

EU-Russian Gas Trade and the Shortcomings of International Law

Ole Gunnar AUSTVIK^{*} & Carolina LEMBO^{**}

This article studies the impacts of international law on the political manoeuvring rooms for Russia and the EU in the natural gas sector. Russian energy policy, with its long tradition of strong state control, conflicts with the EU, which represents a far more liberal economic ideology, both in terms of for whom policy should work and how it should be performed. Legally, natural resources are not widely regulated. In this void, while both sides pressure legal cases to make or prevent, respectively, Russia moving towards a Western-styled policy, the private sector provides solutions for specific cases in which state action is insufficient or non-existent. The article asks to which extent Russia, pressured by international law, eventually will adopt an energy policy aligned to the West. It concludes that Russia's steps towards greater economic integration with the outside world leads to greater similarities with the West in legal forms and processes. However, path-dependencies dominating society and politics, and the particularities of the energy industry, indicate that domestic Russian energy policy and external gas export policy may not necessarily lead to the same degree of similarity in actual political content, and, hence, real political convergence with the West.

1 INTRODUCTION

Russian energy policy has a long tradition of strong state control. In spite of the fall of the Soviet Union and the planned economy in 1991, a centralized Russian gas industry has remained in main aspects. To a large extent, Russian energy policy reflects the weight given to its sovereignty over natural resources, and the control over production and exports to the benefit the Russian nation and state itself, and for the stability of supplies to the markets. In contrast, European Union (EU) countries represent a liberal economic ideology. The EU as purchasers promotes neutral competition to the benefit of the whole EU Community, instead of focusing on any single country. The government's role in industrial affairs is ideally

^{*} Ole Gunnar Austvik is professor of political economy at Lillehammer University College, Norway. He is appointed M-RCBG Senior Fellow at John F. Kennedy School of Government, Harvard University. E-mail: ole.gunnar.austvik@kaldor.no. Web: www.oga.no.

^{**} Carolina Lembo is legal consultant at the Inter-American Development Bank in Washington DC. She is Visiting Researcher at Harvard Electricity Policy Group, John F. Kennedy School of Government, Harvard University. E-mail: clembo@iadb.org

considered to be limited to being a regulator of economic activities undertaken by private actors. The objectives are EU-wide and the measures regulatory. The Russian and EU models confront each other both in terms of for whose interest policy should work and how it should be exercised.

In this article we study the impacts of international law on the political manoeuvring rooms for Russia and the EU in the natural gas sector. The backdrop is that natural resource trade and investments have fewer legal regulations than most other internationally traded commodities. The World Trade Organization (WTO) Treaty of 1994 and the Geneva Convention of 1958 assigns the right for national governments to conserve and control their natural resources. However, no law regulates explicitly their international exchange. In this void, both the EU and Russia pressure legal cases against each other to make or prevent, respectively, Russia from moving towards a Western styled industrial organization and export policy. To which extent may international legal regulations force relationships in this part of the energy sector into commercial market transactions as opposed to existing political actions, negotiations and the use of economic and political power? To which extent will economic, organizational and political differences in Russia and the EU remain, and path dependencies sustained, or is it mainly a question of time before the same policy is fit for and desired by both? What is the political manoeuvring room for both the EU and Russia to formally follow binding international rules while simultaneously support its own defined interests?

The article, first, revisits the continued competing positions in economics and international trade of Russia and the West. Second, the special treatment of natural resources in international law is outlined. Third, European and Russian natural gas policy in international law are presented. Fourth, current legal EU-Russian natural gas disputes are outlined: EU's competition case against Gazprom, and Russia's objections to EU's Third Energy Package (TEP) under the WTO Treaty. Fifth, business-to-business and business-to-government relations to fill the void of international law in government-to-government relations are discussed. Finally, the impact on political manoeuvring rooms for Russia and the EU resulting from international legal bindings in the energy sector are discussed. The article argues that international law lead to greater similarity in participating countries' political forms and processes, but not necessarily to the same degree of similarity in actual political content. The question remains whether the West *de facto*, and in line with increasingly more *de jure* international regulations and the particularities of the energy industry, can expect that relations with Russia can be shaped as a mirror of how the West regulates its own economy and society.

2 THE GOVERNANCE OF EAST-WEST ECONOMIC RELATIONS

In the Western Hemisphere, the WTO, the EU and other Preferential Trading Areas (PTAs) have accommodated for rule-based trade in a gradually more open international economy after World War II (WWII). The WTO (and its predecessor the General Agreement on Trade and Tariffs, GATT) on the global scene is built after the Bretton Woods agreement from 1944, where the later Western winners of WWII designed a new international economic order between themselves. This has had profound implications for global economic developments, regional integration and distribution of wealth, international affairs and national policy making. Especially within the EU, the economic integration taken place has led to strong political integration with accompanying legal, institutional and ideological change across nation states. Law, common institutions and harmonized policies have become increasingly more important and changed the political manoeuvring rooms for participating nations, and made countries more similar in a number of economic, social and political affairs. National independence to formulate policy based on domestic preferences has been balanced against and changed in favour of the benefits of trading in larger markets in order to achieve higher economic standards of living. Russia, and even more the Soviet Union, has historically had a non-liberal approach to economic organization and trade. Through Russia's accession to the WTO Treaty in 2012, as the last of the Group of the 20 (G20) major economies to join after China gained membership in 2001, the country accepted many rules and regulations for both its domestic economy and foreign trade. Still, the situation and path-dependencies from Communist times, and before, contribute in restraining its political convergence with the rest of the world.

The different East-West economic regimes are accompanied with hard powers. The international trade system shaped by the West is framed by political and military integration based on the belief that economic interdependence promotes peace and security in an economic plus-sum game where all parties involved benefit. The system got a security umbrella and hardware from NATO and Western nuclear deterrence assuming that the world over time might be anarchic where the stronger dominates or eliminates the weaker. Hence, it was created as a liberal economic system within a realist external political framework. The other winner of WWII was the Soviet Union. The country created a plan-and-command-economy after the Bolshevik revolution in 1918, which after WWII included a number of domesticized republics and European satellite states. The Warsaw pact and its nuclear capabilities were their security umbrellas, while the Council for Mutual Economic Aid (COMECON or CMEA), represented the bulk of their international economic regime, administering trade between the

hand-on-economies. Hence, it was a realist and managed economic system within a realist external political framework. The Cold War was the name of the East-West relationship at the time. It was spread around the globe and consisted of military, social, political and economic controversies. Trade between the two was limited, often considered a zero-sum game and conflictive (e.g. grain, energy, technology).

Eventually, the Cold War was won by the West. Western liberal values and institutions for trade, finance, and the economy spread around the globe, and became the single dominating international economic and trade system. In Europe, all the Central and Eastern European States (CEEC), together with the former Soviet republics in the Baltics, became EU and NATO members. In Russia, after a period of economic and political volatility in the 1990s, a strong state apparatus was recreated under President Putin, helped by a long period with high oil prices making it able to pursue a more assertive policy towards its neighbours. The most remarkable is the policy towards Ukraine including disputes over energy, territory, political and economic systems, as well as external relations. Other global economic powers also emerged, leading to a gradual weakening of the Western supremacy over the market-based liberal economic foundation and ideology. Most importantly, China is now one of the world's largest economies with a Communist Party as its leadership. Both China and Russia consider energy as a geopolitical asset. The two countries see economics and trade as one out of many instruments in the struggle for geopolitical power together with military power (Kissinger 2014). Hence, today, large part of the world economy is outside the sphere of direct control of the US and NATO, and there is no longer a full match between economic and military relationships.

In EU-Russian energy relationships, the desire to integrate and recognition of mutual dependence exist on both sides. Kratochvil and Tichy (2013) argue that 'the EU and Russian integration discourses share a positive perception of the energy cooperation and the interdependence of the two partners'. Even though the liberal economic idea is largely unchallenged in terms of the benefits of specialization and trade on both sides, the question remains as to what extent the West can expect relations with Russia in its realist-geopolitical narrative to be shaped as an image of how the West in its liberal market-based accounts regulate its own economies. In natural resource trade, policy conflicts both in terms of policy objectives as well as in terms of policy methods and economic organization. Edward Stoddard (2013:457) explains this as 'the contrasting positions that each adopts and their connections to broader historical intellectual trends in international thoughts'. Realists often assume states to be unitary rational actors and that they are the only entities acting in relation to other states. National policies towards other countries and the international system are founded as what

Kenneth Waltz (1959) phrased as a 'Second Image' of domestic affairs. Both the EU and Russia today wants their outside worlds to be Second Images of their domestic affairs. While in Russia it is a strong state that is the ultimate policy actor, the EU is mainly a regulatory system for a number of private and national actors. Interdependence theorists like Keohane and Nye (1977) maintained that international relations have expanded beyond the international sphere, and far into domestic affairs. Although policies towards another country's government are in the final instance set by national governments, persons, companies, institutions and interest groups within a country also exert an influence. The international economy often affects national policy making by acting upon domestic actors, which in turn affect the domestic political system through associations, state structure and ideology. The 'Second Image Reversed' arguments phrased by Peter Gourevitch (1978) emphasize the impact of the international system on domestic affairs. The reversal of the Second Image stresses impacts on domestic policy and the distribution of economic activity, wealth and market power resulting from participation in the international economy, as well as the distribution of (military) power between states. In East-West energy relations, business-to-business and business-to-government relations also influence political outcomes.

Thus, changes in both external and domestic affairs may change a country's policy. In East-West relationships mostly hard political, military and economic powers on each side have been considered important. The relationships are however formed in a complex sum of a number of both hard and soft forces as competing policy instruments, interest-based decisions and path-dependent thinking and constraints. Soft power is in the West often considered to be a strength of the West, although both sides use soft power based on real or promoted images of attractiveness in the forms of reliability, strength, legitimacy, economic interdependence, cultural values (Feklyunina 2012:450–452, Nye 2004:256). EU and Russia presents different conceptions of sovereignty (Ziegler 2013). Supranational institutions characterize the integration process in the EU, which means that Member States had to abdicate of a certain measure of their sovereignty in favour of the Community's objectives, demonstrating a high level of trust among them. Russia, on the contrary, due to historical reasons, has been focused on restoring its sovereignty, deviating from any interference in the country's internal affairs and establishing itself as a strong state. Ziegler (2013) emphasizes the importance of rule-based, predictable institutions for their role in promoting trust among states. According to him, '(m)echanisms such as treaties or trade agreements may reduce uncertainty about future behavior, replacing the need for trust in the relationship'.

In the interdependent world in which both sides now participate, international law is also become increasingly more important. Soft law refers most often to

statements, principles, codes of conduct and practice as part of framework treaties, action plans and other non-treaty obligations which do not have any legally bindings (Fajardo 2014). In the EU it is often used to describe codes of conduct, guidelines, and communications as non-binding agreements. Soft law holds potential for, over time, morphing into 'hard law' and indicates how a later written agreement may be interpreted and implemented. Legal affairs play an increasingly more important role as economic interdependence deepens, which is different from the situation during the Cold War. A 'hard' international treaty has a direct *de facto* harmonizing impact on the formal political practices of the signatories. At the same time, there will for each signatory be various degrees of room for interpretation, implementation and compensatory policies when its *de facto* effects on a country's policy shall be assessed. Same formal rules must not mean same *de facto* policy and full political convergence across countries (Austvik 2015).

In natural gas, the EU sees itself as a more advanced partner in terms of integration experience when compared to Russia, being perfectly able to export its *acquis communautaire* to the latter.¹ This would in turn become a more 'suitable' partner for the EU once it adopted its standards related to energy and international trade, enabling the EU to ensure the security of its gas supply by giving its gas companies the possibility of obtaining access to the hydrocarbon resources of producers (Boussena & Locatelli 2013). The EU requests non-discriminatory treatment from Russia in their energy relationship (especially free access to markets and investments), and its diversification discourse is focused on the political impact and the security implications of the EU's energy dependence on Russia both in terms of Russia's ability to deliver sufficient quantities of gas to the EU in the future (due to the alleged lack of investment in gas development and infrastructure in Russia) and transit security, frequently emphasizing the need for diversity in gas supplies to reduce dependence on Russia. At the same time, the EU does not yet have a common external energy policy towards Russia, especially when it comes to natural gas. The differences among countries are mostly related to pipeline politics, since existing and proposed routes concern different Member States at different levels, with Western Europe on the whole less dependent on Russian natural gas than Eastern Europe (Austvik 2016:378–379).

Russia's main policy, on the contrary, is to ensure security of demand, mainly based in vertical integration in the downstream segment on the European market and in asset swapping and in long-term take-and/or-pay (TOP) obligations, which is in many aspects incompatible with the policy of liberalization and unbundling of network industries established at the EU level. The Russian gas sector is

¹ The *acquis communautaire*, often referred to as *EU acquis* or just *acquis*, is the accumulated legislation and juridical decisions that constitute the body of EU law.

characterized by state control over access to hydrocarbon resources and is dominated by Gazprom, a state company that has the monopoly in transmission and exports of natural gas. The competitive fringe in Russia is still tiny in spite of the great number of companies (IEA 2014). Russia sees itself as an equal partner of the EU, and integration should be based on mutually beneficial and symmetric energy cooperation, not only on the transposition of EU standards through the adoption of its *acquis* as suggested by the EU. Russian diversification efforts are focused on constructing new transport routes (such as the Nord Stream) that do not depend on transit countries (such as Ukraine), and its ultimate goal is to strengthen the presence of Russian energy companies on the EU internal market.

3 NATURAL RESOURCES AND INTERNATIONAL LAW

The WTO Treaty provides a global forum for trade liberalization, where its Dispute Settlement Body (DSB) is responsible for deciding when rules are breached and retaliatory trade sanctions can be imposed. The DSB is a central pillar of the current multilateral trading system to make it predictable. The system is based on clearly defined rules, with timetables for completing a case. First, rulings are made by a panel and endorsed (or rejected) by the WTO's full membership. Appeals based on points of law are possible. If the DSB decides that a member-country is not acting in accordance with WTO rules, the country needs to change its policy in a way that is in accordance with the DSB report. If complying with the recommendation immediately proves impractical, the member will be given a 'reasonable period of time' to do so. If it fails to act within this period, it has to enter into negotiations with the complaining country (or countries) in order to determine mutually acceptable compensation. If, after twenty days, no satisfactory compensation is agreed upon, the complaining side may ask the DSB for permission to retaliate (i.e. to 'suspend concessions or other obligations'). This is intended to be temporary, to encourage the other country to comply (WTO 2015).

Natural resources are considered important strategic commodities and are often treated as a special case, which led to a common perception that the trade in natural resources, and therefore energy, has been excluded from the rules established under the WTO. Natural resources have a number of distinctive features that makes them different from other traded goods. These include their uneven geographical distribution, exhaustibility (hence the large rents associated to their scarcity), environmental externalities deriving from their extraction and consumption, economic dominance in some economies, and high price volatility. The misinterpretation regarding the non-application of WTO rules to energy trade was based on the fact that until the 1980s, the largest energy producing countries had not yet joined the WTO (Selivanova 2007). However, the legal framework

and trade provisions, despite not drafted specifically to regulate trade in natural resources, may be applied to many of the challenges presented by energy trade, particularly principles of non-discrimination, national treatment, prohibition of non-tariff restrictions and access to markets on an open and transparent basis.

Russia's accession to WTO and the consequent removal of trade barriers should stimulate trust, greater and more diversified trade between Russia and the rest of the world, and make the allocation of resources within the country more efficient. As Heiko Pleines (2009:82) outlines: 'Foreign as well as domestic companies in the Russian oil and gas industry are facing high insecurity concerning their property rights and the legal regulations of their business activities.' Ivan Tchakarov, chief economist at Russian brokerage Renaissance Capital, told BBC news (16 December 2011) that Russia was achieving a completely new level of integration into the global economic system 'by becoming a WTO member, (since it) will have to import certain rules and regulations that will address the very issues that foreign investors usually complain about, like corruption, the protection of minority shareholders, the independence of the judiciary'.

WTO recognizes that a member, in certain circumstances, may need to act inconsistently with its obligations in order to manage negative externalities. Both importing and exporting countries must manage environmental externalities associated with the production or consumption of resources. The WTO Treaty has also some relevance to natural resource management, such as in the exceptions set out in Article XX of the GATT that allows protectionist measures to assure the conservation of exhaustible resources. The Geneva Convention of 1958 assigns an active role to the state from the outset by dictating that national governments have the exclusive rights to exploit resources found on their respective countries' onshore and offshore territories. In legal terms, Russia's position of a strong state control over the exploitation of its resources is justified by the 'Principle of Permanent Sovereignty over Natural Resources Conservation' (Cavalcanti, Lembo, and Thorstensen 2013:97). The principle establishes that nations retain ownership of their natural resources and permanent sovereignty over their regulation and exploitation. In several United Nations Resolutions it is recommended that exporting countries may maximize their exploitation through control of the supply chain and sales. In these terms, the principle of permanent sovereignty would reflect a state's inherent, comprehensive right to control the production and use of its natural resources.

According to WTO (2010), energy-exporting countries' policies regarding natural resources trade generally are less dominated by import than by export restrictions. Resource-rich countries restrict exports in order to achieve legitimate policy objectives, including fiscal revenue, development, social and environmental policies. In resource rich states, governments have often been at the core of

economic developments rather than just a regulator and coordinator of economic activities as opposed to the varieties of capitalism (Hall & Soskice 2001) that exists under the liberal international economic regime ‘owned’ by the West (Austvik 2012:316–319).² As exclusive resource owner the state can rent or lease the rights to explore and extract the resources to a private company as a landlord, or it can become an industrial entrepreneur itself (Klapp 1982, 1987). When combining the roles as landlord and industrial entrepreneur, the state can engage in the business in a manner similar to a private entrepreneur or a company, but the state can also use political and legal interventions and regulative measures to reach their goals (Eisinger 1988, Austvik 2010:106–109). As a political entrepreneur the state can define social (as opposed to private) goals for economic activities and use measures to reach those goals that private entrepreneurs do not have at their disposal. The goals for society may converge with the goals of private profit-maximizing firms, but in many aspects social goals also conflict with private ones. Accordingly, the Russian state may, as states in other oil and gas producing countries, be at the core of decisions. Energy import-dependent countries often express concern about the fact that the provisions regulating the use of quantitative restrictions on imports and on exports in the GATT/WTO framework are unbalanced. Article XI of the GATT/1994 requires Members to eliminate all prohibitions and quantitative restrictions on exports with the exception of those imposed temporarily to prevent and alleviate food shortages and those intended to allow time for the application of regulations such as classification and grading. Yet it does not restrict Members to imposing duties, taxes or other charges on exports. The lack of precision related to import restrictions regulation sheds light on the need for enhanced transparency on the theme for both sides.

Transit of energy is another key subject to natural resources trade, especially regarding natural gas and the fixed infrastructure, such as pipelines, needed for its exchange. The existing GATT provision on ‘freedom of transit’, GATT Article V, although covering all tradable goods within the international system makes no clear reference to energy transit, leaving significant gaps in this matter. In spite of allowing transit via existing infrastructure, it does not establish an obligation to construct or allow the construction of new pipelines and grids. Likewise, GATT Article V.2 ensures freedom of transit through the territory of WTO members via the most convenient routes, but fails to define ‘convenience’ and how such convenience is measured.

Investments also raise concern in energy trade. Activities related to energy exploration, production, transport, electricity generation and distribution, and infrastructure related to production and transportation of gas projects demand

² Including countries such as the UK and Canada until the 1990s, Norway, France, and others.

long-term export contracts both as a financial tool able to secure project financing and guarantee future demand for the producer and as a means of assuring stable and reliable energy supplies for the consumer (Konoplyanik 2012). Attracting Foreign Direct Investment (FDI) is a significant policy priority in energy exporting countries, with the aim of achieving technological progress and consequently economic growth and welfare. On the contrary, the lack of a stabilized legal framework for energy investment often leads to ad hoc decisions entailing risks of bureaucratic discretion and opaque implementation. As listed by OECD (2008), in order to increase the flow of investments a secure and stable environment for foreign investors is essential, especially with regard to:

- (1) general standards of treatment, including transparency, non-discrimination and fair and equitable treatment;
- (2) property protection;
- (3) freedom of capital movement; and
- (4) dispute resolution.

Due to resource exhaustibility, price volatility, imperfect competition, geopolitics and the political economy of contracting with governments, FDIs in natural resources are often more complex than other sorts of FDIs. In the absence of a multilateral agreement on investments, its international regulation has been made mostly bilaterally, through Bilateral Investment Treaties (BIT). FDIs are taking comprehensive protection through BITs and through the use of independent arbitral tribunals in order to assure enforcement. Nonetheless, these measures are not capable of preventing every sort of problems arising from imbalance in bargaining power between the parties, and both the government and investors are likely to face a great deal of uncertainty, either by the geological prospects and technical difficulties that will be encountered, by future prices of the resource, or by current and future political risks. Accordingly, the credibility of the arbitration system will be important to decide whether the parties can trust that the enforcement will be real and to their benefit, as well as the contractual and fiscal regime under which the project operates. Ruta and Venables (2012:27–28) argues that ‘allocations have often been done through non-transparent discretionary processes, failing to secure that the most efficient investor is awarded the contract, failing to secure maximum benefit for the state, and frequently being vulnerable to corruption’. In this sense, long-term resource investments would be better off when dealt with within the WTO system in a plurilateral basis in order to reduce market failure and inefficiencies, with the same principles established in the Agreement on Government Procurement (AGP): openness, transparency and non-discrimination.

A mechanism resembling the Extractive Industries Transparency Initiative (EITI) that the OECD now requires for membership could be used to counter corruption in contracts forcing illicit payments into the open, making it a criminal offense to bribe government officials anywhere in the world to win a contract. Both the EU and the Frank-Dodd Act in the US are proposing similar measures against corruption. Ruta and Venables claims that the corruption initiative of the EITI 'could be subsumed and made more effective by bringing corruption in resource extraction contracts under the clear remit of the WTO and requirement of WTO membership'. The WTO system would then offer dispute procedures through the DSB, giving governments a way of committing member countries to non-discriminatory fiscal and contractual terms, analogous to the Most Favoured Nation (MFN). In order to address the bottlenecks of energy trade relations, the EU initiated negotiations for a legally binding international energy regime.

4 THE ENERGY CHARTER TREATY AND WTO-RULES FOR NATURAL GAS TRADE

After 1991, through a variety of international and regional approaches (such as through the IMF and the World Bank), the West has tried to make most countries in the world behave as Western sovereign nations by exerting the means of law and soft power. After the Soviet break-up in the early 1990s, Russia was not a member of the international economic system. Russia and many of its neighbours are rich in energy resources and needed major investments to ensure their developments. At the same time, European states had a strategic interest in diversifying sources of energy supplies. To minimize risks and technical and financial costs, the Energy Charter Treaty (ECT) was established as a common legal environment based on WTO-type of rules for energy trade between Europe, Russia, and the former Soviet republics. Its main elements were (Energy Charter 2015):

- (1) Investment protection (e.g. by granting investors non-discriminatory treatment – national treatment and most-favoured nation treatment – compensation in case of expropriation and other losses, free transfer of capital);
- (2) Trade in energy, energy products and energy related equipment, based on the WTO rules;
- (3) Freedom of energy transit;
- (4) Improvement of energy efficiency;
- (5) International dispute settlement, including investor-state arbitration and inter-state arbitration;
- (6) Improved legal transparency.

Although participated in the negotiation process and even signed the ECT in 1994, Russia never ratified the Treaty. Both Russia and the EU were eager to ensure investment protection but were unenthusiastic to provide non-discriminatory access at the pre-investment phase (Belyi 2009). As result, the ECT did not provide a hard-law mechanism to assure compliance in this phase and the conditions of pre-investment access in both parties remained opaque. Furthermore, negotiations on energy transit were insurmountable difficult. Article 7(1) of the ECT stipulated that '(e)ach Contracting Party shall take the necessary measures to *facilitate* the Transit of Energy Materials and Products', but the meaning of the term 'facilitate transit' was considered far from straightforward, especially regarding transit theft and transit tariffs, circumstances that caused problems already in the context of the Soviet Union. A Transit Protocol was proposed in order to clarify the blurred provisions of Article 7, but Russia and the EU presented diametrically opposed positions on the issue. On the one hand, Russia advocated for the inclusion of the 'right of first refusal' as the means of allocating pipeline capacity. On the other hand, the EU wanted to include a REIO (Regional Economic Integration Organization in the WTO) exception clause and to shorten both transit and supply contracts with the aim of enhancing competition. The Transit Protocol negotiations became an obstacle to the entire ECT process. In 2009 Russia terminated the provisional application of the ECT, stated its intent not to become an ECT Contracting Party, and presented a Conceptual Approach to the New Legal Framework for Energy Cooperation.

The failure of negotiations between Russia and the EU under the ECT reflects essential differences between the two powers regarding the conduct of their energy policies in relation to each other. There is undeniable energy interdependence among them based on the economic complementarity of both parties: while Russia needs EU's technologies, investments and payments for natural resources, the EU is no less dependent on the energy imports from Russia since it is its main supplier. However, differing positions related to natural gas trade has prevailed. Kratochvíl and Tichy (2013) noted that although sharing the notion of integration, liberalization and diversification, the interpretation of each of the ideas differs in the EU and in Russia, causing continuous friction and misunderstandings. The ECT had the role of strengthening rule of law in energy issues, mitigating risks related to energy investment and trade and, consequently, increasing trust among Russia and the EU. When Russia formalized the intention of no longer applying ECT's provisional application, contributed to the rise of mistrust.

According to Article XII.1 of the WTO Agreement, the process of becoming a WTO member is unique to each applicant country. The process takes about five

years, on average. The longest was that of Russia, which after having applied to join GATT in 1993 was approved only in 2011 and became a WTO member on 22 August 2012. For new members to be admitted all existing members must agree to the terms of their accession by the means of prior negotiations.³ As part of this, the Russian accession to the WTO reflected extensive negotiations between the country and the EU. Russia's accession protocol contains obligations that go beyond what was agreed upon between incumbent members of the WTO and reflects matters such as transit, export tariffs, and state-owned enterprises in the natural gas sector. There is even a specific compromise to apply Article V of the GATT 1994 to energy transit. Although it does not mention pipeline transportation as an example of energy transit, it would be difficult to argue that this transportation mode is excluded from the Russian Accession Protocol.⁴ This was crucial to the EU, because although Article V gives important guarantees concerning the transit of goods, it is not clear if it deals with fixed infrastructure or not. As Russia accepted a 'new language' to Article V in order to be a part of the WTO, the text in the Russian accession document became close to what the EU was trying to achieve during the ECT negotiations, concerning transit through fixed infrastructures.

The GATT was based in several negotiation rounds with the main goal to reduce import tariffs with non-discriminatory principles as the MFN clause being applied (Article I). The imposition of export tariffs as an extensive practice in Russia represented for the WTO a different logic than the one of import tariffs. Export tariffs are neither prohibited by the WTO nor do they have a maximum level negotiated. Export tariffs represent an important source of income for exporting states, as well as have the effect of increasing the cost of goods exported, resulting in lower export volumes. An export tariff puts a comparative disadvantage for the exports of a country for most goods and services. In the Russian accession protocol export tariffs were consolidated on approximately 700 tariff lines including mineral fuels (WTO 2011: paragraph 1161). This means that mineral fuels will

³ WTO (1994a) states: 'Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed upon by it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.'

⁴ WTO 2011, para. 1161 took note that 'The representative of the Russian Federation confirmed that the Russian Federation would apply all its laws, regulations and other measures governing transit of goods (including energy), such as those governing charges for transportation of goods in transit by road, rail and air, as well as other charges and customs fees imposed in connection with transit,' ... and that ... 'from the date of accession, all laws and regulations regarding the application and the level of those charges and customs fees imposed in connection with transit would be published. Further, upon receipt of a written request of a concerned Member, the Russian Federation would provide to that Member information on the revenue collected from a specific fee or charge and on the costs of providing the associated services.'

not be subject to higher export tariffs than what was consolidated during the Russian accession.

Article XVII of the GATT establishes rules regarding state-owned and state-controlled companies. The article emphasizes that purchases and selling of products from these companies should respect free market rules, regarding, for instance, price and quality, available quantities, purchasing opportunities, and transporting costs. In the natural gas sector, Gazprom is often accused of making bilateral agreements in gas contracting, setting prices and political side-payments based on what market positions and Russia's relations to purchasing countries allow for in each case. In the Russian accession protocol there was a debate concerning prices implemented by Gazprom, and the representative of the Russian Federation stated that: 'the export price for gas was not regulated by the Government; the prices for deliveries of gas for exports were those negotiated between supplier and buyer. Contrary to the price of exported gas, the price of gas sold to domestic industrial consumers was regulated' (WTO 2011: 23–24).

Diverging views on such price discrimination between exporting and importing countries has been the subject of numerous debates within the WTO. Saudi Arabia, for example, was pressured to take on an explicit commitment to eliminate its dual-pricing program for the natural gas sector (Cavalcanti, Lembo, and Thorstensen 2013:163). The discussions of Russia's protocol of accession followed the same reasoning. Nevertheless, Russia adopted some exceptions to the criteria already established in Saudi Arabia's accession protocol. Russia defended its dual pricing, arguing that it could not be considered a specific subsidy, since lower prices for natural gas in the domestic market would be granted unconditionally across the country, and would be available to all individuals and entities in a non-discriminatory way. It should therefore not qualify as falling under the category of illegal subsidization (Cavalcanti, Lembo, and Thorstensen 2013:163). In an open WTO economy, 'national treatment' requirements of non-discrimination between foreign and national investors and companies is essential. For importers, low and managed domestic prices in exporting countries are perceived as a distortion in the international market and a subsidy to the exporting countries' industries. Hence, dual pricing has been banned in current WTO negotiations (Lembo 2015:94).

5 CURRENT LEGAL EU-RUSSIAN NATURAL GAS DISPUTES

The energy markets of the EU and Russia have developed in different directions: Russia remained a state-dominated 'market' and aims to distance itself from the EU institutional model, while the EU moved towards a neoliberal competitive and integrated internal market (Gusev & Westphal 2015). The common space has become fragmented after Russia expressed its desire of terminate the provisional

application of the ECT and after the Ukrainian crises of 2006, 2009 and 2014. Considering the high level of mistrust it seems unlikely that international regulation and institutions alone will restructure energy relations between Russia and the EU. Considering that disputes result where there is no room for dialogue, EU-Russian natural gas disputes are a great indicator of the seriousness of the situation. The principles of the EU Single Market were gradually drawn into the EU-Russian energy relationship, and the stronger regulations and sectorial specific directives became new topics of controversy. In these, the EU has moved from its 'building block' approach⁵ towards Russia to pursue anti-competitive claims against the Russian natural gas champion Gazprom, and attempted to force the company to adapt to EU regulations both in relation to its activities within Member States as well as in terms of its export monopoly for natural gas. Within the frameworks of the Single market and WTO rules, respectively, both the EU and Russia have been testing each other by legal means over the past few years. In this regard, two cases must be discussed. First, the competition case against Gazprom that the EU put forward; second, the WTO Dispute Settlement case against the TEP⁶ that Russia put forward. Both cases deal with the extent to which the EU may regulate Russian energy policy to become more similar to that common in the West.

In 2012, the European Commission opened proceedings against Gazprom in order to investigate whether the Russian company was acting in breach of EU antitrust rules. The Commission investigated three suspected anti-competitive practices in Central and Eastern Europe: (1) Gazprom may have divided gas markets by hindering the free flow of gas across Member States; (2) Gazprom may have prevented the diversification of supply of gas; and (3) Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil prices. The proceedings had as normative background in Article 102 of the Treaty on the Functioning of the European Union (TFEU), which prohibits the abuse of a dominant position that may affect trade between Member States, and in Article

⁵ Bhagwati & Panagariya (1999) have used the term 'building block' in international trade discussions to describe how trade agreements can lead to a construction of rules that can be used in multilateral negotiations.

⁶ The Third Energy Package or TEP (EU 2009) consisted of two directives and three regulations, besides a focus on the realization of the two first energy packages. The First Energy Package from 1998 allowed the opening of the electricity and gas markets, the gradual introduction of competition, and imposed broad unbundling requirements to integrated companies. The Second Energy Package from 2003 focused on the concepts of unbundling and third-party access, defined the need for independent regulatory authorities, and set deadlines for the liberalization of electricity and gas retail markets in 2004 and 2007. The core elements of the TEP were ownership unbundling to separate companies' generation and sale operations from their transmission networks, the establishment of a national regulatory authority (NRA) for each Member State, and the establishment of an Agency for the Cooperation of Energy Regulators (ACER) to provide a forum for NRAs to work together. The TEP has yet to deliver fully. EU 2015b gives an overview of EU energy-market legislation.

11(6) of the Antitrust Regulation, which provides that the initiation of proceedings by the Commission relieves the competition authorities of the Member States of their competence to also apply EU competition rules to the practices concerned. The allegations were investigated for a long time and, eventually, in April 2015, the Commission sent a Statement of Objection (SO)⁷ to Gazprom alleging that some of its business practices were not in accordance with EU antitrust rules. The Commission also inferred that Gazprom was preventing the diversification of gas supply by denying access to its pipeline network to third-party gas suppliers. Gazprom's conduct was believed to be in breach of the so-called Third Party Access (TPA) regime, set up by the European Gas Directive of 1998 (EU 1998). The claims included:

- (1) Territorial restrictions and measures to partition the market including export ban and destination clauses. Destination clauses prohibiting a buyer from re-selling purchased gas to third customers in different countries have the potential to divide (or 'partition') the EU single market into various national sub-markets, which is incompatible with European competition law.
- (2) Unfair pricing policy on customers by selling its gas through long-term take or pay contracts which link the price of gas to the price of oil. The Commission had assessed prices in different countries and compared them to a number of benchmarks (such as Gazprom's costs, and gas prices in other markets). The findings indicated that prices have largely favoured Gazprom over its customers in five Central and Eastern European Countries.⁸ This is considered a delicate issue since TOP agreements are largely adopted by major gas producers as a means of assure constant demand so that they can plan long term investments (Sartori 2013). The EU believed that it produces unfair extra-rents for suppliers and higher costs for consumers

⁷ A SO is a 'Written communication which the Commission has to address to persons or undertakings before adopting a decision that negatively affects their rights. This obligation of the Commission flows from the addressee's rights of defense which require that they be given the opportunity to make their point of view known on any objection the Commission may wish to make in a decision. The SO must contain all objections on which the Commission intends to rely upon in its final decision. The SO is an important procedural step foreseen in all competition procedures in which the Commission has the right to adopt negative decisions.' See Art. 19(1) of Regulation No 17, Art. 18(3) of the Merger Regulation. Source: www.concurrences.com.

⁸ Bulgaria, Estonia, Latvia, Lithuania, and Poland.

- (3) Extracting commitments in return for gas to keep control over pipelines where Gazprom might be using its market dominance to obtain political commitments regarding two pipelines, one in Bulgaria and the other in Poland. In Bulgaria, Gazprom required the participation of the Bulgarian incumbent wholesaler Bulgargaz in the South Stream pipeline project. In the case of Poland, Gazprom made gas supplies conditional upon maintaining control over key transit pipelines.
- (4) A potential abuse of Gazprom's dominant position closely related to the so-called 'divide and conquer' strategy that Gazprom is alleged to perpetrate in the EU. On the one hand, the company is said to have developed preferential bilateral relations with key Western European customers, to which it gives better contractual conditions. On the other hand, Gazprom is said to have established severe business practices resulting in heavy dependence and higher gas prices in Eastern Europe, in order to preserve Russia's economic leverage and exert its political influence on the region.

Gazprom, although considering that the EU antitrust initiative was 'an attempt [...] to pressure Gazprom and influence prices and the result of commercial negotiations, which is clearly in breach of market principles' (Belton, Barker & Chaffin 2012), in September 2015, the company responded to the SO proposing formal talks as a parallel track on its obligation for a formal response to the antitrust charges made by the EU Commission.⁹ By being willing to negotiate, Gazprom showed that it was eager to reach a compromise solution, not hindering its strategic position in the European market (Farchy 2015a–b). Eventually, in October 2016 the Commission said 'it was down to Gazprom to suggest new ways of doing business in Europe and so avoid a potentially multi-billion dollar fine for anti-trust behavior'. It also decided to allow Gazprom 'to use 30% more of the capacity in the Opal gas pipeline – or another 10.8bn m³/year – while introducing more stringent conditions to ensure fair and non-discriminatory access' (Natural Gas World 31 October 2016).

⁹ The talks have the intention to come with a negotiated solution with the EU, avoiding potential fines which in the EU can be up to 10% of a company's turnover. EU officials have said the Commission is open to the proposed negotiations, the competition commissioner, Margrethe Vestager, has signalled that she is reluctant to settle milestone cases. Furthermore, CEEC countries like Poland and the Baltic States *see* the Gazprom showdown as an important test of whether the EU will take a major antitrust decision in their favour.

In the second case, in May 2015 Russia requested the establishment of a DSB panel¹⁰ to assess EU demands for changes in Gazprom activities within the EU.¹¹ Russia requested consultations with the EU and its Member States regarding measures related the TEP's directives, regulations, implementing legislation and decisions. The measures were understood as inconsistent with obligations and specific commitments under the WTO Agreement (WTO 2014):

- (1) Unbundling of Gazprom operations in the EU, so that, as a producing company, it cannot be the same as a transportation/transmission company.
- (2) A mandatory certification of foreign transmission system owners or operators within the EU territory.
- (3) Non-discrimination. All network users should face the same regulated tariffs, and be able to provide both firm and interruptible third-party services within the EU.
- (4) Discrimination of imported gas in terms of additional requirements (such as resale) affecting its internal sale, offering for sale, purchase, transportation, distribution or use within the territory of the EU.¹²

According to Russia, a major problem with the TEP is that, on every above-mentioned point, the EU offers a number of exemptions, exceptions and derogations to certain EU companies (e.g. Transmission System Operators, TSOs), and the TEP discrimination between these and Russian companies purportedly breaches the MFN clause.¹³ Under the WTO treaty a PTA (such as EU's Single Market) is allowed to grant tariff reductions to its Member States that are not extended to other WTO members (Article XXIV of the GATT as an exception to the MFN clause on non-discrimination). Russia claimed that the EU cannot regulate parties outside the common market (third parties) even if they operate within the EU. There has never been a clear DSB decision regarding the extent to which a PTA can regulate third parties activities inside a PTA.

¹⁰ A panel is established by a DSB meeting when countries do not reach an understanding during the consultation period. A panel addresses the relevant provision cited by the parties in the dispute and comes up with a panel report, what, in the judicial system, would be equivalent to a sentence (WTO 1994).

¹¹ Brazil, China, India, Japan, Ukraine, and the United States are the third parties in this case.

¹² It is significant that this section of the TEP is often called the 'anti-Gazprom clause'; see a related discussion in Cottier, Matteotti-Berkutova, and Nartova (2010).

¹³ More specifically, Russia understands that the EU 'Energy Third Package' is not in accordance to the following WTO rules: (1) Arts II, VI, XVI and XVII of the GATS and EU specific commitments under the GATS; (2) Arts I, III, X and XI of the GATT 1994; (3) Art. 3 of the SCM Agreement; (4) Art. 2 of the TRIMs Agreement; and (v) Art. XVI: 4 of the WTO Agreement.

As the WTO does not establish competition rules as the EU does, it may be expected that WTO must assess the claims from a free-trade perspective. The WTO first and foremost regulates policy for foreign trade (tariffs, quotas), while the EU is more far-reaching in terms of establishing competition rules, directives and regulations for domestic economic activities, many with a de facto impact on foreign trade. However, the EU may try to justify the measures adopted by the TEP as non-discriminatory and necessary to secure energy supply. The General Agreement on Trade in Services (GATS) Article XIVbis is an exception to GATS general rules that allows countries to impose legal measures in order to protect security concerns. In the absence of precedence in DSB ruling as to whether or not a PTA can regulate third parties activities, it remains unclear whether security-of-supply arguments used to defend EU demands on Gazprom will apply. Since the rules in which DSB decisions are based are of a different nature from those used by the European Commission, it is hard to predict the paths that will be followed by the EU providing it loses the WTO case.

6 BUSINESS-TO-BUSINESS AND BUSINESS-TO-GOVERNMENT RELATIONS

The standard reasoning for law and commercial activities is that state authorities set the international political context within which firms operate, while persons, companies, institutions and interest groups within a country exert influence on its policymaking and may alter institutionalized practices to their benefit. Since international law alone is not capable of bridging the differences between Russia and the EU at the government-to-government level, firms find solutions themselves. On commercial business-to-business levels, Abdelal (2011) argues that gas relations between Russia and European firms are not only influencing, but actually driving political outcomes. In the void of international (legal) regulations, trust and mutual understanding built over decades between leading French, German, and Italian energy firms, and a Gazprom by these considered a trustworthy partner, are securing trade and mutual interests of security-of-supply and – demand also on the political level. As a result of such convergence of East-West company interests, the Nord Stream consortium was inaugurated in 2011 with German ex-chancellor Gerhard Schröder as chairman of the shareholders' committee. Nord Stream enabled the direct delivery of Russian gas to Western Europe without crossing transit states. Although several European states like Estonia, Latvia, Lithuania and Poland expressed worries about the project, it was in compliance with EU legislation where 'close bilateral relationships between member

states and Russia could be seen as “useful” to Europe, despite the absence of multilateralism’ (Abdelal 2011).

On the legal business-to-business level, EU companies that feel harmed by commercial practice perpetrated by companies in non-EU WTO countries, there are two principal mechanisms to which they may submit its claims so that the EU can decide which trade barriers to pursue and how: the Trade Barrier Regulation (TBR) and the procedure of the 133 Committee.

- (1) The TBR provides a legalistic mechanism through which European trade associations or firms can raise foreign trade barriers formally with the Commission. The Commission is then under a legal obligation to investigate and to propose action if the barrier is causing harm and if it is in the ‘Community interest’ to do so.
- (2) The 133 Committee route is not governed by any specific legislation, but is derived from the trade policy powers established in the 1957 Treaty of Rome. The Commission again takes the lead, but under this route consults with the Council’s 133 Committee of trade experts. Although there is some ambiguity about the legal requirements, a WTO complaint can only be pursued if it has the support of a qualified majority of the 133 Committee.

According to Alasdair (2004), there is a number of considerations that influence whether and how the Commission pursues such WTO complaints for business-to-business disputes. One of them being the unlikelihood to pursuing aggressively a dispute with a key interlocutor in an ongoing trade negotiation, at least so long as the prospects of the negotiation are considered good.

On the legal business-to-government level, a European company that believes another Member State of the WTO is violating an agreement or a commitment that it has made within the Treaty shall seek the mechanisms provided by the EU so that the dispute may be resolved in the WTO framework, either through negotiations or through the DSB. The ECT is also (still) valid for such disputes. As elucidated by Boute (2014), the investment and dispute resolution regime of the ECT applies for a period of twenty years for foreign investors in Russia’s energy sector who entered the country before 18 October 2009, independent of Russia’s intention to ratify the ECT (i.e. until 2029). One such case is when the majority shareholders of OAO Yukos Oil Company’s (Yukos) initiated arbitration proceedings against Russia under the ECT for the alleged expropriation of their investments in Yukos. Deciding on its jurisdiction and the admissibility of the claims made, the UNCITRAL arbitral tribunal found, under the auspices of the Permanent Court of Arbitration found that, for investments pre-dating 18

October 2009 (termination of provisional application of ECT rules to Russia), Russia was still bound by the ECT. The tribunal considered that Yukos expropriation was not in the public interest, was discriminatory in comparison with the treatment of other oil companies, did not respect due process of law, and given that the company was expropriated without compensation, Russia was found to be in breach of its obligations under ECT Article 13. Hence, the tribunal ordered Russia to pay over USD 50 billion in compensation for the indirect expropriation of Yukos (Brauch 2014). Also the German gas importer RWE questioned Gazprom's pricing of gas contracts. In an arbitrage the UNICTRAL tribunal ruled that RWE did not have to pay for unused gas under the TOP principle, being given the right to amend its contracts with the latter. Gazprom was forced to pay a substantial compensation and to adjust the gas pricing formula (Reuters 2013).¹⁴

Commercial business-to-business relations can also influence political business-to-government relations, and contribute to pressure EU-Russian gas relations from conflict to degrees of cooperation. One part of this concern is the long-term TOP contracts. Long-term contracts have played a stabilizing role in the European gas market since its infant stages in the 1970s. According to Boussena and Locatelli (2013), with price indexation clauses, flexibility clauses, clauses of minimum take-off volumes etc., TOP gas contracts enable risks related to price and volume to be shared between producer and consumer along the gas chain, increasing security for both the importer and the exporter. The long-term contracts between Gazprom and its European partners traditionally have set the price of gas by a formula based on the end-user price of fuel oil.¹⁵ Nonetheless, the EU alleges that such contracts hinder competition in its gas market, and that the possibility of introducing spot prices into the indexation formula related to TOP contracts is a main request of European costumers. Although Gazprom strongly opposes significant changes to the indexation formula, Konoplyanik (2012) argues that 'Gazprom is interested to be competitive at this market in the long-term which means to be as flexible in pricing as it is practical in order to receive highest possible marketable price at any

¹⁴ To do business in Russia requires more efforts than to do business in the EU, and, accordingly, is hampering the growth of the overall East-West economic relationships. Mikhail Krutikhin (2013) outlines that business in Russia is challenged by; 'discriminatory legislation in favor of state companies; administrative hurdles & red tape; poor competence of Russian managers and decision makers; corruption; deficiency of legal protection and perils of takeover raids, and; imperfect taxation based on cash flows rather than profit'. He argues that to do business in Russia within existing formal and informal rules of game you need: (1) due diligence, (2) a reliable local partner, and (3) meticulous control. Krutikhin argues 'if it is not enough, stay away from Russia'. Andrey Kazantsev (2012:7) argues that 'under current circumstances, personal connections with Russian leaders should be practiced in order to diminish risks, better understanding of potential dangers of networking with Russian elite helps to avoid some of them'.

¹⁵ See Austvik (1997:1001–1003) for an overview of how natural gas prices have been set in European LTC.

given point of time.’ This trend can be noticed from fundamental changes in Gazprom’s contractual structure and pricing mechanisms in Europe since 2009, such as (Konoplyanik 2012):

- (1) downgrading minimum TOP obligations from 85% to 60%;
- (2) no penalties for violation of minimum TOP obligation;
- (3) gas sales above minimum TOP obligations on current spot prices;
- (4) increasing flexibility of contractual provisions;
- (5) recalculating base formulae price;
- (6) direct price concessions;
- (7) shorter contract durations;
- (8) shortening of reference period and of recalculation period/interval etc.

While Gazprom is a state-controlled company often related to Kremlin’s policy objectives, it is important to bear in mind that the company also has legitimate economic interests, and has made decisions that could only be understood through the lens of profit-maximization. Companies involved in the trade of natural gas may help finding pragmatic solutions on the political level to ensure the maintenance of their relationships as commercial partners, and to accommodate on the one side security of supply, and on the other side profits and market share.

7 CONCLUSIONS

In spite of the continued rivalries between Russia and the EU, as for any trade, exchanging resources from regions of relative abundance to regions of relative scarcity has the potential to improve efficiency and increase welfare for all. Sales of gas from Russia to the EU are to the benefit of both. However, while other international economic exchange is mostly covered by international (hard) law (mainly the WTO), trade and investments in natural resources are only modestly regulated. Michele Ruta and Anthony Venables (2012:20) note that for natural resources in general the incentives for beggar-thy-neighbour policies are significant and that ‘both importers and exporters have instruments – which are outside WTO disciplines – which they can use to manipulate trade flows and prices in order to meet domestic objectives’. In this context, while Russia attempts to use the power of single countries’ one-sided import dependency for their economic and political benefit, the EU is trying through several directives, most importantly the TEP, to establish competition rules that will assure a less dominant power to Gazprom in its market. The EU considers itself entitled to regulate the activity of any doing economic activities within the area of the Single Market (SM). A common

assumption in the EU is that external relations can be governed in the same way as internal EU affairs and handled similarly by law and institutions regulating economic activities as the EU does for Member States. Viewed from the EU perspective, energy in East-West relations should be treated as just another commodity with policy harmonization across the Community such as privatization programs and market liberalization followed by structural adjustments. In this language, assumed monopolists such as Gazprom for gas and OPEC for oil as external suppliers of energy are largely considered the problem of market failures. Market imperfections connected to pipeline transportation of gas, transit, and external suppliers need be fixed by regulatory and legal measures.

On the Russian side, as a member to WTO, it considers itself entitled to use an international manoeuvring room to pressure the EU into not elaborating rules that can undermine what has been agreed on in the international trade negotiations. The Russian realist perspective sees the importance of a political control of gas pipelines and energy transit as a measure to secure both economic and military positions. In a realist East-West perspective the EU can be considered a weak organization with its intergovernmental structure and absence of financial resources or interventionist measures to address industries and economic policy. These have largely remained the competencies of individual Member States. However, when meeting Russia's hard military and economic (energy) power, Goldthau and Sitter (2015) argue that the EU's soft power is shaped and supported by its market position, determined by both its size and the suppliers depending on it, and the quality and strength of its regulatory power. Harsem and Claes (2012) outline that Russia can exercise power based on its energy resources while the EU can compensate for its lack of power with other trade related capabilities. Without clearer international law directly regulating the exchange, the powers meet today mostly in bilateral arrangements to solve economic disputes or they meet at the business-to-business level, and sometimes at business-to-government relations. Russian accession to the WTO did not solve EU's problems regarding power asymmetry in the energy sector. The case brought by Russia under the WTO against the EU and the one brought by the Commission against Gazprom touches 'unfinished' business regarding natural gas prices, transit, and market dominance. Beyond that, it is a consequence of previous failed attempts to reach consensus under the ECT with WTO-similar rules for economic exchange, or through the EU-Russia energy dialogue. Given the current situation where there is no political trust between them and a way that does not involve disputes cannot be glimpsed, the private sector, which converges in their pragmatic positions, act within the WTO to have a political dialogue between the EU and Russia in the energy sector.

An adequate international legal framework is preferable for both sides to safeguard trade and investment activities in the energy sector. However, instead of exporting/accepting a legal framework established unilaterally, the two powers could address the demands of one and the other, acting on a case by case basis evaluating the possibilities of implementing the suggested policies and the potential consequences of such measures. The EU could consider dropping its usual method of regulatory embrace and rather focus on core market access issues, strong dispute settlement and adoption of international standards for regulation in business and industry (Dreyer & Hindley 2008). By intending to export its *acquis*, the EU imposes its conditions and preferences without taking into account the interests of Russia. The only expected reaction of Russia in these circumstances is to position itself against such impositions as to grant its position as an equal partner who wish to continue to develop and manage its resources independently, even though there is room for negotiation and common agreement regarding some of the EU's requirements. One example of such assertion is the recurrent request of re-examination of long-term TOP contracts, and a possible compromise, as seen in the antitrust case initiated by the European Commission against Gazprom.

If Russia eventually should adapt to EU rules and regulations, it will most likely continue to look for ways of maintaining state control over profits, infrastructure and gas sales. Such national promotion over industrial sectors that a country considers essential may often be possible by ways of implementation of rules and compensatory policies introduced (Austvik 2015:118). Realist-liberalist Joseph Nye (2015) argues that also under a liberal international trade system states must protect themselves against other states, forces, and preferences and, as much as possible, maintain power dominance, under which order may persist. For example, when small state Norway, as the second largest energy exporter to the EU and with some interests shared with Russia in the natural gas field, eventually adhered to SM rules and regulations in the early 2000s, it introduced a number of compensating policies to maintain the ability to maintain the ability to reach national policy goals.¹⁶ Accordingly, if Russia eventually should *de jure* accept WTO/EU types of law in the energy sector, it may not necessarily *de facto* change its policy goals, albeit formally the way it organizes its domestic energy policy and

¹⁶ Norway long objected and resisted against what was considered a threat to national interests and its strong state interventionist policy in its hydropower, oil and gas sectors, when it had to implement EU competition rules and energy directives since the late 1990s. Eventually, Norway went from conflict to acceptance of the EU rules of game. However, by new policies the Norwegian state largely remained at the wheel in its energy sector. Two new fully state owned companies were introduced, Petoro for state ownership of petroleum fields, and Gassco for the control of gas transportation infrastructure, as well as a new regulatory scheme for gas transportation (GasLed). The result was that the state gained a more regulative than interventionist role, in accordance with EU principles. At the same time, the Norwegian state remained the main rent collector in the sector, in control of the infrastructure; and largely could continue in the role as a political industrial entrepreneur and innovator for the sector when considered desirable and/or necessary (Austvik 2010:118–121).

external natural gas export policy. This may not be into a mirror of the purposes for how the West regulates its own economy and society. Most likely it will, in some way or another, maintain 'the hierarchical governance structure based on a quasi-monopoly in the production segment and a transmission and export monopoly' (Locatelli 2013), even if formally and organizationally better adjusted to international norms and rules. Adjusted to the Russian situation, it may represent pragmatic changes that could also benefit the Russian society and state.

East-West competition with hard and soft power and law, take place at all levels and forms. With the creation of the Eurasian Economic Union (EEU) between Belarus, Kazakhstan, Armenia, Kyrgyzstan and Russia in 2015, Russia established an institution much similar to the EU (Single Market, common currency etc.), with Russian language and headquartered in Moscow. Former president of Ukraine Viktor Yanukovich submitted an application to join the EEU in 2013 as an observer to pursue further integration with Russia, and, hence, to abandon the association agreement with the EU. The move was a decisive factor for the Euromaidan protests in Kyiv which eventually ended his term as president, and made him escape to Russia.¹⁷ Path-dependencies from industrial and personal relationships having formed East-West energy trade over decades, in addition to its politicization on country levels, indicate that a full Westernization the Russian energy sector may not be possible, perhaps even not desirable for the EU. In its simplest 'non-politicized' regulatory form, it seems unlikely that an EU-styled unbundling and privatization scheme would work in Russia. In this complexity and the lack of EU-Russian mutual understanding, firms and persons rather than countries may remain in the centre of East-West energy trade and seeking sociological conventions on the way on their own. If further convergence should take place on the government-to-government level, the economic, commercial and political particularities of the energy industry in its interactions in transnational, state and international affairs must be taken into consideration, if formalities and realities should come close.

ACKNOWLEDGMENTS

Thanks to (in alphabetical order) Vicente Bagnoli, Belisa Eleoterio, Øyvind Kalnes, Heiko Pleines, and the anonymous referees for helpful comments to the manuscript. Thanks to the participants in the 'Europe and the geopolitics of energy' study group at Harvard Kennedy School for good discussions. Thanks to Devjani Roy for proof-reading. Any errors that remain are the sole responsibility of the authors.

¹⁷ The following Russian annexation of Crimea and military operation in Eastern Ukraine led to Western sanctions of Russian individuals, companies and officials while Russia responded with sanctions of food imports from the West. As part of this conflictual picture, Russia turned its attention to Asia and wrote several agreements with China in 2015, aiming at deeper economic (and political) ties between the two countries intending to make Russia less economic dependent on the West.

REFERENCES

- The EU-Russian Energy Dialogue* (Pami Aalto ed., Aldershot: Ashgate Publishing Group 2007).
- Abdelal, Rawi, *The Profits of Power: Commerce and Realpolitik in Russia*, 20(3) *Rev. Int'l Pol. Economy* 421–456 (2013).
- Austvik, Ole Gunnar, *Gas Pricing in a Liberalized European Market; Will the Rent Be Taxed Away?* 20(12) *Energy Pol'y* 997–1012 (1997).
- Austvik, Ole Gunnar, *EU Regulation and National Innovation. The Case of Norwegian Petroleum Policy*. in *Innovative Regulatory Approaches Coping with Scandinavian and European Union Policies* 103–130 (Veggeland ed. New York: Nova Science Publisher 2010).
- Austvik, Ole Gunnar, *Landlord and Entrepreneur. The Shifting Roles of the State in Norwegian Oil and Gas Policy*, 25(2) *Governance. Int'l J. Pol'y, Admin. & Institutions* 315–334 (2012).
- Austvik, Ole Gunnar, *Negotiating and Adapting Optimal Integration. Transnational Economic Integration and the Public Management Challenge*, in *Public Administration in the Context of Global Governance* 116–137 (Kim, Ashley & Lambright eds, Cheltenham: Edward Elgar Publishing 2015).
- Austvik, Ole Gunnar, *The Energy Union and Security-of-Gas-Supply*, 96 *Energy Pol'y*. London; Elsevier Science 372–382 (2016).
- Belton, Catherine, Barker, Alex & Chaffin, Joshua, *Kremlin Shield from EU Probe*, *Fin. Times* (11 Sept. 2012).
- Belyi, A.V., *A Russian Perspective on the Energy Charter Treaty*, ARI 98/2009 (Elcona: Royal Institute Elcano 2009).
- Berhidsky, L., *Europe Wrestles with the Gazprom Cronies*, *Bloomberg View* (22 Apr. 2015).
- Bhagwati, Jagdish & Arvind Panagariya, *Preferential Trading Areas and Multilateralism-Strangers, Friends, or Foes* *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* 33–100 (1999).
- Boussena, S & Locatelli, C, *Energy Institutional and Organizational Changes in EU and Russia: Revisiting Gas Relations*, 55 *Energy Pol'y* 180–189 (2013).
- Boute, A. *The Protection of Russian Investments in the EU Energy Market: A Case in Support of Russia's Ratification of the Energy Charter Treaty*, 29(3) *ICSID Rev.* 525–547 (1 Oct. 2014).
- Brauch, Martin, *Yukos v. Russia: Issues and Legal Reasoning Behind US\$50 Billion Awards*, *Investment Treaty News* September 14.9, Winnipeg: International Institute for Sustainable Development (2014).

The Regulation of the International Energy Trade: Fuels and Electricity. Report (Cavalcanti, Carlos, Carolina Lembo, & Vera Thorstensen eds, Sao Paulo: Federation of Industries of the State of São Paulo (FIESP) 2013).

Cottier, Tomas, Matteotti-Berkutova, Sofya & Nartova, Olga, *Third Country Relations in EU Unbundling of Natural Gas Markets: The 'Gazprom Clause' of Directive 2009/73 EC and WTO Law*. Working Paper no-.2010/06. Bern: World Trade Institute (2010).

Dolowitz, David P. & David Marsh, *Learning from Abroad: The Role of Policy Transfer in Contemporary Policy Making*, 13(2000) *Governance* 5–24 (2000).

Dreyer, Iana & Hindley, Brian, *Russian Commercial Policies and the European Union – Can Russia Be Anchored in a Legal International Economic Order?* ECIPE Working Paper no. 05 (2008).

Eisinger, Peter K., *The Rise of the Entrepreneurial State. State and Local Economic Development Policy in the United States* (Madison WI: The University of Wisconsin Press 1988).

Energy Charter, *The International Energy Charter. Consolidated Energy Charter Treaty and Related Documents per. 3.11.2009*, Brussels, The Energy Charter Secretariat (2015), <http://www.encharter.org/index.php?id=7> (accessed 9 June).

EU, European Union, *Directive 98/30/EC Concerning Common Rules for the Internal Market in Natural Gas* (22 June 1998).

EU, European Union, *Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC* OJ L 211, 14 Aug. 2009, Brussels: European Commission.

EU, European Union, *Antitrust: Commission sends Statement of Objections to Gazprom for Alleged Abuse of Dominance on Central and Eastern European Gas Supply Markets*, Brussels, European Commission (22 Apr. 2015a).

EU, European Union, *Energy: Market Legislation*, Brussels, European Commission (2015b).

Fajardo, Teresa. *Soft Law* (Oxford: Oxford University 2014).

Farchy, Jack, *Gazprom Proposes Talks to Settle EU Antitrust Case*, *Fin. Times* (21 Sept. 2015a).

Farchy, Jack, *Gazprom Seeks Peace After Long Fight with Brussels*, *Fin. Times* (28 Sept. 2015b).

Feklyunina, Valentina, *Russia's Image and Its Energy Policy*, *Europe-Asia Studies* (2012) doi.org/10.1080/09668136.2012.661923.

Goldthau, A, & Sitter, N., *A Liberal Actor in a Realist World: The European Union Regulatory State and the Global Political Economy of Energy* (Oxford: Oxford University Press 2015).

Gourevitch, Peter, *Second Image Reversed: the International Sources of Domestic Politics*, 32(4) Int'l Org. 881–912 (1978).

Gusev, Alexander & Westphal, Kirsten, *Russian Energy Policies Revisited: Assessing the Impact of the Crisis in Ukraine on Russian Energy Policies and Specifying the Implications for German and EU Energy Policies*, SWP Research Paper, Berlin (2015).

Hall, Peter & Soskice, David, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press 2001).

Harsem, Øistein & Claes, Dag Harald, *The Interdependence of European–Russian Energy Relations*, 59 Energy Pol'y 784–791 (2012).

Heichel, Stephan, Jessica Pape, & Thomas Sommerer, *Is There Convergence in Convergence Research? An Overview of Empirical Studies on Policy Convergence*, 12(5) J. Eur. Public Pol'y 817–840 (2005).

IEA, International Energy Agency, *Russia 2014: Energy Policies Beyond IEA Countries* (Paris: IEA 2014).

Kazantsev, Andrey, *Policy Networks in European–Russian Gas Relations: Function and Dysfunction from a Perspective of EU Energy Security*, Communist and Post-Communist Studies (2012) doi.org/10.1016/j.postcomstud.2012.07.006

Kissinger, Henry, *World Order* (New York: Penguin Press 2014).

Klapp, Merrie Gilbert, *The State – Landlord or Entrepreneur?*, 36(3) International Organization 575–607 (1982).

Klapp, Merrie Gilbert, *The Sovereign Entrepreneur. Oil Policies in Advanced and Less Developed Capitalist Countries* (Ithaca, NY: Cornell University Press 1987).

Konoplyanik, Andrey A., *Russian Gas at European Energy Market: Why Adaptation Is Inevitable*, 1 Energy Strategy Rev. 42–56 (2012).

Kratochvil, Petr & Tichy, Lukas, *EU and Russian Discourse on Energy Relations*, Energy Pol'y (2013) doi.org/10.1016/j.enpol.2012.12.077i

Krutikhin, Mikhail, *Governance of Russian Business: Law or 'Understandings'*. Lecture at BI Norwegian Business School December, Oslo (2013).

Lembo, Carolina, *Energia E O Sistema Multilateral de Comércio: Perante O Paradigma Do Desenvolvimento Sustentável* (Sao Paulo: Atlas 2015).

Locatelli, Catherine *The Russian Gas Industry: Challenges to the 'Gazprom Model'?*, 26(1) Post-Communist Economies 53–66 (2014).

McNamara, Sally, *Russia's Proposed New European Security Treaty: A Non-Starter for the U.S. and Europe*, Backgrounder no. 2463 (Washington DC: The Heritage Foundation 2010).

Nappert, Sophie, *EU-Russia Relations in the Energy Field: The Continuing Role of International Law*, IAEE Energy Forum, 10–15 (2010).

Nieuwveld, Lisa, & Conway & Partners *Provisional Application of the Energy Charter Treaty: Article 45(1) 'Limitation Clause'*, Kluwer Arbitration Blog (6 Feb. 2010).

Nye, Joseph S. Jr., *Soft Power and American Foreign Policy*, 119(2) *Political Sci. Q.* 255–270 (2004).

Nye, Joseph. S., Jr., *Is the American Century Over?* (Cambridge UK: Polity Press 2015).

OECD, *Investment Policy Review of the Russian Federation: Russia's Energy Investment Policy*, Global Forum on International Investment (2008).

Pleines, Heiko, *Developing Russia's Oil and Gas Industry. What Role for the State?*, in *Russian Energy Power and Foreign Relations. Implications for Conflict and Cooperation* 71–86 (Perovic, Orttung & Wenger eds, London: Routledge 2009).

Pominova, Irina. *Risks and Benefits for the Russian Federation from Participating in the Energy Charter* (Brussels: Energy Charter Secretariat 2014).

Reuters, *Gazprom Dealt Pricing Blow as Loses Court Case to RWE*. Reuters.com (27 June 2013).

Roche, Philip, & Sherina Petit. *Russia's Withdrawal from the Energy Charter Treaty* (Brussels: Norton Rose Fulbright Aug. 2009).

Ruta, Michele, *Resources Trade and the WTO*, VoxEU Policy Portal 4 Aug. 2010. Brussels: CEPR.

Ruta, Michele & Venables, Anthony J., *International Trade in Natural Resources: Practice and Policy*. WTO Staff Working Paper ERSD-2012-07. Geneva: WTO (2012).

Sartori, Nicolò, *The European Commission vs. Gazprom: An Issue of Fair Competition or a Foreign Policy Quarrel?*, 13(03) *Instituto Affari Internazionali Working Papers* (2013).

Selivanova, Yulia, *The WTO and Energy: WTO Rules and Agreements of Relevance to the Energy Sector*. ICTSD, Trade and Sustainable Energy Series. Geneva: ICTSD.

Stoddard, Edward, *Reconsidering the Ontological Foundations of International Energy Affairs: Realist Geopolitics, Market Liberalism and a Politico-Economic Alternative*, 22(4) *Eur. Sec.* 437–463 (2013).

Waltz, Kenneth, *Man, the State and War* (New York: Columbia University Press 1959).

WTO, World Trade Organization, *Agreement Establishing the World Trade Organization* Geneva: WTO (1994a).

WTO, World Trade Organization, *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Geneva: WTO (1994b).

WTO, World Trade Organization, *Trade in Natural Resources. World Trade Report 2010*, Geneva: WTO (2010).

WTO, World Trade Organization, *Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization*, WT/ACC/RUS/70, Geneva: WTO (2011).

WTO, World Trade Organization, *European Union and Its Member States – Certain Measures Relating to the Energy Sector*, Geneva: WTO (2014).

Young, Alasdair, *The European Union's Use of the World Trade Organization's Dispute Resolution Process* (2004).

Ziegler, Charles E., *Energy Pipeline Networks and Trust: The European Union and Russia in Comparative Perspective* 27(1) *Int'l Relations* 3–29 (2013).