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HEARING

United States Commission on Security and Cooperation in Europe (Helsinki Commission)

Congressional Hearing: "Energy and Democracy: Oil and Water?" July 23, 2007

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WITNESSES/PANELISTS: MR. SIMON TAYLOR, DIRECTOR, GLOBAL WITNESS; MR. ROMAN KUPCHINSKY, REGIONAL ANALYST, RADIO FREE EUROPE/RADIO LIBERTY

Written Witness Testimony of Robert Amsterdam, Partner, Amsterdam & Peroff LLP., submitted to the open record on July 27, 2007

Esteemed Commissioners and Colleagues,

It is a great privilege to have the opportunity to submit for the record the following testimony on such an important issue, and I sincerely regret not having been able to attend the hearing in person.

My biographical details will be available to all of you in separate documentation, but to just briefly establish my background and provide necessary disclosure, here are some basic facts: I am a U.S. citizen, and a Canadian citizen as well. I have practiced international law for the past 27 years

in a number of emerging economies in Latin America, Africa, and Eastern Europe. In 2003, I was retained by Mikhail Khodorkovsky, the former CEO of the Yukos Oil Company. I have represented Mr. Khodorkovsky in a series of politically motivated trials that brought significant international attention to the relationship between energy and politics in Russia and beyond.

Prior to its expropriation by the Russian government, Yukos was widely recognized as the most successful and transparent private company in post-Soviet Russia. Mr. Khodorkovsky had opened the company's books, adopting modern scientific, technical and corporate governance standards at the level of the most sophisticated U.S. and Western European energy companies, and thus achieving record levels of efficiency, production and public accountability. As a result, Yukos was perceived by some to be an economic competitor of the Russian state. Moreover, Mr. Khodorkovsky himself became a prominent advocate of democratization, rule of law, and economic transparency in Russia.

Following a show trial that violated fundamental rights guaranteed under the Russian Constitution,¹ and basic principles of due process under law, Mr. Khodorkovsky was sentenced to an [eight] year prison term in Siberia. He has been serving this term, under appalling conditions, thousands of miles from his family in Moscow. According to a 2005 Resolution of the Parliamentary Assembly of the Council of Europe (PACE),

¹ These violations are documented independently by the Council of Europe Rapporteur Sabine Leutheusser-Schnarrenberger.

[t]he circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals and to regain control of strategic economic assets.²

Mr. Khodorkovsky had been eligible for parole in October 2007.

However, in February 2007, the Russian Procuracy brought an entirely new series of charges against him. Last week, referring to Mr. Khodorkovsky as "one of Russia's best-known political prisoners", a July 20, 2007 Washington Post editorial described the Kremlin's new charges against him as "magnificently implausible."³

I have briefly outlined the situation of my client not to focus on one man's unjust persecution but to highlight a prominent example of a much larger problem that continues to have disturbing implications for Western governments and companies, and that impacts directly upon the purposes and obligations of the U.S. Helsinki Commission as they pertain to the question at issue at this hearing: the relationship between energy, natural resources and democracy.

The larger meaning of the Khodorkovsky case was powerfully recognized by Anna Politkovskaya, the exceptionally courageous and important Russian investigative journalist who was assassinated in the elevator of her Moscow apartment complex on October 7, 2006. An English language translation of her

² Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005, para 1-14.

³ Editorial, "Throwing the Books at Them," Washington Post, (July 20, 2007, pp. A18)
<http://www.washingtonpost.com/wp-dyn/content/article/2007/07/19/AR2007071902310.html>

last work has just been published in the United States as *A Russian Diary: A Journalist's Final Account of Life, Corruption, and Death in Putin's Russia*, and I urge the distinguished commissioners to read it for further information.

Reflecting on the appointment by Russian President Vladimir Putin of his deputy Igor Sechin as chairman of the board of directors of the state oil company Rosneft, Politkovskaya writes:

Sechin personally oversaw the dismemberment and destruction of Yukos and the arrest of Khodorkovsky. His appointment to head Rosneft, which claims the choicest parts of Yukos, proves the Kremlin destroyed Yukos for its own benefit. Its ideology requires the formation of a "state economy," supposedly run on behalf of the people. In reality, it is a bureaucratic economy whose principle oligarch is the government official. The higher the official, the bigger the oligarch.⁴

This Commission has been assigned an immensely important responsibility: to monitor and encourage compliance with the Helsinki Final Act and other OSCE commitments assumed by participating states. Specifically, the U.S. Helsinki Commission has been directed by Congress "to monitor the acts of the signatories which reflect compliance with or violation of the articles of the Final Act..." Congress asked the Commissioners to pay particular attention to the human rights provisions of the Final Act. These include requirements that signatory states "promote and encourage the effective exercise of civil, political, economic, social, cultural and other rights and freedoms all of which derive from

⁴ Anna Politkovskaya, *A Russian Diary: A Journalist's Final Account of Life, Corruption, and Death in Putin's Russia* (New York: Random House, 2007), p. 153 (from diary entry dated July 27, 2004).

the inherent dignity of the human person and are essential for his free and full development.”

As a signatory to the Helsinki Final Act and an OSCE member state, the Russian Federation has assumed obligations to adhere to these provisions. In the context of today’s hearing on energy and democracy, I wish to suggest two ideas that might usefully guide the Commissions’ assessment of Russia’s (or indeed any member state’s) compliance with or violations of the Act’s provisions.

The first idea is that resource nationalism, combined with the corruption of democratic process and rule of law, results in violations of human rights guaranteed under the Final Act.

In this regard I want to highlight the OSCE’s monitoring in each participating state of the freedom of the media, the freedom of assembly and association, and the right to liberty and a fair trial. In this regard, I am very pleased to praise this Commission for its May 24, 2007 hearing on “Russia: In Transition or Intransigent?” Chairman Hastings introduced that hearing with the recognition that

“particularly over the last seven years, the Kremlin has moved to recentralize authority and power that it had seen slip away in the wake of glasnost and perestroika. The result has been a significant limitation on the civil liberties that many of us associate with a legitimately open society. Despite President Putin’s lip service in support of democratic institutions and civil society, we now see a political agenda centrally

planned in Moscow.”⁵

In this context, I also recognize Senator Smith’s authorship of H.Con.Res. 151, calling upon President Putin to seek competent outside law enforcement assistance in the investigation of the unresolved murders of dozens of independent Russian journalists over the past decade, including the murder of Anna Politkovskaya.

The second idea, on which I will focus attention on in the remainder of my submission, is that resource nationalism, and the corruption of democracy and rule of law at home, results in violations of the rights of *other sovereign states* as guaranteed by the Final Act.

Most significantly for purposes of this hearing today, the Final Act requires participating States “[t]o refrain from any act of economic coercion designed to subordinate to their own interest the exercise by another participating State of the rights inherent in its sovereignty and thus to secure advantages of any kind.” Unfortunately, having achieved a near monopolistic control of oil, gas and other core natural resources, by methods including illegal expropriation of assets owned by private shareholders, the Russian Federation has effectively utilized its control of these resources to initiate acts of economic coercion prohibited by the Final Act.

⁵ The unofficial transcript of the May 24 hearing can be read here: http://www.csce.gov/index.cfm?Fuseaction=ContentRecords.ViewTranscript&ContentRecord_id=388&ContentType=H,B&ContentRecordType=H&CFID=18849146&CFTOKEN=53

As this Commission is well aware, the Kremlin temporarily cut off the supply of Russian natural gas to the Ukraine (and subsequently to Europe) in an effort to coerce the government to accept an increased price – but with the ultimate goal of gaining control over transit states. Russia used its control over energy supplies in similar ways in efforts to intimidate Belarus and Georgia. The OSCE membership of Ukraine, Belarus and Georgia was of no consequence to Russia in carrying out these acts of economic coercion.

The intended recipients of this coercive economic diplomacy extended far beyond the boundaries of states that formerly belonged to the Soviet Union. Western European governmental and business leaders have come to understand very well that their economies have become largely dependent on Russian state-controlled oil and gas, and therefore increasingly vulnerable to direct and indirect coercion by Gazprom and the Kremlin itself. Unfortunately, some European governments have acted to facilitate and legitimize Russian energy coercion in an effort to minimize political risk in maintaining their dependence on Russian energy sources.

The mandate of this Commission is to monitor the actions of government signatories to the Final Act. However, in analyzing the operation of economic coercion in violation of the Act, it is also necessary to shine a light on the role of multinational corporations with investments, ventures and interests in Russia today.

In addition, a number of Western banks and international oil companies have carried out a "foreign policy" of their own, seeking to ingratiate themselves to the Kremlin in an effort to secure transactions that could potentially enable them to reap significant profits from Russia's enormous oil and gas wealth. Egregious cases include actions by BP, the German bank Dresdner Kleinwort, the Italian energy company ENI, and the Italian government itself, to help the Kremlin facilitate illegal sham auctions of assets belonging to Yukos shareholders. In another recent case, aggressive harassment by the Russian government of the accounting firm PricewaterhouseCoopers, including the initiation of criminal tax prosecutions and illegal police raids, ceased promptly after the firm agreed to the Kremlin's demand that it withdraw years of audits it had prepared documenting the clean financial due diligence review of Yukos Company.

The bitter irony is that such efforts by multinational firms to carry out a "corporate foreign policy" to appease the Kremlin, and thus protect their company's economic interests in Russia, have failed -- over and over again.

Following the consolidation of state power over the energy sector in Russia, which included the Yukos Affair and the monopolization of pipeline infrastructure, the Kremlin embarked on an multinational "energy diplomacy" strategy to build close relations with other exporters and coordinate the markets they sell to. One of the most notable developments of the coordination strategy was Gazprom's landmark swap agreement last year with the Algerian state gas supplier (the deal included debt forgiveness and a major arms purchase), which overnight put 69% of Italy's natural gas

supply under Russian control.⁶ Following this decision, Italian energy firm ENI found itself coerced into signing Russia's largest gas supply agreement in all of Europe, and then later became the first foreign firm to purchase controversial assets in liquidation auctions, only to later hand them over to Gazprom.⁷

In sum, we are faced with *an activist Russian government with an established pattern of using energy supply to achieve economic coercion, and political objectives, in violation of Russia's obligations under the Helsinki Final Act*. As Mr. Roman Kupchinsky describes in his testimony to this record, "Russia is a country which is able and is willing to project its hydrocarbon power around the world." The tactics through which this is accomplished can be viewed in three categories: cooperation, cooptation, and disaggregation, all of which carry serious ramifications for other energy exporters in areas such as Central Asia, and it will especially affect importers in Europe and North America.

Cooperation. Following the formalized market coordination with Algeria, Russia also extended its increasingly close contacts with Iran, Turkmenistan, and Qatar – shortly thereafter the Financial Times published news of a report circulated around NATO warning that the alliance “needs to guard against any attempt by Russia to set up an

⁶ Italian Industry Minister Pierluigi Bersani diplomatically pointed out that this agreement could “eventually lead to economic pressures on European gas prices;” which was another way of warning that Italy is about to submit itself to the whims of a foreign oligopoly.
(http://www.jamestown.org/publications_details.php?volume_id=414&&issue_id=3832)

⁷ See Times of London article, “Eni wins auction for Yukos, then hands it to Gazprom,” (April 5, 2007), http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article1615107.ece

“OPEC for gas” that would strengthen Moscow’s leverage over Europe.”⁸ By the time the gas exporters group decided to form an official committee to study coordination, it was clear that the “Gas OPEC” represented the greatest threat posed by Russia’s coordination efforts. At the time, Representative Ileana Ros-Lehtinen said that “[t]he creation of this cartel would pose a major and long-term threat to the world’s energy supply. We must vigorously oppose the establishment of this global extortion racket.”⁹

Dr. Ariel Cohen of the Heritage Foundation has further argued that Russia’s efforts to coordinate a gas cartel represent three central characteristics of their maneuvering: it will be a gradualist process, it will be stealthy, and they will make great efforts to appear reasonable at all times.¹⁰

Cooptation. Here I refer to Russia’s impressive ability to consistently outflank the West in reaching alternative supply sources in a concerted effort to diminish competition and increase dependence. One need look no further than the recent signing of a memorandum of understanding between ENI and Gazprom to build the South Stream pipeline under the Black Sea – an initiative that many argue is nothing more than a political gesture to scare investors away from a non-Russian owned alternatives, such as the Nabucco and Baku-Tsibils extensions. Observer Vladimir Socor of the Eurasia Daily Monitor of the Jamestown Foundation said the following of the deal: “By putting a multiplicity

⁸ Financial Times, “Nato fears Russian plans for ‘gas OPEC’”, (Nov. 13, 2006), <http://www.ft.com/cms/s/af125540-7358-11db-9bac-0000779e2340.html>

⁹ UPI, “Ros-Lehtinen blasts proposed gas cartel,” (April 2, 2007), <http://www.earthtimes.org/articles/show/46891.html>

¹⁰ Ariel Cohen, “Gas OPEC: A Stealthy Cartel Emerges,” Heritage Foundation, WebMemo #1423, <http://www.heritage.org/Research/EnergyandEnvironment/wm1423.cfm>

of options on the table, Russia can pressure countries it regards as “recalcitrant” into transportation deals favorable to Moscow.”¹¹ All of this is in addition to Russia’s state-ordained monopoly over transport routes from Central Asian countries such as Turkmenistan, Kazakhstan, and Uzbekistan.

Perhaps the most flagrant example of the Kremlin’s cooptation strategy is its success in recruiting former German Chancellor Gerhard Schröder as an ally in government -- and an employee after stepping down from his post. Shortly before his term ended, Schröder signed a German-Russian agreement to build the Nord Stream pipeline under the Baltic Sea to supply Russian gas directly to Germany, bypassing Poland, Ukraine and the Baltic countries. Promptly upon leaving office, Schröder accepted a post as the head of the Gazprom-affiliated shareholders' committee of the Russian-led consortium building that very pipeline. Before leaving office, Schröder had also worked to ensure preferential financing for the project.

The third element of the Russian energy methodology is *disaggregation* – the process by which bilateral deals are sought and promoted in order to disaggregate, or cause divisions, among importers – a trend that is discussed earlier in the record by Mr. Kupchinsky. Not to belabor the point with a laundry list of examples, here I share a comment from Dr. Janusz Bugajski of the Center for Strategic and International Studies: “The Kremlin not only manipulates divisions between older and newer members. It also aims to forestall any

¹¹ http://jamestown.org/edm/article.php?article_id=2372249

common policy among EU newcomers. Hungary and Bulgaria have become the primary targets among former Soviet satellites. The Kremlin is capitalizing on long-standing personal connections with Socialist officials in these countries to construct pipelines and distribution points that will pre-empt Europe's energy diversification."¹²

All of this is worrying. Worrying for anyone who cares about democracy and freedom in states like Russia. Worrying both for consumers of energy and for anyone who cares about the future of the producing countries themselves or our relations with them. For one thing, resource nationalism continues to put upwards pressure on the price of oil. That has long-term implications for the world's biggest energy consumers and, by extension, the world's economy. But resource nationalism is also sowing problem seeds in the countries that practice it. Rising energy demand is not being met by equivalent growth in production and supply of energy. In that scenario, higher prices should mean increased investment in the upstream. Yet the resource nationalists are working to prevent the kind of companies that have capital and know-how to invest from doing so. In the short and medium term, that will hurt those companies and the consumers that rely on them. In the long-term, it will also undermine the demand for the product (oil and gas) that the resource-rich countries can offer. Their economies, increasingly reliant on the resources they produce, will suffer.

¹² Janusz Bugajski, "Influence Far Abroad," Moscow Times, (March 23, 2007), <http://www.moscowtimes.ru/stories/2007/03/23/006.html>

In conclusion, how should governments and companies in OECD countries respond to the abuses of resource nationalism in countries such as Russia? We have identified the harm these abuses generate domestically in the deterioration of human rights necessary for a democratic society, and we have identified as well the harm these abuses generate internationally in the form of economic coercion in violation of the Helsinki Final Act. We need to dedicate ourselves to monitoring, identifying and redressing these abuses. Our objective should be to *de-politicize the energy trade and promote competitive, market-based relationships with exporters which respect international rules, norms, and treaties.*

Certainly I believe there is wide agreement that policy efforts must focus on transparency and accountability among Western businesses in the effort to improve energy security and democracy. But we must also recognize the new reality that powerful state corporatism in Russia, and in other states with a government-controlled energy resource based economy, has weakened our ability to exert influence.

Moreover, there exist today unprecedented diplomatic relationships among these resource autocracies.¹³ Within recent months we have seen Ayatollah Khamenei pledge energy cooperation with Moscow, and then Hugo Chavez making yet another state visit to Russia to sign a major arms deal – just days before the Kennebunkport Summit between George W. Bush and Vladimir Putin. Various regional instabilities are being provoked and exploited by these activist and cooperative policies among pariah states.

¹³ For further information, please consult Joshua Kurlantzic's "Crude Awakening," The New Republic, (October 2, 2006). <https://ssl.tnr.com/p/docsub.mhtml?i=20061002&s=kurlantzick100206>

The engagement of United States and European states with these authoritarian and quasi-authoritarian governments must be predicated upon an adherence to strictly defined rules and norms. The EITI is an excellent mechanism that we must continue to pursue, as well as the promotion of various corollaries of the Foreign Corrupt Practices Act, but these efforts should be made part and parcel of a broader effort to deal with resource nationalism.

A newly strong Russia can and should have a major role in global stability and prosperity, but to engage with them on an equitable basis, we need to see reciprocity, coherence, and consistency in our responses. For example it is clear that Russian companies have been very successful raising money among investors in the West. However, such privileged economic relations should be conditioned upon a constructive attempt by authorities to cooperate, and, above all, to adhere to the rule of law.

Resource nationalist states such as today's Russia have been extended undeserved privileges by foreign governments fearful of coercive reprisals -- and multinational corporations eager to profit from perceived opportunities to trade their technical expertise and managerial capacity for access to tremendous oil and gas wealth. But we should remind these governments and firms that such a strategy exposes citizens and shareholders to extraordinarily high and potentially punishing risks. The presumption of regularity is a dangerous foreign policy for states and corporations alike. In the face of

economic coercion, and with the prospect of profitable opportunities, “business as usual”¹⁴ can be a seductive but potentially catastrophic approach.

And there are other steps we can take. Russia’s successful manipulation of Europe’s energy security dilemma has put it and its company Gazprom in the ascendancy. In part, this has been the result of brilliant strategic thinking by the Russian government and Gazprom. But it has also been caused by the deficiencies of the EU’s policy with Russia. While Gazprom presents a monolithic position vis-à-vis the EU, Europe’s member states present a fractious, disunited assembly, each eager to deal with Gazprom even at the expense of other European neighbours or the EU’s wider strategic goals.

Symbolic of this have been the energy embargoes Russia has perpetuated against the Baltic States. As members of the EU, these countries deserve – morally and legally – the assistance of other member states. Yet such crises in those countries was scarcely acknowledged by governments of the larger European states. Brussels must realize – or be made to realize – that such disunity undermines its very *raison d’ être* and serves only to encourage more aggressive treatment from Gazprom.

Another example of the EU’s failure in this regard has been the Nabucco project. As a pipeline that could help to loosen Russia’s increasingly strong grip over gas imports into Europe, that project ought to be given strategic priority by Brussels – in the same

¹⁴ Right in the midst of an aggressive and bitter dispute between the United States and Russia on the missile defense shield, and while the United Kingdom continued to receive no cooperation from Moscow in its investigation of the murder of Alexander Litvinenko, several leaders of energy companies made a public call to continue “business as usual” with Russia. See the May 23, 2007 article in the International Herald Tribune (<http://www.iht.com/articles/2007/05/23/business/rusoil.php>).

way that Moscow gives priority to projects it considers strategic. Instead, it has been left directionless and at the mercy of Gazprom, which has been able to pick off members of the Nabucco consortium in an effort to render the project defunct. Future projects must not repeat these mistakes.

What else can be done? More broadly, there is a crisis of confidence among consumers of energy vis-à-vis producers, who are considered to be in the ascendancy. Yet consumers have the one commodity that producers need: demand. If consumer governments wish to regain momentum in securing energy supplies, they need to look at solutions to this on the demand side of the equation. This includes pursuing alternative energies, diversifying sources and fuels, building spare infrastructure capacity (pipelines, storage, LNG terminals, refineries) and working to reduce wastage.

Such proposals are broad. But the crisis in energy we face is serious and demands serious answers. Aggressive resource nationalism threatens to damage the world's economy in a profound way. But the success of resource nationalism relies fundamentally on demand patterns. Managing demand effectively could, therefore, be crucial to ending this damaging period of resource nationalism which has brought so many human rights abuses in its wake; to restoring balance to energy markets; and to ensuring the security of energy supplies to consumers.

This year, at the thirtieth anniversary of the founding of the Charter 77 movement, we remember the courage of so many Russian and Eastern European dissidents, like Vaclav Havel, who suffered imprisonment rather than give up their vision of freedom and human rights. Those of us who are now citizens of the fifty-six participating OECD

states are fortunate to enjoy the protections of the Helsinki Final Act. We are grateful to this Commission for your monitoring of states' adherence to their obligations under this immensely important treaty. I am also fully available to the Commission to answer any questions on the record.

A handwritten signature in black ink that reads "Robert R. Amsterdam" followed by a stylized flourish.

Robert R. Amsterdam

Partner, Amsterdam & Peroff LLP

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