

EU-RF Energy Policy Harmonization Issues

Vladimir Feygin,

Institute for Energy and Finance,

Principal Director

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This article is based on a presentation, which was done in October 2008 at the Round Table in Luxemburg arranged jointly by the EU Parliament and Federation Council of the Russian Parliament. A recent crisis on Ukrainian gas transit provided further arguments to the topic.

1. EU-RF Energy Relationships.

There is a long history of stable growth of mutual dependence, trade and investments in energy sphere. It started in 60-es and successfully developed in decades through all turbulences and crisis events – of political, economical nature, of institutional transformations on both sides.

Let mark for instance problems of early 80-es with large scale gas project “gas-for-pipes”, linked with Urengoy-Pomary-Uzhgorod pipeline, when after sending USSR troops to Afghanistan Reagan administration stated an embargo for supply of equipment with US made components as a tool in its attempts to isolate USSR from strong economic cooperation with the West and from increase its currency income as a result of this project realization. It was one of first own decisions of major European countries to withstand this pressure and to assist in this project and it was a prioritized national project in the USSR to provide equipment and services, combined with imported pipes, for this pipeline. This example illustrates a historical link between relations of two political and defense blocks and energy relations of that time – even energy trade and definitely energy cooperation were submerged in inter-blocks relations.

On the other hand, an energy security at that time had to be provided only in this inter-blocks context. Energy links of Central (called then as East...) European countries and their energy cooperation (which was very strong particularly in Orenburg and Yamburg projects) was provided via Comecom instruments, under the Warsaw Pact umbrella.

Another difficult times came in 90-es, after Warsaw Pact, Comecom and the USSR disappeared, and a combination of low international energy prices, huge arrears for supplies to the CIS countries and domestic consumers simultaneously with political instability and economic decline resulted in potential heavy threats to stability of energy supplies but the energy flows maintained astonishingly safe.

In the first half of 90-es this set of increased uncertainties and risks as well as an increased importance of energy supplies from former USSR to Europe (which subsequently included Western, Central and South-Eastern European countries) were reflected in the new format of agreements as a declaration of the European Energy Charter (1991) and then Energy Charter Treaty (ECT, 1994). It purposed to cover three main areas of mutual interest – investments, trade and transit in the new environment when blocks could not further provide security umbrella, and cooperation in energy sector should be based on the transition to market economy in the eastern part of the Europe.

These agreements reflected that time balance of interests and state of market development in countries-participants. We will return to this topic below.

Nowadays there is a large need for further improvement and scaling-up of relations in energy sphere based on well known reasons as:

- EU need for external energy supply
- RF availability of delivery stable oil and increasing gas exports
- Opportunities on both sides to increase cooperation sphere far beyond energy trade (technology, innovations, energy savings, greenhouse gases, investments, equipment supply...).

2. Complications of 2006-Nowadays.

Notwithstanding an importance of energy issues in EU-RF relationships they were not in the focus of politics until 2006. On EU side main driving forces were formation of single energy markets, including accession of new members and liberalization of markets, with all its contradictory and yet not completed issues.

Current wave of strong international attention increase to energy security issues started in 2006 and was linked with a combination of growing energy demand (and growing concerns about availability of sufficient energy resources), rising energy prices, RF initiative to raise this group of questions at the S.-Petersburg G8 Summit and on real security of energy transit problems in the beginning of 2006 and later on.

Though G8 Summit formulated a list of critically important items in the energy security area it had not resulted (and possibly could not – because of its status and mission) in a new legislative and/or institutional instruments to support an implementation of the goals it declared.

But the crisis in Ukrainian gas transit of 2006 had attracted so much of public attention that the necessity of such instruments – at least between EU, RF and transit countries - became obvious and even acute in the eyes of political class.

It resulted in an excessive political pressure from EU to RF on an urgent ECT ratification. Meanwhile ECT since end of 90-es was far from being a favorite of the EU internal energy politics by number of reasons including following:

- it reflected some principles of the energy markets' functioning which EU tried to overcome for the EU internal markets since mid of 90-es. For instance, ECT emphasizes that it does not assume a mandatory Third Party Access to the energy infrastructure (for the ECT purposes – transit infrastructure)
- it was signed and ratified by every EU member state (as well as by the European Communities) and therefore its transit provisions were applied for energy products flows which intersect both borders of a single EU member state while at the end of 90-es the term “transit” was excluded from the internal EU legislation as being in controversy to the “single market” principle.

On the RF side the ambiguous attitude to the ECT was formed on various reasons, and main concerns were expressed by Gazprom who were worried that an open transit of Central Asian gas via Russian and Ukrainian gas systems could damage its positions on the European market. Though ECT is dubious in this respect but some EU politicians (and former Charter Secretariat officials) in practice supported these concerns by their proclamations. As transit provisions were of particular importance for RF interests, Russian State Duma linked a perspective of the RF ratification of the ECT with the success of the Transit Protocol negotiations which had started in 1999.

We have to stress that the excessive politisation of this sphere (incl. “dangers” of excessive EU dependence on external energy supplies) had not

helped to reach progress. Sometimes in the last years it was an impression that politicians even overestimate the energy issues role in the pan-European scene.

The new and most complicated issue on the substance in these relations is the transition state of energy markets status, market and industry regulation - on both sides!

In EU we can state an ideologisation of this transition phase – as a result of liberalization dogma which prevailed until very recently.

In this environment there are real difficulties of reaching a comprehensive and mutually satisfactory agreement.

It is a little premature to finalize lessons of recent Ukrainian gas transit crisis but it is important to mention that again transit issues and security of transit flows became in the focus of the problems. And again the ECT was put into the centre of discussions.

3. Some Other Uncertainties.

In the very last time new series of uncertainties started to have an impact on the energy perspective, including:

- Climate change challenges
- “Extreme” views on its implications on world energy supply.

Scenarios which are a product of these considerations present pictures of perspective of 2020-2030 in which traditional hydrocarbon fuels loose their positions in the global energy supply and in the EU external trade.

So the questions can be on what would be preferable:

- The tendency to rely in energy scenarios on yet industrially non-tested technologies or on available energy resources?
- Energy Self-independence at any cost (including huge budgetary subsidies for alternative energy sources) – or stable external energy relations?

This uncertainty on the EU energy policy may create real dangers among producers regarding “security of demand” at the EU market.

4. Where we are and where we can go?

As now, after delays on the EU side, negotiations on new EU-RF Partnership and Cooperation Agreement (PCA), which Russian side would prefer to call a Strategic Partnership Agreement (SPA), started where energy aspects should play an important role, we can see from some experts on both sides extreme expectations of easy progress which can be reached. Our concern is that it might be not so easy in view of several arguments. In a concentrated form the main problem seems to be an attempt to find detailed agreement “from the scratch” regarding both sides energy markets and energy sectors interactions. In a situation when these markets are in a transition and their final configuration is not yet determined, it would be extremely difficult. So a more balanced approach would be more realistic.

In this context a recent appeal of the RF President D. Medvedev to form a legislative basis for new Europe-wide energy relations which will prevent appearance of new crisis as a recent Ukrainian one, is an important initiative which, in our view, has several immediate aspects:

- it has to resolve real security problems which are in the first instance in the transit sphere;
- it can't be only EU-RF deal as it strongly touches third countries;
- it should be achieved in a realistically short perspective as current lack of such basis can't be further tolerated.

Looking around for an effective implementation of these tasks we easily come to the necessity of combined use and development of the following instruments:

- Energy Charter Treaty
- Its Transit Protocol (TP)
- New PCA (or SPA).

What are the current status and perspectives of each of these instruments?

• **Energy Charter Treaty.**

As it is now widely understood by energy experts of both Russia and EU it is not a perfect document from legal point of view as it contains a number of “ambiguities” with a potential adverse impact on energy sector – so there is a need for contemporary interpretation and clarification.

As RF leaders emphasized while Ukrainian crisis and after it, an ECT has limited capacity to act in the crisis circumstances. Charter Secretariat as the only permanent body established by the ECT does not have clearly expressed authority to act, even to warn the parties on the potentially dangers for energy security issues.

While the Ukrainian crisis it became clear that new means as international observers would be of help in the crisis times. No such provisions are in the current ECT.

New agenda in the energy sphere of this decade posed a number of topics which are not reflected in the ECT – as we told above ECT is a document of mid-90-es.

On the Russian side there were as well a number of complaints that the ECT in some points is not symmetric and more reflects interests of consumers than producers.

And we are well aware that on the EU side there are “fundamentalists of liberalization” who consider ECT as a sort of potential obstacles to reaching their goals.

Bearing all this in mind let mark that in case of latest gas crisis the ECT was the only international treaty which was relevant, and both RF leaders and corporate lawyers appealed to its provisions (mostly transit and dispute resolution clauses) in attempts to persuade partners and/or to appeal to legal protection.

Within last couple years Russian experts made an analysis of potential ways to modernize ECT provisions and to exclude legal ambiguities in its current text. Experts of ministries and leading energy corporations made their comments to these proposals.

ECT contains provisions for its periodic (once in 5 years) review on adequacy to new circumstances and challenges. The year 2009 is the next year of such review. Russian official representatives had in the end of 2007 expressed an initiative to deepen this work and the ECT Conference formed special Strategy Group for this activity. Within 2008 this work made a significant progress.

On the EU side (i.e. by the European Commission) a number of signals of skepticism in this regard were seen but many individual countries – both EU Members and non-EU – expressed their interest in this process.

A latest very positive signal came from the Charter General Secretary Mr. A. Mernier who, based on the lessons of the latest crisis expressed in his Statement (see at www.encharter.com) a strong support to an adaptation and modernization of the ECT and made several suggestions in this regard.

We think that a mutual understanding of the RF and EU on the ways to reach progress in this multilateral process would be very desirable and fruitful step

towards achieving of the goal to build contemporary international energy legislation.

It can be a productive initiative to extend this dialog beyond Eurasian scene where current ECT jurisdiction is. This can be done through such forms as G-8 and G-20 as D.Medvedev recently suggested.

One party can't guarantee the success of these attempts. But the analysis shows that more and more parties consider this approach as realistic.

The RF ratification of the ECT would be a part of this process assuming it is successful.

• **Transit Protocol.**

This document is directed to reduce any risks of further energy transit disruptions, to stabilize basis for continental wide energy transit and exclude impact of price and contract disputes on energy delivery. It clarifies such important items as ban on an unauthorized energy materials and products (EMP) withdrawal while their transit or principles of transit fees establishment. Its draft text contains important provisions on the stability of transit arrangements and increase of transit capacity. Some important ambiguities of the ECT transit provisions were successfully clarified at the expert level due the TP consultations and mutually satisfactory wording was reached.

After long negotiations TP terms are practically agreed on expert level. Last and major point still under discussion – a TP applicability on the EU territory (“REIO Clause”).

On the EU side we could hear reasons that current EU legislation itself provides sufficient guaranties for EMP transportation on the EU territory (don't forget that the EC is against the meaning “transit” within the EU). This argument does not work as the EU legislation on energy markets is not yet finalized and its current status definitely creates risks for supplier and in no way covers all aspects of the TP.

The other reason from the EU end is that TP will establish parallel (to Aquil) legislative base which will cause difficulties in implementation. But our comments are that the ECT being in force at the EU territory and being ratified by every single EU member state already causes same problems.

It is clear that the TP could be acceptable for the RF only if it is applied for the EU as well. REIO problem is a crucial part of the compromise and there is nothing impossible to resolve it at the political level. We can remind that at the mid-2006 both parties – RF and EU – were very close to resolve this issue – even draft text of corresponding formulas was on the negotiation table. The drawback was then from the EU side, and if the clear picture of the whole deal is presented the issue will be settled.

• **Strategic Partnership – what it could be in the energy sphere?**

Russian side expressed its interest in forming the new PCA as the “Strategic Partnership| Agreement”, i.e. as a document leading to deep forms of co-operation and partnership.

What it could be in the energy sphere? Some ideas in this regard:

- Determination of mutual long term goals (integrated economic and energy space?).
- “Road maps” for achieving them.
- Possibly instruments of a “Commitology” as the EC normally uses it. This can be done in many ways including an increased role of the

EU-RF Energy Dialog and/or better determined role of external bodies in the Agency to be established by new EU Gas Directive. The role of business has to be thought through as well.

- Mutual measures to reduce risks.
- Forms of dispute resolution.
- More projects of mutual interest and more cooperation on their funding and implementation.

So definitely a new PCA will be a sort of the road map with goals and principles and instruments to reach them.

The current tensions and dissatisfaction on both ends ask for more urgent fixation of “solid base” for partnership. The pragmatic approach would be a maximum use of already reached progress, its formalization in an obligatory form and in parallel a progress towards deeper forms of cooperation.