.

In 2006 at the EU-Russia summit, President Putin stated that Russia needs to know what it will receive in exchange for the access to its transportation structure: "*It is very easy to understand if you look back at your childhood. You go out for a walk with a candy in your hand, and the guys immediately also want to have it. You clench it in the sweaty fist and ask what you get in return. And we also would like to know what we get in return*". [122] Putin's statement is very illustrative that negotiations between Russia and the EU should be pursued in a wider perspective encompassing the interests of not only importers but also producers transit states as well.

Russia acceded to the WTO in 2012. Covering diverse range of issues related to goods and service, the WTO has a great institutional flexibility which serves its pragmatic needs and provides a forum for state parties to pursue their interests. Having Russia inside of WTO system is a great opportunity to discuss energy trade and third party access to transit infrastructures in these negotiations along with other issues that could not be addressed within the context of the ECT. In other words, Putin's question of what Russia would get in return may be answered within WTO's dispute resolution mechanism. The extent to which WTO can provide solutions for President Putin's concerns and how energy transit issues can be handled within this global trading system is yet to be seen.

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