

# MANAGEMENT OF GAS TRANSIT DISPUTES IN THE EURO-ASIAN REGION

*Milan Sykora*

## ABSTRACT

The recent political crisis between Russia and Ukraine reminded us once again how important gas is in European politics. In this paper, the author firstly presents general issues that lawyers face when dealing with gas transit in the Euro-Asian region. Secondly, a critical evaluation of the current regulatory systems of gas transit is delivered with a focus on the Energy Charter Treaty (ECT) as a multilateral instrument to govern energy trade in the region. While the arbitration practice related to investment protection under the ECT is increasing in volume, conciliation of gas transit disputes has not been invoked yet. Finally, a brief evaluation of the out-of-treaty regime that applies to relations with Russia is given.

The author argues that under the ECT regulatory framework, a sophisticated dispute resolution mechanism was developed. However, this framework is strongly jeopardised by the fact that the ECT treaty is not applicable in Russia. Therefore, not all of gas transit routes in Europe can benefit from the ECT and some of them are more vulnerable to political crises. Externalities of these crises then may impact third parties even though these could have been avoided in a single regulatory regime.

**KEYWORDS:** GAS TRANSIT – ENERGY CHARTER TREATY – CONCILIATION – ALTERNATIVE DISPUTE MANAGEMENT – RUSSIA-UKRAIN GAS CRISIS

# MANAGEMENT OF GAS TRANSIT DISPUTES IN THE EURO-ASIAN REGION

*Milan Sykora*<sup>1</sup>

## 1. Introduction

The recent political crisis between Russia and Ukraine that seemed to threaten use of the most important gas transit pipeline reminded us how important gas is in European politics. Before reaching the final industrial and household customers, there is a long way for gas to be pumped - from massive extraction stations in the East, it flows through thousands of kilometres of pipelines, to be stored in sophisticated gas storage facilities in the territories of any of the transit countries. As many gas fields lie beyond the borders of continental Europe, many different jurisdictions are often involved in this chain and the longer the chain is the more probable it is that a dispute will arise. In this paper, transit disputes under the Energy Charter Treaty (ECT) are going to be considered. Therefore, other issues regulated by the ECT or commercial arbitrations considering transit of gas will not be covered even though they may sometimes play a big role.<sup>2</sup>

Firstly, the author will briefly present general issues that lawyers face when dealing with gas trade in the Euro-Asian region including those consisting in political risks. Secondly, a critical evaluation of the current regulatory systems will be delivered with a focus on the Energy Charter Treaty (ETC) as a multilateral instrument to govern energy trade in the region. While the arbitration practice related to investment protection under the ETC is

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<sup>2</sup> On 16 June 2014 when Russia cut off the gas supplies to Ukraine, there were at least two pending cases related to the gas prices before the Arbitration Court of the Stockholm Chamber of Commerce. One was brought by the Russian party, the other one by the Ukrainian party. Simon Pirani, 'Ukraine's Import of Gas: How a Deal Might be Reached' (2014) Oxford Energy Comment, 4 <<http://www.oxfordenergy.org/wpcms/wpcontent/uploads/2014/07/Ukraines-imports-of-Russian-gas-how-a-deal-might-be-reached.pdf>> accessed July 27 2014

increasing in volume as Hobér noted,<sup>3</sup> the transit dispute management system<sup>4</sup> has not been used yet. However, the availability of gas supplies is essential for energy security of the region and repetitive Russian-Ukrainian crises shattered confidence in the main pipeline that pumps gas into the EU. Thirdly, a brief evaluation of the out-of-treaty regime that applies to relations with Russia will be given.

The author evaluates the gas transit dispute management in the context of sophisticated gas trade situated in a landscape rich in political risks. The mechanism of dispute management is dealt with only at theoretical level as it has not been called upon to manage any dispute so far. Scholars such as Liesen<sup>5</sup> or Roggenkamp and others<sup>6</sup> have described profoundly its functionality and there is a certain academic consensus on how this mechanism should be applied. However, in this author's opinion, the practical application may show a certain divergence to this academic consensus and the recent political events show that it may be of much less use than academics in the 1990s thought.

## 2. Generally on Trade with Gas

### 2.1 Peculiarities of Gas as a Trade Commodity and of Gas Market

As the reader may be aware, gas<sup>7</sup> is not an easy commodity to trade with. Despite its undisputed advantage that it is capable of heating up houses and lighting up street lamps, it is very hard to keep in one's hands. Further difficulties of gas trade regulation emerge from its cross-border nature.

Unlike trading in bricks, trading in gas is highly complicated. Gas is not very tangible. It is permanently being pumped through pipelines and other pieces of sophisticated

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<sup>3</sup> In 2010 Hobér noted that only in four cases an award on merits has been rendered. This number has risen five times during the last four years. Kaj Hobér, 'Investment Arbitration and the Energy Charter' (2010) 1 *Journal of International Dispute Settlement* 153. The updated list of the ETC investment cases is accessible at the official webpage of the ECT <[http://www.encharter.org /index.php?id=213&L=0](http://www.encharter.org/index.php?id=213&L=0)> accessed 27 July 2014

<sup>4</sup> The transit dispute management of the ECT is a unique mechanism of dispute settlement to be found in its Article 7.

<sup>5</sup> Rainer Liesen, 'Transit under the 1994 Energy Treaty' (1999) 17 *Journal of Energy & Natural Resources Law* 56

<sup>6</sup> Martha M. Roggenkamp and others, *Energy Law in Europe: National, EU and International Regulation* (2nd edition Oxford University Press 2007) at 3.12

<sup>7</sup> From here on, the author will refer to all gaseous hydrocarbons based on methane and in commercial context being called "*natural gas*" simply as to "*gas*". For further technical characteristics described in a way open to lawyers and all other non-technicians, see Lars Albath, *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May 2004) 15.

infrastructure such as gas storage facilities. Alternatively, it can also be transported liquefied, but this technology is still too expensive to wholly replace the standard means of gas transportation. Gas is generally stored in special facilities and these are usually owned by third parties. Transit and storage facilities are therefore used by multiple trading parties at the same time resulting in large quantities of gas being mixed and being fully dependent on the owners of these facilities.<sup>8</sup> This brings an important element to transit disputes as many third parties will naturally be concerned by any disruptions caused.<sup>9</sup>

Secondly, the facilities for transporting and storing of gas require major investments with broad economic and environmental consequences. Gas is dependent on thousands of kilometres of pipelines that enable it to be pumped from the point A to the point B. These infrastructure projects are highly capital intensive, often resulting in minimal alternative routes for transport. Gas exporters are fully dependent on those established routes of transit<sup>10</sup> that, moreover, have to be shared by all market participants.<sup>11</sup>

These characteristics make gas transit an issue that requires special regulation. Moreover, gas is often an issue of national security, commonly referred to as energy security.<sup>12</sup> Importing countries can find themselves in a very vulnerable position in relation to gas exporters. For these reasons, trade with gas is more secure if regulated by multilateral legal frameworks that are capable of covering all parts of the production and transit chain.<sup>13</sup>

## 2.2 Gas Trade in the Euro-Asian Region

Relations between the European Union and its Euro-Asian trade counterparts have been increasingly marked by energy security concerns since the second half of the 20<sup>th</sup> century.

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<sup>8</sup> For analysis of property rights in mixed gas, see David Mildon, 'Property in Commingled Gas – Legal Structures Compared' (2006) *Oil, Gas & Energy Law* <<http://www.transnational-dispute-management.com/article.asp?key=882>> accessed 27 July 2014

<sup>9</sup> For example, during the Russia-Ukraine gas crisis in 2009, it was unclear until international observers were sent to the border facilities if the cut offs are caused by the Ukrainian party refusing to transit gas through its territory or it is because of Gazprom failing to pump enough gas into the system. Simon Pirani and others, *Russo-Ukrainian Gas Dispute of January 2009: A Comprehensive Assessment* (Oxford Institute for Energy Studies 2009) 50 <<http://storage.globalcitizen.net/data/topic/knowledge/uploads/20110630223130533.pdf>> accessed 27 July 2014

<sup>10</sup> Liesen (n 4) 59

<sup>11</sup> Lothar Ehring and Yulia Selivanova, 'Energy Transit' in Yulia Selivanova (ed.), *Regulation of Energy in International Trade Law: WTO, NAFTA and Energy Charter* (Wolters Kluwer 2011) 50

<sup>12</sup> Please see also Alan Berlin, 'Managing Political Risk in the Oil and Gas Industries' (2004) *Transnational Dispute Management* <<http://www.transnational-disputemanagement.com/article.asp?key=34>> accessed 10 May 2014

<sup>13</sup> *ibid*

Nevertheless, the first consignments of gas were not exported by the USSR before 1968.<sup>14</sup> Since the 1990s we find, on the one hand, developed industrial countries with sophisticated technologies requiring large amounts of energy. On the other end, there are countries rich in natural resources, but frequently subject to unstable political situations and poor property rights protection. At the centre of all this there are thousands of kilometres of gas pipelines.

Today, the European Union is the world's third largest energy importer<sup>15</sup> and it currently bases 24% of its energy mix on gas.<sup>16</sup> From these statistics it further follows that dependency of the European Union is 67% of the overall gas consumption and this figure has been steadily increasing over the last 20 years.<sup>17</sup> Since almost half of the overall imports of gas originate from Russia or other Asian countries where gas is used for political leverage, the current state of energy dependency of the European Union is key concern to the energy security of the region.<sup>18</sup>

The majority of the gas transits from Russia (and of gas from Central Asian countries being imported via the Russian territory) are conducted through pipelines in Ukraine, Belarus and Moldova. Ukraine has by far the greatest portion of gas being transported through its territory through the Druzhba (*Brotherhood*) pipeline.<sup>19</sup> This current state of affairs raises many concerns. In the 1990s, many cases of cut offs affecting the supplies for the EU were reported in the region of Central Asia.<sup>20</sup> Furthermore, since the Russian-Ukrainian gas disputes in 1993,<sup>21</sup> 2006,<sup>22</sup> 2009<sup>23</sup> led to disruption of Gazprom supplies to Western

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<sup>14</sup> Andrei Konoplyanik, 'Gas strategies post-Crimea' (2014) 391 *Energy Economist* 3

<sup>15</sup> *EU Energy in Figures: Statistic Pocketbook 2013* (Publications office of the European Union 2013) 13 <[http://ec.europa.eu/energy/publications/doc/2013\\_pocketbook.pdf](http://ec.europa.eu/energy/publications/doc/2013_pocketbook.pdf)> accessed 27 July 2014. See also Andrei Belyi, 'New Dimensions of Energy Security of the Enlarging EU and their Impact on Relations with Russia' (2003) 25 *Journal of European Integration* 351, 352.

<sup>16</sup> *EU Energy in Figures: Statistic Pocketbook 2013* (n 13) 20

<sup>17</sup> *ibid* 22

<sup>18</sup> Lothar Ehring and Yulia Selivanova, 'Energy Transit' in Yulia Selivanova (ed.), *Regulation of Energy in International Trade Law: WTO, NAFTA and Energy Charter* (Wolters Kluwer 2011) 50

<sup>19</sup> Jonathan Stern, 'The Russian-Ukrainian Gas Crisis from January 2006' (2006) *Transnational Dispute Management* <<http://www.transnational-disputemanagement.com/article.asp?key=767>> accessed 12 May 2014

<sup>20</sup> Bryan Clark, 'Transit and the Energy Charter Treaty: Rhetoric and Reality' (1998) *Web Journal of Current Legal Issues* <[http://50.57.111.125/revenuewatch\\_archive/training/Clark%20-%20Transit%20and%20the%20Energy%20Charter%20Treaty%20-%20Rhetoric%20and%20Reality.doc](http://50.57.111.125/revenuewatch_archive/training/Clark%20-%20Transit%20and%20the%20Energy%20Charter%20Treaty%20-%20Rhetoric%20and%20Reality.doc)> accessed 27 July 2014

<sup>21</sup> Liesen (n 4) 57

<sup>22</sup> *ibid*

<sup>23</sup> Pirani and others (n 8)

Europe, the EU has tried to decrease its dependency on this route.<sup>24</sup> Most recently, Gazprom cut off the gas supplies for Ukraine in June 2014 (by the time of writing of this article, the situation was still unresolved). The Russian-Ukraine gas crises are a clear example of the political and security implications surrounding cross border transit, with disputes between such parties affecting third parties.<sup>25</sup>

### 3. Transit Dispute Management and the Energy Charter Treaty

#### 3.1 About the Energy Charter Treaty

The peculiarities, legal and political risks described in the previous section, present an urgent need for a complex legal framework for international trade with gas in the Euro-Asian region. This regulatory framework was incorporated in the Energy Charter Process in the early 90s that further developed into a multilateral treaty known as the Energy Charter Treaty<sup>26</sup> under which the Western industry energy dependence and the Eastern need for capital were to be brought together.<sup>27</sup> The treaty came into force on the 16 April 1998. So far, fifty two signatory states and the European Union have signed and acceded to the ECT. The number of ratifications reached forty seven as of June 2013.<sup>28</sup>

The ECT is the only legally binding tool specifically developed for the energy sector so far.<sup>29</sup> The main goal of the ECT is expressed in its Article 2: ‘...to promote long-term cooperation in the energy field, based on complementarities and mutual benefits’. Nevertheless, transit provisions of the ECT were unofficially declared to be the most innovative features of the ECT.<sup>30</sup> As was explained before, in order to move gas from the driller to the end customers, the transit infrastructure is essential. Article 7 of the ECT creates a completely new and

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<sup>24</sup> Konoplyanik (n 13) 4

<sup>25</sup> Andrei Konoplyanik, ‘Rossijsko-Ukrajinskij gazovyj spor: Rozmyshlenie po itogam Coglashenija ot 6 yanvarya 2006 g’ (2006) *Neft, gaz, pravo*, issue 3, 46

<sup>26</sup> Energy Charter Treaty from 17 December 1994

<sup>27</sup> Roggenkamp and others (n 5) at 3.06. See also Yulia Selivanova, ‘The Energy Charter Treaty and the International Energy Governance’ in Yulia Selivanova (ed.), *Regulation of Energy in International Trade Law: WTO, NAFTA and Energy Charter* (Wolters Kluwer 2011) 373.

<sup>28</sup> Australia, Belarus, Iceland, Norway and the Russian Federation have not ratified the treaty yet. However, the treaty provisionally applies in Belarus. Until 18 October 2009, the treaty was also provisionally applicable in Russia. For more information on signatory states and ratifications, please refer to *Status of Ratification of the Energy Charter Treaty as of June 2013* <[http://www.encharter.org/fileadmin/user\\_upload/document/ECT\\_ratification\\_status.pdf](http://www.encharter.org/fileadmin/user_upload/document/ECT_ratification_status.pdf)> accessed 10 May 2014

<sup>29</sup> Selivanova (n 26). This is still valid despite Russia’s proclamations that a new instrument for transnational governance of the energy sector is needed as the ECT failed to solve the 2009 Russia-Ukraine gas crisis. Pirani and others (n 8) 52.

<sup>30</sup> Roggenkamp and others (n 5) at 3.12

complex regulatory framework for transit of energy products, considering free access to transit, non-discriminatory conditions of transit and non-interference with transit.<sup>31</sup> It prevents the contracting states from obstructing transit and reducing its capacity and even imposes an obligation not to obstruct the creation of new transit capacities (under certain conditions). The expected outcome of broad transit freedom and states' obligation not to impede transit is increased stability in energy supplies.<sup>32</sup>

Article 7 (3) of the ECT is probably the most controversial. It contains provisions ensuring that domestic transits cannot be treated more favourably than international transit. This non-discrimination provision has been criticized mainly by the Russian federation that refused to ratify the ECT on this basis.<sup>33</sup> To rectify relations with Russia, a new Transit Protocol is being negotiated; however, no consensus has been reached yet. The outcome so far is that Russia has suspended the provisional application of the ECT.

### **3.2 Transit Disputes under the ECT**

The provisions on transit of energy under the ECT are considered innovative and so is the regime for management of dispute considering the transit.<sup>34</sup> The rights and obligations concerning transit of energy imposed on the contracting states by the Article 7 of the ECT are ample and so a complex mechanism was created to ensure their observance.

Being a transit country for gas usually comes with significant power as alternative transit infrastructure usually do not exist.<sup>35</sup> In a case of a dispute, all parties that participate in the gas supply chain downstream are affected and a multilateral framework is needed to regulate such disputes.<sup>36</sup> Effectively, there is a broad collective interest in a prompt resolution of the dispute. For this reason, the draftsmen of the ECT were to create a system that would prevent transit countries from disturbing energy supplies by obstructing their transit facilities. Apart from ample substantive rules prohibiting cutting off pipeline interconnection, Article 7 also contains provisions on dispute management that should lead to a prompt resolution of the dispute.<sup>37</sup>

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<sup>31</sup> *ibid* 63

<sup>32</sup> Andrei Konoplyanik and Thomas Wälde, 'Energy Charter Treaty and its Role in International Energy' (2006) 4 *Journal of Natural Resources Law* 523, 543

<sup>33</sup> See for example Ehring and Selivanova (n 10) 87 or Theodore I. Shtiklind, 'Energy Charter Treaty: A Critical Russian Perspective' (2005) *Transnational Dispute Management* <[http:// www.transnational-dispute-management.com/article.asp?key=475](http://www.transnational-dispute-management.com/article.asp?key=475)> 27 July 2014.

<sup>34</sup> Ehring and Selivanova (n 10) 91

<sup>35</sup> Liesen (n 4) 57

<sup>36</sup> Konoplyanik (n 24) 45

<sup>37</sup> Liesen (n 4) 69

To safeguard ongoing supplies of gas in case of dispute, an interim obligation not to cut off the pipelines is imposed.<sup>38</sup> According to Article 7 (6), no party can in an event of dispute reduce or interrupt the energy transit or permit any entity under its jurisdiction to reduce or interrupt the transit of energy while the dispute lasts.<sup>39</sup> This provision is arguably the most important one in the gas sector.<sup>40</sup> However, the practical meaning of the provision remains uncertain as it has not yet been invoked. During the 1996 crisis the Russian government threatened to invoke the Article, but the dispute was settled quickly by other means.<sup>41</sup> Then again during the 2009 crisis when Ukraine denied transit of Gazprom's gas for 19 days, the Article was not used to place pressure on Ukraine to restore supplies.<sup>42</sup> Failure to enforce this rule resulted in missing a historic opportunity to transition from having a law in theory to having a law in action.

Unlike other dispute management mechanisms under the ECT that take advantage of arbitration, the transit disputes are to be solved by conciliation that should provide with a quicker resolution than arbitration according to Article 26 or 27 of the ECT.<sup>43</sup>

Theoretically, the core idea of the special mechanism of the Article 7 (7) is to resolve the dispute in an amicable way<sup>44</sup> even though there might have been a previous decision on the merits in previous proceedings based on contractual or other means established by the parties in their contract. If the previous award is unacceptable for one of the parties and this threatens to object enforcement of the award by cutting off the transit services, the conciliation under the Article 7 (7) should bring parties back to cooperation in energy transit. Even though it may seem unjust under certain circumstances, the advantage of this mechanism is that it prevents further side effects harming third parties and therefore eliminates enormous externalities of the transit dispute. Further policy beyond this rule is that involuntary enforcement of the Article 7 (6) 'non-disruption rule' is very difficult to imagine.<sup>45</sup> Therefore, more space for compromise is offered.

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<sup>38</sup> Roggenkamp and others (n 5) at 3.81

<sup>39</sup> Konoplyanik and Wälde (n 31) 544

<sup>40</sup> Liesen (n 4) 65

<sup>41</sup> Craig S. Bamberger, 'Adjudicatory Aspects of Transit Dispute Conciliation under the Energy Charter Treaty' (2006) *Transnational Dispute Management* <<http://www.transnational-dispute-management.com/article.asp?key=766>> accessed 27 July 2014

<sup>42</sup> The European countries decided not to interfere and Russia could not invoke the provision as it had not ratified the ECT before. Pirani and others (n 8) 50

<sup>43</sup> Investment arbitration according to Article 26 usually takes several years before the tribunal renders the final award.

<sup>44</sup> Conciliation usually brings more amicable outcomes than arbitration. Alan Redfern and Martin Hunter, *Redfern & Hunter: Law and Practice of International Commercial Arbitration* (5th edition, Oxford University Press 2009) para 1.136

<sup>45</sup> As we can imagine on the basis of the 2009 crisis.

Furthermore, before commencing the conciliation according to the wording of the Article 7 (7), all contractual or otherwise agreed mechanisms of dispute resolution have to be exhausted. Some commentators believe that these mechanisms also include arbitration under Article 26 and 27.<sup>46</sup> However, as Ehring and Selivanova stipulate, this would deprive the Article 7 mechanism of much of its operability.<sup>47</sup>

However, the practice can differ significantly from the academic-based interpretation of the mentioned provisions. The events of the 2009 crisis and related application of the ECT suggest that even a breakdown of negotiation between the parties to a dispute may trigger the conciliation procedure.<sup>48</sup> In this author's opinion, this interpretation makes complete sense should it help the dispute be resolved as soon as possible. However, it may interfere with the Article 7 (7) wording which requires exhaustion of all other mechanisms.

The conciliation procedure has two stages. Firstly, the conciliator is nominated by the Secretary-General to facilitate negotiations. At the first stage, his or her main role is to propose a solution acceptable for both parties. This proposal is not legally binding without the mutual consent of the parties. However, the conciliation time is limited to 90 days, the second stage is then triggered. After this period, the conciliator decides on further dispute resolution mechanisms that should be binding for both parties. The appointed conciliator also makes an interim decision on tariffs, terms and conditions of transit for a period of maximum 12 months in order to secure provisional conditions for gas transit. As such, this interim measure should serve to avoid transit interruptions and reductions.<sup>49</sup> As Roggenkamp and others noted, in the capacities of deciding upon tariffs and on further dispute resolution, the conciliator acts more like an arbitrator than a conciliator<sup>50</sup> and appears to be very powerful in determining further developments.

The conciliation proceedings for transit dispute have not been used to date.<sup>51</sup> Liesen argues that it is merely for financial reasons.<sup>52</sup> He purports, using the example of the Russian-Ukrainian crises in the 90s, that parties to these disputes have an imminent interest on their quick resolution. The financial losses connected to supply distortion are high and

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<sup>46</sup> Bamberger (n 40)

<sup>47</sup> Ehring and Selivanova (n 10) 93

<sup>48</sup> Compare Pirani and others (n 8) 50.

<sup>49</sup> Liesen (n 4) 70

<sup>50</sup> Roggenkamp and others (n 5) at 3.83

<sup>51</sup> Erhart and Selivanova (n 10) 92

<sup>52</sup> Liesen (n 4) 71

therefore the disputes are usually promptly settled by the parties.<sup>53</sup> Also, it is to be noted that Gazprom sustained immense reputation damage during the 2006 and 2009 crises<sup>54</sup> and has been very prudent since then. However, it should be noted that the disputes to date were largely motivated by financial issues.<sup>55</sup> In politically motivated cut offs such as that of June 2014, which had still not been solved at the time of writing this paper, the outcome could be different.

The conciliation of transit disputes in general offers enough flexibility to preserve the gas flowing through pipelines while the parties are disputing. It mitigates tension between the parties and should reduce the negative impact on third parties affected by the gas cut off. If the conciliation proceedings are unsuccessful, a binding dispute resolution proceedings installed by the conciliator follows. Nevertheless, the 2009 crisis experience shows that it can be very hard to enforce the non-cut off rule without cooperation of the disputing parties, and third parties participating in the supply chain can sustain serious harm despite the Article 7 (6) provision.

#### **4. Russia and out-of-the-ECT Regime**

The above described regulatory framework for dispute resolution in gas trade seems to be well tailored for the post-soviet Euro-Asian region. However, there is one big catch – the Russian Federation has never ratified the ETC and, moreover, in 2009 suspended its provisional application. The Euro-Asia gas market, therefore, does not operate in a single regime and has a separate regime for Russia. As Russia is one of the most important gas suppliers to the EU, this brings additional concerns. We have observed many of them in the 2014 gas crisis.

As a signatory state from 1994, Russia was provisionally bound to apply the ECT provisions based on the Article 45. This state of affairs lasted for 15 years as the Russian government bound ratification with acceptance of the Transit Protocol. However, as negotiation about the Protocol has not been finalised, the Duma notified the Secretary-General about termination of provisional application of the ECT in August 2009.<sup>56</sup> It is clear that Moscow will never ratify the ECT with its current wording.

As far as this author is concerned, Russia's withdrawal was related to two main reasons:

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<sup>53</sup> *ibid* 71. One of the reasons is probably Russian fiscal dependency on gas exports that, according to Kharlamova and Filimonova accounted for 50% in 2004. Kharlamova & Filimonova (n12) 109

<sup>54</sup> Pirani and others (n 8) 57; Konoplyanik (n 13) 3

<sup>55</sup> See Stern (n 18) and Pirani and others (n 8)

<sup>56</sup> According to Article 45, the ECT ceased to be applicable in Russia as on 18 October 2009.

Firstly, the non-discrimination rules on transit prices outlined in Article 7 (1) of the ECT could be interpreted as not allowing separate domestic tariffs and therefore Russia would have to raise transit prices for its domestic transits or subsidize foreign transits from Central Asia.<sup>57</sup> It should also be noted that the liberalization of the Russian gas market had not even started by 2009 when Moscow suspended the provisional application.<sup>58</sup>

Secondly, the accession of the EU as a Regional Economic Integration Organization diminished applicability of the ECT to the EU Member States individually. Under the wording of the ECT, the market of the whole European Union is considered as a single market and therefore Russia's position would be threatened as transit through member states is not considered as transit under the Article 7 (10) of the ECT and as such, is regulated under the EU internal law.<sup>59</sup> Once again, Moscow relied on the proposed Transit Protocol to change the transit rules,<sup>60</sup> but as already mentioned its final version has not been negotiated so far.

The practical outcome of the current situation is that the EU cannot rely on the single regime when importing gas from Russia which brings about several problems. The advantages of the multilateral instrument discussed in the previous section are not, therefore, present. As a result, the EU cannot rely on the special dispute resolution mechanism that distinguishes the ETC regime from the WTO regime and the conciliation mechanism cannot be triggered in the Russia-Ukraine crises – at least not against Russia as a party of dispute. Moreover, the prohibition on obstructing access to pipelines during a transit dispute does not apply to disputes between Russia and Central Asian countries regarding transit of their gas through the Russian territory. In case of transit dispute, the parties only have contractual means of dispute resolution,<sup>61</sup> as we have seen in the 2014

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<sup>57</sup> Shtilkind (n 36)

<sup>58</sup> V. N. Kharlamova and N. A. Filimonova, 'Vneshnaya energeticheskaya politika Rossiji (na primere energo-dialoga ES-RF)' (2006) 5 Vestnik SPbGU 113

<sup>59</sup> Shtilkind (n 32)

<sup>60</sup> Andrei Belyi and others, 'Modernizing the Energy Charter Process? The Energy Charter Road Map and the Russian Draft Convention on Energy Security' (2011) Transnational Dispute Management <<http://www.transnational-dispute-management.com/article.asp?key=1717>> accessed 27 July 2014; Y. N. Masakin, 'Energeticheskij dialog ES-Russiya: Politicheskoe i pravovoe osnovy sotrudnichestva' (2010) 1 Vestnik Moskovskovo gosudartvenovo oblastnovo univerziteta, 162

<sup>61</sup> Such was for example case of *RWE Transgas v Gazprom* (2013) (unreported). See Rob Singer and Katya Zapletnyuk 'RWE wins natural gas dispute with Gazprom' *icis.com* (27 June 2013) <<http://www.icis.com/resources/news/2013/06/27/9682664/rwe-wins-natural-gas-price-dispute-with-gazprom/>> accessed May 9 2014. For information about the 2014 Ukraine-Gazprom dispute see Stanislav Pogorilov, 'Kak Ukraine pabyedit v yevropeyskom sude' *biz.liga.net* (4 April 2014) <<http://biz.liga.net/all/tek/stati/2721160-kak-ukraine-pobedit-gazprom-v-evropeyskom-sude-.htm>> accessed 27 July 2014.

crisis.<sup>62</sup> Pirani and others believe that ratification would have strengthened Russia's position in the 2009 crisis.<sup>63</sup>

However, it remains doubtful how useful the multilateral framework would be in the current conditions of 'un-cooperation' in the whole area. As discussed above, the conciliation process depends to a large extent on the willingness of the parties to settle the dispute.

Russia's EU partners face several risks that would have been otherwise theoretically mitigated by the ETC. The fact that Russia is one of the biggest gas importers to the EU makes the whole regulatory framework of the ETC much less useful than it would have otherwise been. The EU must, therefore, rely on financial concerns that do not allow Russia to stop supplying gas to the EU, as stipulated by Liesen in connection with the previous Russia-Ukraine crises.<sup>64</sup> The current Ukraine gas crisis reveals that under such conditions the EU will still be exposed to a wide range of risks and be fully dependent on Ukraine's compliance with its transit duties and Russia's willingness to cooperate with Ukraine. However, the current crisis cannot be mitigated by a prompt third party ruling on interim tariffs.

## 5. Conclusion

Given the specifics of the gas sector and its importance for the economy, the dispute management on gas transit has to reflect all political risks included. As there is a strong collective interest in transit fluency, parties to the dispute should not be allowed to cut off the transportation infrastructure during the dispute. Therefore, the ECT conciliation rules designed to reach an amicable solution as soon as possible in order to minimise the impact on third parties participating in the gas supply chain, seem to be adequate.

However, the transit provisions of the ECT have not been invoked so far. The current Ukraine gas crises shows the importance of an amicable resolution of the dispute without any disturbance regarding gas supplies. The ECT could offer such a resolution mechanism. However, this system is strongly jeopardised by the fact that the ECT is not applicable in Russia and therefore, the rule on independent interim tariffs does not apply. For this reason, the transit of gas through Russian territory is more vulnerable to political crises and externalities of gas disputes may impact third parties, mainly the EU.

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<sup>62</sup> Simon Pirani and others, 'What the Ukraine Crisis Means for Gas Markets' (2014) Oxford Energy Comment, 6 <<http://www.oxfordenergy.org/wpcms/wpcontent/uploads/2014/03/What-the-Ukraine-crisis-means-for-gas-markets-GPC-3.pdf>>, accessed 27 July 2014

<sup>63</sup> Pirani and others (n 4) 50

<sup>64</sup> Liesen (n 4) 71