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RUSSIAN ENERGY LEGISLATION: REGULATING STATE MONOPOLIES TO ALLOW THE DEVELOPMENT OF COMPETITIVE MARKETS

*Patricia Fry Eldridge**

Two themes are familiar to anyone who has followed the demise of the Soviet Union and the uncertain beginning of the Commonwealth of Independent States (CIS): (1) a revitalized energy industry is imperative to the independent survival of the former Soviet republics, and (2) foreign investment is imperative to the revitalization of the energy industry. Current and prospective industry participants, however, universally agree that the needed investment will not occur without the development of a rational and transparent legal system that will provide a level playing field for all potential investors, particularly in light of the apparent commitment of the CIS republics to the creation of a competitive, free market economy.

The largest of the eleven CIS republics, the Russian Federation, is in the process of adopting laws intended to provide orderly development of energy resources in a free-market economy. Under a protocol of a September 2, 1991, meeting signed by the Russian Federation Vice Prime Minister and the Director of the University of Houston Law Center's Russian Petroleum Legislation Project, teams of academic and industry experts from both the Russian Federation and Western countries (principally the United States) are drafting legislation that will govern the control and development of underground resources through licensing, tax and fiscal matters, environmental regulation, and conservation of natural resources in the Federation. The teams are also drafting a treaty to be considered by all of the former Soviet republics governing the inter-republic transportation of oil, hydrocarbon products, and natural gas. This article briefly describes the oil and gas industry in the Russian Federation

* Patricia Fry Eldridge is a partner at Bracewell & Patterson, specializing in oil and gas regulation, litigation, and transactions. She has drafted legislation regulating privatized natural gas transportation systems in Bolivia and Argentina as a consultant to the World Bank and currently is a reporter on the Transportation Committee of the University of Houston Law Center's Russian Petroleum Legislation Project, drafting legislation governing the inter-republic transportation of oil, oil products, and natural gas in the CIS.

and the scope and status of the University of Houston Law Center's Russian Petroleum Legislation Project (University of Houston Project).

I. RUSSIAN OIL AND GAS INDUSTRY

Any attempt to create laws encouraging the development of the oil and gas industry in the Russian Federation requires an understanding of the governmental and political context in which the industry has grown, as well as an appreciation of the sheer magnitude of the resources and existing organization of the industry.

A. *Overview of the Russian Federation Government*

The former Soviet Union was a federation of fifteen national republics. Three of the republics, the Russian Federation, Ukraine, and Belarus, formed the CIS on December 8, 1991. As of March 1992, eleven of the former Soviet republics had joined the CIS: the Russian Federation, Ukraine, Kazakhstan, Belarus, Uzbekistan, Tadjikistan, Kirghizstan, Turkmenistan, Azerbaijan, Armenia, and Moldova.

The Russian Federation is by far the largest of the republics. It covers an area of over 6.6 million square miles (over twice the size of either the United States or China), and represents seventy-six percent of the total area of the former Soviet Union.¹ Its population as of 1989 was about 150 million, about fifty-one percent of the population of the former Soviet Union.²

The Russian Federation is known as a federation because it is comprised of several smaller governmental and administrative subdivisions organized according to principles of both geography and nationality. The basic administrative subdivision of the Russian Federation is the oblast (roughly analogous to a province), which is usually named after its capital and consists of a town and the surrounding area. There are forty-nine oblasts in the Russian Federation. A kray is a geographically larger administrative division, and there are six in the Russian Federation. While there is no legal distinction between the two, oblasts generally are located in the more industrially developed regions of the west, and krays generally are located in the agricultural south and in Siberia.

The Russian Federation also contains three types of autonomous administrative subdivisions with boundaries generally drawn according to nationality or language. These include sixteen autonomous republics, five autonomous oblasts, and ten autonomous okrugs. The status of autonomous republic is assigned generally to geographical regions heavily populated by one nationality. Most of the smaller ethnic minorities that do not have the status of an autonomous republic form an autonomous okrug or oblast, as a subdivision within a basic oblast or kray subdivision. The status of autonomous oblast is usually assigned to territories inhabited by ethnic minorities with larger populations and/or more developed cultural systems than those inhabiting autono-

1. *Russian Soviet Federated Socialist Republic*, in 28 THE NEW ENCYCLOPEDIA BRITANNICA 1017 (15th ed. 1986).

2. SOVIET UNION: A COUNTRY STUDY (Raymond E. Zickel ed., 2d ed. 1991).

mous okrugs. The status of autonomous okrug is usually assigned to large, remote areas of sparse populations.³

The highest governmental body in the Russian Federation is the Congress of Deputies, which meets infrequently. The unicameral Supreme Soviet, which is elected by the citizens of the Russian Federation for a term of four years, conducts the day-to-day governmental business of the Federation. It historically has confirmed the regional divisions of autonomous republics, oblasts, and okrugs; confirmed the economic plan and budget for the Russian Federation; elected the Presidium; and chosen the Council of Ministers.

Between sessions of the Supreme Soviet, the Presidium of the Supreme Soviet of the Russian Federation serves as the highest governmental body and exercises all of the powers of the Supreme Soviet. The Presidium is elected by the Supreme Soviet and includes a chairman, sixteen vice-chairmen (one from each autonomous republic), a secretary, and thirteen members.

The Council of Ministers is the highest executive and administrative body of the Russian Federation. It coordinates the work of the ministries, adopts measures to carry out State economic plans, implements the budget, and directs and inspects the work of the autonomous republics and other administrative bodies.

Each autonomous republic has its own constitution and exercises substantial self-government through its own legislature (a locally elected supreme soviet with its presidium), administration (a local council of ministers), and judicial bodies. As a federated part of the Russian Federation, each autonomous republic is represented in the Presidium of the Supreme Soviet of the Russian Federation. The authority of each autonomous oblast and okrug historically has been generally limited to self-government in its internal affairs.⁴

This governmental structure is required by the current Constitution of the Russian Federation, and it defines the powers of the legislative bodies upon the premise that the Communist Party rules the country. The role of President Yeltsin is formally ceremonial under existing law, and President Yeltsin is acting principally under emergency powers. Accordingly, a new constitution has been proposed that would create a body similar to the U.S. House of Representatives, which would be comprised of 300 members directly elected according to the distribution of voters. A federal assembly similar to the U.S. Senate would be comprised of three delegates from each autonomous republic or oblast. The two houses would pass laws separately. Finally, the Federation president would be assigned clear executive powers. The new constitution is scheduled to be proposed for adoption in April 1992.

3. See generally Barry A. Zulauf et al., *Government Structure and Functions*, in *SOVIET UNION: A COUNTRY STUDY* at 361-62 (Raymond E. Zickel ed., 2d ed. 1991); LESLIE SYMONS ET AL., *THE SOVIET UNION: A SYSTEMATIC GEOGRAPHY* (1983); *Russian Soviet Federated Socialist Republic*, in 28 *THE NEW ENCYCLOPEDIA BRITANNICA* 1017, 1018 (15th ed. 1986).

4. See generally Barry A. Zulauf et al., *Government Structure and Functions*, in *SOVIET UNION: A COUNTRY STUDY* at 327-98 (Raymond E. Zickel ed., 2d ed. 1991); LESLIE SYMONS ET AL., *THE SOVIET UNION: A SYSTEMATIC GEOGRAPHY* (1983); *Russian Soviet Federated Socialist Republic*, in 28 *THE NEW ENCYCLOPEDIA BRITANNICA* 1017, 1019 & 1021 (15th ed. 1986).

B. Management of the Russian Federation Oil and Gas Industry

1. Overview

In September 1991, Russian Federation President Yeltsin decreed that all natural resources and energy-related systems in the Russian Federation were owned by the Federation and directed the Russian Federation's Ministry of Energy and Fuels to take over the management of the oil and natural gas industries. Since that time, the management policies in the oil and gas industry in the republic have been in a state of rapid flux. The administrative command system used to manage the industry for over sixty years under the control of the Soviet Union is being dismantled in a piecemeal fashion, and individual joint stock corporations are taking over industry operations subject to the continuing direction of the Ministry of Energy and Fuels. While these rapid changes reflect significant movement toward competitive markets, there is still great uncertainty as to the identity of the industry decisionmakers and the limit of their power to engage in free market activities.

2. Management of the Oil and Gas Industry in the Russian Federation Before September 1991

Prior to President Yeltsin's appropriation of the Russian Federation oil and gas industry in September 1991, the central theme of the Soviet economic policy was the Communist doctrine proclaiming that only State ownership of the means of production could deprive the capitalist class of its power over the working people and ensure prosperity for all.⁵ In accordance with this doctrine, Stalin had established an economic system in the 1930s in which private incentives were replaced by strict State controls, and industries and farms were to be efficiently operated under economic plans developed by the Communist Party and enforced by an effective and loyal government and legal system.⁶ While subsequent Soviet leaders variously challenged Stalinist systems, it was Gorbachev's policy of *perestroika* (restructuring) that significantly undermined and led to the demise of the power of the Communist Party. Even after the defeat of the Communist hardliners during the coup of August 1991, however, the development, production, and marketing of oil and gas in the Russian Federation continued to be directed principally by the central Soviet Union government.

The "enterprise" historically was the basic legal operating industrial unit in the Soviet economy, and most enterprises were relatively small. Under reforms instituted in the late 1970s and early 1980s, enterprises were deprived of their legal powers and several were joined together in larger entities known as production associations. The production associations were formed essentially as corporations operating on the basis of economic accountability; they were expected to show a profit and were subject to evaluation on the basis of a balance sheet and income and expense statement.⁷ Commercial relationships among production associations were governed by a system of planned con-

5. JOHN N. HAZARD ET AL., *THE SOVIET LEGAL SYSTEM: THE LAW IN THE 1980'S* 111 (1984).

6. *Id.*

7. *Id.* at 141.

tracts in which the basic terms of transactions were determined by State economic plans while details were negotiated by the production associations by contract.⁸

Accordingly, under the Soviet system, production associations did not formulate their own production and marketing strategies. Rather, central Soviet government planning agencies (principally Gosplan), working in conjunction with the Communist Party, formulated the basic tasks to be accomplished by all industries, including the oil and gas industry. Based in part on production capability estimates from the oil and gas production associations on the one hand, and estimates of refinery, domestic consumer, and export requirements on the other, the central planning agencies set production and transportation quotas that each of the respective associations were required to meet under threat of penalty. The various energy-related ministries of the Council of Ministries of the Soviet Union were charged with executing the economic plans as set forth by Gosplan and its related agencies.

Immediately before President Yeltsin appropriated Russian Federation oil and gas resources and management in September 1991, exploration, development, transportation, refining, and processing of oil and natural gas were performed by hundreds of industry associations operating under the direction of six principal agencies of the Soviet Union:

- (1) The Bureau for the Fuel and Energy Complex was a standing body of the Council of Ministers of the Soviet Union and was responsible for coordinating the work of the energy ministries.
- (2) The Ministry of Geology (Mingeo) was charged with the development of selected oil fields, the exploration and surveying of the Soviet Union's mineral resources, expansion of proved reserves, and development of new exploration techniques.
- (3) The Ministry of Oil and Gas (Minnefteprom) was charged with the management of the onshore extraction of crude oil and associated gas and gas condensate as well as offshore natural gas extraction. The ministry was also responsible for managing the operation of oil and oil products pipelines through Glavtransneft, a State enterprise within the Ministry of Oil and Gas.
- (4) The State gas concern Gasprom was formed in 1989 from most of the elements of the former Soviet Ministry of Natural Gas (Mingazprom). Gasprom functioned as a vertically integrated company with bank accounts, property ownership, contracting rights, and the right to sue and be sued in courts of justice and arbitration tribunals. Gasprom controlled the United Gas Supply System which included the production, processing, transportation, and storage of most of the natural gas produced in the Soviet Union. Local distribution of natural gas typically was handled at the republic level.
- (5) The Ministries of the Chemical and Petroleum Refining Industry (Goscomnefteproduct and Minneftechemprom) were charged with the refining and production of oil products and petrochemicals, among other commodities in the Soviet Union. Oil and oil products typically were distributed at the republic level.
- (6) The Ministry of Construction of Petroleum and Gas Industry Associations (Minneftegazstroy) was the primary contractor for the construction of oil and gas facilities and infrastructure (including processing plants), installation of equipment during development, and the laying of oil and natural gas pipe-

8. *Id.* at 153.

lines (including compressors and pumping stations) in the Soviet Union.⁹

The Soviet ministries in turn assigned the various industry tasks to the oil and gas ministries of the respective republics. The republics' oil and gas ministries then set concrete production, supply, and delivery targets for the producing associations operating within each republic and also allocated supplies and equipment to the associations. Investment in the industry came out of the State budget. Earnings went back into the State budget, although associations often operated at a loss because the prices of fuels were not set with regard to costs, but to social goals. Exports, on the other hand, were handled by the State trade monopoly that purchased oil and gas from production associations at low wholesale prices and sold at world market prices, with the difference going into the State budget.¹⁰

3. Management of the Oil and Gas Industry After September 1991

Prior to September 1991, decisions affecting the oil and gas industry in all of the republics of the Soviet Union, including the Russian Federation, were made at the Union level. However, when on September 11, 1991, President Yeltsin decreed that the Russian Federation's Ministry of Fuel and Energy would take over Soviet oil, nuclear power, natural gas, and coal industries in the Federation,¹¹ enterprises such as Glavtransneft and Gasprom were directed to continue carrying out their duties in the Federation but to do so under the direction of the Ministry of Fuel and Energy. That ministry now determines energy policy and regulates all energy industries in the Russian Federation.¹²

Power changes are also occurring at the local government level. The political leaders of the Tyumen Oblast in Western Siberia, for example, have been particularly active in pressuring the Federation government for independent control over the oil and gas resources in the Oblast. As a result, on September 24, 1991, President Yeltsin issued a decree that gave the Tyumen Oblast ten percent of oil and gas revenues from the region (they had demanded thirty percent). The decree also established a chain of authority over the development of oil and gas resources in the Tyumen Oblast. Under the decree, the Russian Federation will own the oil and gas resources, and the control of the development of those resources is delegated to the Ministry of Fuel and Energy which in turn will delegate the authority to Rosneftgas (the

9. Anatoly Sharai, Division of Spheres of Activities, Plenary Powers and Interrelations Between the USSR Ministry of Oil and Gas, the USSR Ministry of Geology and "Gasprom" Concern, Paper Presented at the MD SEIS/USSR Oil & Gas Seminar in Houston, Tex. (1991).

10. Paul R. Gregory, Barriers to Reforming the Soviet Legal System, Paper Prepared for the University of Houston Law Center's Russian Petroleum Legislation Project (all rights reserved). Professor Gregory is the Project Coordinator for the University of Houston Project.

11. *Yeltsin Orders Takeover of Oil, Gas Sectors*, PLATT'S OILGRAM NEWS, Sept. 13, 1991, at 1; *Yeltsin Takes Control of Energy Resources on Russian Territory*, THE REUTERS LIBRARY REPORT, Sept. 12, 1991.

12. The Russian Federation Committee of Geology apparently has principal responsibility for issuing licenses for resource development to the individual production associations, and the Russian Federation Ministry of Economics and Finance apparently also plays a role in regulating the industry, having the responsibility of reviewing all joint venture applications from Western companies.

new Russian Oil Company) and the local producing associations.¹³ It is unclear, however, how the authority to regulate oil and gas development will be divided among these authorities.

Meanwhile, former government entities are converting themselves to private and quasi-private status, claiming ownership and control of the facilities and resources they used to regulate. Two of these new energy companies, Rosneftegas and Gasprom, continue to exercise the monopoly power over the production, transportation, and marketing of oil and natural gas formerly enjoyed by their State enterprise predecessors.

a. Rosneftegas

Rosneftegas was created as a joint stock company in October 1991, when forty-seven principal oil production, exploration, and related-service associations of the Russian Federation rejected economic control by the Ministry of Energy and Fuels. These associations together account for about ninety percent of the oil output of the former Soviet Union. Rosneftegas is now undertaking all administrative functions of the former Soviet Ministry of Oil and Gas, and the oil production associations are part of Rosneftegas.¹⁴ Glavtransneft (renamed Transneft) remains virtually intact within Rosneftegas as basically a subsidiary. It still manages the economic and commercial decisions of most of the inter-republic oil and oil products pipelines.

Because of the vast distances from the producing fields to markets, the oil and gas transportation systems in the former Soviet Union are immense. The length of the oil pipeline system totaled about 43,500 miles, with nearly 600 pumping stations and a storage capacity of over seventeen million cubic meters. Almost 40,000 miles of the total network length is comprised of large-diameter pipelines with an average diameter of over thirty inches. The long-distance lines are divided among the former Soviet republics as follows:

Russia	30,422 miles
Kazakhstan	3,045 miles
Ukraine	2,175 miles
Belarus	1,765 miles
Azerbaijan, Georgia	740 miles
Turkmenistan, Kirghizstan, Uzbekistan	1,131 miles
Latvia, Lithuania	466 miles

Transneft controls the operation of the unified pipeline system from seventeen regional centers, ten of which are in the Russian Federation.¹⁵

Under the Soviet system, Glavtransneft purchased oil and oil products at

13. *Order of the President of the RSFSR [Russian Federation] About the Development of Tyumen Region*, ROSSUSKAYA GAZETA, No. 198, Sept. 24, 1991.

14. *Power Plays Seen Worsening Russia's Oil Chaos*, REUTERS, Nov. 15, 1991.

15. P. Davies et al., *The Challenge of New Pipeline Systems in Russia and the Republics*, Paper Presented at the International Conference on the New Realities in Pipeline Design, Construction and Operation (Jan. 28-29, 1992); see also Valery D. Chernyaev, *Shipment of Joint Venture Crude Oil by the USSR Trunk Pipelines*, Paper Presented at the MD SEIS/USSR Oil & Gas Seminar in Houston, Tex. (1991).

State-determined prices from production associations and transported and sold oil and oil products to domestic refineries and other domestic purchasers, also at State-determined prices. It also transported all oil and oil products destined for export. Thus, Glavtransneft was the principal buyer, transporter, and reseller of oil in the Soviet Union and employed over sixty thousand people to conduct these activities.

In contrast, effective January 2, 1992, Transneft attempted to adopt a tariff system in which it would cease functioning as a buyer and reseller of oil and hydrocarbon products in domestic markets and would become a transporter only, both for the domestic and export markets. Production associations and refinery associations had sufficient notice of Transneft's efforts to attempt to contract directly for the sale and purchase of oil (still at State controlled prices). Some refiners, however, were left with insufficient supplies of oil, and the absence of accounting procedures created some confusion as to whose oil was delivered to a particular refinery. As a result, the Ministry of Energy and Fuels again has intervened to some degree to direct the flow of oil. Nonetheless, Transneft (which still monopolizes the transportation of oil and oil products in the former Soviet republics) has taken significant steps to facilitate a more competitive market for the sale of oil and oil products.

b. Gasprom

A reformulated Gasprom remains in control of the inter-republic United Gas Supply System. More specifically, in January 1992, the governments of the Russian Federation, Ukraine, and Belarus agreed to reorganize Gasprom as a joint-stock corporation. The founding shareholders are the Russian State Committee for the Management of State Property, the Ukrainian Cabinet of Ministers, and the Belarussian State Committee for the Management of State Property. Corporate stock ownership apparently will also be open to other republics, as well as to private investors (both domestic and foreign), in which event Gasprom will emerge as a quasi-State corporation.

Gasprom is comprised of twenty-five natural gas production and transportation associations. Eighteen associations operate in the Russian Federation, and one association operates in each of the Ukraine, Belarus, Turkmenistan, Uzbekistan, Georgia, Azerbaijan, and Armenia. The operating premise of the Gasprom is the continued management of the production, processing, and transportation of natural gas as a single system.

The system is totally integrated and includes gas deposits in Western Siberia, the Komi Republic, Orenburg Oblast, Turkmenistan, Uzbekistan, Ukraine, and the Caspian area, with estimated gas reserves of more than 1,000 trillion cubic feet. The system also includes over 130,000 miles of trunklines with diameters from forty to fifty-five inches,¹⁶ 376 compressor stations, more than 500 gas fields, 46 underground storage facilities (with a total capacity of

16. The annual throughput of a 55-inch diameter pipeline is more than one trillion cubic feet.

more than 2.8 trillion cubic feet), and 6 gas processing plants.¹⁷

In 1990, Gasprom produced more than 26.4 trillion cubic feet of natural gas and 17 million tons of condensate. This amounts to about forty percent of world gas production. In 1992, the Gasprom associations are projected to produce more than 27 trillion cubic feet of natural gas (ninety-two percent of all production from the former Soviet Union).

Unlike Rosneftegas, therefore, Gasprom has made no move to diminish its monopoly power in the production, transportation, and marketing of natural gas. Moreover, it continues to operate subject largely to State control, although its founding documents provide some opportunity for private investment.

C. Opportunity and Need for Investment in the Oil and Gas Industry in the Russian Federation

The former Soviet Union was the world's leading petroleum producer. Known Soviet proven reserves were estimated to be about 58 billion barrels of oil (an estimated ten percent of the world's proven total) and 52 trillion cubic meters of natural gas (forty-four percent of the world's proven total). The official estimate of potential oil reserves is between 60 and 80 billion barrels, and estimated gas reserves are 268 trillion cubic meters.¹⁸

Russian Federation reserves are concentrated in Western Siberia, which is comprised principally of the Tyumen and Tomsk Oblasts.¹⁹ In 1991, the Russian Federation accounted for more than ninety percent of Soviet oil production and about seventy-five percent of its natural gas production.²⁰ In May 1991, the Russian Federation produced crude oil at a rate of about 9 million barrels per day, compared to U.S. production of about 7.4 million barrels per day and Saudi Arabian output of 8.2 million barrels per day. It also produced a reported 21.9 trillion cubic feet of natural gas in 1990, compared to 17 trillion cubic feet in the United States and 3.5 trillion cubic feet in Canada.

Notwithstanding the accomplishments of the oil and gas industry under the government of the former Soviet Union, by all accounts the oil and gas production and transportation infrastructure is in a discouraging state of disrepair. This results from insufficient capital, obsolete equipment and technology, and inefficient production practices. Oil output from the historically prolific Western Siberian regions in the Russian Federation has declined precipitously from a peak of about 10 million barrels per day in 1988 to about 9.2 million barrels per day in 1990, a decrease of 8.8 percent. This decline of oil production in the Russian Federation is consistent with the

17. Nikolai I. Belyi, *Huge Soviet Gas Industry Set for Participation, Major Expansion*, OIL & GAS JOURNAL, Oct. 21, 1991, at 53.

18. UNITED STATES GENERAL ACCOUNTING OFFICE REPORT, SOVIET ENERGY (1991); ENERGY ATLAS OF THE USSR (Jones & Bartlett Publishers 1985).

19. The most important of the other oil producing republics are the European republics of Kazakhstan and Azerbaijan and the Central Asian republics of Turkmenistan and Uzbekistan.

20. *Yeltsin Takes Control of Energy Resources on Russian Territory*, THE REUTERS LIBRARY REPORT, Sept. 12, 1991.

decline in the former Soviet Union as a whole, from about 12.5 million barrels per day in 1987 to about 10 million barrels per day in 1991.²¹ Exports from the former Soviet Union declined from a high of nearly 4.1 million barrels per day in 1988 to 3.5 million barrels in 1990.²²

One expert on Soviet energy policy enumerates several factors that have led to the dramatic decline in oil production in the former Soviet Union, including:

- (1) the failure of the Soviet central planners to anticipate production declines in the early 1970s;
- (2) over-production of fields in an effort to meet production targets;
- (3) an unbalanced response to production declines that emphasized development at the expense of exploration;
- (4) a loss of labor productivity and performance as large numbers of temporary workers were sent to remote areas without adequate housing and support services;
- (5) a lack of coordination with planning agencies responsible for providing oil field drilling supplies;
- (6) inadequate technology to develop and fully produce some fields; and
- (7) reliance on increasing supply rather than balancing those efforts with energy conservation measures designed to reduce demand.²³

While natural gas production has continued to increase, it has done so at a much slower rate than in the past. The gas industry's performance has been hurt principally by investment cuts and heavy taxes, gas field equipment shortages, and skyrocketing increases in maintenance and repair requirements on trunk pipelines.

The oil and gas industry overall has declined to such a degree that, in February 1992, fifty-six major oil associations engaged in the exploration, development, processing, transportation, and trading of oil and natural gas in ten former Soviet republics, formed the Union of Oil Industrialists. The Union adopted an appeal to the presidents and governments of the CIS republics calling for coordination of activities to save the industry. The appeal emphasized the need for inter-republic agreement on financing and supplying the oil and gas industry, as well as for a special integrated program for the reconstruction of the industry's infrastructure.²⁴

Foreign investment is universally perceived as the salvation of the energy industry in the CIS and, ultimately, the economy of the CIS republics. At the same time, investment in the vast resources of the Russian Federation is seen to be potentially extremely profitable to potential investors. Indeed, literally hundreds of Western companies have rushed to the main energy players among the CIS republics, the Russian Federation, Ukraine, Belarus, and Kazakhstan, seeking to capitalize on the need for modern technology, serv-

21. *Soviet Flow Skids to Less than 10 Million B/D*, OIL & GAS JOURNAL, Dec. 30, 1991, at 24. See *infra* note 22.

22. UNITED STATES GENERAL ACCOUNTING OFFICE REPORT, SOVIET ENERGY (1991).

23. THANE GUSTAFSON, CRISIS AMID PLENTY: THE POLITICS OF SOVIET ENERGY UNDER BREZHNEV AND GORBACHEV (1989).

24. See *CIS Oil Industry Union Founded to Prevent Break Up of Industry*, SUMMARY OF WORLD BROADCASTS, (The British Broadcasting Corp. Feb. 7, 1992).

ices, capital goods, and, most importantly, investment capital.²⁵ However, the abrupt renunciation of Communism and commitment to free-market principles has created a legal vacuum frustrating all areas of commerce, including the energy industry.

II. THE UNIVERSITY OF HOUSTON LAW CENTER'S RUSSIAN PETROLEUM LEGISLATION PROJECT

A. *History of the Project*

In June 1991, the Minister of Oil and Gas of the former Soviet Union invited Dr. Paul R. Gregory, professor of economics and finance at the University of Houston and an expert in Russian business and economics, to organize a team of experts to assist in the drafting of energy legislation. Dr. Gregory enlisted the support of Dean Robert L. Knauss of the University of Houston Law Center and the University of Houston Law Center Foundation, a non-profit foundation that funds legal scholarship. Dean Knauss in turn enlisted Mr. George W. Hardy, III, a former dean of the University of Houston Law Center, as project director and Jacqueline Weaver, a professor at the University of Houston Law Center, as Executive Director.

Realizing that the Soviet Union lacked the hard currency necessary to fund a meaningful project, the project leaders contacted industry participants, non-profit organizations such as The Houston Endowment, law firms, and other potential sponsors, asking them to fund the expenses of the project and to provide research support. Both the project leaders and potential sponsors, however, wanted assurance that the University of Houston Project would have the official support of the government and would not be one of many similar projects that would make little or no meaningful contribution to the development of a sound legal system in the Soviet Union. Also, political developments in the Soviet Union following the August 1991 coup suggested that the project would require the approval of the government of the Russian Federation, in addition to the government of the Soviet Union.

After additional discussions with Soviet and Russian Federation officials, Russian Federation Vice Prime Minister Gavrillov and Mr. Hardy signed a protocol of a September 2, 1991, meeting, in which the Russian Federation officially endorsed the University of Houston Project and assured that the project would be the designated coordinating body for international cooperation on energy legislation in the Russian Federation. The protocol was subsequently endorsed by Mr. Vladimir Lopukhin, then the Deputy Minister of Economics and now Minister of the Russian Federation's Ministry of Energy and Fuels. The University of Houston Project began its work and continues to work under the direction of Minister Lopukhin and his staff.

B. *Underground Resources Code*

Meanwhile, Dean Knauss, Mr. Hardy, and Dr. Gregory returned to Moscow and immediately began work on a draft of an Underground

25. See *More Deals Forged in Former U.S.S.R.*, OIL & GAS JOURNAL, Jan. 20, 1992, at 28; *More Ventures Crop Up for Work in U.S.S.R.*, OIL & GAS JOURNAL, July 1, 1991, at 26.

Resources Code that had been prepared by the Ministry of Geology. That draft, however, included strict regulation of companies' investment and development strategies and production, among other remnants of the traditional administrative command system.²⁶ In response, the University of Houston team outlined several principles that (issues of transition aside) would ultimately be necessary, at a minimum, to create a free market economy in energy:

- (1) Energy enterprises must have the freedom to determine their own level of investment and production, as well as the distribution of their products.
- (2) Energy prices should reflect the commodities' true value; they should not be used as an instrument of social policy.
- (3) Multiple prices for energy commodities (low domestic prices, higher world export prices) should be eliminated.
- (4) The threat of monopoly abuses can be controlled by regulation that would, for example, ensure relative freedom of entry to all parties.
- (5) Complex and dense tax systems should be avoided.

The University of Houston team, however, found that the entrenched principles of Communist doctrine, as well as practical concerns, made acceptance of these free market principles by their Russian counterparts difficult.

As analyzed by Dr. Paul Gregory in a paper prepared for the University of Houston Project,²⁷ the Russian counterparts tended to think in terms of administrative rather than market solutions. Russian authorities, even those who have a strong belief in market economies, have difficulty believing that markets can allocate resources in a rational manner. Moreover, because the administrative command economy produced an industry structure dominated by a few producers and monopoly pipelines, Russian authorities believe monopoly power will be a tremendous problem under a free market system.²⁸

In addition, the Russian economy historically has been an industrial economy based on the premise that energy is cheap. Russian officials recognize that their economy cannot tolerate the 3,000-4,000% increase in domestic energy prices which would occur if the artificially low domestic prices were allowed to rise to world market levels. Accordingly, oil prices will have to be gradually adjusted to world prices, but in the meantime administrative controls will continue to be needed to force producers to meet domestic needs.²⁹

Ownership of natural resources is also perceived as an immense problem. Even if natural resources remain public property, the disputes between the Russian Federation, the autonomous administrative divisions within the Russian Federation, and local governments over ownership and control of oil and gas resources and infrastructure have yet to be resolved.³⁰

Against this background of concerns and discussions between the University of Houston team and their Russian counterparts, an Underground

26. Paul R. Gregory, *The Making of Economic Laws in the Soviet Union: Observation of the Process*, Paper Prepared for the University of Houston Law Center's Russian Petroleum Legislation Project (all rights reserved).

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

Resources Code was drafted, submitted to, and adopted by the Russian Federation Supreme Soviet in February 1992. The Underground Resources Code provides the basis for all uses of the subsoil, including petroleum development. For example, the Code identifies authorities with whom investors must deal to secure binding agreements and describes the mechanisms by which exploration rights can be granted, whether by bidding or direct negotiations. While the Code does not incorporate all of the principles and provisions advocated by the University of Houston team, it nonetheless effects laws pertaining to the development of oil and gas resources in the Russian Federation that can be evenly applied to all industry participants.

C. Legislation Addressing Licensing, Conservation and Environment, Tax and Fiscal Matters, and Transportation

While the drafting of the Underground Resources Code was ongoing, the remainder of the University of Houston Project was organized into teams of Western and Russian industry and legislative experts.

1. Structure of the Western and Russian Legislative Teams

The University of Houston Project is structured around four groups of Western experts and a Russian legislative team. The Western groups are comprised of accountants, tax experts, economists, lawyers, and professors drawn from large and small oil and gas companies, private law and accounting firms, consulting firms, and universities. The Western experts are responsible for drafting legislation in the areas of licensing, conservation and environment, tax and fiscal matters, and transportation, as follows:

- (1) Licensing Group: This group is drafting model legislation governing the contractual relationship between the Russian Federation, as host country, and private companies that seek to invest in the exploration and production of oil and gas on federation territory. The topic includes dispute resolution and administration, including such issues as how the Russian Federation should structure its agencies or ministries to provide for effective regulation through administrative processes.
- (2) Conservation and Environment Group: The legislation drafted by this group addresses the manner in which oil and gas wells are drilled, completed, produced, and plugged and abandoned; the spacing and density of wells; and sound reservoir engineering practices to assure maximum ultimate recovery of oil and gas (such as gas-oil and water-oil ratios). Generally, all matters related to the physical and environmental safety of oil and gas operations and the maximum efficient use of a valuable nonrenewable resource fall within this topic. This group will coordinate its efforts with existing and generally applicable environmental laws and regulations in the Russian Federation. This topic also includes proposals for administering and enforcing the conservation and environmental laws through expert agencies and a permitting and monitoring system.
- (3) Tax and Fiscal Matters Group: A tax regime is critical to the goal of creating an economic environment attractive to investment and to the legitimate interests of government in receiving a fair portion of the wealth produced from oil and gas. Legislation drafted by this group interfaces with issues arising in connection with licensing. For example, what share of production, or its value, will be payable to the government as grantor of exploration and

production rights in the form of royalties? This topic also addresses the treatment of foreign taxes and royalties in the investor's home country.

- (4) Transportation Group: The transportation group will address the inter-republic regulation of the transportation of oil, hydrocarbon products, and natural gas by pipeline. In this connection, most of the major oil and gas pipelines traverse the territory not only of the Russian Federation, but of other CIS republics as well.³¹ For example, the former Soviet Union's largest crude oil export pipeline, the Druzhba (Friendship) line, is 2,900 miles long, originates in the Volga-Ural fields in the Russian Federation, and crosses Belarus and the Ukraine to reach refineries in Poland, Czechoslovakia, Hungary, and Germany.³² Accordingly, the task of the transportation committee originally was to draft a law to be issued by the Soviet Union. After the demise of the Soviet Union and creation of the CIS in December 1991, however, the task now is to draft a treaty to be adopted by the former republics of the Soviet Union. The principal goal of the treaty will be to ensure nondiscriminatory access to essential facilities and markets.³³ In the absence of any CIS-level agencies or enforcement mechanism, the draft treaty also will propose the formation of some sort of inter-republic body that will enforce the provisions of the treaty.

Each group is led by two co-reporters, typically one from academia and the other from active law practice or industry, who are charged with actually drafting proposed legislation. The reporters in turn are advised by the other members of their respective expert teams. Finally, once each draft is completed, it is reviewed by University of Houston Project leaders to determine its consistency with the other draft laws, as well as with the Project's goal of developing legislation that not only will satisfy the interests of the people of the Russian Federation, but also will encourage domestic and foreign investment in the development of oil and gas resources in the Russian Federation.

Once completed, the draft laws are forwarded to the Russian legislative team for review. The Russian legislative team includes academic specialists and representatives of ministries, institutes, and other Russian Federation industry organizations. Team members' expertise includes natural resources, particularly oil and gas, and economic reform. They are supervised by Vladimir M. Lopukhin, Minister of the Ministry of Energy and Fuels, and his staff.

2. Status of the Project

Initial discussions between the Western and Russian teams commenced in Houston in October 1991, when the Russian team travelled to Houston to meet with the four Western groups. During the meetings, the Russian dele-

31. In fact, the major pipelines transport gas from Western Siberian fields in the Russian Federation for export to Eastern and Western Europe cross the Ukraine and Belarus. Exports directly from the Russian Federation to, for example, Finland represent only a small percentage of total Russian Federation gas exports. Similarly, some Russian oil is exported at ports in the Baltic and Black Sea areas on Russian Federation territory, but the largest ports are located on the territories of Latvia, Lithuania, the Ukraine, and Georgia. See *Russia Grapples With New Tariffs, Oil & Gas Law*, OIL & GAS JOURNAL, Oct. 14, 1991, at 30.

32. *Id.*

33. Transneft and Gazprom, the current oil and gas transportation monopolies, would be subject to regulation under the treaty, as would any future entities that construct new facilities and enter the transportation market.

gates echoed some of the concerns expressed in the earlier meetings in Moscow during the drafting of the Underground Resources Code. For example:

- (1) How should the existing oil and gas industry in the Russian Federation be structured? Should the federation privatize all existing oil and gas operations, retaining ownership of the minerals and facilities, and acting as lessor or licensor to private entities?
- (2) If the existing oil and gas industry in the Russian Federation is privatized, should the current State and quasi-State monopolies be restructured?
- (3) What legal systems will assure free trade and competitive conditions among the autonomous republics, oblasts, and krais, so that one area with great oil and gas wealth does not restrict entry or raise trade barriers to the flow of oil and gas in commerce?

Based on the information and concerns exchanged during the meetings in Houston and subsequent meetings in Moscow, the Western teams have produced draft legislation for further discussion with their Russian counterparts. The draft licensing, conservation and environment, and tax codes ultimately will be submitted to the Russian Federation Supreme Soviet, and expeditious passage is anticipated by University of Houston Project leaders. The draft transportation treaty will require further discussion among the CIS republics affected by the treaty.

3. Relationship of the Project to the European Energy Charter

The legislation drafted by the University of Houston Project teams also will reflect and be consistent with the provisions of the European Energy Charter. On December 17, 1991, representatives from more than forty-five countries signed the European Energy Charter.³⁴ The purpose of the Charter generally is to promote cooperation among Eastern and Western European countries in the exploration, production, transportation, distribution, trade, and use of coal, oil, and natural gas.³⁵ The Treaty states:

Within the framework of State sovereignty and sovereign rights over energy resources and in a spirit of political and economic co-operation, [the signatories] undertake to promote the development of an efficient energy market throughout Europe, and a better functioning global market, in both cases based on the principle of non-discrimination and on market-oriented price formation, taking due account of environmental concerns. They are determined to create a climate favorable to the operation of enterprises and to the flow of investments and technologies by implementing market principles in the field of energy.³⁶

The signatories agreed that they would pursue their cooperative efforts in the following fields: (1) access to and development of energy resources; (2) access to markets; (3) liberalization of trade in energy; (4) promotion and protection of investments; (5) safety principles and guidelines; (6) research,

34. Concluding Document of the Hague Conference on the European Energy Charter, Dec. 17, 1991 (attached as an Appendix to this article).

35. Significantly, the Preamble of the Charter recognizes the need for western countries to assist the development of free market economies in formerly Communist countries, stating that the signatories are "[a]ware that account must be taken of the problems of reconstruction and restructuring in the countries of Central and Eastern Europe and in the USSR and that it is desirable for the signatories to participate in joint efforts aimed at facilitating and promoting market-oriented reforms and modernization of energy sectors in these countries." *Id.*

36. European Energy Charter, Dec. 17, 1991, tit. I (see Appendix).

technological development, innovation, and dissemination; (7) energy efficiency and environmental protection; and (8) education and training.³⁷ The signatories also emphasized the need for cooperation in the coordination of energy policies and the formulation of stable and transparent legal frameworks.³⁸

The Charter is a politically binding but not a legally binding document.³⁹ Accordingly, the signatories committed to negotiate in good faith an additional Basic Agreement and Protocols to implement the principles stated in the Charter.⁴⁰ The chairman of the Hague Conference on the European Energy Conference has stated that he expects the Basic Agreement to be completed by the end of July 1992, producing a document that will have the force of a treaty and be legally binding on the signatories.⁴¹

All of the CIS republics, including the Russian Federation, signed the European Energy Charter, illustrating their commitment to free market principles in energy markets. Russian Federation officials, including Minister Lopukhin of the Ministry of Energy and Fuels, have further committed to reflect these principles in the energy legislation currently being developed through the University of Houston Project.

III. CONCLUSION

By the end of 1991, steps had already been taken to decentralize decision-making in the oil and gas industries in the Russian Federation by converting State-supported enterprises into self-sufficient, free-standing corporations that have assumed responsibility for operating on their own resources rather than on resources provided from the State budget. Moreover, as a signatory to the European Energy Charter, the Russian Federation has politically committed to the establishment of free market principles in its energy industries.

However, the State generally continues to decide production, transportation, and marketing policies in the present economy in the Russian Federation. The current environment is still very much in a state of flux, with ownership and control of resources under contention and the final structure of the Russian Federation economic regulatory apparatus unclear.

It is clear that the Russian Federation will have to continue its efforts expeditiously to develop basic market-oriented economic legislation to attract the investment needed to revitalize its oil and gas industry. Moreover, this legislation will have to regulate the monopolistic State and quasi-State enterprises and corporations to ensure, at a minimum, nondiscriminatory access to essential facilities and markets, non-discriminatory rates and prices, and non-discriminatory operating practices. Whether this goal can be achieved in light of the still entrenched administrative command system and the very real problems of transition to a free market system remains to be seen.

37. *Id.*, tit. II.

38. *Id.*, tit. I, ¶ 2.

39. *See More Than 45 Countries Sign European Energy Charter*, BNA INT'L ENVTL. DAILY, Jan. 24, 1992.

40. European Energy Charter, Dec. 17, 1991, tit. III (see Appendix).

41. *Id.*

APPENDIX

CONCLUDING DOCUMENT OF THE HAGUE CONFERENCE IN
THE EUROPEAN ENERGY CHARTER

The representatives of Albania, Armenia, Australia, Austria, Azerbaijan, Belgium, Belorussia, Bulgaria, Canada, Cyprus, Czechoslovakia, Denmark, Estonia, the European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, The Interstate Economic Committee, Ireland, Italy, Japan, Kazakhstan, Kirghizstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, The Russian Federation, Spain, Sweden, Switzerland, Tadjikistan, Turkey, Turkmenistan, Ukraine, the United Kingdom of Great Britain and Northern Ireland, The United States of America, Uzbekistan, Yugoslavia convened in The Hague, the Netherlands, from 16 to 17 December 1991 in order to adopt the European Energy Charter.

The Conference was opened and closed by the Minister of Economic Affairs of the Netherlands.

Her Majesty, Queen Beatrix of the Netherlands, attended the opening of the Conference.

The Prime Minister of the Netherlands and the Commissioner for Energy of the European Commission addressed the Conference.

During the Conference, contributions were received and statements made by delegates of the signatories.

Determined to give full effect to the results of the Conference, the representatives of the signatories adopted the following text for the European Energy Charter:

European Energy Charter

The representatives of the signatories meeting in The Hague on 16 and 17 December 1991,

Having regard to the Charter of Paris for a New Europe, signed in Paris on 21 November 1990 at the summit meeting of the Conference on Security and Co-operation in Europe (CSCE);

Having regard to the document adopted in Bonn on 11 April 1990 by the CSCE Conference on Economic Co-operation in Europe;

Having regard to the declaration of the London Economic Summit adopted on 17 July 1991;

Having regard to the report on the conclusions and recommendations of the CSCE meeting in Sofia on 3 November 1989, on the protection of the environment, as well as its follow-up;

Having regard to the Agreement establishing the European Bank for Reconstruction and Development signed in Paris on 29 May 1990;

Anxious to give formal expression to this new desire for a European-wide and global co-operation based on mutual respect and confidence;

Resolved to promote a new model for energy co-operation in the long

term in Europe and globally within the framework of a market economy and based on mutual assistance and the principle of non-discrimination;

Aware that account must be taken of the problems of reconstruction and restructuring in the countries of Central and Eastern Europe and in the USSR and that it is desirable for the signatories to participate in joint efforts aimed at facilitating and promoting market-oriented reforms and modernisation of energy sectors in these countries.

Certain that taking advantage of the complementary features of energy sectors within Europe will benefit the world economy; persuaded that broader energy co-operation among signatories is essential for economic progress and more generally for social development and a better quality of life;

Convinced of the signatories' common interest in problems of energy supply, safety of industrial plants, particularly nuclear facilities, and environmental protection;

Willing to do more to attain the objectives of security of supply and efficient management and use of resources, and to utilize fully the potential for environmental improvement, in moving towards sustainable development;

Convinced of the essential importance of efficient energy systems in the production, conversion, transport, distribution and use of energy for security of supply and for the protection of the environment;

Recognizing State sovereignty and sovereign rights over energy resources;

Assured of support from the European Community, particularly through completion of its internal energy market;

Aware of the obligations under major relevant multilateral agreements, of the wide range of international energy co-operation, and of the extensive activities by existing international organizations in the energy field and willing to take full advantage of the expertise of these organizations in furthering the objectives of the Charter;

Recognizing the role of entrepreneurs, operating within a transparent and equitable legal framework, in promoting co-operation under the Charter;

Determined to establish closer, mutually beneficial commercial relations and promote energy investments;]

Convinced of the importance of promoting free movement of energy products and of developing an efficient international energy infrastructure in order to facilitate the development of market-based trade in energy;

Aware of the need to promote technological co-operation among signatories;

Affirming that the energy policies of signatories are linked by interests common to all their countries and that they should be implemented in accordance with the principles set out below:

Affirming, finally, their desire to take the consequent action and apply the principles set out below:

HAVE ADOPTED THE FOLLOWING DECLARATION CONSTITUTING THE "EUROPEAN ENERGY CHARTER"

TITLE 1: OBJECTIVES

The signatories are desirous of improving security of energy supply and of maximising the efficiency of production, conversion, transport, distribution and use of energy, to enhance safety and to minimise environmental problems, on an acceptable economic basis.

Within the framework of State sovereignty and sovereign rights over energy resources and in a spirit of political and economic co-operation, they undertake to promote the development of an efficient energy market throughout Europe, and a better functioning global market, in both cases based on the principle of non-discrimination and on market-oriented price formation, taking due account of environmental concerns. They are determined to create a climate favourable to the operation of enterprises and to the flow of investments and technologies by implementing market principles in the field of energy.

To this end, and in accordance with these principles, they will take action in the following fields:

1. Development of trade in energy consistent with major relevant multilateral agreements such as GATT, its related instruments, and nuclear non-proliferation obligations and undertakings, which will be achieved by means of:
 - an open and competitive market for energy products, materials, equipment and services;
 - access to energy resources, and exploration and development thereof on a commercial basis;
 - access to local and international markets;
 - removal of technical, administrative and other barriers to trade in energy and associated equipment, technologies and energy-related services;
 - modernization, renewal and rationalization by industry of services and installations for the production, conversion, transport, distribution and use of energy;
 - promoting the development and interconnection of energy transport infrastructure;
 - promoting best possible access to capital, particularly through appropriate existing financial institutions;
 - facilitating access to transport infrastructure, for international transit purposes in accordance with the objectives of the Charter expressed in the first paragraph of this Title;
 - access on commercial terms to technologies for the exploration, development and use of energy resources.
2. Co-operation in the energy field, which will entail:
 - co-ordination of energy policies, as necessary for promoting the objectives of the Charter;
 - mutual access to technical and economic data, consistent with proprietary rights;
 - formulation of stable and transparent legal frameworks creating conditions for the development of energy resources;

- co-ordination and, where appropriate, harmonization of safety principles and guidelines for energy products and their transport, as well as for energy installations, at a high level;
 - facilitating the exchange of technology information and know-how in the energy and environment fields, including training activities;
 - research, technological development and demonstration projects.
3. Energy efficiency and environmental protection, which will imply:
- creating mechanisms and conditions for using energy as economically and efficiently as possible, including, as appropriate, regulatory and market-based instruments;
 - promotion of an energy mix designed to minimise negative environmental consequences in a cost-effective way through:
 - (i) market-oriented energy prices which more fully reflect environmental costs and benefits;
 - (ii) efficient and co-ordinated policy measures related to energy;
 - (iii) use of new and renewable energies and clean technologies;
 - achieving and maintaining a high level of nuclear safety and ensuring effective co-operation in this field.

TITLE II: IMPLEMENTATION

In order to attain the objectives set out above, the signatories will, within the framework of State sovereignty and sovereign rights over energy resources, take co-ordinated action to achieve greater coherence of energy policies, which should be based on the principle of non-discrimination and on market-oriented price formation, taking due account of environmental concerns.

They underline that practical steps to define energy policies are necessary in order to intensify co-operation in this sector and further stress the importance of regular exchanges of views on action taken, taking full advantage of the experience of existing international organizations and institutions in this field.

The signatories recognize that commercial forms of co-operation may need to be complemented by intergovernmental co-operation, particularly in the area of energy policy formulation and analysis as well as in areas which are essential and not suitable to private capital funding.

They undertake to pursue the objectives of creating a broader European energy market and enhancing the efficient functioning of the global energy market by joint or co-ordinated action under the Charter in the following fields:

- access to an development of energy resources;
- access to markets;
- liberalization and trade in energy;
- promotion and protection of investments;
- safety principles and guidelines;
- research, technological development, innovation and dissemination;
- energy efficiency and environmental protection;
- education and training.

In implementing this joint or co-ordinated action, they undertake to fos-

ter private initiative, to make full use of the potential of enterprises, institutions and all available financial sources, and to facilitate co-operation between such enterprises or institutions from different countries, acting on the basis of market principles.

The signatories will ensure that the international rules on the protection of industrial, commercial and intellectual property are respected.

1. Access to and development of energy resources.

Considering that efficient development of energy resources is a *sine qua non* for attaining the objectives of the Charter, the signatories undertake to facilitate access to and development of resources by the interested operators.

To this end, they will ensure that rules on the exploration, development and acquisition of resources are publicly available and transparent; they recognize the need to formulate such rules wherever this has not yet been done and to take all necessary measures to co-ordinate their actions in this area.

With a view to facilitating the development and diversification of resources, the signatories undertake to avoid imposing discriminatory rules on operators, notably rules governing the ownership of resources, internal operation of companies and taxation.

2. Access to markets

The signatories will strongly promote access to local and international markets for energy products for the implementation of the objectives of the Charter. Such access to markets should take account of the need to facilitate the operation of market forces, and promote competition.

3. Liberalization of trade in energy

In order to develop and diversify trade in energy, the signatories undertake progressively to remove the barriers to such trade with each other in energy products, equipment and services in a manner consistent with the provisions of GATT, its related instruments, and nuclear non-proliferation obligations and undertakings.

The signatories recognize that transit of energy products through their territories is essential for the liberalization of trade in energy products. Transit should take place in economic and environmentally sound conditions.

They stress the importance of the development of commercial international energy transmission networks and their interconnection, with particular reference to electricity and natural gas and with recognition of the relevance of long-term commercial commitments. To this end, they will ensure the compatibility of technical specifications governing the installation and operation of such networks, notably as regards the stability of electricity systems.

4. Promotion and protection of investments

In order to promote the international flow of investments, the signatories will at national level provide for a stable, transparent legal framework for foreign investments, in conformity with the relevant international laws and rules on investment and trade.

They affirm that it is important for the signatory States to negotiate and

ratify legally binding agreements on promotion and protection of investments which ensure a high level of legal security and enable the use of investment risk guarantee schemes.

Moreover, the signatories will guarantee the right to repatriate profits or other payments relating to an investment and to obtain or use the convertible currency needed.

They also recognize the importance of the avoidance of double taxation to foster private investment.

5. Safety principles and guidelines

Consistent with relevant major multilateral agreements, the signatories will:

- implement safety principles and guidelines, designed to achieve and/or maintain high levels of safety, in particular nuclear safety and the protection of health and the environment;
- develop such common safety principles and guidelines as are appropriate and/or agree to the mutual recognition of their safety principles and guidelines.

6. Research, technological development, innovation and dissemination

The signatories undertake to promote exchanges of technology and co-operation on their technological development and innovation activities in the fields of energy production, conversion, transport, distribution and the efficient and clean use of energy, in a manner consistent with nuclear non-proliferation obligations and undertakings.

To this end, they will encourage co-operative efforts on:

- research and development activities;
- pilot or demonstration projects;
- the application of technological innovations;
- the dissemination and exchange of know-how and information on technologies.

7. Energy efficiency and environmental protection

The signatories agree that co-operation is necessary in the field of efficient use of energy and energy-related environmental protection. This should include:

- ensuring, in a cost-effective manner, consistency between relevant energy policies and environmental agreements and conventions;
- ensuring market-oriented price formulation, including a fuller reflection of environmental costs and benefits;
- the use of transparent and equitable market-based instruments designed to achieve energy objectives and reduce environmental problems;
- the creation of framework conditions for the exchange of know-how regarding environmentally sound energy technologies and efficient use of energy;
- the creation of framework conditions for profitable investment in energy efficiency projects.

8. Education and training

The signatories, recognizing industry's role in promoting vocational education and training in the energy field, undertake to co-operate in such activities, including:

- professional education;
- occupational training;
- public information in the energy efficiency field.

TITLE III: SPECIFIC AGREEMENTS

The signatories undertake to pursue the objectives and principles of the Charter and implement and broaden their co-operation as soon as possible by negotiating in good faith a Basic Agreement and Protocols.

Areas of co-operation could include:

- horizontal and organisational issues;
- energy efficiency, including environmental protection;
- prospecting, production, transportation and use of oil and oil products and modernisation of refineries;
- prospecting, production and use of natural gas, interconnection of gas networks and transmission via high-pressure gas pipelines;
- all aspects of the nuclear fuel cycle including improvements in safety in that sector;
- modernization of power stations, interconnection of power networks and transmission of electricity via high-voltage power lines;
- all aspects of the coal cycle, including clean coal technologies;
- development of renewable energy sources;
- transfers of technology and encouragement of innovation;
- co-operation in dealing with the effects of major accidents, or of other events in the energy sector with transfrontier consequences.

The signatories will, in exceptional cases, consider transitional arrangements. They, in particular, take into account the specific circumstances facing some states of Central and Eastern Europe and the USSR as well as their need to adapt their economies to the market system, and accept the possibility of a stage-by-stage transition in those countries for the implementation of those particular provisions of the Charter, Basic Agreement and related Protocols that they are, for objective reasons, unable to implement immediately and in full.

Specific arrangements for coming into full compliance with Charter provisions as elaborated in the Basic Agreement and Protocols will be negotiated by each Party requesting transitional status, and progress towards full compliance will be subject to periodic review.

TITLE IV: FINAL PROVISION

The signatories request the Government of the Netherlands, President-in-Office of the Council of the European Communities, to transmit to the Secretary-General of the United Nations the text of the European Energy Charter which is not eligible for registration under Article 102 of the Charter of the United Nations.

In adopting the European Energy Charter Ministers or their representatives record that the following understanding has been reached:

The representatives of the Signatories understand that in the context of

the European Energy Charter, the principle of non-discrimination means Most-Favoured-Nation Treatment as a minimum standard. National Treatment may be agreed to in provisions of the Basic Agreement and/or Protocols.

The original of this Concluding Document, drawn up in English, French, German, Italian, Russian and Spanish texts, will be transmitted to the Government of the Kingdom of the Netherlands, which will retain it in its archives. Each of the Signatories will receive from the Government of the Kingdom of the Netherlands a true copy of the Concluding Document.