
Energy Security of Russia and the EU: Current Legal Problems

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Introduction

Security of energy supply is a cornerstone of European energy policy. It receives specific mention both in the Constitution Treaty and in the Lisbon Treaty. Of course, energy and energy-generated revenues are vital for Russia as well. It is a common understanding that Russia and the EU are extremely interdependent in terms of energy. On the one hand, Russia is the strategic energy supplier to the EU as a whole; for some member states Russian supplies represent the only source of the external energy flows. On the other hand, the revenues generated from the west-bound supplies of oil and gas constitute a significant share of the overall export income and of the budget of Russian Federation.

Taking the interdependency as a point of departure the present article answers the following questions: What are the differences and the similarities in the European and the Russian approaches towards security of energy supply? Is their understanding of energy security so different? What are the current legal instruments guiding interaction in this sphere? What are the actual trends that could give some indication of how the situation may develop in the future? – While the concepts of “security of energy supplies” or of “energy security” are theoretical in nature, the ways the concepts are understood and the legal framework for them directly influences the way they are applied in practice.

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Definition of security of energy supply

In Russia the definition of energy security is found in the Energy Strategy of Russian Federation adopted by the Government Decision in 2003¹. It is defined as the “state of protection of the country, its citizens, society, state, economy from the threats to the secure fuel and energy supply”. There is also another definition contained in the document: “the full and secure provision of energy resources to the population and the economy on affordable prices that at the same time stimulate energy saving, the minimization of risks and the elimination of threats to the energy supplies of the country”. In accordance with the Strategy the basic elements of the energy security in Russia are:

- the ability of the energy sector to meet internal and external demand with affordable energy resources of the necessary quality;
- the ability of consumers to use the energy resources efficiently, preventing unnecessary expenditure by society on energy supply creating a deficit in the energy balance;
- the stability of the energy sector in the face of internal and external economic, technical and natural threats and its ability to minimize the damage caused by different destabilizing factors.

There are two basic terms in English having generally the same meaning: “energy security” and “security of energy supply”. The first one in its general meaning is widely used by many organizations and government advisors, whereas the second is accepted by the EU and is included in the text of Lisbon Treaty and many already implemented legal and political documents of the Union.

In accordance with the Green Paper 2000, “the European Union's long-term strategy for energy supply security must be geared to ensuring, for the well-being of its citizens and the proper functioning of the economy, the uninterrupted physical availability of

¹ Energy Strategy of Russia for the period until 2020. Adopted by the Decision of the Government of Russian Federation No. 1234-r dated August 28, 2003.

energy products on the market, at a price which is affordable for all consumers (private and industrial), while respecting environmental concerns and looking towards sustainable development²...”The security of energy supply in the European understanding has two essential components – technical and commercial. Technical component consists of the physical accessibility to the resources and non-interruption of energy flows. Commercial component presupposes the affordability of the energy prices. After the entry into force of the Amsterdam Treaty in 1997 the security of energy supply policy was built into the concept of sustainable development. Therefore, making part of the EU sustainable development policy, it presupposes sustainability as one of its core elements. The wording “energy security” also makes part of the EU vocabulary, albeit being construed rather narrow – mostly as the technical security of the energy installations and infrastructure.

The comparison of the ways the security of supplies is defined both in Russia and in the EU and of the elements accepted by political and legal doctrines on both sides of the border leads to the essential conclusion – the general understanding of the security of energy supplies is largely the same for Russia and for the EU. The crucial difference consists in the factual circumstances: the Russian Federation is the energy exporter and the EU is the energy importer.

The differences between various segments of the energy sector should also be taken into consideration, e.g. the security of the energy supply in the gas sector in the EU presupposes one set of circumstances (lack of internal resources, import dependency, one predominant external supplier, relatively expensive alternative technologies, etc.) and in the electricity sector – another set (impracticability to store the electricity and the permanent necessity to balance supply and demand, existence of sufficient internal capacity, variety of alternative technologies, etc.).

² Green Paper. Towards a European Strategy for the security of energy supply, Luxembourg, Office for Official Publications of the European Communities, 2001, p.9.

EU international measures aimed at security of energy supply

The political documents of the EU contain a vast variety of measures aimed at securing stable and affordable energy supplies to the Union. The most significant are:

- measures and agreements aimed at creation of the single European energy space;
- interaction and cooperation with the largest consumer states, inter alia within the framework of the development policy;
- improvement of the access of the European companies to global energy resources;
- improvement of the investment conditions in the international projects;
- use of the financial instruments to increase the security of supplies;
- elaboration and promotion of an energy efficiency agreement.

At present the legal basis for cooperation in the energy sector in general, are the following international instruments: Agreement on Partnership and Cooperation (PCA³), Energy Charter Treaty (ECT⁴) and political agreements within the framework of EU-Russia Energy Dialogue. Each of the said mechanisms has its own strong and weak points.

³ Agreement of Partnership and Cooperation establishing a partnership between the European Communities and their Member States, of the one part, and the Russian Federation, of the other part, dated June 24, 1994; see: www.europa.eu.int

⁴ See: www.encharter.org

Partnership and Cooperation Agreement

The Partnership and Cooperation Agreement (PCA) with Russia was the first one entered into by the European Community. Other PCAs with the former Soviet Republics followed this one. The objectives of this Agreement and of the Partnership established thereby are to provide an overall framework for political dialogue between the parties, for the gradual integration of Russia and wider Europe and to create the necessary conditions for the future establishment of a free trade area between the European Community and Russia creating the conditions for bringing about freedom in the establishment of companies, of cross-border trade in services and of capital movements.

The trade regime provided for by the PCA is based on GATT provisions. The Parties to the PCA grant to one another most-favoured-nation treatment. The Agreement prohibits quantitative restrictions and excessive (discriminatory) taxation of imported goods. The principle of the freedom of transit is deemed as one of the conditions essential for the achievement of the purposes of the Agreement. Each Party is expected to provide for freedom of transit through its territory of goods originating in the customs territory or destined for the customs territory of the other party⁵.

With respect to freedom of transit it is necessary to bear in mind the exceptions from that principle contained in the article 19 of the PCA. These exceptions provide that the Agreement shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security and also on grounds of protection of natural resources.

The representatives of the European Union have repeatedly expressed concern over the obstacles for the natural gas transit from Middle Asia through the Russian Unified System of Gas Supply to the European market. However, these concerns have never been taken to formal dispute resolution under the rules of international law. It would suggest that the exception for the purposes of protection of natural resources may serve as a valid legal basis for the limitation of the freedom of transit. In our opinion in such a situation the requirements of the last passage of the PCA article 19 stating that the limitations in question shall not constitute a means of arbitrary discrimination or a disguised restriction on trade between the Parties would not be violated. It is therefore clear that the rules of the PCA

⁵ Article 12 of the PCA.

cannot guaranty the security of energy supply to European Union by means of diversification of supply and transportation from Middle Asia countries that do not have common frontier with the EU.

Article 65 of the PCA, specifically dedicated to energy, refers to cooperation in such areas as formulation of energy policy, improvement in management and regulation of the energy sector, introduction of institutional, legal and fiscal conditions necessary to encourage increased energy trade and investment, promotion of energy saving and modernization of energy infrastructure including interconnection of gas supply and electricity networks. Cooperation in the area of improvement of the quality and security of energy supply in an economic and environmentally sound manner is stated as the main priority. It is worth noting that article 65 of the PCA with Russia does not make reference to the diversification of supplies which is a common feature of the Agreements on Partnership and Cooperation with other ex-Soviet republics⁶. The provisions of the article 65 thereby implicitly confirm the role of Russian Federation as the key energy supplier for the European Union.

A suspensive condition is contained in Article 105 of the PCA which relates to the application of the Energy Charter Treaty and Protocols thereto in matters covered by the PCA. In case of Russia it is especially important to note that the provisions of the ECT substitute the respective norms of the PCA only upon entry into force of the ECT on the territory of Russian Federation, i.e. upon its ratification by Russian Federation.

Energy Charter Treaty

At present the relations between Russia and the EU in the energy sector, and inter alia in the sphere of energy security, apart from the Partnership and Cooperation Agreement rules, are formally governed by the provisions of the Energy Charter Treaty. Russian Federation has signed the ECT, but has not ratified it. Nevertheless, the rules of the ECT are applied provisionally on the territory of Russian Federation to the extent that such provisional application is not inconsistent with Russia's Constitution, laws or regulations. Such possibility of provisional application is provided for by the article 45 of the ECT.

The scheme of the ECT may be qualified, albeit very simplistic, as "investments for the producers (mostly from the Eastern countries) in exchange for the security of the energy supplies

⁶ See e.g. article 53 of the Agreement on Partnership and Cooperation with Kazakhstan, article 54 of the Agreement on Partnership and Cooperation with Kyrgyzstan, article 61 of the Agreement on Partnership and Cooperation with Ukraine.

(predominantly for the West)”. The ratification of this Treaty by the Russian Federation is the key element of the scheme, and without this element the system does not function properly. The ECT has never been implemented into practice in the absence of the ratification on the part of Russia.

Basically the grounds for non-ratification of the ECT are common for all the leading energy-exporting countries. The foreign investments regime in the energy sector, as laid down in the ECT, being so comfortable for the importers does not correspond to the interests of the exporting countries. The latter view their fossil energy sources as national patrimony, which are subject to depletion and which cannot be renewed. The freedom of the foreign companies to get access to the extracting industry of the producing countries promotes the redistribution of the ground rent (which in our understanding covers all natural resources, including hydrocarbons⁷) in favour of the foreign companies. Moreover, the foreign investors obtain certain rights, which are directly connected with the object of investment, i.e. natural resources. On the one hand, this limits the powers of the state acting as the owner of the subsoil and, on the other hand, it gives the possibility for the investors to claim a certain share in the ground rent.

Norway may serve as a good example in this respect. The country is also a strategic oil and gas exporter to the European market, but it too has not ratified the ECT and it seems that the Norwegian parliament does not intend to do so. Apart from the foreign investment regime Russia has a number of concerns with regard to ECT provisions governing transit.

The change in energy consumption structure of the EU evidences an increase in the share of natural gas. Russian natural gas reserves therefore increase the importance of Russia as the key energy exporter to the European market. Moreover, the Middle Asia states – Kazakhstan, Kyrgyzstan, Turkmenistan and Uzbekistan – also possessing significant energy reserves require large and stable transit routes in order to be able to supply energy to Europe. Bearing in mind the geographic location of those countries, energy transit through the territory of Russian Federation seems the most suitable. Therefore the legal regulation of international energy transit in Russia exerts significant influence on the amount of energy supplied from the Middle Asia countries to the European market and hence - on the security of the EU energy supply.

The international transit regime as laid down by the ECT⁸ if applied on the territory of Russian Federation would serve as a solid legal basis for free and uninterrupted energy transit from Middle Asia

⁷ For detailed explanation of the rent theories as applied in the oil sector see: Mommer, Bernard (2002): *Global Oil and the Nation State*, Oxford: Oxford University Press.

⁸ Article 7 of the ECT.

to Europe. However, for Russia the relationship with the transit countries (and the conflicts in this respect which have arisen three winters in succession) and with the countries that use the territory of Russian Federation for the transit of their gas have revealed important priorities in this area, which are not fully recognized by the text of the ECT. The international recognition of the principle of non-interruption of transit and inviolability of the resources transported, and the establishment of an obligatory international dispute resolution mechanism that could validly apply those principles must correspond to the interests of Russian Federation. However, the principle of the freedom of transit cannot be included in this list.

Moreover, it is not clear at present whether the ECT provisions governing transit would be applicable on the territory of the European Union on the basis of international law or as a consequence of the EU legal system. In the first case Russia and other non-EU parties to the ECT shall have clear remedies for the breach of the ECT transit regime by the EU and its member states, whereas in the second variant EU will be able to change the rules by means of its secondary legislation. The 2006 and 2009 gas disruptions occurred due to the controversies between Russian Gazprom and Ukrainian Naftogaz also show that ECT mechanism can not prevent such situations, although Ukraine has ratified the ECT.

Bearing in mind that the economic and political environment in Russia has changed over the recent years, it is necessary to take into consideration new challenges and requirements. There are now (or, at least, were before the start-up of the financial crisis) sufficient internal investment resources in the Russian Federation and the market capitalization of the Russian companies has increased significantly. It is evident that a large amount of investment is necessary for the EU energy sector, which is *inter alia* underlined in the last Green Paper adopted by the European Commission in 2006⁹. Therefore, the possibility of expansion of the Russian energy companies to the European market becomes real.

The Energy Charter Treaty in its present form can hardly serve as an adequate legal framework for the new economic and political realities. The abovementioned scheme “investments in exchange for the security of energy supplies” had been changed significantly since the adoption of the ECT, which objectively has created the necessity to review the legal basis for the EU-Russia cooperation.

⁹ Green Paper. *A European Strategy for Sustainable, Competitive and Secure Energy*. Brussels, 8.3.2006, COM (2006) 105 final.

EU-Russia Energy Dialogue

A decision was adopted during the EU-Russia summit in 2000 to establish a strategic partnership in the energy sector which was later called the Energy Dialogue. The reason for that was basically the refusal of the Russian Federation to ratify the Energy Charter Treaty. Apart from this, the new Energy Dialogue could serve as a basis for bilateral cooperation. The underlying reasons were to ensure stable energy markets, reliable and growing imports and exports, to address the need to modernize the Russian energy sector and to improve energy efficiency.

By establishing the Energy Dialogue, the parties put forward five major topics of common interest. Those topics included ensuring the security of energy supplies of the European continent, the development of the potential of the Russian economy, in particular Russia's energy resources, the opportunities of the pan-European market, the challenge of climate change and the conditions framing the use of nuclear energy¹⁰. It is thus evident, that the major part of the ECT elements was embodied in the programme of the Energy Dialogue. It gives an additional argument in favour of the opinion that the Energy Dialogue represented a specific substitute for the ECT.

Security of energy supply in Europe was obviously the key-element of the Energy Dialogue. A number of political and legal measures were initially proposed in that area. As a starting point, the parties highlighted the necessity to share adequately the risks between the energy producers (investors) and the energy consumers. Such risk-sharing is essential in order to create the conditions for long-term investment decisions in large-scale projects, on the one hand, and guaranty the security of energy supply, on the other.

At present certain results in the sphere of energy security are evident under the framework of the Energy Dialogue. The European Union acknowledged the importance of the long-term contracts for the supply of natural gas as such. The EU confirmed the absence of a 30% limit for the import of the fossil fuels from one external source. On the one hand, it proves the impossibility for Europe to diversify the import of oil and still more the import of natural gas. On the other hand, it shows the necessity to develop a strategic cooperation with Russia as the major energy exporter, which means that Russian energy supplies should be stable and uninterrupted no matter how the international situation evolves.

From the legal standpoint, the Energy Dialogue represents a permanent consultative mechanism aimed at the development of international relations in the energy sector. At present it does not

¹⁰ EU-Russia Energy Dialogue, Synthesis Report, Brussels/Moscow, September 2001, p.1.

provide for the guaranties of EU energy security within the meaning of the international law. Potentially, however, it may serve that purpose.

In general the level of legal formalization of the security of energy supplies from Russia to the EU does not adequately correspond to the scale of international relations and the amount of supplies. The enormous volumes of energy involved in the Russia-EU trade require a solid legal basis. Of importance in this respect may be the policy, currently being elaborated by the EU institutions. The said policy is aimed at creating a single European energy market that should embrace all European countries including Russia.

It is proposed to extend the basic principles of the EU law, particularly the rules of competition, free movement of goods and services, freedom of access to the energy infrastructure, to the markets of the energy exporting countries. Such measures aimed at energy prices reducing and establishing common requirements common for producing and consuming countries to reduce the amount of the natural rent received by producers. This can hardly coincide with the economy guidelines and the energy security of the Russian Federation.

In order to adopt and implement an agreement which would be legally binding and effective, the strategic interests of the Russian Federation should be taken into consideration. First, Russian energy companies are keen to gain access to downstream assets in EU member states. They want to sell their goods and provide services to the final consumers. Second, of importance to Russia are principles of non-interruption of transit and inviolability of resources transported. However, the freedom of transit is definitely contrary to the interests of Gazprom. Third, the emerging market players in Russian electricity sector, which has undergone the liberalization processes, may be looking forward to sell electricity in the EU-countries and hence require the interconnection of the network systems.

It should also be noted that even if there is success in the first three points, Russia would hardly accept EU competition rules. Such acceptance would lead to significant interference in the corporate structure of the energy companies in Russia. It is, of course, impossible to follow completely the demands of Russia, but vice versa it is illogical for Russia to accept all the requirements of the EU. Therefore the agreement should somehow identify a better balance of interests.

Basic trends and recent legal developments

If we could simplify the variety of factors and circumstances in EU-Russia energy relations, it could be said that two opposite trends are possible: open relationship and markets' foreclosure. Open relationship would presuppose mutual concessions formalized by means of an international treaty (or a chapter in the new PCA). It will mean exemptions from certain EU competition rules for Russian energy companies (first of all, for Gazprom) in exchange of the less rigidity in rules governing investments and transit in Russia. The outcome of greater openness would be the greater level of interaction and mutual control. The markets' foreclosure trend may become effective by means of escalating the controversies between the parties. The question of electricity grid interconnection will be taken out of the agenda, oil and gas will be traded on the border. Less intercommunication will increase the political risks.

The above is a starting point for the analysis of recent legal acts adopted by EU and Russia. The following three may be qualified as having the greatest importance for the bilateral energy relations – the Lisbon Treaty adopted by the EU institutions (but not yet ratified by all Member States) and two Federal Laws of Russian Federation enacted in April 2008 introducing important amendments to the foreign investments regime in the strategic sectors of the Russian economy, including energy.

Lisbon Treaty

The Lisbon Treaty following the text of the Constitution of the European Union has established the main priorities of the European energy policy and has envisaged the possibility for the EU to play a more active role in the sector, inter alia in international energy relations. The main objectives of the EU energy policy as set down by the Constitution of the European Union (the functioning of the energy market, the security of energy supply in the Union; the promotion of energy efficiency and energy saving and the development of new and renewable forms of energy) are complimented by the objective of

promotion of the energy networks interconnection¹¹. The text of the Lisbon Treaty thereby consolidates within the auspices of the common energy policy both the elements of the policy as provided for in the Constitution and the development of the trans-European energy networks. In this respect the rules of the Treaty title on trans-European networks applicable to the energy networks may be deemed as a logical part of the common energy policy of the EU. The provisions of the mentioned title have not suffered any changes.

The EU competences as defined by the Lisbon Treaty are similar to the categories of competences provided for in the Constitution. Energy and trans-European networks fall within the sphere of the shared competence between the Union and the Member States together with the internal market regulation and the environment. The basic provisions of the EC Treaty (which should be called the Treaty on the Functioning of the European Union after the entry into force of the Lisbon Treaty and hereinafter referred to as the "Treaty on the Functioning") relating the 4 freedoms of the internal market and the competition rules have not undergone any significant changes. However, a number of amendments were made, which enable the Union to undertake the restrictive measures in relation to the third countries.

Thus, in accordance with point 3 of the Article 57 of the Treaty on the Functioning, the Council may unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalization of the movement of capital to or from third countries. The application of this provision potentially may serve not only for the purposes of fight against terrorism, but also in order to conduct a restrictive energy policy of the Union with regards to the companies from the third countries.

The establishment of subsidiaries or affiliated companies is one of the forms of international movement of capital. Thus, the limitations on the movement of capital from third countries may be applicable to the subsidiaries and affiliated companies of the companies incorporated in the energy exporting countries, thereby precluding or significantly hindering their intervention in the form of direct investments to the internal European market. Such limiting measures, or at least the possibility to apply them, may serve as a significant instrument in reaching EU goals in the energy sector. Apart from this, Lisbon Treaty provides for the possibility of applying restrictive taxation measures in relation to companies from third countries¹². The above comments are *mutatis mutandis* applicable to this rule as well. It is also not entirely clear, whether this last provision is consistent with WTO rules.

¹¹ Point 1 of the Article 176A of the Treaty on the Functioning (the Lisbon Treaty text).

¹² Point 4 of the Article 58 of the Treaty on the Functioning (the Lisbon Treaty text).

An important supplement is introduced to the Article 100 of the EC Treaty. The initial text of this Article stated that the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products. The Lisbon Treaty wording specifically mentions that the said measures may be undertaken in case of the severe difficulties in the supply of “certain products, notably in the area of energy”.

It is obvious that the “products ... in the area of energy” include, first of all, energy resources; one may assume, however, that energy equipment may also be part of this notion. The specific mentioning of energy resources in the text of the Treaty clearly evidences the attention given to the problem of the security of energy supply in the EU. On the other hand, it may also be construed as a signal addressed to exporting and transit countries showing that the EU is ready to act as a single entity in case of threats to its stable and secure energy supplies.

There is an important new concept which cannot be met in the Constitution of the EU – the solidarity requirement for the common energy policy of the EU¹³. In our opinion, it can influence international cooperation of the EU in a given sector, especially bearing in mind the changes of overall international activities regulation. The Treaty of the European Union is amended by a number of provisions relating to the relationship with neighbouring countries, including Russia, to common foreign policy and to individual actions of the Member States in international relations. In accordance with the general provisions, the Union shall develop a special relationship with neighbouring countries, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterised by close and peaceful relations based on cooperation¹⁴. It is interesting to note that the basis for the area of prosperity and good neighbourliness includes the values of the Union and does not include the values of the neighbouring countries or, at least, generally used passage about “common values shared by all parties”.

Determining the basic priorities, the Lisbon Treaty provides that the Union shall define and pursue common policies and actions, and shall work for a high degree of cooperation in all fields of international relations, including development of international measures to preserve and improve the quality of the environment and the sustainable management of global natural resources, in order to ensure sustainable development and promotion of an international system based on stronger multilateral cooperation and good global

¹³ Point 1 of the Article 176A of the Treaty on the Functioning (the Lisbon Treaty text).

¹⁴ Article 7A of the Treaty on the European Union (the Lisbon Treaty text).

governance¹⁵. The introduction of such priorities in the text of the Treaty suggests the European Union will “speak with one voice” with respect to a greater number of issues of the international politics and international relations. The new status of the High Representative of the Union for Foreign Affairs and Security Policy as institutionalized by the Lisbon Treaty will also provide for this. Moreover, the introduction into the scope of the Union’s interests the “management of global natural resources” may involve the entire organization into discussions on a number of key energy-related topics, such as the legal status of the natural resources of the Arctic region.

Before undertaking any action on the international scene or entering into any commitment which could affect the Union's interests, each Member State shall consult the others within the European Council or the Council. Member States shall ensure, through the convergence of their actions, that the Union is able to assert its interests and values on the international scene and shall show mutual solidarity¹⁶. Such kind of solidarity represents significant limitations on the unilateral actions of the Member States on the global scene. Some unilateral actions and initiatives may be qualified as undermining the solidarity requirements.

Nevertheless, the Treaty does not contain any obligatory criteria which would establish, in which case the proposed action may “affect the Union’s interests”, i.e. in which case the Member State should use the consultative procedure within the Council. Secondly, it is not clear, what are the limits for the convergence (harmonization) of the actions of the Member States and what should be the result of the consultations within the Council, should it be formalized as an approval or interdiction of actions or as a general guideline of the international policy. And thirdly, since the answer to the previous question is far from being clear, the consequences, if a Member State steps away from the recommendations of the Council, are not clear.

In the light of current international relations in the energy sector, such requirement gives rise to certain doubts relating to the bilateral and multilateral relations between Russia and certain Member States. Even at present we may argue, that the projects of this kind (Nord Stream, Stockman, Burgas-Alexandropolis pipeline, etc.) and any agreements negotiated and signed during those projects, shall have more attention and maybe more control from the part of the EU institutions.

Summarizing the novelties of the Lisbon Treaty with respect to energy policy, two key elements should be noted. First, following the Constitution, the Treaty formalizes the main objectives of the policy in the sector, one of which is still the security of supply. Second, the role and the influence of the EU in international relations is increased,

¹⁵ Article 10A of the Treaty on the European Union (the Lisbon Treaty text).

¹⁶ Article 16 of the Treaty on the European Union (the Lisbon Treaty text).

inter alia by means of consolidation of the Member States' policies. The Union's limitations with respect to the third countries, are designed as part of the anti-crisis instruments for the situations of the difficulties in the energy supplies or, maybe, extremely high energy prices.

Russian Laws on Foreign Investments

The period of high oil prices was obviously one of the underlying reasons for the adoption of the two Federal Laws in Russian Federation that mark the shift in the foreign investments policy. Those are the Federal Law dd. April 29, 2008 No. 57 "On the order of making the foreign investments in the companies having strategic importance for defense and security of the country" (hereinafter referred to as the "Law No. 57") and the Federal Law dd. April 29, 2008 No. 58 "On making amendments to certain legal acts in relation to the enactment of the Federal Law "On the order of making the foreign investments in the companies having strategic importance for defense and security of the country" (hereinafter referred to as the "Law No. 58").

Law No. 57 sets up the ex-ante approval requirement for transactions resulting in the establishment of control of a foreign investor over the companies doing business in the strategic sectors of Russian economy, including energy. The notion of "control" is construed very wide for such transactions; the definition includes not only the possession of 50 and more per cent of voting shares, but also the variety of indirect mechanisms of control in the best traditions of the European competition law¹⁷.

The approval for the transactions should be given by the government commission. In order to receive the approval prior consent of the designated authority and the Federal Security Service (FSB) is needed. This mechanism is enacted in parallel with the already existing merger control mechanisms provided by Russian competition law. The underlying reasons for introduction of the additional one for the strategic sectors of the economy may be twofold: weak tradition of the competition regulation on the one hand and the desire to introduce the regulatory mechanism of a purely political nature aimed at controlling the foreign business.

The approval of transactions of the companies exploiting the subsoil parcels of the federal importance should be given on the lower threshold – 10 % of the voting shares. The list of the subsoil parcels of the federal importance is rather wide and includes all subsoil parcels in the internal waters, territorial sea and continental

¹⁷ Article 5 of the Law No. 57.

shelf and other parcels that contain extractable reserves over certain threshold (70 millions of tons for oil and 50 bcm for natural gas¹⁸). Once introduced into the list of the subsoil parcels of the federal importance the subsoil parcel cannot be automatically excluded from it due to the depletion or re-estimation of the reserves. The transfer of the right of the use on the subsoil parcels of the federal importance to the companies with more than 10 % foreign share is also strictly limited. The lower figures for the approval threshold show that the companies involved in the subsoil use are qualified as having “especially strategic” character.

Law No. 57 does not have retroactive effect with regard to the transactions finalized before its entry into force; however, foreign investors must notify the designated authority if they hold at least 5 % of shares in strategic companies. Thus, the designated authority would be able to monitor the activities of foreign investors in the relevant sectors of the economy.

Significant and, of course, the most important part of the Law No. 58 relates to the legal regime of the subsoil in general and the subsoil parcels on the continental shelf in particular by introducing amendments to the Federal Law on Subsoil and the Federal Law on Continental Shelf. Now the license to use the subsoil parcels of federal significance on the continental shelf may only be granted to the Russian legal entities that correspond the following criteria:

- have at least 5 years experience of the Russian continental shelf exploration/production and
- have at least 50% participation of the Russian Federation.

De facto it means that only Gazprom and Rosneft or their subsidiaries may be granted licenses to use subsoil parcels on the continental shelf.

In our opinion the new regime for the foreign investors in the energy sector introduced by the Laws No. 57 and No. 58 contradicts the investment provisions of the ECT, especially the non-discrimination and national treatment clauses, and undermines or, at least, represents additional obstacle for the ratification of the ECT by Russian Federation.

¹⁸ Article 2.1. of the Federal Law on Subsoil (as amended by the Law No. 58).

Conclusion

In spite of similar understanding of what constitutes security of energy supply – stable and uninterrupted energy flows on affordable prices – Russia and the EU find themselves in strategically different situations. Russia is an energy exporter and EU – an energy importer. Therefore the energy well being of the EU is to a certain extent dependent on Russian energy sources.

In terms of international law, the existing mechanisms, such as PCA, ECT and the Energy Dialogue create the legal basis for cooperation in the energy sector. However, each of them has significant deficiencies in the light of the EU security of energy supply priorities and none of them can serve as a valid guarantee for stable energy flows from Russia westwards. The amount of oil and gas traded between Russia and the EU obviously requires a more solid international legal basis. In order to create an international regime providing for security of supply, the strategic interests of both Russia and the EU should be taken into account and both parties should obviously make mutual concessions.

Recent legal trends show us, however, that both parties tend to formalize unfriendly restrictive measures in the energy sector. Of course, some of these may never become real. However, the creation of the legal basis for “unfriendly” actions, on one hand, and the lack of progress with respect to the new international agreements (be it PCA II with the specific energy chapter or new protocols to the ECT) and the fact that Russia is highly unlikely to ratify the ECT, on the other hand, is grounds for some pessimism. As Romans said, “si vis pacem, para bellum” – hopefully, the open relationship trend will be revived in the future when the parties will have tired building defenses.