

Croatia's drawn out energy dispute with Hungary has possibly dampened its hopes of acting as an energy hub for the EU, as Brussels looks to bring in more gas from the east. The newest bloc member has a lot of work to do to repair rifts, writes Mehmet Ögütçü.

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Arbitration or litigation is normally the last resort in any dispute, as it often poisons a business relationship and destroys confidence between the parties over the long term.

I have experienced several disputes during my career in the energy business involving a series of legal, financial and environmental discords. Without exception, a win-win settlement was reached in all of them before leaving the matters to the hands of our hour-counting legal advisors to tidy up the details.

However, during my recent visit to Budapest and Zagreb, it was striking to observe an intriguing case of arbitration. Facing a bill for \$30 million is probably not the most encouraging way to start the new year, yet this is exactly the financial hangover that Croatia's conservative-led government is facing, following its ill-fated litigation with the Hungarian oil and gas champion MOL. It was a wake-up call for former diplomat Andrej Plenković, installed as prime minister late last year.

The affair stems from the privatisation, over a decade ago, of Croatia's state owned hydrocarbons company INA. The company was progressively gobbled up by MOL as Zagreb sold off more and more of its holding, to the point where MOL gained management control. But after Croatian prime minister Ivo Sanader was jailed for corruption in 2012, Croatia tried to renege on its shareholder agreement with MOL, claiming that alleged bribes paid to Sanader by MOL's boss invalidated the accord.

MOL sought redress through the United Nations Commission on International Trade Law under the Energy Charter Treaty, to which both states are parties. MOL argued successfully that there was no evidence of corruption in this case, and that no one in Hungary had been accused or convicted in relation to the case.

Croatia was relying on a provision of the ECT relating to invalidity of investment, claiming that MOL's accumulated shareholding was void because it was acquired through bribes. But the Croatian case was undermined by a court decision to quash Sanader's conviction in the MOL case and order a retrial, which is ongoing.

There are, in my view, two key lessons that have emerged from energy arbitration in the past two years. The first is that the stakes are often dizzyingly high, not least because energy lawyers are both highly expert and highly expensive.

This remains abundantly clear from the ongoing YUKOS-era litigation, the fallout from

Russia's seizure of Mikhail Khodorkovsky's oil company in the early Putin years. Whether Russia will ever pay even a fraction of the \$50 billion arbitration award – now under appeal – remains to be seen, but the litigants are shelling out millions on legal fees trying to enforce the judgment.

In the case of MOL v Croatia, the taxpayer in the EU's newest member state will be paying those bills – meaning the government, led by Plenković's Croatian Democratic Union party, must make up the shortfall with borrowing or spending cuts elsewhere.

The arbitration cost is nearly a fifth of the country's education budget. US law firm Patton Boggs is reportedly being paid \$10 million annually to fight the government's corner.

The affair also vindicates the stance of HDZ's former leader and anti-corruption standard-bearer, Tomislav Karamarko, who warned repeatedly that the arbitration would favour Hungary and urged the government to settle before the bills piled up unacceptably high. Karamarko had the benefit of knowing almost everything about Sanader's case – he led efforts to prosecute his former boss as interior minister at the time.

However, it would seem that – as is often the case in the energy sector – broader interests are at play here, and malign forces pushed the government to try to snatch back control of INA.

Croatia now needs to uncover why this costly and unnecessary fiasco could continue for so long, and who ultimately stood to benefit if Croatia had won. Karamarko, as the country's one-time intelligence chief, seems determined not to let the government off the hook on this one either.

Indeed, the intrigue may be far from over. Shortly after the arbitration judgment was made public, Plenković announced that Zagreb would buy out MOL's 49.08% stake in INA.

That would amount to more than €2 billion in additional costs for the finance ministry, and while Plenković believes it can be achieved without adding to Croatia's public debt, most others are sceptical.

Plenković's argument was not helped by the 10% leap in INA's share price as soon as he announced the buy-back plan. This case raises more questions than answers: just why must INA return to Croatian control at all costs, at a time of consolidation and cross-investment in the sector elsewhere?

The second important lesson is that this saga underlines the continued relevance of the ECT as an appropriate framework for dispute resolution. The ECT exists primarily as a constructive framework for energy investment. If more countries saw it this way, instead of as a last line of defence, its relevance would grow.

Unfortunately, the ECT tends to make the press only in cases like MOL v Croatia, and not

for the pioneering work it has done to establish norms and safeguards for the global energy investment sector. Having said that, the ECT has undoubtedly proved its worth as a reference point for large-scale disputes, even if the EU continues to chip away at and compete with its mandate.

Croatia may yet become an important EU energy hub, as Brussels looks for more options to bring in gas from the east. With Serbia considered to be a close Russian ally in the region, Croatia makes sense as a conduit, especially given its proximity to energy-hungry Italy. Zagreb is accelerating plans for an LNG import terminal active from 2018 in which Hungary is keen on taking part.

But marketing Croatia as a magnet for energy investment will become trickier in the light of this judgment and Plenković's response to it. Also, Plenković must now work hard to heal rifts with Hungary, a regional powerhouse and emerging EU leader with whom Croatia enjoys significant energy infrastructure integration. Balkan politics is rarely easy, but Plenković looks set for a prolonged baptism of fire in his job.

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