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The Fast Dealing Oil Trading Game: Oilopoly Russia's Geostrategic Dominance of the Oil Market Vís-a-Vís the European Union

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INTRODUCTION

Winter 2009—New Year's Day—Russia cuts off the gas supply to Ukraine, like flipping off a light switch. Six days later, exports to sixteen European Union member states are affected.[1] By day seven of the crisis, supplies have been

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[1] Simon Pirani et al., *The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment*, OXFORD INSTITUTE FOR ENERGY STUDIES 1, 4

completely cut off to Europe and Slovakia has declared a state of emergency with dwindling gas reserves.[2] Eastern European countries including Croatia, Slovenia, and Turkey struggle to keep their nations' lights on.[3] The crisis continues for thirteen more days until a resolution is reached by Ukraine signing expensive ten-year "supply and transit" contracts with Russia in order for gas supplies to resume into the Ukraine and European Union member states. The end result: Ukraine's power will stay on until its next argument with Russia, and the match igniting the current European energy crisis between the European Union (the "EU") and Russia has been lit. At the time of the cutoff, Russia controlled two-fifths of the EU's total natural gas supply.[4] As a result of this event, the EU realized that it needed to find alternative sources of natural gas supplies. This article explores the ensuing competition for gas market access in Europe between the European Union and Russia.

The EU-Russian security dilemma is best understood as a quest for energy security. The fundamental differences between the EU approach and the Russian approach are the goals and strategies. Russia maintains geopolitical strategies in order to securitize its market while the European Union strives for energy independence through liberal

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(2009), http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG27-TheRussoUkrainianGasDisputeofJanuary2009AComprehensiveAssessment-JonathanSternSimonPiraniKatjaYafimava-2009.pdf.

[2] *See* Mark Scott, *Russian Gas Crisis Seeps into Europe*, BLOOMBERG (Jan. 7, 2009), http://www.businessweek.com/stories/2009-01-07/russian-gas-crisis-seeps-into-europebusinessweek-business-news-stock-market-and-financial-advice.

[3] *Id.*

[4] *Id.*

institutionalism. Russia utilizes international treaties and bilateral energy agreements for its own securitization practices, effectively weakening the EU's control over its member states' ability to contract under the Energy Charter Treaty ("ECT"). Considering the geopolitics behind Russia's legal moves to secure the energy market across Europe, the EU's only hope to avoid Russian dominance at this stage of the expanding petroleum industry is to secure the future of its own pipelines to offset member countries' need for Russian pipelines. This article predicts that Russia and the EU will continue the battle for striking rich pipeline deals over the next decade as both attempt to check each other in the energy market through incompatible legal and political frameworks (the EU trying to institutionalize the energy market; Russia using geopolitics to manipulate EU institutions for its own gain), constantly undermining each entity's ultimate quest for energy security.

This note examines legal and extra-legal means deployed by both the EU and Russia towards achieving their respective goals. Part I of this note lays out the political and legal framework, focusing on EU-Russian energy conflicts, and explaining the relevant laws and treaties governing the energy sector. Part II considers Russia's current relationship with the EU under the Energy Charter Treaty, current Bilateral Investment Treaties ("BITs") with EU member states, and other relevant investment provisions. Part III explores the current, proposed, and future gas pipeline projects of both the EU and Russia. Lastly, Part IV considers the legal and political ramifications for the future of the European energy sector based on Russia's mission to securitize the energy market and the European Union's drive for gas independence.

I. GROUNDWORK

A. RUSSIAN GEOPOLITICS V. EUROPEAN UNION INSTITUTIONALISM

Russian foreign policy in the energy sector is based on achieving geostrategic advantages.[5] Conversely, the European Union's approach focuses on using the institutional mechanisms such as the ECT rules and regulations to establish the energy market, setting a uniform method for contracting.[6] Russia seeks to securitize using a Realist, geopolitical approach while the European Union continues to try and regulate the industry, bringing Russia into conformity with its market principles.[7] These differing frameworks make it almost impossible to form any long term EU-Russian energy market agreement.

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[5] In International Relations theory, Russia's foreign policy approach would fall under the Realist paradigm, a theoretical framework used to explain changes in states' behavior on the basis of geostrategic gains. Realist states see politics as a zero-sum game. There is a finite amount of power and a state gains security only at the expense of another state's loss. This will be helpful in understanding the Russian strategy in the oil market.

[6] In International Relations theory, this approach falls under the liberal-institutionalism paradigm, an alternative theory to realism, which posits the belief that international norms and institutions create cooperation among states. This approach best characterizes the European Union strategy in developing policy and resolving conflicts. The realist paradigm is incompatible with the very nature of the European Union because it denies the efficacy of extra-governmental bodies and international organizations in world politics.

[7] Henry Helén, *The EU's Energy Security Dilemma With Russia*, 4 POLIS J. 2 (2010).

1. RUSSIAN GEOPOLITICS

The territory that makes up the Russian Federation today extends across a vast amount of land, lacking easily defensible borders, and is home to several hostile ethnic populations that are often at odds with the centralized government.[8] Russia's unique place on the world map—straddling both Europe and Asia—and its diverse ethnic enclaves, make Russian stability dependent on its ability to balance internal and external security. The quests for expansion and security throughout Russian and Soviet history can all be explained in terms of securitization practices.

a) RUSSIAN HISTORY

The Russian empire was formed after three eras of expansion to guarantee security through buffer zones, gaining land in the southeast to protect itself from the Mongols, expanding to the southern territories for access to the Caspian Sea, and lastly, conquering Ukraine and the Baltic territories to deter western threats.[9] The Soviet Union then balanced these external security interests against a newly created internal threat: the disgruntled, conquered minorities. Balance was formed by the creation of a strong,

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[8] Lauren Goodrich and Marc Lanthemann, *The Past, Present and Future of Russian Energy Strategy,* STRATFOR ENTERPRISES, LLC (Feb. 23, 2013), https://www.stratfor.com/weekly/past-present-and-future-russian-energy-strategy [hereinafter "*Russian Energy Strategy*"].

[9] George Friedman, *The Geopolitics of Russia: Permanent Struggle,* STRATFOR (Oct. 15, 2008), http://www.colorado.edu/geography/class_homepages/geog_4892_sum10/Geopoliticsofrussia_stratfor.pdf.

centralized government in Moscow to bring all of the ethnic groups under one authority. The government then began militarizing and occupying the buffer zones to control the diverse internal neighborhood, better defend itself externally from other great power nation threats, and last but not least, utilize its natural resources as a leverage point against other great powers.[10]

The use of natural resources (mainly oil exports) as a leveraging tool has constituted a large part of Russia's past and present geopolitical practices.[11] Since the 1800s, energy has been a vital commodity for Russia's geostrategic goals.[12] During the Soviet era, energy exports accounted for half of the government's export revenue.[13] This allowed the government to fund its expensive militarization practices and subsidize the high cost of transit for food to its internal population, while also subsidizing gas prices to the eastern block that made up buffer zones to keep the conquered territories at bay.[14] Meanwhile, Russia's ultimate geostrategic goal was to secure its western border and ocean access because Russia lacked warm water ports, like the other great power nations, that could be used to combat its economic shortcomings for transit in a land-based empire.[15]

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10 *Id.*

11 *Russian Energy Strategy*, *supra* note 8.

12 *Id.*

13 *Id.*

14 *Id.*

15 Due to Russia's northern land-based territory, the Russian empire and Soviet Union struggled to provide food to its entire populous. First, the growing season was extremely short as the "breadbaskets" are at the latitude equivalence of Maine in the U.S. Second, the vast territory is lightly settled and the farmlands were great distances from urban centers and cities, thus making timely transport problematic, especially in the

Russia's failure to secure timely access to the ocean and external borders, while continuing to divert all of its internal resources towards the government's arms race, subsidizing agriculture and the price of oil tanking, all led to the collapse of the Soviet Union.[16] The government could maintain the high costs of its internal security only if it continued to receive the high revenues relied on from exporting oil to the West.[17]

As the Soviet Union began falling behind the West in technology and resources, the oil market that the Soviet Union heavily relied on to fund its expensive state operations collapsed after the 1970s energy crisis, decreasing demand for the Soviet Union's oil.[18] By the mid-1980s, the Soviet Union tried to raise energy prices in the Baltic region to recover some of the lost revenue and reform its market—but it was too little, too late.[19] The Union fell and the Russian territory contracted, retreating from its western borders and central Asia in order to re-focus its resources to regain internal security and live to fight another day. That day came a decade later with Vladimir Putin's presidency in 2000.[20] The energy market was first on Putin's list to reform by reconsolidating the energy sector under state control after

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winter. Third, the cost of the transport made the food unaffordable. For more information, *see generally* Friedman, *supra* note 9, at 6.

[16] *Id.* at 10-11; *Russian Energy Strategy*, *supra* note 8.

[17] *Russian Energy Strategy*, *supra* note 8. The Soviet Union was able to sell its oil at 50% lower cost than the Middle East due to keeping labor costs low. This gave the USSR power over its periphery while undercutting the West. Problems would soon follow with inefficient oil production, and the fluctuation in the market.

[18] *Id.*

[19] *Id.*

[20] *Id.*

two decades of market liberalization.[21] As a result, the energy sector became effectively nationalized and energy strategy, still used for securitization practices, became Putin's most useful foreign policy tool.

b) RUSSIAN FOREIGN POLICY TODAY

The Russian government underwent a series of restructuring in the two-and-a-half decades following the collapse of the Soviet Union, but the securitization practices never changed, only the audience. Under the Putin regime, the only modification of the strategy was to become more aggressive in utilizing its natural resources as a leveraging tool against the East and West, to not only threaten powerful countries such as the United States, Western European countries, and China, but also to reestablish stability in its periphery.[22] To achieve this, Putin's government consolidated the oil and gas industries into three monster, state-owned companies: Gazprom, Rosneft, and Transneft.[23] Once Russia's gas industry was secured, the Kremlin[24] began

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[21] *Id*. The period immediately preceding the collapse of the Union under the Gorbachev government, into the 1990s reign of Yeltsin, underwent a series of energy liberalization attempts to create a market-based economy. The energy market became even less efficient, as oligarchs bought up the former state owned oil industries, leading to corruption and fragmentation.

[22] *Id.*

[23] To learn more about how the Putin regime was able to swiftly and efficiently consolidate the privatized oil industries, *see* KHODORKOVSKY, http://www.khodorkovsky.com (last visited Feb. 6, 2015). It provides an explanation of the breakup of YUKOS, the largest oil company in Russia owned by billionaire Khordokovsky in 2003 due to alleged "tax fraud."

[24] "Kremlin" is a term used in place of the Russian government/former Soviet government.

aggressively negotiating supply contracts containing large quantities at sky rocketed prices with the former Soviet states and European countries (distinct from the EU) simply because Russia was in the position to do so as the only supplier.[25] The 2009 crisis with Ukraine is illustrative of this approach.

Putin's revised energy strategy has provided Russia with excess funds to pump into its political, military, and economic sectors[26] just as before; but high reward comes with high risk. Over half of the Russian government's budget now comes from the energy sector (more than during the Soviet era); thus, Russian stability remains tied to the success of the gas industry.[27] Putin, acutely aware of this, has tried to shift Russian revenue-raising ventures away from the energy market to decrease its dependency on its oil market, but with little success. Ten years of relying on the Gazprom monopoly has left Russia with lagging technology

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[25] *See Russian Energy Strategy*, *supra* note 8; *see also* THE FUTURE OF NATURAL GAS, AN INTERDISCIPLINARY MIT STUDY 147-58 (2010), *available at* http://mitei.mit.edu/system/files/NaturalGas_Report.pdf. The structure of Europe's natural gas market was shaped by the OPEC embargo of 1973. Europe tied the price of natural gas to the price of crude oil, which limited development of a deep and liquid spot natural gas market. As a result, "this dependence places a high premium on security of supply, which is reflected in the region's dependence on long-term, relatively high-priced contracts indexed to oil." The need for the long-term contracts was to secure supply and accommodate for fluctuating energy prices but oil is an imperfect index for natural gas. The relationship between Oil and Gas will be discussed in detail in Part III.

[26] A specific example is from the early 2000s when Russia paid off its hefty debt and added billions of dollars to a rainy-day "stabilization fund."

[27] *See Russian Energy Strategy*, *supra* note 8.

(reminiscent of Soviet problems) and has made it unfriendly toward outside investment.[28] This economic vulnerability has affected Russia's foreign policy behavior—using energy as a political tool—toward regional and international actors, such as the European Union.[29]

Putin's resulting foreign policy—while aimed at restoring Russia to its previous glory based on territorial boundaries that guarantee Russian security—seeks to use the international institutions in place to achieve its own ends: securing revenue from the European energy market, encouraging bilateral treaties and agreements over EU negotiated deals, and helping establish the rules of the game in those deals contracted with EU institutions. Russia seeks to "divide" Europe to "rule" the energy market and be accepted by the international community as an effective pole in a postmodern, multipolar world.[30] This strategy plays into Russia's divide-and-conquer strategy, its role in international organizations such as the WTO, and its provisional agreement under the ECT, explained further below. Russia's end-goals are to use these institutions to pursue its own unilateral interests in positioning itself to help set the rules for these institutions.[31]

2. EUROPEAN UNION INSTITUTIONALISM

The eventual formation of the European Union was a response to the Realist geopolitics that governed countries'

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[28] *Id.*
[29] *Id.*
[30] *See* Andrei P. Tsygankov, *Preserving Influence in a Changing World*, 58 PROBLEMS OF POST COMMUNISM 28, 36 (2011).
[31] *Id.*

past aggressions across Europe after two world wars. The European Economic Community (EEC), founded in 1958, was originally established to create interdependence among European nations after WWII with the aim of avoiding future conflicts.[32] The hope was that countries that traded together would stay together. Since its creation, the EEC expanded both its members and policy areas, warranting a name change in 1993 to become the European Union, an intergovernmental economic and political partnership that today consists of 28 partner countries.[33] From the EEC's conception to its transformation into the large institutional body called the EU, an institutionalist approach to energy securitization practices has dominated, which entails diversification of the energy markets to attain flexibility and independence.

a) GROWTH AND DIVISION

The European Union, starting from just six member states, expanded to over four times its original size. After WWII and during the ensuing Cold War between the Soviet Union and the United States, the former EEC began to expand to include more Western European member states: the United Kingdom, Ireland, and Denmark in the 1970s; Greece, Spain, and Portugal in the 80s; and Austria, Finland,

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[32] *See generally About the EU*, EUROPA.EU, http://europa.eu/about-eu/index_en.htm (last visited Dec. 14, 2014). The original founders in 1958 for the European Economic Community were Belgium, Germany, France, Italy, Luxembourg, and the Netherlands.
[33] *See The EU in Brief*, EUROPA.EU, http://europa.eu/about-eu/basic-information/about/index_en.htm (last visited Dec. 14, 2014).

and Sweden in the 90s.[34] After the collapse of the Soviet Union and the arms race, the EU consisted of 15 members and conducted its largest acceptance and expansion of membership in 2004 to include more Eastern European countries such as Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia.[35] Part of the motivation behind the large expansion was to instill democracy and bring more of the former Soviet states into the peaceful, civilized European Union that is committed to democratic ideas and fair market trade principles. The Union members in favor of expansion saw this as an opportunity to help the newly established democracies and countries that had undergone democratic revolutions to solidify their commitment to democracy through incentives to join the Union and become part of a trade and political organization that would help their nascent market economies and democratic political structures.[36]

Expansion continued in 2007 to include Romania and Bulgaria.[37] In 2013, Croatia became the newest member.[38] Both the 2004 and 2007 candidates had to undergo a series of internal transformations of their government structures, policies, and laws so as to align themselves with the Union

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34 *See Countries,* EUROPA.EU, http://europa.eu/about-eu/countries/index_en.htm (last visited Dec. 14, 2014)

35 *Id.*

36 *See Enlargment,* EUROPA.EU, http://europa.eu/pol/enlarg/index_en.htm (last visited Dec. 14, 2014).

37 *Countries*, *supra* note 34.

38 *Enlargment*, *supra* note 36.

prior to accession.[39] The concern with accepting the newer members from Eastern Europe is twofold: (1) fear of deviating from the original political goals of the Western European members, and (2) wealthier members like Germany, France, and the United Kingdom bearing the brunt of the costs to revitalize the new members' underdeveloped economies.

Turkey and Ukraine also play roles in changing the composition of the EU, specifically in terms of the discussion below. Turkey filed an application for membership in 1987 and was declared an official candidate in 1997.[40] While negotiations began in 2005, Turkey has yet to accept the additional protocol[41] and negotiations cannot continue until it agrees to do so. The story with Ukraine is different. Ukraine is part of the EU's neighborhood policy and thus cooperates with the EU. An application has not been accepted and Ukraine is not a candidate at this time, but the EU's goal is to continue to bring Ukraine closer to the EU through support packages and assistance to aid the

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[39] *European Neighborhood Policy and Enlargement Negotiations*, EUROPEAN COMMISSION, http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index_en.htm (last visited Dec. 14, 2014).

[40] *See, e.g.*, *Arguments For And Against EU Enlargement*, DEBATING EUROPE, http://www.debatingeurope.eu/focus/infobox-arguments-for-and-against-eu-enlargement/#.Vk6SP9bZrdt

[41] For more information on the additional protocol, *see Additional Protocol and Financial Protocol signed on November 23, 1970, annexed to the Agreement establishing the Association between the European Economic Community and Turkey and on measures to be taken for their entry into force- Final Act- Declarations/* Unofficial translation*/*, 293 OFFICIAL J. L. 4 (Dec. 29, 1972), *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:21970A1123(01).

economy, human rights, and civil society.[42] The EU has not experienced many limitations in implementing uniform policies and expanding its areas of interest with the larger group of members. Despite the EU's ability to efficiently expand its economic, monetary, and social welfare programs in the Union, divisions between old member states with newer eastern members, and each state's separate political and economic agenda, create impediments for a unified EU front on other issues that affect several members of the Union. This is especially true in the energy sector.

The EU members create European policies and initiatives and implement them in their state to increase ease of travel, trade, and welfare among states. "Rule setting is particularly important to the EU because it lacks many other sources of traditional power" as a supranational organization.[43] Members of the European Union are bound by legislation from both their national parliaments and the EU institutions. The European Union has a "single institutional framework" consisting of seven sub-organs that function like a state government.[44] Three of these sub-organs

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[42] For more information on the neighborhood policy and partnership with Ukraine, *see European Neighborhood Policy and Enlargement Netogiations*, *supra* note 39.

[43] *See* Helén, *supra* note 7, at 9 (*quoting* Laffan, *The European Union Polity: A Union of Regulative, Normative and Cognitive Pillars*, 8 J. OF EUR. PUB. POL'Y 709, 711 (2001)).

[44] Under Article 13 of the Consolidated Version of the Treaty on European Union, the seven sub-organs are: (1) the European Parliament; (2) the European Council; (3) the Council of Ministers; (4) the European Commission; (5) the Court of Justice of the European Union; (6) the European Central Bank; and (7) the Court of Auditors. *See* Consolidated Version of the Treaty on the European Union, art. 13, October 26, 2012, 55 O.J. 13, *available at* http://eur-lex.europa.eu/legal-

(the European Council, the European Parliament, and the European Commission) together have power and influence over the EU's policy and law making.[45] The European Council (EC) consists of the heads of state from each country and provides for the political direction of the Union as the essential EU decision maker, negotiating and adopting new EU legislation.[46] The EC does not have the power to exercise legislative functions.[47] The European Parliament (EP) consists of 751 representatives selected by countries that are democratically elected to represent blocs of European citizens.[48] The European Commission (Commission), with 28 members (one from each member state), is the main institution in the EU that has the power to draft proposals for new European laws, take care of day-to-day business, and implement policies.[49] The Commission, in conjunction with the Court of Justice of the EU, enforces policies and has power to place restrictions, fines, and take legal action against members in violation of EU laws.[50]

Legislative acts are formed by "ordinary legislative

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content/EN/TXT/?uri=OJ:C:2012:326:TOC#text [hereinafter "EU Treaty"].

45 *EU Institutions in Brief*, EUROPA.EU, http://europa.eu/about-eu/institutions-bodies/index_en.htm#goto_1 (last visited Dec. 14, 2014).

46 *See generally*, *Counsel of the European Union*, EUROPEAN COUNCIL, http://www.consilium.europa.eu/en/european-council/ (last Dec. 14, 2014).

47 *Id.*

48 *See European Parliament,* EUROPEAN UNION, http://europa.eu/about-eu/institutions-bodies/european-parliament/index_en.htm (last visited Dec. 14, 2014).

49 *See European Commission*, EUROPEAN UNION, http://europa.eu/about-eu/institutions-bodies/european-commission/index_en.htm (last visited Dec. 14, 2014).

50 *Id.*

procedure" as defined by the Treaty on the Functioning of the European Union, which consists of joint adoption by the Parliament and the Council of proposals initiated by the Commission.[51] There are four types of laws that govern EU policies: regulations, directives, decisions, and recommendations.[52] Any regulation passed by the EU sub-organs has general application and is binding on all member states, any directive is binding on the members it is addressed to but leaves the national authority the right to choose how to implement such directive, a decision is binding in its entirety, or if the decision is directed at certain member states, it is binding only on those parties, and recommendations are not binding at all.[53] Member states are required to adopt any national laws to allow implementation of Union acts and when the laws conflict, if the Union was within its competency to create such a law, policy, treaty, etc., it is binding on the state.[54]

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[51] EU Treaty, *supra* note 44, at art. 16(1); *EU Law*, EUROPEAN UNION, http://europa.eu/eu-law/index_en.htm (last visited Dec. 14, 2014).

[52] *EU Law, supra* note 51.

[53] Consolidated Version of the Treaty on the Functioning of the European Union, art. 288, Oct. 26, 2012, 55 O.J. 47 available at, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2012.326.01.0001.01.ENG [hereafter "EU Function Treaty"].

[54] For an example, *see* Case C-6/90 and C-9/90, Andrea Francovich and Daniela Bonifaci and Others v. Italian Republic, 1991 E.C.R. I-5403. This case involved an EC directive that would have given the claimants guaranteed payments due to the insolvency of their employer, but Italy had not yet implemented the directive in a timely fashion. The European Court of Justice held that a directive is still binding on a state even if they have not adopted implementing measures required by the directive. Italy was thus held liable for the violation as a breach of community law and required to provide compensation for the loss suffered by citizens of the community.

B. LEGAL FRAMEWORK

The development of Russia's modern energy market and the formation of an economically interdependent union, the EU, has led to an inevitable clash of laws, ethics, and political frameworks. Below are the laws and regulations that govern the EU and Russia respectively in the energy market. These laws and regulations that govern Russia, the EU, and the Russian-EU relationship have often been formed in response to actions of the other. Additionally, the rules and laws set up by Russia, the EU, and other institutions are further manipulated to achieve their own ends of dominating the energy market, as illustrated in Part II.

1. THE EU ON ENERGY

The European Union and its EEC predecessor were always concerned with establishing uniform energy security and technology across Europe. The EU commitment to energy technology and resources is evident through its multiple appearances in the Treaties of the European Union. Article 3(1)(b) of the Treaty on the Functioning of the European Union, as amended by the Lisbon Treaty, states that the Union shall have exclusive competence for establishing the "competition rules necessary for the functioning of the internal market," and have exclusive competence[55] over a common commercial policy under

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[55] The dichotomy between complete/exclusive or shared competence is the power with which the EU law or regulation has over individual member states. Complete, or exclusive competence and regulations means that they have been established by a unanimity of members in the Council of Ministers, that any law or regulation in that area supersedes

Article (3)(1)(e).[56] This Article implicitly gives the EU competence to set the rules governing the energy market within the Union and Article 4 explicitly puts energy within the competence of the Union. Article 4(2)(i) gives the Union "shared competence" over energy, even if it is not expressly granted or referenced in Articles 3 and 6 of the treaty.[57] Despite these multiple attempts by the EU to create exclusive competence over the energy market, member states have been unwilling to give up their national competence over their domestic oil and gas markets in the energy sector.

In theory, because the EU is an institution governed by the rule of law (treaties) and has established either exclusive competence or shared competence over certain energy issues (through the articles mentioned above), it should not be difficult to regulate and secure its energy market. In practice, the venture is much harder to achieve as the EU has failed to effectively control the energy market and secure energy supplies for its member states. The crucial problem limiting the EU's ability to unify the energy market and complete contracts lies in its inability to act as a unified body towards the energy market. Such shortcomings can be found in the conflicting distribution of competencies within its own treaties, articles, and member states' insistence on controlling their own energy policies. On the one hand, in the Chapter on Energy from the EU Function Treaty, Article

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conflicting national laws. Shared competence means that both the EU body and member states have competence over the area. In order for any law or regulation to be binding on the individual countries, a unanimous vote of the Council of Ministers, comprised of the relevant minister in each member state, agrees to be bound by that regulation.

[56] EU Function Treaty, *supra* note 53, at art. (3)(1)(e).

[57] *Id.* at art. 4.

194(1) and the beginning of Article 194(2) give the EU the power to pass laws and create policy concerning its energy market goals:

> Article 194.
>
> 1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:
>
> (a) ensure the functioning of the energy market;
>
> (b) <u>ensure security of energy supply in the Union</u>;
>
> (c) <u>promote energy efficiency and energy saving and the development of new and renewable forms of energy; and</u>
>
> (d) promote the interconnection of energy networks.
>
> 2. Without prejudice to the application of other provisions of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary to achieve the objectives in paragraph 1. Such measures shall be adopted after consultation of the Economic and Social Committee and the Committee of the

Regions.[58]

On the other hand, if one reads further in Article 194(2), paragraph 2 contains a significant reservation:

> Such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 192(2)(c).[59]

This large reservation undermines the ability of the EU to act as a unified body, giving the individual member states the right to maintain sovereignty over their energy sources and supplies. To remedy this shortcoming, especially in terms of the threat of a Russian oil monopoly, the EU sought to further regulate the energy market as much as it could, creating an energy policy agreeable to all members to protect all energy endeavors in the Union through the Third Energy Package and Energy Charter Treaty.

2. THIRD ENERGY PACKAGE

The EU's attempt to securitize its gas supply to each of its member states came in response to the disunion among members, the repeat incidents with Ukraine and Russia, and

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[58] *Id.* at art. 194 (emphasis added). Article 194(1)(c) will become important for the discussion of newer energy sources (i.e. shale gas and fracking).
[59] *Id.* (emphasis added).

the inability to guarantee its own EU gas supplies. The EU's Third Energy Package came into force on March 3, 2011, containing two directives and three regulations aimed at unifying the EU energy market.[60] The main components of the package are concerned with unbundling the energy market to create a single energy supply market. This means separating the "operation of gas pipelines and electricity networks from the business of providing gas or generating power."[61] The Package also created the European Network of Transmission System Operators for Gas or Electricity (ENTSO) to facilitate cooperation among different national energy system operators.[62] A last major component is the creation of Pan-European Network Codes and ten-year plans to develop these networks.[63] The hope was to have electricity grids and gas pipelines linked among nations by 2014 to allow for the cheap circulation of power.[64]

The EU interdependence structure has created an institutional setting to regulate the relationship among states' activities, but can rely only on soft power to implement any energy policy. In addition, not only does the institutionalization occur internally, the EU effectively "projects onto its relations with other states the type of interstate relations that its own members have succeeded in

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[60] *Third Energy Package*, NATIONALGRID.COM, http://www2.nationalgrid.com/UK/Industry-information/Europe/Third-energy-package/ (last visited Jan. 9, 2015).

[61] *EU Moves Towards 'Single Energy Market,'* RTE.IE (Mar. 3, 2011), http://www.rte.ie/news/2011/0303/298313-eu/.

[62] *Third Energy Package*, *supra* note 60.

[63] *Id.*

[64] *EU Moves Towards 'Single Energy Market, supra* note 61.

setting up with one another."[65] This external projection of EU institutionalism can be seen from the EU's attempted partnership with Russia in the Energy Charter Treaty.

3. THE ENERGY CHARTER TREATY

The Energy Charter Treaty was created after the end of the Cold War as an attempt to provide a framework for international cooperation under the Energy Charter declaration of December 1991.[66] In 1994, the ECT and the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) were created to provide a binding multilateral treaty aimed at leveling the playing field in energy-related investment and trade.[67] By December 1994, The ECT and PEEREA were ready for signature. The ECT and PEEREA entered into force in April 1998, after the first thirty members ratified the treaty.[68] To date, sixty-two states, including EURATOM members, have signed the ECT.[69] Russia was one of the 1994 signatories, but it never ratified

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[65] Helén, *supra* note 7, at 9 (*quoting* Dominique Finon & Catherine Locatelli, *Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?*, 36 ENERGY POL'Y 423, 426 (2008)).

[66] *See generally* ENERGY CHARTER, http://www.energycharter.org/process/overview/ (last visited Jan. 9, 2015).

[67] *Id.*

[68] *Id.*

[69] *'Updated' Energy Charter Frequently Asked Questions,* ENCHARTER.ORG (Sep. 12, 2014), http://webcache.googleusercontent.com/search?q=cache:GPpRBw-1808J:www.encharter.org/fileadmin/user_upload/document/UEC_FAQ.pdf+&cd=1&hl=en&ct=clnk&gl=us.

the treaty.[70] In 2009, Russia announced its statement of intent not to ratify the ECT.[71]

Article 2 of the ECT explains the purpose of the Treaty as, "establish[ing] a legal framework in order to promote long-term co-operation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter."[72] The idea behind the ECT was to liberalize the energy market by creating a multilateral investment treaty as opposed to traditional bilateral investment treaties, discussed in further detail below. The Treaty further makes clear that states retain sovereignty over their energy resources, as Article 18(1) states that "[t]he Contracting Parties recognize state sovereignty and sovereign rights over energy resources. They reaffirm that these must be exercised in accordance with and subject to the rules of international law."[73] This provision guarantees protection from expropriation and other prejudices a foreign investor may face with a less reliable trading partner by holding them accountable in arbitral proceedings if such a situation occurs. Parties to the charter become bound to provide protections to these foreign investors to help promote trade with countries. Despite Russia's intent not to ratify the ECT, as an initial signatory, Russia is bound to protect an investor who is a national of a party to the treaty until 2029 under Article

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[70] Anatole Boute, *The Protection of Russian Investments in the EU Energy Market: A Case in Support of Russia's Ratification of the Energy Charter Treaty*, 29 ICSID REV. 525, 526 (2014).
[71] *Id.* at 526.
[72] Energy Charter Treaty, pmbl, Dec. 17, 1994, 2080 U.N.T.S. 95.
[73] *Id.* at art. 18(1).

45(3)(b) of the ECT.[74] Therefore, any claims by foreign investors can be brought under the ECT against Russia until 2029, but Russia does not have the same privilege. This is important to note for the discussion below.

4. RUSSIAN DOMESTIC LAW AND GAZPROM

The EU's initial energy policies in the early 2000s failed to control the energy market across Europe, vis-à-vis its member states, giving Russia, with its centralized energy policy, an enormous advantage in the short term. With Putin's rise to the presidency in 2000, came the re-consolidation of the energy sector under the Russian government's control. It was all part of the "Putin Doctrine"—Putin's commitment to reviving the economic, political, and geostrategic position of the former Soviet Union.[75] In order to recover the economic component, the Kremlin steadily accrued state sway over the oil and gas industry starting with Gazprom. Gazprom is a majority-state

[74] Energy Charter Treaty, *supra* note 72, at art. 45(3)(b). Article 45(3)(a) states in relevant part that "any signatory may terminate its provision application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty," however, under article 45(3)(b) "[i]n the event that a signatory terminates provisional application under paragraph (a)… any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination." Because Russia has not ratified the ECT, it is not entitled to these same protections.

[75] For more information on the Putin Doctrine, *see* Leon Aron, *The Putin Doctrine*, FOREIGN AFFAIRS (Mar. 8, 2013), https://www.foreignaffairs.com/articles/russian-federation/2013-03-08/putin-doctrine

owned global energy company that was created in 1993, pursuant to the Russian Government Resolution and Presidential Decree as a Russian Joint Stock Company.[76] It was subsequently reorganized to become an open joint stock corporation; however, the government maintains a controlling majority of the company to coordinate its activities with the Kremlin's policies and goals.[77] Gazprom currently holds between 72-78% of the national output and a monopoly over the pipelines and exports from Russia.[78]

The Russian state then pursued its monopoly to also include over half of the oil industry by expanding the majority state-owned Rosneft, Russia's now leading petroleum industry, by "expropriating" Russia's former largest privately owned oil company, YUKOS, in 2004.[79] The Russian government brought tax fraud charges against YUKOS, bankrupting the corporation to break it apart and then put it up for auction by the Government so that Rosneft could acquire the main assets. Putin then appointed former KGB officer Igor Sechin as head of the corporation.[80] Despite

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[76] GAZPROM, http://www.gazprom.com (last visited Feb. 8, 2015).

[77] Paolo Sorbello & Ludovico Grandi, *From Concentration to Competition: The Struggle for Power Between The Kremlin and Gazprom Through The Study of TNK-BP and South Stream*, 25 IRISH SLAVONIC STUD., 106, 109 (2013).

[78] *See The Political Economy of Russian Oil and Gas*, AMERICAN ENTERPRISE INSTITUTE (May 29, 2013), http://www.aei.org/publication/the-political-economy-of-russian-oil-and-gas/; *see also* GAZPROM, *supra* note 76.

[79] *The Political Economy of Russian Oil and Gas*, *supra* note 78.

[80] *Id.* The Russian government achieved a monopoly through bringing false tax fraud charges against Mikhail Khodorkovsky, the former Russian businessman, oligarch, and owner of YUKOS. Khodorkovsky was one of the wealthiest men in Russia and his company was attacked under false auspices in order to bankrupt and break up the corporation and offer the assets up for auction sales at cheap prices. After a series of government actions to cover up the sale, including putting the core

Russia's signature on the ECT, a treaty that was designed to prevent such expropriations, an arbitral award was not considered or rendered until 2014—years after Russia had successfully absorbed the former YUKOS into its own state companies.[81] This demonstrated the EU's inability to effectively control the energy market through 2014 and Russia's willingness to breach the ECT in favor of pursuing its own short-term goals, which may have major repercussions later.[82] After 2004, Rosneft continued to prosper and in 2012 it acquired a 100% stake in TNK-BP, officially making it the largest publicly traded oil company in the world by output.[83] Russia's majority state-owned oil pipeline company, Transneft, led by another former KGB officer, Nikolay Tokarev, completes the Kremlin's energy trifecta.[84] As a result, the Russian energy companies (Gazprom, Rosneft, and Transneft), are *de facto* state controlled companies that are concerned with reasserting Putin's power-vertical state through using energy resources

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assets of YUKOS under a front name in a local province, Rosneft was able to make the purchase inconspicuously. For more information on the expropriation of YUKOS and trial of Khodorkovsky, *see* KHODORKOVSKY, *supra* note 23.

[81] To see highlights and details of the arbitral decisions *see* Martin Dietrich Brauch, *Yukos v. Russia: Issues and Legal Reasoning Behind US $50 billion awards*, IISD (Sept. 4, 2014), http://www.iisd.org/itn/2014/09/04/yukos-v-russia-issues-and-legal-reasoning-behind-us50-billion-awards/.

[82] The 2014 arbitral award was unfavorable to Russia, ruled to owe tens of billions of dollars to the original YUKOS investors that were injured from the expropriation of YUKOS.

[83] *History of Rosneft*, ROSNEFT, http://www.rosneft.com/about/history/ (last visited Feb. 6, 2015).

[84] *Transneft*, FORBES, http://www.forbes.com/companies/transneft/ (last visited Feb. 6, 2015).

as a political tool against the EU and Russia's near abroad.

II. LEVELING THE PLAYING FIELD IN INTERNATIONAL INVESTMENT LAW

The Russian-EU relationship is best understood through the concept of energy security: security of a stable oil market (demand) for Russia and security of direct access to oil lines (supply) to the European community.[85] The current interdependent relationship has made interaction mandatory, but cooperation optional. The relevant laws and regulations that govern Russia, the EU, and the Russian-EU relationship have often been in response to the actions of the other. Russia and the EU have a choice: to work together in the energy market (unlikely based on their differing motives), or to seek a competitive advantage. If the latter strategy is adopted, one of two outcomes will likely prevail: Russia's monopolization of the gas market or the EU's reliable access to non-Russian markets.

A. RUSSIAN-EU RELATIONSHIP UNDER THE ECT

The ECT is an example of the EU's attempt to create a rule of law in the energy market through the provision of legally binding protection for foreign investors. Under the Realist paradigm, the ECT is viewed by Russia as a treaty to secure Europe's energy supply at the expense of Russian

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[85] Silvia Caneva, *EU-Russia Energy Relations: lack of Unity in the Union*, EU-INTERNATIONAL RELATIONS (Mar. 7, 2011), http://www.e-ir.info/2011/03/07/eu-russia-energy-relations-lack-of-unity-in-the-union/.

market security.[86] Russia's subsequent geostrategic planning for its initial signature on the ECT, and later intent not to ratify the treaty based on its Bilateral Investment Treaties (BITs) with European nations, illustrates the different foundations on which the EU-Russian energy relationship is based.

BITs are bilateral agreements between two countries that provide the terms and conditions upon which investments can be made. These agreements grant protection for investments from expropriation and unfair prejudice or bias based on nationality. This is usually done through a specified form of dispute resolution, either by the International Convention for the Settlement of Investment Disputes (ICSID) or in accordance with the rules and procedures of the United Nations Commission on International Trade Law (UNCITRAL).[87] Many of the BITs signed between Russia and other EU member states were initiated while Russia was still legally the Soviet Union, resulting in a lot of narrow dispute resolution clauses since the policies of the Soviet Union were not as concerned with foreign investor rights, as a primarily nationalized economy with few direct foreign investments.[88] The expropriation of YUKOS is a prime example of the way Russia manipulated its legal obligations through individual BITs to gain complete influence and control over the oil and gas industries in Russia.[89]

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[86] For a more detailed explanation, *see generally* Boute, *supra* note 70, at 526.

[87] For a basic understanding of international arbitration and international dispute resolution mechanisms, *see generally* JAN PAULSSON, THE IDEA OF ARBITRATION (Oxford University Press, 2014).

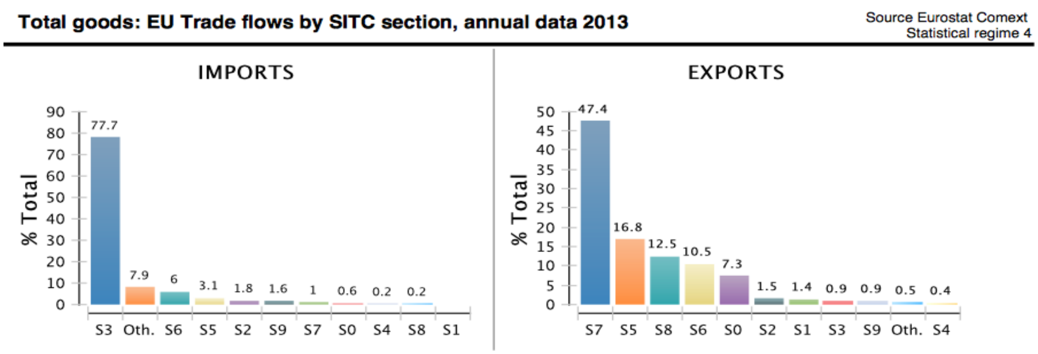
[88] Boute, *supra* note 70, at 530-31.

[89] KHODORKOVKSY, *supra* note 23.

Today, Russia needs EU investments to modernize its natural gas extraction technology and secure its markets, and the EU needs Russian gas reserves to supply its power. The interdependent trade relationship between Russia and the EU is best shown in terms of imports and exports, illustrated in Figure 1.1 below. Attracting foreign investments became necessary for Russia to fund its energy market and the ECT provided a special dispute resolution clause for energy investments that would encourage investment. In 2008, more than 75% of the foreign direct investment Russia received—particularly in the energy sector—came from the EU.[90] Conversely, the EU relied on, and still relies on, large quantities of energy from third party states.[91] For these reasons, the EU used the ECT to try to bring Russia in line with its market principles and institutionalize its relationship with a major gas provider. Russia would benefit from foreign investment with its strategic markets in the EU, mainly Germany, France, Italy, and Spain.

[90] Miroslav Jovanovic, *EU-Russia Energy Relations: the Role of International Law from Energy Investment and Transit Perspective*, 65 INSTITUT EUROPEEN DE L'UNIVERSITÉ DE GENÈVE 1, 62 (2011).
[91] *Id.* at 63.

FIGURE 1.1



SITC Sections

Section	label	Section	label
	Total	S5	Chemicals and related prod, n.e.s.
S0	Food and live animals	S6	Manufactured goods classified chiefly by material
S1	Beverages and tobacco	S7	Machinery and transport equipment
S2	Crude materials, inedible, except fuels	S8	Miscellaneous manufactured articles
S3	Mineral fuels, lubricants and related materials	S9	Commodities and transactions n.c.e.
S4	Animal and vegetable oils, fats and waxes	Oth.	Other

(The above chart indicates trade between the EU and Russia from 2013. The EU imports 77.7% of its S3 category: mineral fuels, lubricants, and related materials from Russia. This category is inclusive of oil and gas. Conversely, the EU exports 47.4%, almost 50% of its machinery and transport equipment (as indicated in category S7) which includes oil and gas extraction technologies, pipeline equipment, and other transport mechanisms for these types of natural resources.)[92]

As an initial signatory to the ECT, Russia has provisional membership for 20 years after its statement of intent not to ratify (until 2029).[93] Provisional membership in

[92] European Union, *Trade in Goods with Russia*, EUROPEAN COMMISSION (Aug. 27, 2014), http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf.
[93] Energy Charter Treaty, *supra* note 73, at art. 45(3).

the ECT means that Russia is bound to apply investment promotion and protection, as well as dispute settlement of the ECT for investments within its territory from the period of provisional application until the expiration of the 20 years in 2029.[94] This would encourage investors from within the EU to invest in Russia's gas market, knowing that any investments they make in Russia from now until 2029 will be protected. However, this protection does not extend to investments made by Russian companies or nationals after 2009 in any of the EU nations. Why then would Russia have signed the treaty in the first place? The answer is twofold.

First, it is possible that many of the investments Russia sought to protect in the EU through its gas conglomerate, Gazprom, were made prior to the 2009 cut off date and formed part of a geostrategic move on the part of Russia. While Russia is bound to protect European member state investments for the 20-year period under the charter, after these EU upstream resources[95] and companies have entered Russia and the protection expires, Russia will have all the technology and resources it needs again. Then Russia,

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[94] Boute, *supra* note 70, at 534.

[95] Upstream and downstream resources are business terms, regularly used in the oil and gas industries. Upstream resources, in terms of the petroleum industry, refer to locating the underwater oil reserves, bringing oil and gas to the surface, and even processing of the raw materials. Downstream resources, in the context of the petroleum industry, refer to the processing of the materials collected from extraction, i.e. oil refineries, and selling the oil and gas products to individuals, governments, or other businesses. The entity responsible for downstream processing has direct contact with customers, providing the finished product. For more information, *see* Brian Bass, *The Definitions of "Upstream" and "Downstream" in the Production Process,* CHRON, http://smallbusiness.chron.com/definitions-upstream-downstream-production-process-30971.html (last visited Feb. 8, 2015).

returning to liability only under the narrow BITs, will feel free to expropriate some of the businesses as part of its energy securitization strategy. Second, the refusal to ratify could stem from the Treaty's Transit Protocol, which would have required Russia to agree to the principles of freedom and transit "without distinction of the origin, destination, or ownership of energy, and non-discriminatory pricing."[96] This would go against the nature of Russia's securitization strategy and practices as it would force Gazprom to give up its physical monopoly of supply when delivering gas to Europe and severely undercut Russia's main revenue-raising venture.

B. RUSSIA'S DIVIDE AND CONQUER STRATEGY: OPERATING UNDER BIT AGREEMENTS

Russia, conscious of the EU shortcomings on enforceability of unified energy legislation, has taken advantage of this weakness in the institutionalism approach (the inability to fully control individual states on a supranational level) by further fragmenting the Union through its refusal to cooperate under the ECT and its own bilateral energy agreements with the major energy providers and innovators of the EU member states. While the EU seeks to institutionalize its relationships, individual member states within the Union still maintain Realist goals to secure their own energy resources, markets, and wealth like Russia. This has made it easy for Russia to contract with individual member states to secure separate, private gas deals on

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[96] Helén, *supra* note 7, at 10 (*quoting* AALTO & WESTPHAL, THE EU-RUSSIAN ENERGY DIALOGUE: EUROPE'S FUTURE ENERGY SECURITY 11 (2008)).

Russian terms without unbundling, while creating incentives for those member states to block a unified energy market in the EU so as to keep their nation's monopoly on gas distribution.

Russia has established "special partners" in the EU through private gas contracts to undercut the EU's ability to create an internal market. These special partners include France, Germany, Italy, and Spain.[97] The energy companies in these countries enjoy separate deals with Russia that favor their own national energy companies, such as Germany's E.On Ruhrgas, France's Gaz de France, and Italy's ENI over a unified energy market.[98] For example, in 2005, Germany and Russia signed a deal to create a pipeline, Nord Stream, from Russia to Germany via the Baltic Sea.[99] Despite Russia's loose BITs with members of the EU, such as Germany, the individual countries are still willing to contract in exchange for lucrative gas deals with terms that would economically favor their domestic energy companies and markets.[100] This will be discussed further below, but for the purposes of the divide-and-rule strategy, the pipeline ends in Germany, making Germany a major hub of distribution of gas for the rest of Europe, giving it power of distribution over the other

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[97] Helén, *supra* note 7, at 13.

[98] Caneva, *supra* note 85.

[99] *See Nord Stream Gas Pipeline (NSGP), Russia-Germany*, HYDROCARBONS-TECHNOLOGY.COM http://www.hydrocarbons-technology.com/projects/negp/

[100] *See* TILMAN DRALLE, A GLANCE INTO THE FUTURE: THE PROSPECTIVE INVESTMENT LAW REGIME BETWEEN THE EUROPEAN UNION AND THE RUSSIAN FEDERATION 23 (2013), *available at* https://tu-dresden.de/die_tu_dresden/fakultaeten/juristische_fakultaet/jfoeffl9/globaltransaxion/veroeffentlichungen/DreRePIEL_paper_0213.

states.[101] These individual gas deals provide Russia with powerful agents in the EU (the states contracting with Russia) to hamper the successful formation of a unified energy policy that would restrict Russia's ability to deliver gas at high prices and maintain its monopoly over gas supplies to the EU.

Not only have these partnerships undermined the creation of an internal, unified gas market, they have also hampered the EU's ability to form an external energy policy with the individual states signing bilateral deals with Gazprom for future energy supplies. Aware of the Russian strategy, especially after the 2009 Ukraine crisis, the EP and EC passed a 2010 regulation to safeguard against future gas cut offs, combating Russia's attempt at dividing the members by furthering the institutionalization of energy supply.[102] Regulation No. 994/2010 provides a Preventative Action Plan and Emergency Plan to ensure that the 2009 Ukraine gas dispute does not repeat itself. Under the regulation, there must be multiple exits for gas distribution to other EU members and certain amounts of gas must always be kept in oil reserves in a member state that is part of the transit and distribution of gas.[103] It further calls for increased cooperation among certain member states in Annex IV to ensure collective security of gas supplies.[104] It is no surprise that Germany, one of Russia's greatest advocates against a unified energy policy, is listed in groups needing

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101 Caneva, *supra* note 85.
102 *See generally* Council Regulation 994/2010, 2010 O.J. (L 295) 1 (EU) [hereinafter "Gas Supply Regulation"], *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0994&from=EN.
103 *Id.*
104 *Id.*

more intra-EU cooperation and transparency.[105]

C. Using other Institutions to Further Respective Russian-EU Policies

In addition to the legislative and contractual activities of the EU and Russia respectively in the energy market, Russia and the EU have further polarized their relationship through retaliations against each entity's disagreeable behavior. While the EU continues to use institutions and rules to combat Russia's aggressive behavior toward establishing a gas monopoly in Europe, Russia has begun using institutions against the EU. The ability of Russia and the EU to negotiate future energy market conditions and regulations has continued to diminish through each side's attempts to gain strategic advantages over the other before continuing gas negotiations.

1. The EU Sanctions Russia for its Behavior in Ukraine

When Russia announced its annexation of Crimea in March of 2014, the EU attempted to use its institutional rules against Russia to demonstrate the EU's ability to control its own member states and trade market. The EU refused to recognize the annexation and placed sanctions against Russian-turned-Crimean officials in addition to restrictive trade conditions already in place under the Council

[105] *Id.* at Annex IV - Regional Cooperation. Germany is listed in three relationships that need improvement: (1) Germany and Poland; (2) Germany, France, Belgium, the Netherlands and Luxembourg; and (3) Germany, the Czech Republic and Slovakia.

Regulation of July 31, 2014.[106] The EU restriction on the sale of goods to Russia under Article 3(1) of the July Regulation required prior authorization for the "sale, supply, transfer or export, directly or indirectly of technologies as listed in Annex II, whether or not originating in the Union, to any natural or legal person, entity, or body in Russia or in any other country if such equipment or technology is for use in Russia."[107] Annex II listed, specifically, line pipe drilling or production platforms, oil and gas extraction tools and machinery, making clear that EU sanctions were not targeted only at Russia's aggressive behavior in the Ukraine, but also at combatting Russia's potential to expand gas projects in the newly annexed part of Ukraine.

If Article 3(1) did not give the impression that the EU was targeting Russia's oil and gas industry, Article 3(5) did so by stating:

> The competent authorities shall not grant any authorization for any sale, supply, transfer or export of the technologies included in Annex II, if they have reasonable grounds to determine that the sale, supply, transfer or export of the technologies is for projects pertaining to deep water oil exploration and production, Arctic oil exploration and

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[106] Erik de Bie and Sanne Mulder, *New EU Sanctions Target Crimea and Sevestopol*, NAT'L L. REV. (Dec. 29, 2014), http://www.natlawreview.com/article/new-eu-sanctions-target-crimea-and-sevastopol.

[107] Council Regulation 833/2014, art. 3(1), 2014 O.J. (L 229) 1, 3 (EU), *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0833&from=EN.

production, or shale oil projects in Russia.[108]

The EU sanctions would effectively cripple Russia's economy, which is dependent upon the upstream resources, previously indicated in Figure 1.1, to produce its oil and gas products. While the EU has been weakening Russia's market access, including bank and loan access, it is clear the EU is still dependent upon Russian gas and oil supplies as it did not limit Russia's gas exports. Such action would have completely crippled Russia, whose largest gas export market is the EU.[109] The sanctions target Russia's oil firms Rosneft, Transneft, and Gazprom by limiting access to EU energy markets, but the fact that the gas industry remains excluded from sanctions demonstrates the EU's inability to completely sever ties with Russia. The sanctions fail to do two things: (1) exercise control over its energy market, as it still relies on Russian gas exports, and (2) make negotiations of subsequent gas agreements amicable.

2. RUSSIA'S WTO CLAIM AGAINST THE EU

In response to the EU's Third Energy Package that would not allow Gazprom to have more than a 50% stake in any energy contracts signed in EU member states, Russia sought to utilize other international institutions for its own agenda, using the EU's institutionalism approach against it. On April 30, 2014, Russia filed a request with the World Trade Organization against the EU's Third Energy

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[108] *Id.* at Annex II.
[109] *Id.* at art. 3(5).

Package.[110] In its request, Russia alleged that EU regulations—specifically, the Third Energy Package provisions—were "inconsistent with a number of obligations and specific commitments of the EU and its Member States under the WTO Agreement."[111] Russia alleged that most of the unbundling procedures of the Energy Package constituted violations of the EU's agreement under the WTO, specifically, the inconsistent application of unbundling procedures and the certification requirements that place higher burdens on third parties and foreign investors.[112]

Russia's interest in settling the matter stemmed from the proposed South Stream Pipeline that Russia and EU members had begun working on, and will be examined further in Part III. Because the Third Energy Package limits Russia's ability to own and operate a pipeline, the regulation would mandate that "50 percent of the pipeline can be operated by Russia's Gazprom, but the other 50 percent must be operated by a third party, a condition Russian energy ministers do not accept" as the Russian State's Gas conglomerate, Gazprom, is the only company with the legal right to export gas from Russia.[113] This would mean Russia giving up complete control of its pipeline, destroying the potential for an independent Russian gas monopoly in Europe, and undermining Russia's profit incentive.

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110 *See Russia files dispute against EU over regulations in the energy sector*, WTO.ORG (Apr. 30, 2014), http://www.wto.org/english/news_e/news14_e/ds476rfc_30apr14_e.htm.

111 *Id.*

112 *Id.*

113 *Russia sues EU over 'Third Energy Package'- report,* RT.COM (Apr. 30, 2014), http://rt.com/business/156028-russia-sues-eu-energy/.

III. RACE TO THE PIPELINE

The EU's recent laws and regulations (the Third Energy Package and sanctions) have weakened Russia's ability to completely dominate the EU's energy market through the government-driven Gazprom. Russia's divide-and-conquer strategy has been successfully deployed to undercut any EU plans for gas liberalization and independence. Both the EU and Russian attempts to control the energy market are best illustrated through the pipelines that have been proposed, implemented, and cancelled. The proposed pipelines are discussed below in terms of the respective strategies and circumstances surrounding the success or failure of the projects, Russia's 30-year gas deal with China, and EU versus Russian plans moving forward.

A. THE NORD STREAM PIPELINE, NABUCCO, AND SOUTH STREAM

The 2005 contract between Germany and Russia to create the Nord Stream pipeline allowed Russia to not only reignite a special relationship with Germany, but was also a strategic legal agreement for Russia to begin securing its energy market. The Nord Stream pipeline was the first direct pipeline from Russia to the EU, bypassing other transit countries.[114] It directly linked Russia and Germany, commercially and politically.[115] Initially, the pipeline was

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[114] For a complete history and background of the planning and construction *see* NORD STREAM, https://www.nord-stream.com/the-project/pipeline/ (last visited Feb. 9, 2015).

[115] It was strategically beneficial for Germany to serve as the major hub of supply of gas to Europe, while also beneficial to Russia in maintaining

viewed as increasing EU's security of supply. The EU later realized, after the Ukraine crisis, that this also meant an increase in gas dependence from an untrustworthy partner: Russia.[116] This led the EU to solidify plans for an alternative gas market and pipeline, the Nabucco pipeline. In response to the EU's Nabucco plan, and after successfully contracting with Germany to construct the Nord Stream Pipeline, Russia also launched a South Stream project between Gazprom and the Italian ENI Company (a mixed corporation) to be completed by 2015.[117] South Stream would require a large amount of financial backing from the energy companies and governments, but would send gas directly to Europe, bypassing Russia's troublesome neighbor, Ukraine, by routing the pipeline under the Black Sea to Bulgaria, where the gas would reach Italy via Greece.[118]

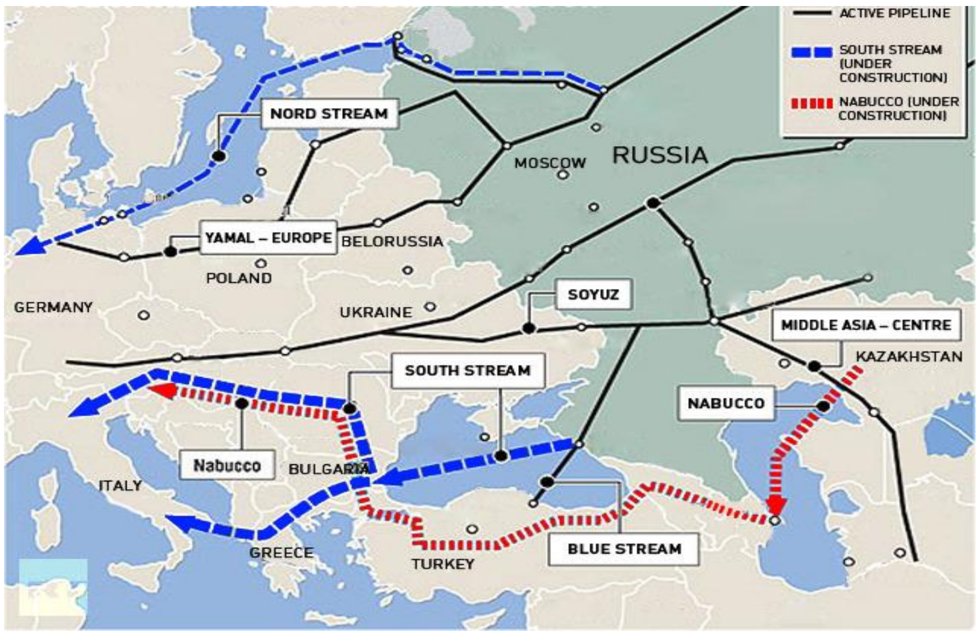
EU dependence on its gas supply. Further, a political alliance between Germany and Russia emerged from Germany's desire to keep its favorable pipeline contract, which brought Germany on board with Russia's desire to limit EU unification of a single energy market.

116 Caneva, *supra* note 85.

117 *Id.*

118 *Id*. The author argues that the agreements showed a tendency of the EU countries to sign bilateral deals with Russia in line with their national interests, regardless of the collective security concerns as members of the EU.

FIGURE 1.2



(This map indicates the four main European-Russian pipelines discussed in this article: The Nord Stream Pipeline (established), South Stream pipeline (scrapped as of December 2, 2014), the Nabucco pipeline (scrapped in the summer of 2014), and the proposed Blue Stream pipeline (Russian pipeline project with Turkey). Pipelines not included in this chart are an alternative EU pipeline and the Power of Siberia pipeline that would feed from Russia to China.)[119]

The South Stream pipeline would further increase EU dependency on Russian gas exports as Russia gained

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[119] *The Russia-Turkey Energy Axis: Putin has chosen the Middle East over Europe,* GLOBAL RESEARCH (Dec. 4, 2014), http://www.globalresearch.ca/the-russia-turkey-energy-axis-putin-has-chosen-the-middle-east-over-europe/5417836.

bilateral agreements with the partially government-owned Italian energy company and struck a huge deal with Bulgaria and Greece to begin the project in 2012.[120] The South Stream project was designed to block any independent EU pipeline, such as the Nabucco pipeline that the EU had been planning for nearly a decade. South Stream and Nabucco had similar planned pathways, as illustrated in Figure 1.2 above. Despite the EU impression that the high costs of building South Stream would make the project highly improbable, it became clear to the EU that Russia was willing to do anything to keep the government-controlled Gazprom from having any competition, including Nabucco.[121]

Russia's second step in its divide-and-rule strategy targeted Nabucco. The pipeline would further divert some of Russia's gas supply percentage to the EU. The Nabucco pipeline became a reality in 2004, under the Austrian OMV company, after being included in the EU Trans-European Energy Network Program and receiving a 2003 EU Project

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120 Parties to the intergovernmental agreements for South Stream between 2008-2011 included the following: Austria, Bulgaria, Croatia, Greece, Hungary, Serbia, and Slovenia. In addition, Gazprom sealed six bilateral agreements with the national companies for cooperation on South Stream: Serbian Srbijagas, Hungarian Development Bank MFB, Bulgarian Energy Holding, Greek gas transmission system operator DESFA, Austrian OMV, and Slovenian Geoplin Plinovodi. *See South Stream*, GAZPROM, http://www.gazprom.com/about/production/projects/pipelines/south-stream/ (last visited Feb. 8, 2015).

121 Judy Dempsey, *Victory for Russia as the EU's Nabucco Gas Project Collapses*, CARNEGIE EUR. (July 1, 2013), http://carnegieeurope.eu/strategiceurope/?fa=52246.

grant to provide half of the funding.[122] The pipeline's construction was planned in two parts: the first part was initially scheduled to be completed in 2012 (later postponed to 2015) to deliver gas from pipelines established in Turkey to Austria, after an intergovernmental agreement was signed between Austria, Hungary, Romania, Bulgaria, and Turkey in 2009. The second part was scheduled for completion in 2013 (postponed to 2019), to bridge the first part of the pipeline in Turkey to Iran and Georgia.[123] Russia's second step in securing its energy market was realized through Russia's state gas conglomerate, Gazprom, gaining control over the companies that the EU sought to use as its own transit network. First, Gazprom signed a memorandum of understanding in 2006 with the Hungarian company, MOL (a transit state in the Nabucco pipeline), to build a rival pipeline to Hungary via Turkey and the Balkins.[124] Second, Gazprom signed a deal with the Austrian-led OMV, which would allow Gazprom to have control over gas delivered to Austria through the Nabucco pipeline.[125]

The combination of (1) incentives for gas companies (OMV and MOL) to leave Nabucco for more lucrative contracts, and (2) the main transit supplier (Azerbaijan's state-owned gas company) backing out due to its close proximity to and fear of upsetting its relationship with Russia, led to the cancellation of the Nabucco pipeline in July 2013. At this point, it appeared as though Russia had won a double victory over the EU through its bilateral

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[122] *Nabucco Gas Pipeline*, HYDROCARBONS-TECHNOLOGY.COM, http://www.hydrocarbons-technology.com/projects/nabuccopipeline/ (last visited Feb. 8, 2015).
[123] *Id.*
[124] Caneva, *supra* note 85.
[125] *Id.*

agreements as (1) the EU's only pipeline project had failed, and (2) it secured Russia's South Stream project. South Stream would effectively be controlled by Russia, with 50% of the project owned by Gazprom, 20% by Italian state-owned ENI, 15% for France's state-owned EDF, and 15% for Germany's Wintershall.[126] Further, each of the incorporated joint contracts to the project gave Gazprom at least 50% ownership.[127] The project would have furthered Russia's securitization of the EU energy market; however, since the onset of the construction in 2012, the EU in Brussels has opposed the project on the basis that South Stream's construction is in direct violation of several EU laws and regulations, including the Third Energy Package.[128]

B. THE BATTLE OF SOUTH STREAM

The legal battle in the ensuing EU-Russian pipeline relationship and conflicting institutionalist versus realist approach came head-to-head in the recent negotiations for

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126 *Why Putin pulled the plug on South Stream*, RT (Dec. 3, 2014), http://rt.com/business/211023-eu-south-stream-putin/.

127 *See South Stream*, GAZPROM, http://www.gazprom.com/about/production/projects/pipelines/south-stream/ (last visited Feb. 8, 2015). The following agreements were made: (1) South Stream Bulgaria-Gazprom and the Bulgarian Energy Holding each had 50% shares; (2) South Stream Serbia- Gazprom held 51% and Srbijagas held 49%; (3) South Stream Hungary- Gazprom and Hungarian Development Bank MFB each had 50%; (4) South Stream Slovenia-Gazprom and Plinovodi each held 50%; and (4) South Stream Austria-Gazprom and OMV owned 50% each.

128 During the time that both the Nabucco and South Stream were in the planning stages, the EU passed the Third Energy Package to create an obstacle to Russia's construction of the South Stream pipeline, which would increase EU dependence on gas from Russia.

South Stream. The EU's response to Russia's individual attacks on Nabucco (including possible reasons for creating the anti-competition laws in the energy sector) was staunch opposition to South Stream on the basis that it competed against Nabucco and ran contrary to the EU anti-competition laws and regulations. Russia's intention with South Stream was to further capitalize on the EU market through Gazprom's 50% stake in each of the pipelines, maintain its ownership of the pipeline and gas travelling through it, and limit the pipeline access to transport only Russian gas, rather than leave the pipeline open for third party access.[129] This runs contrary to the Third Energy Package's requirements that a company cannot own more than 50%, cannot own both the pipeline *and* the gas passing through it, and must abide by the registration requirements for third parties.

Beginning in 2013, the EU opposition to South Stream had seemingly halted the project, as the EU Commission stated the bilateral agreements for South Stream favored Gazprom, and were in breach of EU Law.[130] The EU Commission sought to stop the project through enforcing its laws, ultimately testing the EU's ability to institutionalize the energy market under its own rules. The Commission

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[129] Russia's strategy to gain a monopoly over the South Stream supply and transit routes was also a tool to undermine the EU's ability to diversify away from Russia with the Nabucco pipeline. *See e.g. Russia Tightens Grip on European Gas Supplies with Serbian Energy Pact, Stake in Baumgarten Hub,* IHS, https://www.ihs.com/country-industry-forecasting.html?id=106597195 (last visited Oct. 21, 2015).

[130] *South Stream bilateral deals breach EU Law, Commission says*, EURACTIVE.COM (Apr. 12, 2013), http://www.euractiv.com/energy/commission-south-stream-agreemen-news-532120

sent requests to Bulgaria, Serbia, and other contracting parties to cease work on the pipeline until the contracts were renegotiated because they were in violation of EU law.[131] The Commission articulated three concerns: (1) Russia needed to observe the ownership unbundling rules, meaning Gazprom could not own the production and the transmission network at the same time; (2) third party access to pipelines must be non-discriminatory; and (3) the tariff structures needed to be addressed.[132] Despite the EU's demands to renegotiate the contracts, Russia's realist divide-and-conquer strategy appeared to briefly succeed in the spring of 2014. During this time, Bulgaria passed legislation that freed South Stream from most EU regulations, especially the regulation that would have forced Gazprom to allow non-Russian gas to flow through the pipeline, by classifying South Stream as a "gas-sea" interconnector instead of a pipeline.[133] By the summer of 2014, after condemning the Bulgarian legislation, the EU regained control and told Bulgaria to cease work until further investigation of EU competition laws were conducted. When Bulgaria refused, the EU cut off millions of Euros in regional development funds.[134]

The legal battle ensued, and the EU appeared to have enough power to block the pipeline, until Russia struck another deal to bypass EU laws with Hungary in November

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[131] *Id.*
[132] *Id.*
[133] Jim Yardley & Jo Becker, *How Putin Forged a Pipeline Deal that Derailed*, N.Y. TIMES (Dec. 31, 2014), at A1, http://www.nytimes.com/2014/12/31/world/europe/how-putin-forged-a-pipeline-deal-that-derailed-.html?_r=0.
[134] *Id.*

2014.[135] The Hungarian law essentially approved building South Stream without EU permission by putting the pipeline out of EU jurisdiction. The law would allow companies to construct gas pipelines in Hungary even if the corporation does not have the license to operate it.[136] Therefore, the decision of who could operate the pipeline would be left solely up to the domestic Hungarian Energy Office.[137] Hungary received a reprimand from the EU Commission, which demanded an explanation for plans to continue South Stream, while the EU also launched separate legal action against Hungary for its laws restricting foreign purchase of agricultural land.[138] The battle reached its climax on December 1, 2014, when Putin announced during his visit to Turkey that it was scrapping South Stream for a pipeline with Turkey.[139]

C. RUSSIA'S GAME CHANGING PLAY

Just when the EU thought it had finally won a legal victory over Russia, Gazprom confirmed Russia's decision to abandon the South Stream pipeline project on December 9,

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[135] *Hungarian Law gives green light to South Stream in defiance of EU*, RT (Nov. 4, 2014), http://rt.com/business/202171-hungary-south-stream-eu/.
[136] *Id.*
[137] *Id.*
[138] *See The bullying of Hungary – the Country that Dared to Disobey the US and EU*, RT (Nov. 7, 2014), https://www.rt.com/op-edge/203151-hungary-independent-politics-west/.
[139] *See Russia confirms decision to abandon South Stream*, EURACTIVE.COM (Oct. 12, 2014), http://www.euractiv.com/sections/energy/russia-confirms-decision-abandon-south-stream-final-310712.

2014.[140] This decision left EU members and companies at a loss of over € 2.5 billion.[141] Russia's decision made clear that it does not intend to contract with the EU on Europe's terms. Russia still seeks to manipulate the rules and laws that govern the energy market and is unwilling to take a back seat to the EU institutionalist rules and regulations. Thus, Russia's response to the EU's delays on the South Stream construction and increased sanctions against Russia for its actions in Ukraine was to work with Turkey to build a pipeline on Russian terms. Such a decision is clearly intentional as Turkey was the original transit state picked for the EU's Nabucco pipeline that Russia effectively undermined through separate bilateral agreements.

The new pipeline would effectively circumvent any Third Energy Package regulations which South Stream conflicted with because gas would be delivered to the EU via the Turkey-Greece border, cutting out any EU member state such as Bulgaria or the Ukraine. The Gazprom chief stated that once the new Turkey pipeline becomes operational, "the role of Ukraine as a transit country will be reduced to zero."[142] Thus, Russia's new project aims to demonstrate that it does not plan to conform to the EU's Third Energy Package, nor blink at the sanctions the EU placed on Russia for its activity in Ukraine. As a result, the EU again remains vulnerable until it can acquire alternative gas access and Russia's full strategy becomes clear from its new plans. If Russia can't set the rules directly, Russia will take its ball

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[140] *Id.* Additionally, on December 30, 2014, Gazprom bought back the shares of South Stream from ENI, Wintershall and EDF to gain 100% stake in South Stream.

[141] *Why Putin pulled the plug on South Stream*, RT (Dec. 3, 2014), http://rt.com/business/211023-eu-south-stream-putin/.

[142] *See Russia confirms decision to abandon South Stream*, *supra* note 139.

back and go home; as illustrated by Russia's scrapping of South Stream. Meanwhile, Russia will continue finding loopholes in EU laws and regulations to achieve its own end-goals (securitizing the energy market) until Putin can position Russia to become the umpire in the energy market. Scrapping South Stream in favor of a Turkish pipeline is just another strategic move by Russia to change one of its pawns into another queen to appear stronger on the energy market chessboard against what will be a lengthy game with the EU.

D. RUSSIA'S OTHER PROJECT: ANTI-FRACKING

2014 was a big year for Russia. In addition to the legal battle with the EU over South Stream, a battle over shale gas was playing out in the background between Russia and Chevron. The American energy giant Chevron showed up in Romania in 2013 to lease land for exploratory shale gas drilling.[143] The development of any shale gas or U.S. entry into the European gas market would marginalize Russia's oil and gas prices that fund Kremlin Co., especially in countries that are highly dependent on Russian gas.

Romania, one of these heavily dependent countries, thought it had struck rich with Chevron's plan to look for shale gas, but the region quickly and mysteriously became loud with anti-fracking[144] protests, of which the Russian government is believed to be spearheading. There has been

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[143] Andrew Higgins, *Russian Money Suspected Behind Racking Protests*, N.Y. TIMES (Dec. 1, 2014), at A6, *available at* http://www.nytimes.com/2014/12/01/world/russian-money-suspected-behind-fracking-protests.html?_r=0.

[144] "Fracking" is a term used to define the type of extraction used in shale gas production.

no substantial evidence of Russian involvement in the anti-fracking protests, but it is important to note that while anti-fracking protests developed in all of Russia's near abroad countries that are dependent on Russian oil,[145] no protests have resulted from Gazprom's own exploration of shale gas and oil. Additionally, Russian broadcasters were especially interested in covering the anti-fracking protests, instilling fear in the villagers watching in Romania, Bulgaria, and Ukraine, that they, "along with their crops and animals, would perish from poisoned water," if shale exploration expanded in their regions.[146] Russia seemingly won another victory against the EU through its divide-and-rule strategy, nipping regional shale gas projects in Europe in the bud by pitting the populations of eastern European states against European development of the shale gas market.

E. LOOKING EAST

One other pipeline looms in the discussion of future EU-Russian energy market competition: the Power of Siberia Pipeline. In May of 2014, just after Russia sent its complaint to the WTO regarding the EU's prejudicial Third Energy Package, Russia struck a large deal with China for a 30-year, $400 billion dollar gas supply contract.[147] Potential reasons for the timing and selected partner for the project include the EU sanctions on Russia's energy market and Russia's need for a second large energy market to diversify its own

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[145] I.e. Bulgaria, Lithuania, Romania, and Ukraine. *See* Higgins, *supra* note 143.

[146] *Id*.

[147] *Russia signs 30-year gas deal with China*, BBC NEWS (May 21, 2014), http://www.bbc.com/news/business-27503017.

supplies.[148] The gas deal did not have the most favorable terms as China's president drove a hard bargain on the prices of gas supplied by the pipeline. This could be due to Russia's vulnerability from a combination of EU sanctions, falling gas prices, and a simultaneous drop in the Russian ruble. The more likely answer is that this is another geostrategic move by Putin to secure Russia's long-term energy market consumers before new developers hit the scene, including shale gas operations.

Additionally, in November 2014, Russia and China signed a second pipeline deal, slightly smaller than the initial agreement, which would supply gas from western Siberia to China.[149] Russia, looking east, has turned its attention towards China with two large gas deals to supply almost one fifth of China's total supply.[150] This, in combination with the Turkish pipeline in the works, plays into Russia's geostrategic pivot towards Asia. As a result, Russian dependence on China will increase astronomically in the next few years, but this may all be part of Russia's geostrategic plan. While Russia will remain dependent upon China for now, because China is one of the few countries of the world with the "financial ability and the market capacity to consume Russia's huge energy exports on a sustainable basis over a long period of time," it will enable Russia to prove to the EU that the sanctions will not isolate Russia or bring Russia under its institution's rules.[151] Such economic

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[148] *Id.*

[149] James Paton & Aibing Guo, *Russia, China Add to $400 Billion Gas Deal With Accord*, BLOOMBERG BUS. (Nov. 9, 2014), http://www.bloomberg.com/news/articles/2014-11-10/russia-china-add-to-400-billion-gas-deal-with-accord.

[150] *Id.*

[151] *Id.*

reliance will allow Russia to maintain a stake in the energy market. It is unclear whether the deals with China are a strength or weakness due to the dropping prices of gas and oil this past year. However, for purposes of EU-Russian relations in the energy market, Russia's turn towards Eurasia will continue to increase competition between the two and likely hinder future negotiations with the EU anytime soon to soften the Third Energy Package regulations or sanctions against Russia's ventures in Crimea.

IV. A FUTURE RUSSIAN MONOPOLY?

The EU-Russian race for energy market security in Europe entails several moving pieces. How the pieces fall will shape the legal framework and parameters in which the EU and Russia can contract in the energy market in the future, if at all. Currently, EU-Russian relations hang by a thread as the EU Institutionalist-oriented and Russian Realist-oriented states battle over regional versus national laws prevailing in the energy sphere, particularly concerning the legality of the EU's Third Energy Package. Despite Russia's recent actions shifting its attention away from Europe, it has not taken its eyes off the prize: a monopoly of the energy market in its near abroad, spanning from Western Europe to Eurasia. Similarly, the EU has not given up hopes for gaining energy security for its member states. This section briefly discusses the current status of the EU and Russia respectively, considers their current legal oblations to each other, and then makes concluding remarks, including a prediction and recommendation for future energy market relations between the two.

A. WHERE DOES THIS LEAVE THE EU?

The scrapped South Stream project has left the EU still dependent on Russian gas moving from Russia through Ukraine and the Nord Stream pipeline to Germany. However, the EU is not as vulnerable as it was when the 2009 Ukraine gas crisis occurred. The EU has taken the necessary legal measures to ensure that each member retains natural gas reserves in abundance so that any immediate shut off by Russia will not affect the EU members immediately or harshly.[152] Additionally, the EU has gained confidence from its showdown with Russia over ceasing construction of the South Stream pipeline until Russia conforms to EU laws: keeping member states from working on the project despite Russian attempts to undermine the Third Energy Package and the EU successfully sanctioning Russia for its illegal annexation of Crimea.

The EU also has other plans in the aftermath of the scrapped South Stream pipeline, specifically a smaller pipeline called TANAP.[153] While it does not help the countries that suffered as a result of the scrapped South Stream like Hungary and Bulgaria, TANAP will offset some of the EU's dependence on Russian gas in the future.[154] Despite plans to create new pipelines, the EU's main focus will be promoting "interconnectors" to ensure gas and electricity flow between countries. This is a chance for the

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[152] Gas Supply Regulation, *supra* note 102.
[153] *The European Union heads into battle with national governments on energy*, THE ECONOMIST (Jan. 17, 2015), http://www.economist.com/news/europe/21639577-european-union-heads-battle-national-governments-energy-only-connect?zid=307&ah=5e80419d1bc9821ebe173f4f0f060a07.
[154] *Id.*

EU to make progress on the interconnectedness of EU member states, which had been lagging behind EU timeline goals, mainly due to Russian influences. The EU will not have a problem funding new energy projects and greener alternatives; the problem the EU faces is time.[155] Lastly, the EU, as of January 15, 2015, has been considering whether to prosecute Gazprom for abusing the EU's single energy market rules by forming bilateral agreements with its member states.[156] It appears that the EU has not been broken by Russia's scrapping of South Stream, but has instead found strength to reunify the union to fight new legal battles with Russia.

B. IS RUSSIA AT A POINT OF STRENGTH OR WEAKNESS NOW?

More light will be shed on Russia's position in the energy market after the decisions are made concerning the Third Energy Package from the WTO and if any softening of relations after Crimea occur. The decision by President Putin to scrap the South Stream project and turn to Turkey has raised a lot of questions about the ultimate Russian strategy. The EU claims Russia's decision was a sign of weakness while its economy suffers; however, Russia has portrayed the decision to cease construction of the pipeline as a failure of the EU to cooperate in negotiations, leading to the EU's own economic blunder.

The problem is that Russia cannot completely turn its back on the EU, its largest energy export market and import market for energy technologies. However, how far is too far? The development of the new pipelines with Turkey and

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[155] *Id.*
[156] *Id.*

China, if they ever pan out, would provide Russia with a second energy market, free from EU regulations. If South Stream is ever revisited, the Turkish pipeline is completed, and the energy agreements with China come to fruition, Russia could be headed for the gas monopoly across Europe that it has wanted all along. However, such success, if possible, is far down the road, and Russia's main concern will be securing an energy market so that it can continue its expensive foreign policy to control Ukraine and form an energy alliance with NATO member, Turkey. Now, more than ever, Russia's fate will depend on its ability to securitize a stable flow from the energy market to fulfill its goals under the Putin regime.

C. THE CONTINUED RELATIONSHIP: NECESSARY INTERACTION UNDER THE ECT

The ECT forces Russia and the EU to maintain relations until 2029, meaning that Russia can be held accountable if it goes too far in its divide-and-rule strategy, pulling a similar stunt like the YUKOS expropriation against investors from other EU member states. The end of 2029 will be a decisive year if Russia has managed to hold on to or strengthen its position in the energy market. It is unclear how Russia will behave when its contract under the ECT expires. In order to "level the playing field between energy producers (for instance, Russia) and consumers (for instance, the EU), it is essential to minimize the perception of the ECT as being biased towards consuming States."[157] Further, if the EU is to have any chance to create the framework for the energy market under the ECT, it is in the EU's best interest

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[157] Boute, *supra* note 70, at 547.

to recognize Russia's major role in the modernization of the ECT before going into negotiations with Russia. Russia's role in the draft Convention on Ensuring International Energy Security (an attempt to modernize the ECT), and Russia's determinative role in the development of arbitration[158] in the energy field, make clear that Russia wants an equal seat at the table on the ECT.[159] Such a strategy by the EU could contribute "toward the creation of a genuine level playing field between producing and consuming countries within the framework of the ECT."[160] At the same time, the EU needs to be cautious in its negotiating process with Russia, as indicated by Russia's divide-and-rule strategy that undermined EU institutionalized energy rules and Russia's expropriation of YUKOS.

D. CONCLUDING REMARKS

Russia's actions with South Stream epitomize the Russian divide-and-conquer strategy, using behind-the-scene bilateral deals to create disunity, while simultaneously using the laws and institutions set up by the EU against it. In response, the EU will continue to use the available legal institutions and rules to beat Russia's economy down and isolate Russia's energy market. One thing remains clear: the battle for gas markets is far from over, as is the EU-Russian interaction. So long as Russia has the ability to fund its operations in the near abroad or maintain the appearance that it has the financial wherewithal to achieve its goals, the

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[158] YUKOS made a claim against Russia, and Russia's Gazprom has made an independent claim against Lithuania.
[159] Boute, *supra* note 70, at 547.
[160] *Id.*

EU will struggle to secure its own energy market. Russia's Realist perspective will prevent the co-existence of the EU and Russia in the energy sector. Meanwhile, the EU will not allow Russia to trample on or change the rules set up by its institutions. The incompatible frameworks the EU and Russia operate under have led to further estranging of their abilities to contract in the energy market.

The EU cannot beat Russia by continuing to isolate Russia and further weaken Russia's position in the energy sector. It will need to greet Russia as an equal partner at the negotiation table if it hopes to peaceably form a unified energy market that includes Russia. Conversely, Russia's view of victory leaves room for only one country to be on top: either Russia will effectively create a European gas monopoly or Russia will bring the EU under its energy umbrella. If Russia is unable to secure its market access within a reasonable time span, history will repeat itself and Russia's gas control will implode, leaving the EU with an opportunity to rule the energy market. Neither scenario is likely to happen in the near future.

Russia and the EU will continue to fight for striking rich pipeline deals over the next decade, but they will likely be geared towards different energy markets: Russia looking to Eurasia, while the EU returns its gaze to alternative energy supplies and the Middle East. Despite these diverging directions, both the EU and Russia will continue to "check" each other in the energy market. The EU will resume its pursuit of a uniform energy market across Europe. Russia will continue securing more pipelines for itself while simultaneously undermining rules of the EU institutions to ensure that a unified European gas market is never established unless Russia and its state conglomerate, Gazprom, play a leading role in its creation.