A RULE-BASED ARCHITECTURE FOR THE ENERGY SECTOR: THE WTO AND THE ECT

NATASHA A. GEORGIOU

ENERGY CHARTER SECRETARIAT KNOWLEDGE CENTRE
2016
DISCLAIMER

Information contained in this work has been obtained from sources believed to be reliable. However, neither the Energy Charter Secretariat nor the work’s authors guarantee the accuracy or completeness of any information published herein, and neither the Energy Charter Secretariat nor the work’s authors shall be responsible for any losses or damages arising from the use of this information or from any errors or omissions therein. This work is published with the understanding that the Energy Charter Secretariat and the work’s authors are supplying the information, but are not attempting to render legal or other professional services.

The contents of this work are the author’s sole responsibility. They do not necessarily represent the views of the Energy Charter Secretariat or any members of the Energy Charter Treaty.

Boulevard de la Woluwe, 56
B-1200 Brussels, Belgium

ISSN: 2507-1114

Reproduction of this work, save where otherwise stated, is authorised, provided the source is acknowledged. All rights otherwise reserved.
A RULE-BASED ARCHITECTURE FOR THE ENERGY SECTOR: THE WTO AND THE ECT

Natasha A. Georgiou

ENERGY CHARTER SECRETARIAT KNOWLEDGE CENTRE
2016
I. Introduction

It is indeed the case that cross-border trade and investment requires predictability and transparency that can only be effectively achieved through a multilateral legal framework. Unlike any other commodity, the regulation of energy in international trade is challenging, as energy resources are predominantly under the sovereign control of only a handful of countries. As such, negotiations within the energy sphere are driven by divergent interests that are politically motivated, making opposing interests of different stakeholders, such as energy importing and energy exporting countries, difficult to achieve.

From a broad perspective, the World Trade Organisation (WTO) framework is applicable to all trade with non-discrimination, transparency, legal certainty and a dispute settlement mechanism constituting the underlying pillars of the multilateral trading system. The WTO regulates trade relations between its members, which one would assume included energy as the largest and most significant primary commodity of global trade. However, unique features to energy have set this sector apart with the ongoing debate over the applicability of WTO disciplines to energy trade. For many years therefore trade in energy has been excluded from the WTO scope although this is not established by law.

The role of the Energy Charter Treaty (ECT) in the international legal architecture should therefore not be underestimated in that it is the only energy specific multilateral agreement that covers all facets of energy within this strategic sector, including trade, transit, investment and energy efficiency. Furthermore, the ECT,

---

which advocates non-derogation from the WTO, facilitates the general WTO legal framework with its investment and transit rules, which are more elaborate than that of the WTO. The ECT can therefore be said to be strengthening the rule of law and in so doing, providing a legally ordered institutional environment both internationally between member states and investors; and domestically by promoting good governance instruments between its members and non-WTO ECT members aspiring to join the WTO.

With the modernisation of the Energy Charter and the expansion of its geographical scope pushed to the fore following the inception of the International Energy Charter (IEC), the ECT arguably constitutes a model of good governance for which there is to date no better alternative in the current global and interdependent energy world. The adoption of the IEC represents a bolstered impetus to strengthen energy cooperation under a common legal framework, building on the established principles of the European Energy Charter of 1991, to reflect the new challenges prevalent today. The IEC therefore stands as testament to the development of global energy governance and the significance of the Energy Charter Treaty (ECT) in the multilateral legal architecture.

This article discusses the role of the WTO and the ECT in the legal architecture regulating energy trade. The article advocates that both legal institutions serve as vital tools to global energy governance in a rapidly changing trading landscape riddled with fragmentation. While both the WTO and ECT are treaty-based regimes, the WTO is a broad trade framework regulating trade in all goods and services of its Members, whereas the ECT is a specialised regime regulating trade and investment in the energy sector. Despite the potential overlap between both frameworks, this article argues that the ECT’s energy specific provisions and non-derogation from WTO rules, serves to bolster the multilateral trade framework with the added value of

---

transit and investment protection, as pertinent facets of energy trade. The ECT therefore facilitates a rule-based architecture for the energy sector, thereby serving as a vital instrument of global energy governance.

II. The WTO and Energy

The General Agreement on Tariffs and Trade (GATT)\(^5\) was originally established to regulate trade in goods which developed into a broader set of responsibilities when it evolved into the WTO in 1995, with trade in services (GATS)\(^6\), Trade Related Investment Measures (TRIMS)\(^7\) and intellectual property (TRIPS)\(^8\) added to its scope of governance.\(^9\) The objective of the WTO is to eliminate discriminatory treatment in international trade relations by promoting free trade by reducing tariffs and other trade-related barriers.\(^10\) The WTO regulates trade in goods by way of the GATT and trade in services by way of the GATS, however for many years, trade in energy has been perceived as falling beyond the scope of the GATT and therefore treated as excluded from the ambit of the WTO.\(^11\) This perception has largely been fuelled by the fact that the WTO does not have specific rules dealing with trade in energy. Nevertheless, energy related issues featured in several rounds of the GATT

---


\(^9\) The GATS, TRIMS Agreement and TRIPS Agreement are all published in WTO, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations (WTO 1999).

\(^10\) Marrakesh Agreement Establishing the World Trade Organization (adopted 15 April 1994, entered into force 1 January 1995) 1867 UNTS 154, art II.1 (‘Scope of the WTO’): ‘The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.’

negotiations and therefore energy trade was intended to be incorporated in the framework of the GATT, the successor to the stillborn International Trade Organisation (ITO). Therefore, even though energy is not addressed as a distinct sector within the WTO framework, the default position has always been that WTO rules are applicable to all trade, including energy.

III. Energy-Related Challenges for the Multilateral Trade System – Transit and Investment

The WTO clearly has significant interests in energy. WTO rules cover trade in goods, services and trade-related intellectual property rights, thereby capturing a multitude of elements of trade in energy. Furthermore, steps to include energy-specific commitments have been taken in the services schedules - some members have undertaken commitments on services incidental to energy distribution in their schedules of concessions, whilst others have undertaken commitments on pipeline transportation of fuels. This impetus is also evident in recently acceded members that have incorporated energy-related commitments to their Protocols of Accession. In addition, the WTO dispute settlement system has addressed several energy-related disputes on renewables, thereby giving credence to the fact that energy issues are increasingly becoming a part of the WTO's day-to-day work.

---

15 Ibid.
16 The Appellate Body report Canada – Certain Measures Affecting the Renewable Energy Generation Sector (WT/DS412/AB/R and WT/DS426/AB/R) was the first of many however several other disputes have been filed challenging the WTO-law consistency of measures in the energy sector – by way of example, see biodiesel dispute between the EU and Argentina (cases DS459 and DS473), or China’s claim with respect to the EU FIT program (case DS452).
Cases such as the Canada — Renewable Energy and Canada — Feed-In Tariff Program\textsuperscript{18} give credence to this assertion.

Nevertheless, it is important to note the plethora of issues that energy trade poses for the multilateral trade system. These energy related pitfalls have ultimately led to doubts being cast as to whether energy can effectively be regulated by a broad trade framework. This stems from the fact that the WTO legal infrastructure was not originally drafted with the intention of resolving the challenges that energy posed.\textsuperscript{19}

By way of example, the multilateral trade rules do not adequately address investment protection\textsuperscript{20} and transit, two fundamentally important facets of energy trade.\textsuperscript{21}

\textbf{Investment Protection}

The need for investment in the energy sphere inevitably requires solid legal foundations with sufficient investment protection rules in place to facilitate cross-border trade and investment. This is significant given that the regulation of investment has largely been absent from the WTO framework. There is no comprehensive system of rules pertaining to investment or competition within the WTO.\textsuperscript{22} The creation of an investment framework was initially discussed in the beginning stages of the Doha round, but was eventually dropped at the negotiations


\textsuperscript{20} Investment protection is only dealt with to a limited extent through the GATS under Mode 3, to the extent that the member country undertakes such commitments.


of the Cancun ministerial in 2003. As such, the WTO does not deal with investment policy except to a limited extent through: (i) the GATS in relation to services; and (ii) the TRIMS in relation to goods, for which this coverage is not sufficient. The GATS covers several issues with specific commitments undertaken by WTO members in relation to various services sectors, however few of these commitments are for energy services specifically. As such, the commitments undertaken under the GATS are limited to aspects of the services sector whereas energy trade is not limited to energy services alone. Energy services therefore require new classifications suitable to deal with energy as an integrated sector. The successful regulation of energy requires a coherent combination of rules for both goods and services. For this reason, an energy investment framework is required, which goes beyond services.

Transit

Cross-border energy trade requires secure transit of energy between and through the territory of different states. Unlike the transportation of any other goods, energy transit is grid bound and capacity restricted as it cannot be easily stored. Fixed infrastructure such as transportation pipelines and transmission grids, are built specifically for the purpose of carrying hydrocarbons or electricity however, there are

26 Ibid.
28 Ibid.
physical limitations to fixed infrastructure given the lack of capacity, which leads to limited transportation. This inevitably obstructs access to infrastructure and enables monopoly suppliers to charge excessive transportation fees.\textsuperscript{30} WTO rules provide a basic framework for energy transport and transit with disciplines that are fragmented and incomplete in terms of practical application.\textsuperscript{31} Although energy is covered by the general WTO framework, WTO rules are not well tailored to address acute problems pertinent to transit and transportation.\textsuperscript{32} Article V establishes the principle of freedom of transit with substantive legal obligations such as most favoured nation (MFN) and prohibition to apply custom duties.\textsuperscript{33} The application of GATT Article I (MFN)\textsuperscript{34} and GATT Article III (National Treatment (NT))\textsuperscript{35} have raised concerns given the inconsistencies with prevailing market practice in energy trade. This is evident in the preferential pipelines access granted by WTO members to vertically integrated state-owned companies, which is a permitted exception to GATT Article III.\textsuperscript{36} Therefore, whilst Article V establishes a general rule of freedom of transit based on the principle of non-discrimination, it does not address important issues such as uninterrupted transit flow and development of new infrastructure.\textsuperscript{37} Furthermore, it is not clear whether Article V provisions cover fixed infrastructure and thus distribution


\textsuperscript{34} Most Favoured Nation (MFN) is a fundamental principle of the world trading system which is aimed at promoting trade without discrimination. Pursuant to the MFN principle, countries are not permitted to discriminate between their trading partners by making exclusive concessions to one member over the other.

\textsuperscript{35} All WTO members are provided with MFN status and their respective products and services are granted national treatment (NT) to ensure there is no discrimination between foreign and domestic goods amongst trading partners.

\textsuperscript{36} Leal-Arcas R and Abu Gosh E S, ‘Energy Trade as a Special Sector in the WTO: Unique Features, Unprecedented Challenges and Unresolved Issues’ (2014) 6 Indian Journal of International Economic Law 1, 39

through pipelines thereby creating further controversies in as far as transit is concerned.\(^{38}\)

Therefore, although the WTO encompasses basic disciplines addressing transit of goods, they are incomplete and lack substantial obligations with relevance to the specific challenges that energy trade poses.\(^{39}\) This is a fundamental weakness of the WTO as it is impossible to properly address energy concerns without taking into consideration all facets of energy that are prevalent in the global energy sphere.\(^{40}\) To date, energy regulation in international law has predominantly been highly fragmented.\(^{41}\) Energy therefore needs to be addressed coherently across the different fora and agreements within the WTO so that core issues prevailing in the energy domain can be dealt with by undertaking a more holistic approach.\(^{42}\) These issues include investment protection and transit.\(^{43}\) In this respect, the Energy Charter has an important role to play with the ECT making a significant contribution to the energy sector as the only multilateral agreement that covers all aspects of the energy sector.

IV. The Energy Charter

The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (Protocol) entered into legal force in April 1998 having been signed in December 1994. To date, the ECT has 54 signatories and contracting

---


parties. The ECT was set up to establish a legally binding framework promoting better investment conditions in international energy trade for the purpose of providing investment protection and promoting international energy cooperation. As the only agreement of its kind, establishing inter-governmental cooperation in the energy sector covering the whole value chain, the aim of the ECT was to strengthen the rule of law by creating a level-playing field in the energy sector.

The ECT is the only multilateral agreement in the energy sector that has legally binding rules backed by a dispute settlement mechanism, which promotes and protects foreign investment in the energy field and sets out detailed principles of energy transit. 44 By establishing a set of rules to be observed by all participating governments, the ultimate goal was that risks associated with energy-related investment and trade would be mitigated.

The significance of the ECT’s role is vested in its global dimension – the fact that it applies across the board to all players along the energy chain including producers, consumers and transit states of both developed and transitioning economies. 45 With the signing of the International Energy Charter and the subsequent increased number of observers to the Energy Charter Conference, the ECT is uniquely placed to reduce risk premiums and provide a framework for global energy governance that the sector desperately needs. 46 As a legally binding framework intended to create better investment conditions in international energy trade, as well as to provide investment protection and promote international energy cooperation, the ECT is able to cater to that need. 47 With the ever-pressing call for multilateral energy

---

46 Karel Beckman, Interview Urban Rusnak, Secretary-General of the Energy Charter Secretariat (Brussels, 7 June 2012).
47 Ibid.
governance, the ECT’s rules can be used as a basis for that infrastructure and in doing so, providing a solid legal architecture for investments in the energy domain.

V. Energy Regulation under the ECT: Creating Coherence and Overcoming Fragmentation

To sum up, there are several prevailing legal challenges that have revealed limitations in the WTO system, which include, amongst the substantive issues, the nature of energy materials and products that are fundamentally different to manufactured goods, which the WTO predominantly deals with. There is a clear distinction within the WTO discipline between trade in goods and trade in services, with specific rules applicable to trade in goods by way of the GATT and trade in services by way of the GATS. This distinction has raised concerns as it is neither prevalent nor clear in the energy sector. In addition thereto, the traditional focus of GATT has been on market access of domestic products rather than access to foreign supplies. This means that trade rules are designed to address import barriers rather than export barriers, which is problematic, as trade restrictive practices in global energy trade stem from export taxes and restrictions. Furthermore, legal challenges have been brought to the fore with doubts raised as to whether GATT Article V addresses issues crucial to energy trade such as disruption to transit and new infrastructure for insufficient capacity. Additional concerns relate to whether GATT Article V, which establishes a general rule on freedom of transit of goods, is applicable to

transportation of energy through fixed infrastructure.\textsuperscript{53} As energy trade is conducted through fixed infrastructure such as pipelines and transmission grids, the WTO therefore appears to be unable to effectively address these issues pertinent to the energy field.\textsuperscript{54}

In contrast, the trade provisions of the ECT, which draw largely on WTO, are better designed to address the requirements of energy trade given the extensive definition of energy products and services and the fact that gas pipelines are included as a means of transport in Article 7 ECT.\textsuperscript{55} Article V is less sophisticated than the corresponding provision in the ECT, which addresses national treatment, new infrastructure construction and dispute settlement under Article 7(6) and Article 7(7).\textsuperscript{56} Furthermore, the deeply enshrined investment protection provisions of the ECT are more favourable than the WTO, given that the WTO’s rules appear to be basic in nature with expropriation largely neglected and accession to the WTO’s dispute settlement restricted to members only.\textsuperscript{57} Further limitations in the WTO’s dispute settlement framework are also evident in the lack of direct effect in most WTO member’s domestic legal order.\textsuperscript{58} Whereas the ECT has a system of state-to-state and investor-to-state dispute settlement mechanism to resolve potential disputes arising from matters covered by the ECT, in addition to a special conciliation procedure under Article 7(7) intended for the resolution of transit disputes.


\textsuperscript{55} Anna Marhold, ‘The World Trade Organization and Energy: Fuel for Debate’ (2013) 2(8) ESIL Reflections 1


\textsuperscript{57} Ibid, 120.

\textsuperscript{58} Guillaume Van der Loo, ‘EU-Russia Trade Relations: It Takes WTO to Tango?’ (2013) 40.1 \textit{Legal Issues of Economic Integration} 17.
VI. The ECT as an Added Value to the WTO

The ECT’s trade regime sets the trade foundation for Contracting Parties that have not yet acceded to the WTO, by creating a platform whereby they can familiarise themselves and be exposed to the disciplines and practices that WTO membership requires.\textsuperscript{59} The ECT assumes that all contracting parties will eventually become members of the WTO and therefore endeavours to fill any gaps in the interim period pending accession, as far as any trade related issues are concerned.\textsuperscript{60} The ECT therefore has the effect of treating contracting parties which have not yet acceded to the WTO, as if they were WTO members and thus incorporated into the energy related trade framework.\textsuperscript{61} For non-WTO members, the ECT trade regime establishes the platform for WTO membership through the application of WTO rules by reference to trade in energy materials and products. Whilst not all WTO rules apply, given the exceptions under Annex W\textsuperscript{62} to the application of the WTO Agreement provisions, the ECT trade rules nevertheless have an important role to play in facilitating processes of accession to the WTO for many ECT Member States by bringing their respective energy-related domestic legislation in-line with WTO norms.\textsuperscript{63} The ECT assists these members in carrying out domestic reforms in their respective energy sectors and in their subsequent membership of the WTO.

The ultimate goal of the ECT is to create a liberalised energy market for which a stable and transparent energy trade framework is required which is facilitated by the adoption of trade rules of the GATT and other WTO Agreements, as provided in the


\textsuperscript{61} Ibid., 542.

\textsuperscript{62} Annex W: Exceptions and Rules Governing the Application of the Provisions of the WTO Agreement (in Accordance with Article 29(2)(A)).

ECT.64 Non-derogation from WTO rules is the cornerstone of the ECT trade regime as clearly stipulated in Article 4. Through the application of WTO rules by way of the ‘WTO by reference’ approach, the ECT has the effect of treating signatory states that are not yet members of the WTO as if they were members and thus exposed to the energy related trade frameworks.65 The ECT therefore complements the general WTO framework and its wider constituency by bringing more energy specific rules to the table, the key provisions being in relation to investment and transit.

According to the tribunal of the Plama case, the ECT is the first multilateral treaty to provide as a general rule the settlement of investor-state disputes by international arbitration which provides investors with an almost unprecedented remedy for claims against a host state.66 The ECT investment regime therefore provides significant added value to the WTO framework considering that the WTO does not adequately address investment except to a limited extent through the GATS; and then only to prohibit measures undertaken in investment that are deemed inconsistent with obligations of national treatment and prohibition of quantitative restrictions.67 The multilateral trade rules of the ECT that are specifically applicable to the energy sector are therefore of strategic significance given that existing WTO agreements are not designed to provide for such a framework. Instead, as mentioned above, their focus is on market access rather than on more pressing issues such as investment protection and export restrictions, which are crucial challenges in oil and gas that need to be addressed.68

68 Ibid, 68.
The deeply enshrined investment protection rules of the ECT are reinforced by the ECT dispute settlement mechanism, which includes both state-state and investor-state arbitration.\(^69\) The ECT dispute settlement system is therefore unique in that it can be enforced by private investors and that it is broad in scope both with regard to the elements of energy covered (namely trade, investment and transit) and the number of countries within its scope which include consuming, producing and transit states.\(^70\) As the only intergovernmental agreement in the energy field with legally binding rules backed by dispute settlement, the ECT is therefore the first binding multilateral instrument, which includes detailed principles on energy transit and which promotes and protects foreign investment in the energy sphere.\(^71\)

**VII. Conclusion**

Cross-border energy trade and investment require predictability and transparency that can only be effectively achieved through a multilateral legal framework.\(^72\) For this reason, efforts to regulate energy at a bilateral level have not been effective. Recurring trade disputes have often revolved around transit, which usually involves at least three states. For this purpose, multilateral rules are more favourable. The same holds true for energy security. As such, uniform rules applied at a multilateral level create a balanced and predictable framework, which is more effective in ensuring energy cooperation in the international arena than energy governance addressed at a bilateral level.\(^73\)

---


\(^73\) *Ibid.*
Despite the WTO being a broad multilateral framework, it has been shown above that WTO rules do not appropriately address all the needs of energy trade today.\textsuperscript{74} Energy requires an integrated approach as energy production and transmission are complex operations, which involve both goods and services.\textsuperscript{75} These ambiguities in the WTO framework need to be addressed for the purpose of ensuring legal certainty in the application of WTO rules to the global energy market. Whilst the prevailing issues can best be addressed by seeking comprehensive negotiations within the WTO, the ECT offers a swift solution. As an added value to the multilateral trade framework, the ECT has the potential to enhance coherence and overcome unnecessary fragmentation in regulating trade in energy. It is indeed the case that ECT rules are better tailored to tackle the challenges prevalent in the energy sphere and it is therefore within such a multilateral framework that the prevailing issues should be addressed and the proposals for reform dealt with.

If one concedes that there are several \textit{lacunae} in the WTO legal architecture when it comes to providing an appropriate legal framework for energy trade, which suggest that the matrix of agreements were not drafted with the energy sector in mind, then the ECT has an important role to play in bolstering the legal regime, given its energy focus. As a plurilateral energy trade and investment agreement with Member Countries consisting of both energy producers and consumers as well as transit states, the ECT is the only treaty with established legal norms specific to energy trade and investment.\textsuperscript{76} Furthermore, the fact that these investment rules are enforceable through a dispute settlement mechanism means that the Energy Charter is the only

\textsuperscript{75} Ibid, 8.

international energy investment treaty.\textsuperscript{77} It is important to note that the ECT advocates a nexus and non-derogation from WTO rules and therefore constitutes a valuable addition to the WTO framework, given the more detailed investment and transit rules (that have not been negotiated to the same degree within the WTO).\textsuperscript{78} By facilitating synergy with the WTO rather than fragmentation, the ECT thus serves as a complementary forum in addressing the complexities of energy regulation in international trade. The ECT can therefore be said to be strengthening the rule of law and in so doing, providing a legally ordered institutional international environment in the energy sector. In this respect, the ECT’s multilateral provisions that purport to advocate and constitute a model of good governance validate the assertion that there is to date no better alternative in the current global and interdependent energy world.\textsuperscript{79}

\textbf{The Author}

\textbf{Natasha A. Georgiou}, PhD Candidate, University of Reading, United Kingdom


