

Transiters Protection under ECT: Fact or Fiction?

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Energy Dispute Resolution Conference: Investment Protection, Transit and the Energy Charter Treaty

Brussels, 22-23 October 2009

The Goals behind the ECT

- Liberalization of investment and trade in energy
- Implementation of “full national treatment” and “most favored nation” principles
- Avoidance of discrimination in international trade
- Removal of technical, administrative and other barriers in energy trade
- Potential GATT membership and harmonization of rules
- Support of the existing competition rules

What is the importance of ECT transit provisions in this context?

- **Primary purpose of the transit provision – fostering of trade in energy (similarly to GATT, WTO rules etc., mind ECT Article 4)**
- **Article 7 imposes some typical rules:**
 - “non-discrimination” principle in respect of availability of transit facilities and pricing (1);
 - “national treatment” of Energy Materials and Products in Transit (3);
 - “no new obstacles” obligation (4)
- **The original purpose of the transit provision appears to be trade-oriented**

- **Recent events demonstrated that energy relations in Europe bring challenges other than trade concerns**
- The most feared events – interruptions of supply/transit, potential consequences are beyond being measured in money – energy security is at stake:
- industrial aspects
- social aspects
- political aspects
- **Energy supply/transit is a multi-billion-dollar business, the problems are magnified**
- Europe-Ukraine-Russia relations in gas trade – the brightest example

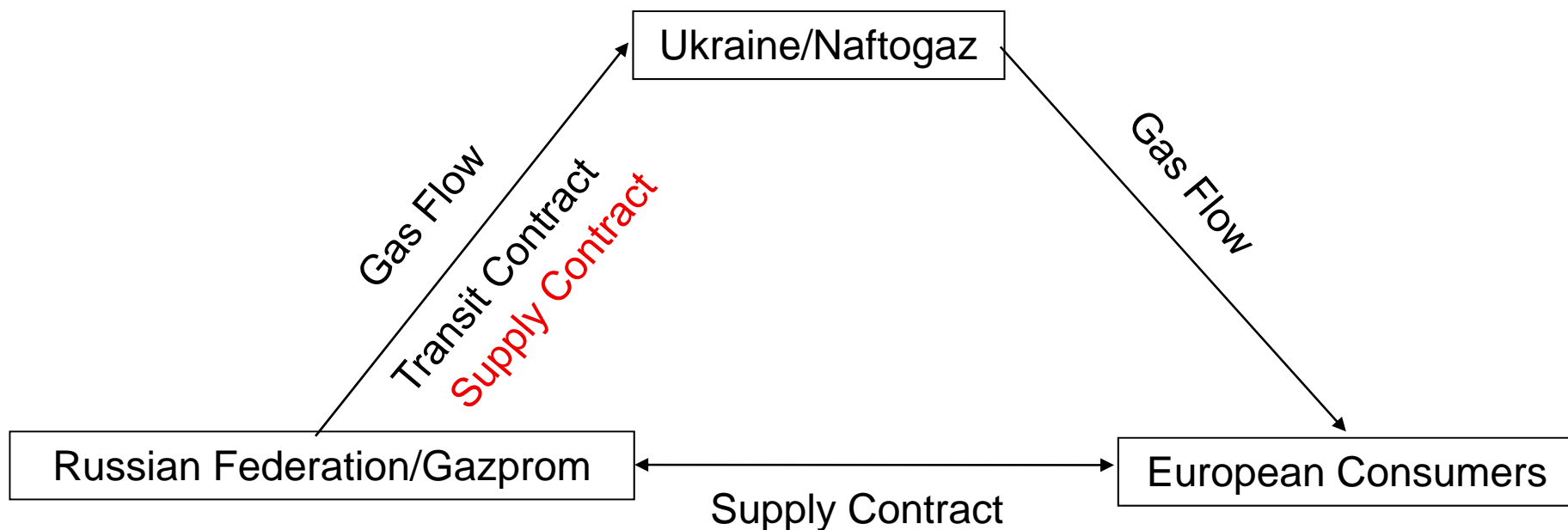
The Gas Trade Relations Structure

- Familiar structure of the gas trade:



Gas Relations Triangle

- Because there are several levels of relations, this structure is a triangle:



Several mechanisms that provide for security in gas supplies to Europe on different levels:

- **Supplier's security:**

- Supply contract with its European counterparties;
- Transit contract with the transiter

- **Consumers' security:**

- Supply contract with its Russian supplier
- ECT provisions calling for non-interruption of transit

- **Transiter's security:**

- **Is there a security for the transiter?**

ECT Article 7 contains the core of the Charter's rules on ensuring stable and uninterrupted transit of Energy Materials.

How does it distribute risks? Let's take a look at transitters' rights and obligations under Article 7:

Obligations:

- Take necessary measures to facilitate transit;
- Avoid discrimination in access to transit facilities and pricing;
- Ensure no less favorable treatment than for materials or products for its own purposes;
- Avoid placing additional obstacles for transit;
- Secure established flows of Energy Materials to, from or between other Contracting Parties
- Not to interrupt the flow of Energy Materials in the event of a dispute, including a pricing dispute

What are the transitters' **rights** under Article 7?

- Apply for the conciliator's decision in case of a dispute;
- Not much else.

The transitters are vulnerable to virtually any irregularities in energy supply/transit relations, especially when all of the parties involved are not subject to the same legal provisions

What Happens when Crisis Strikes?



Several crises in gas supply/transit during the past years:
2006, 2009

Origin of crisis: **Russia-Ukraine supply contract.**

Historically, there was a balance between the price for Russian gas and transit fee charged by Ukraine for transit – **pricing disputes.**

What are Ukraine's options?

- It may not impose increased transit tariff – there are other transiters, it means renegotiation of terms with them;
- It may not cut off the gas transit – it would mean liability under the ECT;
- It (probably) may apply for the conciliator's decision, but it is not efficient – **no such applications**
- **It must ensure uninterrupted transit flow, no matter what**

Further aggravation: Supplier can cut off gas for Ukraine (for commercial, political, other reasons)

- It has happened at least twice (2006, 2009) – during the winter period
- Causes economic and social distress in Ukraine
- Causes uncertainty as to the volumes of transited gas (claims of unauthorized taking, difficulties in gas accounting)
- **Undermines Ukraine's technical possibility to maintain transit: deficit of fuel gas**
- **Creates significant difficulties for operation of the gas transporting system that potentially can disrupt transit (necessity to facilitate reverse flow)**

- **In such situation Ukraine is potentially open to claims from:**
 - **Russia/Gazprom** – under the transit contract;
 - **European consumers/states** – under the ECT provisions
- Ukraine's defenses in such situations are not obvious.
- **ECT: energy security of the energy consumers dominates security of the transit countries.**
- After Russia's formal withdrawal from the ECT, situation for Ukraine is all but hopeless.

- **Difficulties with ECT transit provisions are acknowledged – Draft Transit Protocol under consideration, and questions still remain:**
 - Prohibition of unauthorized taking of transited materials;
 - Transit tariffs determination – how liberal is this?
 - Supply of energy materials to the transiter – what are the consequences of failure to do so?
- **It all may prove to be meaningless if the supplier (Russia) is not bound by these provisions**

- Russian President declared the need to replace the ECT with a “better” instrument. **Perhaps not such a bad idea for Ukraine?**
- The new legal framework should complete the “triangular” supplier-transiter-consumer structure: **supply and transit contract must be legally “merged”**
- East-West energy supply is a trilateral process, and **all three parties involved must be inter-connected** via respective rights and obligations
- **Transiter must build its relations with a consumer.** The scope of actual responsibility before the consumer is greater than before the supplier – purchase of gas at Ukraine/Russia border

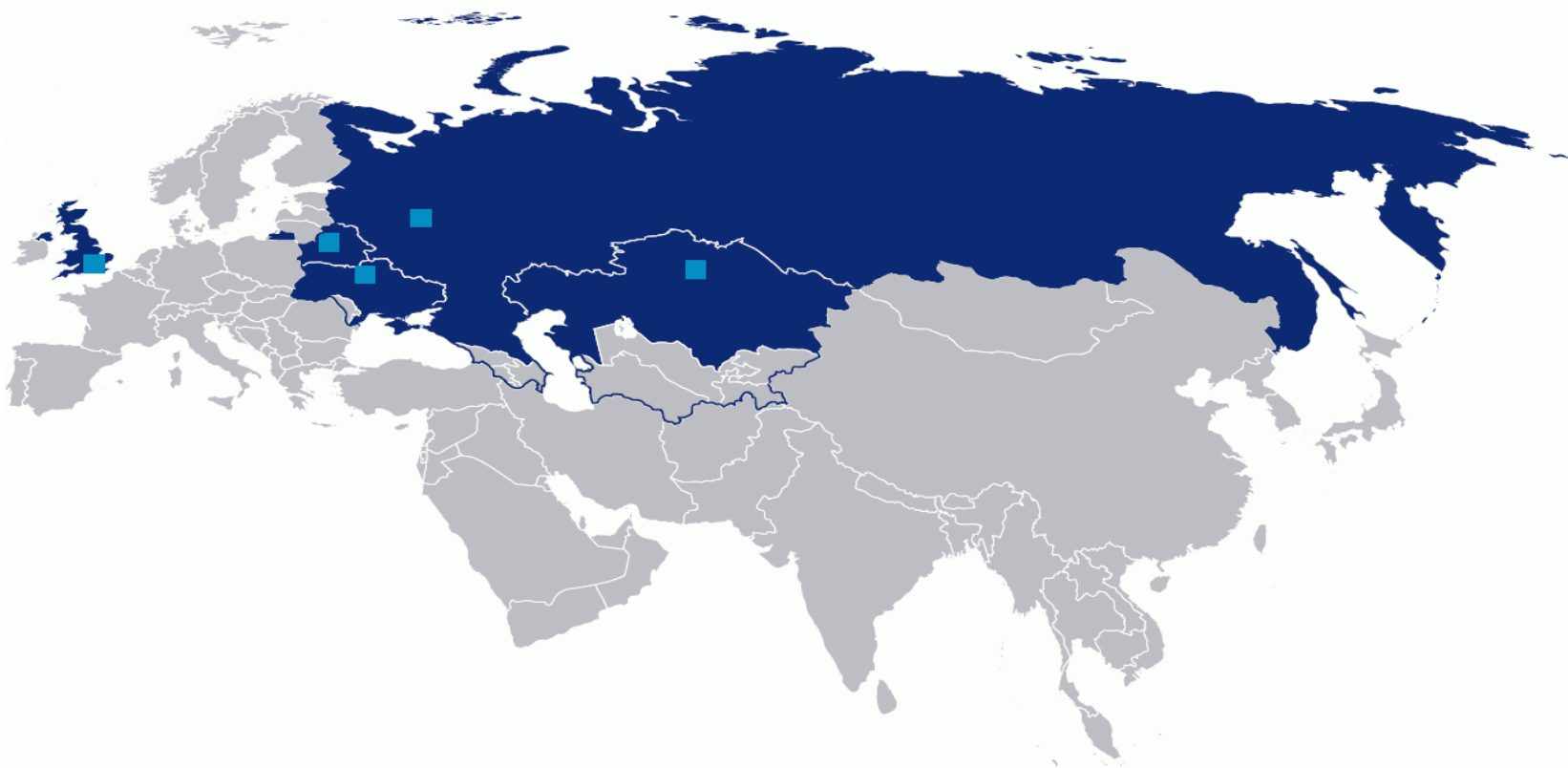
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Questions? Comments?

Thank You!

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