

CHAPTER II

INTRODUCTION OF ENERGY CHARTER TREATY AND RUSSIAN REFUSAL

A. Energy Charter Treaty

A.1 Background

After the end of the Cold War in the countries of Western Europe establish cooperation in the energy sector with countries in Eastern Europe and some former Soviet countries in rich energy resources. Russia as a country that has the largest gas reserves in the world with proven reserves of 1680 Teff (Trillion cubic feet) or two times larger than Iran's gas reserves, second largest for coal reserves after the United States with a reserve of 173 billion tons and proven oil reserves of 60 billion barrels.¹⁷ Kazakhstan has gas reserves of 100 Teff, Ukraine for 39 Teff, Uzbekistan for 65 Teff, Azerbaijan registrations 30 Teff, and registration 2014.8 Teff for throughout Eurasia region¹⁸. And according to the same source, Europe only has a gas reserve of 172 Teff and 14 billion barrels of oil reserves are dominated by Norway. The countries of Western Europe offer the technology and capital

¹⁷ Langdon D. Clough, Energy Profile of Russia (accessed on January 3, 2010); available from http://www.eia.doe.gov/cabs/Russia/oil_export.html

¹⁸ Energy Information Administration, World Proved Reserve of Oil and Natural Gas, Recently Estimates (posted on August 2008) (accessed on December 28, 2010); available from <http://www.eia.doe.gov/emeu/international/reserves.html>

that they have to exploit the natural resources owned by the countries of Eastern Europe on the basis of mutual benefit.

Western Europe initiative was first raised in The Hague, Netherlands, on December 17, 1991.¹⁹ At the time of Energy Charter just a political declaration on international energy issues concerning trade, shipping lines, and investment. But the Energy Charter as it does not have legal force to binding its members.

Western Europe saw that the investments in the energy sector that will they establish in the countries of Eastern Europe will greatly benefit both parties. On the one hand, Western Europe wanted a guarantee the availability of energy for industry and their households and on the other hand the countries of Eastern Europe require huge investments to sustainability of their development after the war. The signing of the Energy Charter in The Hague will not guarantee these desires. It takes a rule that binds all signatories in order to the launch of the goals of Energy Charter can be achieved.

Approximately three years after the signing of the Energy Charter in The Hague, precisely in December 1994 in Lisbon, Portugal, Energy Charter have binding legal force members and became the Energy Charter

¹⁹ Energy Charter Treaty (accessed on 5 January, 2010); available from http://www.en.wikipedia.org/wiki/Energy_Charter_Treaty

Treaty.²⁰ Along with the signing of the Energy Charter Treaty also signed protocols for energy efficiency and the impact of the Environment (Protocol on Energy Efficiency and Related Environmental Aspects / PEEREA). Energy Charter Treaty provides a multilateral framework in the energy sector under international law and strategic points in it is the basis for the creation of global energy security that based on the principles of openness, competitive markets, and sustainable development.²¹

In the period between the years 1994-2007 there are 52 countries signed the Energy Charter Treaty and 46 of them have ratified it.

A.2 Scope

Energy Charter Treaty is a mechanism for global cooperation in the field of energy that gave priority to transparency and equal treatment in trade. Energy is a vital need for a state, and then all countries will always try to meet their energy needs, either by exploring their energy fields or by importing energy from other countries.

Western European region is one of the regions with fastest economic growth in the world, it is unsurprising that the energy needs in this area is very high. In the year 2000 oil demand in the region reached 14 million

²⁰ Ibid

²¹ The Energy Charter treaty and Related Document, published by energy Charter Secretariat. September 2004 (accessed on January 2, 2010); available from <http://www.encharter.org>

barrels per day and reached 15 million barrels per day in the year 2007.²² Energy charter treaty is one of the mechanisms used by Europeans for their energy needs.

In the energy charter treaty, there are five things to focus on provisions²³, namely:

1. Protection and encouragement of foreign investment in the energy field.

In this case the energy charter treaty encourage to their constituents countries to create a conducive investment climate in the energy sector and reduce the non-commercial risks in investments. By accepting this treaty means that the state should provide non-discriminatory treatment to investors of the constituent countries that will invest in energy sector in the country concerned. Matters relating to investments set out in Article 10-17 of Energy Charter Treaty.

2. Free trade in energy materials and products and equipment that support the energy industry.

The provisions on trade in the energy charter treaty based on the principles of the GATT trade regime. This makes the provisions on trade in this treaty is conducted in accordance with the principles of the WTO (World Trade Organization). The principle of non-discrimination,

²² David L. Goldwyn, The United States, Europe, and Russia : Toward a Global energy Security Policy (accessed January 8, 2010); available from http://www.goldwyn.org/downloads/us_europe_russia_toward_a_global_energy_security_policy.pdf

²³ The Energy Charter treaty and Related Document, published by energy Charter Secretariat. September 2004 (accessed on January 2, 2010); available from <http://www.encharter.org>.

openness, and commitment to trade liberalization toward a progressive world is the proof. For the constituent states or observers is not a member of the WTO, the implementation of the provisions of this treaty can be a reference to become more familiar with the WTO disciplines. Matters concerning the trade set out in Article 29-32 Energy Charter Treaty.

3. Assurance regarding the distribution of energy products through a pipeline or other means.

Each constituent country should facilitate energy transit with the advanced principle of non-discrimination and freedom of transit. Transit problem becomes a prominent issue in every discussion in the forum this treaty. This is because the pipelines that crosses several countries before reaching the delivery destination. However, the transit Provisions is regulated that transit politicization has to be removed and a guaranteed supply and income security. It also regulated multilateral procedures to reduce the transit politicization by taking preventive measures for transit countries that want to blockade transit and remove excess transit tariffs. Transit problems set forth in Article 7 Energy Charter Treaty.

4. Commitment to reduce the negative impact of energy use on the environment by improving energy efficiency.

This commitment was signed in 1994. Commitment is about energy efficiency mechanisms as stipulated in PEEREA (Protocol on Energy

Efficiency and Related Environment Aspects). In implementation, the charter of energy provides a forum to share experiences and discuss policies that encourage energy efficiency and energy usage more environmentally friendly. This forum will produce recommendations which will be adopted into policy in the constituent countries. One result is in a ministerial-level conference in Europe, "Environment for Europe" held in Kyiv, Ukraine, in May 2003 basing agreement on energy efficiency in the implementation PEEREA.

5. Dispute settlement mechanism between states or between the investor with the country concerned.

In an agreement is possible occurrence of a dispute between certain parties. In the energy charter treaty also contains the guidelines for dispute settlement between investors with the state (investors with contracting party) or inter-state disputes (state to state dispute). In case of disputes between investors with state, the solution is the investor to report the dispute to the Secretariat of Energy Charter Treaty that would form the Energy Charter Treaty Arbitration. If the problem has not done so can be solved by using a mechanism that applies to the ICSID (The International Center for Settlement of investment Disputes). Next will be formed ad-hoc arbitration under the rules of UNCITRAL (United Nations commission on International Trade Law) which would produce binding decisions. In the settlement of inter-state dispute mechanism

that used is settlement by diplomatic way. If the diplomatic way not settle yet the dispute, so the way that be used is forming Energy Charter Treaty Arbitration. However, if still not be resolved under the settlement mechanism will be used UNCITRAL. The use of facilities at the Permanent Court of Arbitration at The Hague is also very possible. Dispute resolution mechanisms contained in Article 26-28 of Energy Charter Treaty.

A.3 Membership

Until 2007 there are 52 countries signed the Energy Charter Treaty and 46 of them have ratified it. In the energy charter treaty, there are several agencies that have specific duties. Energy Charter Conference (ECC) which consists of all the countries signing the Energy Charter. ECC has the task to discuss policy issues of cooperation in energy sector among the signatory countries, to assess the implementation of the provisions in the Energy Charter Treaty and the implementation PEEREA, looking for possibilities for the use of new instruments and projects on energy issues. ECC has a sub-agency that assists the ECC²⁴, namely:

1. Ad Hoc Group on Strategy; the group assigned to monitor the achievements of the implementation of the provisions in the energy

²⁴ Energy Charter Treaty (accessed December 20, 2009); available from http://en.wikipedia.org/wiki/Energy_Charter_Treaty

charter treaty and examine the possibility of using new instruments to maximize the implementation of the provisions in the Energy Charter Treaty.

2. Investment Group; this group served to promote investment in energy field toward the member countries of ECC and other countries outside the ECC members. This group also ensures that investments made with a safe and promising a conducive investment climate.
3. Trade and Transit Group; group's task is to monitor the implementation of the provisions in the Energy Charter Treaty in matters of trade energy products and other commodity-related energy. This group also ensures that the energy product has reached the destination country through pipelines. This group also noted that disputes may occur and then seek solutions through forums held by ECC.
4. Working Group on Energy Efficiency and Its Impact on the Environment (Working Group on Energy Efficiency and Related Environmental Aspects); group's task is to monitor the implementation of PEEREA in member countries and looking for new instruments to improve energy efficiency and suppress energy use negative impact on the environment .
5. Budget Committee; committee was tasked to design the budget needs in every activity undertaken within the framework of Energy Charter in a year and then report on the ECC for later ratified.

6. Legal Advisory Committee; this committee handle all problems related to legal issues of formal inter-state-ECC, whether related to employment contracts and violations may be conducted by the ECC members.

Here are the countries members of the ECC:

Table 2.1
Member States Energy Charter Conference

MEMBER COUNTRIES ENERGY CHARTER CONFERENCE (ECC)
Albania, Armenia Austria, Australia*, Azerbaijan, Belarus*, Belgium,
Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Cyprus,
Denmark, Estonia, European Communities, Finland, France, Georgia,
Germany, Greece, Hungary, Iceland*, Ireland, Italy, Japan, Kazakhtan,
Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta,
Moldova, Mongolia, Netherlands, Norway*, Poland, Portugal, Romania,
Russian federation*, Slovakia, Slovenia, Spain, Sweden, Switzerland,
Tajikistan, The Former Yugoslav Republic of Macedonia, Turkey,
Turmenistan, Ukraine, Uzbekistan, United kingdom.
*- Countries that recorded still delaying ratification of the Energy Charter Treaty

Source : "Members and Observers", Energy Charter treaty and Related Document, 2007. <http://www.encharter.org>

Daily tasks of ECC performed by the Energy Charter Secretariat / ECS, and headed by a Secretary General who is appointed by the ECC and served for a period of five years.

ECS has the task²⁵:

1. Monitor the implementation of provisions of Energy Charter Treaty and the implementation PEEREA.
2. Organize and administer meetings of the Conference and its subsidiary bodies.
3. Provide analytical support and recommendations to the ECC and its subsidiary bodies on all aspects of the ECT.
4. Represent the ECC in conducting relations with non-member states.
5. Supports negotiations to find new instruments mandated by the ECC.
6. Conduct or facilitate dispute resolution/conciliation procedures.

In addition there are some countries or organizations whose members are the countries that became an observer. Observer has the right to attend all the meetings, get all the documentation, and reports held by the ECS. They are also entitled to follow the discussions held by the ECS. It aims to better introduce the Energy Charter Treaty and its function in the hope that one day

²⁵ "An Introducing to Energy Charter Treaty, Energy Charter Treaty and Related Document, published by energy Charter Secretariat. September 2004 (accessed on January 2, 2010); available from <http://www.encharter.org>

they will join in it. Here is a list of countries and international organizations to observer:

Table 2.2
List of Observer in the Energy Charter Conference

OBSERVER ON ENERGY CHARTER CONFERENCE (ECC)	
Countries:	
Afghanistan**, Algeria, Bahrain, People's Republic of china, Canada**,	
Islamic Republic of Iran, Hashemite, Kingdom of Jordan**, Republic of Korea,	
Kuwait, Morocco, Nigeria, Oman, Pakistan**, Qatar, Saudi Arabia, Serbia**,	
Tunisia, United Arab Emirates, United States of America**, Venezuela	
International Organizations:	
ASEAN, EBERD, IEA, OECD, UN-ECE, World bank, WTO, CIS electric Power	
Council, BSEC, BASREC	
** - Countries have signed the record of Energy Charter in 1991	

Source: "Members and Observers", energy Charter Treaty and Related Document, 2007.
<http://www.encharter.org>

A.4 Mechanism of Decision Making

In the Energy Charter treaty, the supreme decision is any decision taken by the ECC. ECC can cancel the trial, and changing all the decisions, whether generated by the meetings of the previous ECC and the decisions taken by the ECS and its sub-owned entities.

The decisions taken in the context of energy Charter Treaty are taken by consensus of all members of the ECC. If the consensus is not reached agreement then mechanism used is a vote that must be approved

by at least three-quarters of all members of the ECC. Therefore, the presence of every member of the ECC is very important in every meeting held by the ECS. If any member of the ECC is not able to send its representative in the ECC meeting, but at the same time ECC should take an important decision, the ECC members who did not attend must submit his opinion on decisions that will be determined by the ECC through correspondence. This is in accordance with stipulated in article 36 (5) energy charter treaty. In certain cases, such as a Regional Economic Integration Organization that become members of the ECC, in this case the European Union, then in every vote that counted is votes from countries not members of the European Union or the voice on behalf of the European Union. For example the decision regarding acceptance of new members in the Energy Charter Treaty, the use of instruments - a new instrument for the implementation of the Energy Charter Treaty, and the appointment of the Secretary General who led the ECS.

Annual budget prepared by several member countries who have contributed the majority of the Energy Charter Treaty progress which then also must be approved by three-quarters of the members of the ECC. In other words that budget have been prepared must be met to reach 100% by its members.

B. EU's general views

The key trading partners and trade for EU is Russia. Mostly Europe imports the energy from Russia for Europe need. Since the signing of the Energy Charter Treaty, the European Commission has used its existing competency in competition and environment and consumer protection policy to attempt to shape a European energy policy in a variety of ways. The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investments and trade.

“The Energy Charter Treaty which was concluded in 1994 gives specific rules for trade and investment in energy. We believe it would be beneficial for our energy relations and for the Russian Federation to ratify this multilateral instrument.” Andris Piebalgs, Energy Commissioner of EU²⁶

The key provisions of the Treaty concern the protection of investment, trade in energy materials and products, transit and dispute settlement. As regards completed investments, Contracting Parties must promote and create stable, favourable and transparent conditions for foreign investors and apply

²⁶ EU – Russia energy cooperation, International Energy Week, Moscow, 23 October 2007 (accessed April 24, 2010); available from <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/654&format=HTML&aged=1&language=EN&guiLanguage=en>

the most-favoured nation principle or offer the same treatment that is given to national investors, whichever arrangement is the most favourable.

The European Commission continues to believe that the Energy Charter is a valuable instrument regulating multilateral energy relations. Both Russia and the EU have an interest in basing their energy relations on a sound legal footing. EU leaders and Russia have reiterated their conviction that energy cooperation should be based on principles of predictability and the mutual dependence of supply and demand, transparency, the rule of law, reciprocity and non-discrimination along with market opening and market access.

Robert L. Larsson's 362-page study *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier* (2006) concluded:

From Europe's perspective, Russia is moving in the wrong direction. Russia has largely ignored criticism, and has been unwilling to change its behaviour. Dependence on Russian energy would not be a problem if Russia played by the same rules as other energy players or European states. In conclusion, the core problem is the combination of Russia's perception, intentions, capabilities and track record along with lack of real stability, a

*high degree of unpredictability and a development away from democracy, rule of law and market norms.*²⁷

The emergence of Energy Charter Treaty is one of attempts to avoid economic stagnation due to lack of energy supply. No less than 40% of gas needs and 30% of oil demand in Europe is the supply from Russia. This makes Russia has an important position in the energy security issues in Europe through energy superpower.

EU should maintain good relations with energy supplier countries, to ensure energy security. The energy for the EU itself is vital for survival for his people. On the other hand, the Energy Charter Treaty is needed to ensure this. Therefore the EU is always urged Russia to ratify the Energy Charter Treaty.

C. Russian refusal on the Energy Charter Treaty

C.1 Russian energy policy

Russian policy changes in the energy sector began in the period 2003-2004, where there is a large state intervention to the energy sector. Previously, the government of President Yeltsin's period, Russia implemented liberal policies in the energy sector. Yeltsin emphasized privatization, liberalization,

²⁷ Russia – European Union relations; available from http://en.wikipedia.org/wiki/Russia_%E2%80%93_European_Union_relations

stabilization, and internationalization.²⁸ Yeltsin did a lot of cut military budget and the governments, sells the assets of national companies, and open the doors widely to foreign investment in the industry sector of Russia. In 2000 Russia announced plans to privatize some of its assets in the company's power generation, oil and gas. Until 2002 there have been several large Russian companies are privatized, among other ONACO, VNK, and Slavneft. The Russian government also announced it would open a wider cooperation in the project of oil pipeline from East Siberia to Daqing, China, sponsored by Yukos.²⁹

In 2003 the Russian government refuses to privatize Rosneft, a state-owned oil company. The reason is the Russian government will lose revenue in the oil sector, where shares held will be no more than 10% if Rosneft privatized. Another reason is the opinion of some circles in the Kremlin, who call themselves "reformers group", that Rosneft must be state-owned enterprises so that the state can control the oil production and generate large profits for the state. As President Putin's statement:

"Unfortunately, when market reforms began the state lost control of the resource sector. However, now the market euphoria of the first years of economic reform is gradually giving way to a more measured approach, the resource sector. Allowing the possibility and recognizing

²⁸ MSN Encarta, "Russian Federation" (accessed December 27, 2009); available from <http://encharta.msn.com/encyclopedia/761569000/22/Russia.html>

²⁹ Vladimir Milov, "The Use of Energy As a political Tool" (accessed December 29, 2009); available from <http://www.res.ethz.ch/kb/search/details.cfm?id=48826&lng=en>

the need for regulatory activity by the state in economic processes in general and in natural resource use in particular. . . .A contemporary strategy for rational use of resources cannot be based exclusively on the possibilities of the market."³⁰

A restriction on foreign investment is also a Russian strategy to maximize the potential energy. Russia also seeks to increase its energy assets by mastering existing pipelines in its neighboring countries. In 2006 Gazprom seeks to take over by buying a majority stake Beltransgaz, a major gas company in Belarus, with the aim of mastering the distribution of oil pipelines in Belarus.³¹ Through Gazprom Russia trying to expand its mastering to pipeline which will distribute the oil and gas to the export destination countries. In other words, Russia tried to monopolize the oil pipeline and gas in the European region. In addition, Russia is also building new pipelines, even to China, Japan, and South Korea, to facilitate market access to energy products.

In terms of price fixing, Russia imposed a different price at the Commonwealth countries Russia (CIS). Russia provides gas prices are far cheaper to CIS countries aimed that countries are not biased toward the West and more to balance their relations with Russia. Although the time a dispute between Russia with Ukraine which resulted cut gas supplies to Ukraine,

³⁰ Harley Balzer, "Vladimir Putin on Russian Energy Policy" (accessed on February 1, 2010); available from <http://energypolitics.org/9c.pdf>

³¹ Vladimir Milov, *Opcit*

where it caused the gas crisis in most of Western Europe for two days, and ended with an increased Russian gas price to Ukraine three times the original price. Moscow stated that only quoting prices based on world market, but Washington condemned the step and accused the Kremlin use oil to achieve political objectives.³²

At the beginning of the reign of President Vladimir Putin the Russian energy policies suffered a drastic change. Where in the previous, particularly the President Yeltsin, the Russian government launched a vigorous liberalization and privatization of key sectors in the Russian economy. Putin wants to change these policies by taking majority shareholdings in several companies that have strategic in the privatization. By returning control of strategic sectors, in this case the energy sector, the state can perform the control of all company activities fully and obtain huge profits that will go into the state treasury. In other words, Russia wants to take advantage of all the potential owned to achieve its national goals.

As expressed by the Russian foreign minister, Sergey Lavrov, who was released by the Russian Federation Embassy in Indonesia, that until now no one can prove that Russia did "blackmail" or "breach of contract" in any energy sector against anyone. The fact that the Russians have a great income

³² Jaringan Pipa Minyak Asia Tengah ke Timur Tengah: Untuk Singkirkan Pengaruh Rusia (accessed January 25, 2009); available from <http://www.mail-archive.com/iagi-net@iagi.or.id/msg03745.html>

by strengthening its corporate-owned energy company is solely aimed at strengthening Russia's economic dynamism to the development of innovative.³³

C.2. Russian policy not to ratify

Energy liberalization in the European region carried by the European Union through the Energy Charter Treaty seems to be opposite with energy policy run by the Russians. On the one hand, Russia's attempt to expand its dominance in the energy sector in the European region by strengthening their largest energy companies, Gazprom and Rosneft, and do intervene in the energy sector. But on the other hand, Energy Charter Treaty calls for transparency and progressive liberalization in the energy sector to create a competitive climate for business in the energy sector.

Actually, Russia has signed the Energy Charter, which means that Russia agreed to the principles that set in it. However, so far Russia has not ratified the charter, which means that Russia has no obligation to implement the rules contained in it. Energy Charter established on the basis of the existence of free markets in various countries. The signatories of this charter, has to open its energy market materials, from production to distribution stage, to companies of foreign investors. Thus,

³³ S.V. Lavrov, Masa Kini dan Masa Depan Politik Global: Pandangan dari Moscow (accessed December 28, 2009); available from http://indonesia.mid.ru/mfa_ind.html

after the collapse of state power in the monopolized energy materials, the state's role in determining the price of energy and materials exports will decline. The Russian government also signed the Energy Charter, but the Duma, the Russian parliament, has still not ratified.

Various approaches made by EU to persuade Russia immediately ratify Energy Charter Treaty. For example through the G8 summit forum in which developed countries urged Russia to implement an open policy in the energy sector. Some officials within the European Union, such as German Chancellor, Angela Merkel, Polish Foreign Minister Anna Fotyga, Commissioner for EU External Relations, Benita Ferrero Waldner, issued the same pressure on Russia to immediately ratify the Energy Charter Treaty.

In an opportunity in Finland in the 2006 the Russian President, Vladimir Putin, declared that Russia refuses to ratify the Energy Charter Treaty.³⁴ Putin also denied that the Russian energy policy has never been used to threaten anyone or any country. All steps by Russia are a pragmatic and have nothing to do with political. In February 2007 in Moscow, Russian Minister of Foreign Affairs, Sergey Lavrov, met with the Head of Foreign Affairs and Security of the European Union Javier Solana, Commissioner for EU External Relations Ferrero Bennita-

³⁴ Dan Bilefsky, Putin Rejects EU Demand that Russia Ratify energy Charter (accessed January 3, 2010); available from <http://www.euherald.com>

Waldner, German Foreign Minister Frank-Walter Steinmer. In the meeting Sergey Lavrov stated that the establishment of "supra-national organizations" is not required to agree on energy issues. Lavrov added that Russia did not reject the Energy Charter, as evidenced by the signing of the Charter, nevertheless Russia will try to negotiate the deficiency.³⁵

Dialogue between the EU and Russia on the Energy Charter Treaty seems still far from agreement. Russia considers that there is nothing wrong with energy policy so far, as it claims of some countries consider Russia using energy as a political tool. For the European Union, Russia is an important actor in achieving energy security in the EU region. Trade-offs interest is the main issue in the energy dialogue between Russia and the European Union.

³⁵ Radio Free Europe (accessed December 29, 2009); available from <http://www.rferl.org/newsline/2007/02/1-rus/rus-060207.asp>