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# Yukos & the EU-Russia Energy Relationship

ESCP London

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## Mutual Dependency

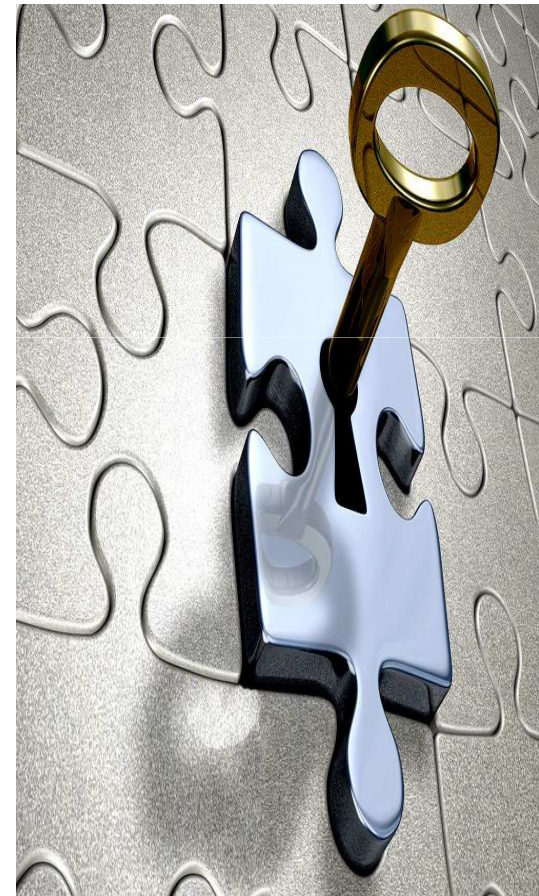
- Received view mutual dependency.
- The Russians need to sell their gas and oil to the EU
- Russian needs western investment
- The EU needs the fossil fuels from Russia
- Especially clear in the gas market
- Europe is becoming more energy dependent
- Mutuality maintains incentives to co-operate no matter legal & political conflict





## Negotiated Solution?

- The implications of the mutuality view is that conflict will be limited because of the powerful incentives on both sides.
- EU-Russia energy relationship cannot be derailed by a single case
- Some ‘bumps along the road’
- But the ‘usual relationships’ will remain in place
- Prospect of a deal?





## Three Major Factors in Play

- Multiple Rule of Law Problem-there is more than one case, Yukos, plus..Gazprom & Magnitsy..all at core rule of law of questions and autonomous
- Impact of shale revolution...how far will we need Russia in future?
- Investment Requirements...Russia needs immense quantities of external capital to maintain production





## The Yukos Case

- Prospect of potentially significant litigation throughout OECD countries
- Questions of sovereign immunity litigated in Western courts
- No politically negotiated solution due to judicial nature of proceedings
- Judicial autonomy will mean cases can be heard and decisions made which may make EU-Russian relationships much more difficult





## Commission v. Gazprom

- Commission launched investigation in September 2012.
- Antitrust practices of Gazprom in the CEE and Baltic States.
- Prospect of prohibition decisions and fines
- Forced sales of Gazprom owned assets in CEE states?
- Indexation threat
- Timeline with Yukos case
- Again Judicial plus regulatory autonomy





## UK/EU Magnitsky Legislation

- US Magnitsky legislation, “Rule of Law Accountability Act”
- Deny visas and freeze assets
- Prospect of EU and UK legislation on the same lines
- Again rule of law non-negotiable in a judicial setting
- And this time directly aimed at the Russian power elite





## EU-Russia Relationship..into the freezer?

- Yukos, plus Gazprom, plus Magnitsky..rule of law value questions underpinned by judicial autonomy
- While threatening the corporate and personal interests of the Russian state and its elite.
- What EU-Russia relationship?
- Potential for major breakdown



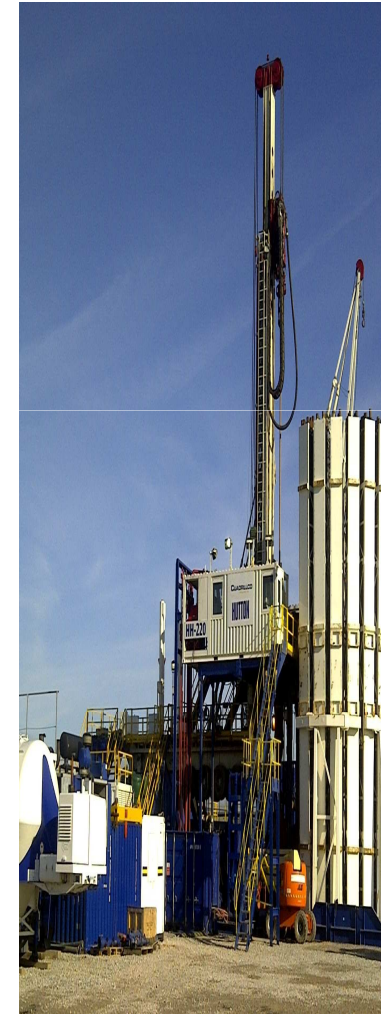
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## Second Context Factor-Shale

- Gas is greatest expression of mutual dependency
- Russian pipelines only point Westwards..two-thirds of Russian gas profits from EU.
- Shale even if years before Europe develops...impact of US shale
- Diversionary impact of LNG, more LNG as shale...and coal....
- Compound impact of energy liberalisation





## Greatest impact of Shale-Oil not Gas!

- Russian view gas is power oil is money...but for how long?
- Developed shale oil resources in the US will put at least 6mbd on the market by 2020
- Potential for shale oil elsewhere, Argentina, Ukraine, China and Mexico.
- Natural gas becomes a second transportation fossil fuel





## Growing Perception of Russian Weakness

- Greatest lever is gas in certain parts of the EU
- In relatively short time period by the time Yukos, Gazprom and Magnitsky develop perception of gas threat is reduced..
- Impact of shale on oil markets longer time scale...but it will become clearer where markets are going
- Massive dependence on fossil fuel rents for the economic and political system





## Third Factor Investment Requirements

- Overlooked IEA 2011 WEO Report on Russia's financing requirements
- \$700 billion plus required to maintain current Russian gas production and distribution network.
- Capital needs to be invested by 2035
- Similar scale of capital in the oil industry.
- Questions as to whether 'hard to get' gas is worth developing in shale era
- Impact of shale on oil markets on investment decisions





## Significant hostility..but

- Not negotiable values of the EU and the US
- Perception and reality of Russian energy weakness
- Requirements for investment capital to maintain fossil fuel production
- Mutual dependency replaced by Western leverage and Russian dependence





## Impact on Western Energy Companies

- Hostage investors to rule of law cases in the West?
- ECT 20 year legacy protection from October 2009 set off further cycle of Western cases
- Selective targets non-protection...Exxon/BP? Post 2009-application of bilateral investment treaties?
- Impact on Russian Energy Investment

ExxonMobil



bp





## Developing a New-EU Russia Relationship?

- Non-negotiable realities...rule of law, Russian state owned assets in West, need for access to West and Russian energy investment
- New deal focussed on liberalised energy markets and fossil fuel liquidity
- A Russian model for energy liberalisation? State influenced competitive networks
- Access Russian shale?





## Alternative Scenario

- Does TINA apply?
- Hostility results in loss of market share and loss of investment capital and accelerates Western switch to alternative sources
- Only other play is the Chinese play...an energy resource centre for Beijing or a partnership with the EU?

