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ECT, Transit, Transit Protocol and all that. How it looks from Moscow

***"TO PROMOTE LEGAL FRAMEWORK
OF TRADE, INVESTMENT AND TRANSIT
IN THE ENERGY SECTOR IN THE ASIA-PACIFIC REGION"***

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Ladies and gentlemen!

TRANSIT & ECT

Transit is of fundamental importance for world energy supply and trade because typically to reach markets EMP have to cross the Areas of a number of states. Reliable Transit is one of the major prerequisites of security of energy supply. Transit is one of the foundations of the ECT and is covered by its Article 7.

Definitions

Terms, as used in the ECT are:

“Contracting Party”

CP is a state or Regional Economic Integration Organization which has consented to be bound by the ECT and for which the Treaty is in force.

To become a CP a state has to sign and then to ratify, accept or approve the Treaty, or accede to the Treaty.

“Regional Economic Integration Organization”

REIO is constituted by states to which they have transferred competence over certain matters, including the authority to take binding decisions.

REIO's Area is the Areas of the member states of such Organization.

European Union is now a single REIO – Contracting Party to the Treaty in addition to the 27 EU states).

“Energy Materials and Products”

**EMP, listed in Annex EM of the ECT,
include Nuclear Energy, Coal, Natural Gas,
Petroleum and Petroleum Products,
Electrical Energy, etc.**

“Transit”

is the carriage through the Area of a CP of EMP originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a CP.

To be in Transit EMP have to cross the borders of a CP at least twice.

“Energy Transport Facilities”

ETC consist of high-pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines, and other fixed facilities for handling EMP.

Transit Provisions **of the ECT**

Freedom of Transit

Each CP shall take the necessary measures to facilitate the Transit of EMP consistent with the principle of freedom of transit and without distinction as to the origin, destination or ownership of such EMP or discrimination as to pricing, and without imposing any unreasonable delays, restrictions or charges.

International Cooperation

CP shall encourage relevant entities to cooperate in:

- (a) modernization of ETF for Transit of EMP;**
- (b) the development and operation of ETF serving the Areas of more than one CP;**
- (c) measures to mitigate the effects of interruptions in the supply of EMP;**
- (d) facilitating the interconnection of ETF.**

Favourable Treatment

Each CP undertakes that its provisions relating to transport of EMP and the use of ETF shall treat EMP in Transit in no less favourable a manner than its provisions treat EMP originating in **or** destined for its own Area, unless an existing international agreement provides otherwise.

Proviso

**A CP shall not be obliged to:
permit new or additional Transit through
existing ETFs or their modification,
or construction of new ETF which it
demonstrates to the other CP concerned
would endanger the security or efficiency
of its energy systems, including the
security of supply.**

Sanctity of Transit

Contracting Parties shall secure established flows of EMP to, from or between their Areas.

A CP through whose Area EMP transit shall not, in the event of any Transit dispute, interrupt or reduce the existing flow of EMP prior to the conclusion of the dispute resolution procedures ... except where this is specifically provided for in a contract or other agreement or permitted by the conciliator's decision.

Conciliation procedure - 1

Contracting Party – party to the dispute – may appeal to the Secretary- General (SG) **only following the exhaustion of all relevant dispute resolution remedies** previously agreed.

Within 30 days the SG shall appoint a conciliator, who shall seek the agreement of the parties within 90 days. Failing that, he shall recommend a resolution to the dispute and decide the interim tariffs and other terms and conditions to be observed for Transit until the dispute is resolved.

Conciliation procedure -2

The Contracting Parties undertake to ensure that the entities under their control or jurisdiction observe any interim decision on tariffs, terms and conditions for 12 months following the conciliator's decision or until resolution of the dispute, whichever is earlier.

The SG may elect not to appoint a conciliator if Transit concerned is or has been the subject of the dispute resolution procedures which failed.

ECT – general impression

Generally, the ECT as the first multilateral legally binding instrument in energy sector is very helpful. Nevertheless, it is still not perfect.

Some ECT provisions are not clear (or even exact) enough (for example, favourable treatment of EMP or conciliation procedures). There are extremely important modern challenges which are not reflected in the ECT (for example, security of supply). Some provisions related to technology transfer or access to capital markets may sound more binding.

What is a Protocol to the ECT?

A Protocol to the ECT is a Treaty which itself is to be adopted by Charter Conference and then signed and ratified by at least two CP.

It is designed to complement, supplement, extend or amplify the ECT's provisions with respect to any specific sector of activity within the scope of ECT. Only CP (which has signed and ratified the ECT) may be a party to a Protocol.

Draft Transit Protocol **Provisions**

1. Achievements

Available Capacity Definition

As used in the Protocol, “Available Capacity” is the total physical operating capacity of the ETF, less that which is necessary :

- (a) for the efficient operation of the ETF, with regard to security and reliability of the system;
- (b) for the fulfillment of obligations by the owner or operator of the ETF under any valid and legally binding agreements relating to the transportation of EMP;
- (c) for the fulfillment of other binding obligations to ensure the supply of EMP within the territory of a CP;
- (d) to account for the reasonable requirements for transportation of EMP which belong to the owner or operator of the ETF (regarding hydrocarbons, and subject to requirements for open access to ETF applicable within a CP).

Draft Transit Protocol **Provisions**

2. Outstanding issues

Transit Tariffs

A compromise between Parties regarding this issue seems likely to be reached.

Experts preliminarily agreed that:

- 1. Transit Tariffs and other conditions shall be objective, reasonable, transparent and shall not discriminate on the basis of origin, destination or ownership of EMP in Transit and be affected by market distortions, in particular those resulting from abuse of a dominant position by any owner or operator of ETF used for Transit.**
- 2. Transit Tariffs shall be based on operational and investment costs, including a reasonable rate of return.**
- 3. Transit Tariffs may be determined by appropriate means, including regulation, commercial negotiations or congestion management mechanisms.**

Congestion Management Mechanisms

CMM include “first come – first served”, “pro rata” and auctions.

The negotiation problem was in acceptability of auctions for allocating Available Capacity which may lead to unreasonably high Transit Tariffs. Preliminarily agreed that:

1. Auctions may be used only in a fair, transparent and nondiscriminatory manner and for limited time and shall be related to really congested points or sections only.
2. Where sustained or recurrent use of auctions causes a Transit Tariff to be too high, the excess revenues shall be used for reducing or mitigating current or foreseeable congestion.

Utilization of AC for Transit - 1

The following Article 8 of the draft TP is too complicated to be presented in full. Its wording should be amended, but common understanding between Parties in substance seems to be achieved.

1. Each CP shall ensure that owners or operators of ETF will negotiate in good faith with any other CP or their Entities requesting access to and use of Available Capacity for Transit. The applicable procedures shall be transparent and non-discriminatory as to the origin, destination or ownership of the EMP and prevent speculative hoarding and blocking of capacity and apply “use it or lose it” rule.
2. CP shall ensure that their owners or operators of ETF shall be obliged to provide a duly substantiated explanation in case of not according in whole or in part access to and use of Available Capacity for Transit.

Utilization of AC for Transit - 2

3. If the use of AC for Transit is needed to fulfill a hydrocarbon supply contract, the related Request shall be submitted a reasonable time in advance, and be supported by a credible commitment.

If existing AC can satisfy all the Requests received, its owner or operator shall just offer this AC at cost-reflective tariffs, and on a competitive and nondiscriminatory basis.

Otherwise, if unsatisfied Requests are sufficient in volume and duration to justify the expansion of ETF in an economically efficient manner, the owner or operator shall undertake to create additional AC and then offer it to the users, subject to the same conditions as above. If such expansion cannot be accomplished, the requested AC (with a lot of reservations) shall be offered to the existing user who needs AC the fulfill supply contract in force.

Regional Economic Integration Organization

This Article was proposed by EU which is a single REIO – Contracting Party to ECT (in addition to each of the 27 EU states).

1. For the purposes of this Protocol, the “Area” of a CP shall mean the area to which the treaty establishing such a REIO applies.

2. A REIO undertakes to ensure that its provisions treat EMP originating in another CP and in free circulation in its Area no less favourably than EMP originating in its constituent member-states.

Furthermore, the rules of a Regional Economic Integration Organisation shall provide an overall standard at least equivalent to that which would result from the provisions of this Protocol.

Why REIO clause is not fair

Under REIO clause EU is a single Area, so if EMP are crossing an individual member state, it cannot be regarded as Transit.

Because of the EU geographic location there are practically no EMP transit flows through this REIO at all! For example, for the Russian gas Transit through EU will be limited to transportation to Switzerland (less than 1% of total Russian gas exports).

Was a proposal to include REIO clause into TP a brilliant trick to evade undertaking obligations ensuing from the Transit Protocol?

Let's recall that the ECT was signed not only by EU, but by each EU member state as well. And every member state is now going to sign the Transit Protocol almost with no obligations.

Is it fair?

Current state of the draft TP

As a whole, the draft Transit Protocol is not bad. Some definitions and articles are simply good. Two of three outstanding issues (Tariffs and Utilization of AC) are likely to be agreed.

The contradictions regarding REIO are of principal nature and may be overcome on political level only by means of broad general decision on all unresolved issues.

Russia, the ECT and the TP

As one of the World's biggest gas and oil exporter Russia urgently needs secure and reliable Transit of its EMP to international markets.

Russia signed the ECT in 1994 but still not ratified.

The Russian State Duma ruled that the ECT ratification should be linked to the success of the Transit Protocol negotiations primarily aimed at improving the ECT.

Now as a result of bilateral and multilateral consultations on draft Transit Protocol the positions of the Parties have been somewhat bridged and next round of negotiations can be started.

Russian proposals

We are convinced that some measures should be undertaken to enhance the importance of the ECT and its role, activity and weight in world energy sector. These ideas have been reported to the last Energy Charter Conference in 2008 in Athens.

In our view some provisions of the ECT or related documents (Protocols, Declarations and such) may be amended.

Other provisions, notably based on the results of the St. Petersburg G-8 summit in 2006, may be included (especially that related to security of energy supply).

All such proposals, as well as the need and ways of their realization, we are going to discuss in detail in the framework of the Energy Charter Ad Hoc Strategy Group and that of the Review under ECT Article 34(7).

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**THANK YOU
FOR YOUR ATTENTION!**