Testing the Water for Global Energy Governance Reform:

Can the Energy Charter Provide a New Benchmark?

Occasional Paper

By Dr. Marat Terterov

Energy Charter Secretariat Knowledge Centre 2013
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Testing the Water for Global Energy Governance Reform: Can the Energy Charter Provide a New Benchmark?

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Global Energy Governance and Global Energy Challenges

Global energy governance is a topic which has come under increasing levels of scrutiny at the moment. Debates about energy security have become more acute in recent years, as concerns which consumer nations once had over access to cheap oil flows during the 1970s have transformed into an even more alarming politicisation of present-day gas supplies. Peaking demand for hydrocarbons has caused oil and gas prices to spiral inexorably upwards, as consumer-country watchdog organisations continue to warn us of the finite nature of fossil fuels. Most informed sources suggest that demand for hydrocarbons will continue to not only peak in the years ahead, but that the main source of future demand will come from non-traditional consumer countries, which are mostly located in Asia. Countries like China and India, rather than Europe and the United States, are already becoming the drivers for fossil fuel demand and this trend is only set to accelerate further, looking ahead. These are just some of the challenges which presently confront decision makers as global energy issues inevitably take a higher profile in the international arena.

The axiomatic trend of accelerating demand for energy in the developing world immediately poses two further, inter-related challenges which widen the scope of the energy security debate and create space for an academic discussion on global energy governance. The first of these relates to the fact that managing harmful CO₂ emissions remains a highly complex task in developing countries, with nefarious implications for climate and the environment due to the increased consumption of oil, gas as well as coal. China and India, where energy efficiency strategies remain underutilised, are in the process of joining the United States in the club of the “world’s largest emitters”. China is, for all intensive purposes, already there. They may well overtake America if present trends continue unabated.

Second, we need to take note of the fact that, as energy consumption in developing countries grows, such states begin to stake their case for a stronger voice in debates on energy security within the framework of existing international fora. We have already seen a substantial power shift and commensurate wealth transfer from West to East over the last decade or so, as the BRICS countries become more prominent global actors at all levels. Further, their national ‘oil champions’ hold a commanding stake in existing oil reserves, super-ceding the original “seven sisters” (group of international oil companies). This trend is often seen as a new challenge, and even a security threat, by mainstream OECD/EU (energy consuming) countries. This is particularly the case when developing and/or oil rich countries band together in establishing international organisations in order to forge “solidarity blocs” to uphold their own interpretation of energy security with power politics.

Managing the Energy Security Debate through Governance Institutions

Managing such extremely complicated (and often politically charged) international energy relations is, as history has already shown us, no task for the faint hearted. Indeed, the questions asked of policy makers when it comes to some of the core energy challenges of the present time – such as managing hydrocarbons demand, reducing CO₂ emissions and mitigating climate change, whilst reconciling the interests of suppliers, consumers and other stakeholders along the energy value chain – are often beyond the capacity of mere mortals. That being said, a landscape of actors and institutions attempting to manage and regulate the conduct of the international energy relations not only exists but has been present for decades.

Those of us old enough to remember the 1960s and 70s, will recall the rowdy days of Arab Gulf monarchies and other oil producing states from the developing world using the newly established OPEC cartel to ram home strident political messages to developed oil consuming countries. OPEC’s politically motivated reduction of oil flows to international markets, and the resulting hike in the global oil price, was the first time that energy was used as a political instrument on such a scale. OPEC’s actions led to a political crisis within the OECD membership, which was defined predominantly through a security framework. The (now household) concepts of energy security, and security of supply, entered our lexicon.

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Vexing questions related to energy security take us back in time much further than the ‘oil shocks’ of the 1970s, however. Japan’s geopolitical expansion into Asia during the 1930s and 40s was driven by the quest for “security of (oil) supply”, while the British Empire already viewed Gulf oil in strategic terms as of the early 20th Century. For much of the last century, oil (particularly access to it) equated to national power, elevated the significance of state sovereignty (especially with respect to natural resources) and involved diplomatic engagements at the highest political and corporate levels.

The securitisation of oil supply and consumption thus required the creation of powerful international organisations to manage its trade and exchange in the international economy. The establishment of such ‘interstate energy actors’ helped to institutionalise the process of energy diplomacy, although from a purely economic perspective their objective was the creation of instruments aiming to correct inevitable cases of market failure. The creation of OPEC (1960) and the IEA (1974) reflects national actors striving to create such institutions at the level of producer and consumer countries respectively.3

Despite the fundamental role that oil continues to play in the international economy, debates about energy security have changed substantially since the end of the Cold War period. As we have already alluded to above, this is due to the fact that global power distribution has changed substantially in the present-day international order, which is now far more multi-polar than it has been since at least the mid-20th Century. Much of the energy security debate now centres on the security of the gas supply, since the advent of environmentally friendlier, sustainable energy strategies call for the reduction of the use of oil within the energy mix of OECD energy consuming countries.

A heightened debate over security of the gas supply is now particularly evident in Eurasia, where the EU-Russia gas trade has led to the development of (increasingly interconnected) regional gas markets. Interdependence and regionalisation of gas markets has led to the emergence of new governance institutions such as the Gas Exporting Countries Forum (GECF), as well as supra-regional legal frameworks intended to protect energy trade and investment such as the Energy Charter Treaty (ECT). Nevertheless, Eurasian gas markets have become characterised by transit and supply disputes – 21st century cases of market failure – rather that a smoothly functioning inter-regional gas trade.

**Global Energy Governance or Global Energy Governors?**

Given all of these trends related to the conduct of international energy relations, an analytical industry has emerged in recent years in order to capture these dynamics within the framework of one conceptual rubric. The preferred term, or conceptual instrument, which analysts employ in this respect, is global energy governance. It should be stated from the outset, however, that the employment of this type of label to discuss international energy relations is wrought with imperfections. The term global governance implicitly points towards a form of ‘global order’ in the international system, perhaps as an appendage of the term ‘government’ in a domestic context, applied at the international level. There is no global government in global energy, however. Neither is there an intergovernmental treaty applying itself unilaterally to global energy (energy lies largely outside of the World Trade Organisation). Further, the manner in which inter-governmental actors engaged in global energy governance have evolved during the past decades has lent itself more to the creation of a landscape full of ‘governors’ – with highly diverse policy objectives – rather than any form of international energy order, or ‘governance’.

While the likes of OPEC and the IEA have remained amongst the dominant actors in global energy governance, as the energy business has taken on a higher profile internationally, the number of governors has increased substantially in recent years. Energy governors now not only include intergovernmental bodies and agencies, but also international industry associations, NGOs, environmental and climate oriented groups and informal bodies. While often less outwardly political in their work, the additional field of actors in global energy governance may however have stronger networks and access to wider information platforms than the more ‘high profile’ governors. The World Energy Council (WEC), for example, was established in 1923 – well before OPEC and the IEA – and has national committees in some

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93 countries. An administrative secretariat (of the WEC) co-ordinating this network is located in London. The WEC holds bi-annual energy summits which attract around 100 participants at the level of national ministers and company CEOs, as well as a show case event taking place every three years and involving up to 7000 participants from the networks arranged by the 93 national committees.

Further undermining any sense of global order, or concerted attempt at forging common rules of the game in international energy, is the fact that there is no ‘one global energy’, as such. Energy is divided into many industry and sub-industry commodity segments, including not only traditional fossil fuels such as oil, gas and coal, but also electricity, nuclear and renewable energy sources. Renewables themselves are divided into many sub-segments: wind, solar, biofuels, etc. All of these industry and sub-industry segments require the application of highly distinct technological levels of expertise, have different implications at the policy level and are often far removed from one another at many practical, industrial and operational levels. Adding further to the need for different ‘governors’ are issues relating to climate and environmental concern, which has led to the establishment of governing institutions such as the United Nations-driven UNFCCC, together with other less prominent actors involved in managing the relationship between energy and environment.

Thus, instead of any sense of order, or a common rules framework underscoring the concept of global energy governance, what we have is an energy landscape (literally) littered with governors and institutions, many of whom have competing as well as overlapping objectives. The landscape itself is rather inchoate and uncoordinated, which is – as already implied above – due to the fact that ‘governors’ have emerged in a path dependant fashion, often in response to one form of crisis or another. While in more recent years an emergent array of partnerships and networks is coming together to further crowd into the landscape, path dependency ensures that governors retain ownership rights over their own – often narrowly defined – narratives of energy security.

Transparency remains a problem and the lack of priority (and clarity) for the objectives of any forms of collective energy security, or oneness in global energy governance, impedes coordination and communication between governors, at least implicitly. Although the awesome nature of the energy challenge of the early 21st century confronts all stakeholders in global energy, the need to harness the diversity of governing institutions into one system of order has thus far failed to transpose itself into successful action.

The Only Consensus Is in (the Need for) Reform

In fact the only sprinkling of consensus over global energy governance coming from the (largely) academic debates is an understanding that reform of the current landscape is highly desirable, if not badly needed. In a recent paper by the Grantham Institute for Climate Change/Imperial College London, it was argued that international (global) energy governance has not kept pace with today’s major energy policy challenges: the ‘emergence’ of major developing nations; changing relations between oil producers and consumers; the emergence of climate mitigation as a central energy policy issue; and with the technological revolution now required to address some of these challenges. The thrust of the Grantham paper involved simultaneously discussing both the prospects and limitations of reforming the IEA, as a means of rising up to the challenge faced by our imperfect, present-day system of global energy governance.

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4 Discussion with WEC representative in Brussels, March 2013.
5 Ibid.
7 Ibid.
Other recent academic papers on the subject matter have also argued the merits of reforming the Agency so that it can become the *primus inter pares* global energy governance institution.\(^9\) Debates about reforming the IEA presently centre on the theme of expanding the Agency to include the major emerging energy economies – India, China, Russia – into the Club of OECD (largely) consumer countries. Indeed, proponents of expansion of the Agency’s country membership base were spurred on by the recent public statements of former US Secretary of State, H.R. Clinton, who called for “the IEA to (now) lay the groundwork for eventual Chinese and Indian membership.”\(^10\)

**US Political Ownership Limits Scope of IEA Reform**

While such statements may be encouraging for global energy governance reformers, they are somewhat “brought back down to earth” when confronted by the actual task of implementing reform. Membership of the Agency is underscored by binding legal commitment to the inter-governmental OECD Treaty. As a rule, legally binding intergovernmental agreements are very difficult to alter, as they involve highly complex, almost impossible sets of multilateral negotiations and legal procedures. When speaking about the prospect of expansion of the Agency to include new energy powers, Maria van der Hoeven, IEA Executive Director, recently said that “OECD membership is a constraint. It is not something that I will be able to change.”\(^11\) Further, given that the Agency remains under large-part-ownership of the world’s predominant geopolitical superpower, the United States, it is questionable as to whether the political will exists in order to see through reformist efforts.

This particularly applies to any discussion of including countries like Russia into the Agency, and possibly China too. A recent report of the Committee on Foreign Relations in the United States Senate entitled ‘Energy and Security from the Caspian to Europe’,\(^12\) provides an inkling of evidence with respect to the US position towards Russia from an energy policy perspective. Far from embracing Moscow as a global energy partner with whom the Agency may genuinely like to develop closer ties, the report is filled with language depicting Russia as an eminent security threat to ‘US interests and to NATO allies’ alike. The context for the ‘colourful language’ littered through the report was the need to secure Caspian gas supplies for Europe through the Southern Energy Corridor in circumvention of Russia, given that latter’s ‘gas-fuelled pressure against NATO allies’.

Although in recent years the Agency has taken steps to develop a closer working relationship with developing countries (including, in this context, Russia), hostile attitudes towards Russia (and to a lesser degree, China) from senior Agency (often former US State Department decision makers) executives, while not always explicit, remain present. It is highly unlikely, therefore, that parochial national interests driving IEA policy would welcome Russia into the Club. One is almost led to conclude that the recently emerging ‘closer working relationship’ (advocated by the Agency towards Russia) is a way of monitoring Russian energy policy, rather than a means of actively promoting institutional reform.

**Towards a More Realistic Case Study of Reform**

A more realistic case study for present-day global energy governance reform may yet be found in the example of one of the less hard hitting, albeit long-present ‘global governors’: the Energy Charter. The Energy Charter dates back to the early 1990s, when it emerged as an ambitious ‘international energy cooperation’ project driven by the political ownership of the Prime Minister of the Netherlands of the time, Ruud Lubbers. The Energy Charter foresaw a potential opportunity arising out of the demising Soviet Union in helping to open up energy investment opportunities in this region by creating a legal framework designed to stimulate investor confidence. American and European oil and gas

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10 Hirst and Froggatt, op.cit, p.11.

11 Ibid.

companies were at the time eyeing new business opportunities ‘to the east’, while capital-deprived Soviet markets desperately needed investment, thus inspiring win-win oriented energy cooperation. At least this was the plan.

The (so-called) ‘Lubbers Plan’ did not suffer from lack of political ambition, even managing to attract the world’s leading powers and oil countries of the time – the United States and Saudi Arabia – into what essentially was a European-driven initiative. Political ambition and ebullience on the part of the Energy Charter’s founding fathers, (together with the unique international political climate at the end of the Cold War), led to 51 countries signing the Energy Charter Treaty (ECT) by mid-1995. The ECT came into legal force four years later, in April 1998, following the 30th signatory country ratifying the Treaty through national legislature. The ECT remains an existing body of international law to the present day, forming a part of the landscape of global energy governance.

Since the latter 1990s the Energy Charter project began a gradually downward slide, however. ECT negotiators showed impressive resolve to overcome Cold War rivalries in order to bring the newly emergent Russian Federation (as well as other ex-Soviet Republics) into a European-driven multilateral legal instrument, which purported to significantly encroach into Russian sovereign space. That being said, Moscow always harboured more than notable scepticism about the intentions of the Treaty. While the Russian government signed the ECT in 1994, the Russian Duma never ratified it. Washington, which signed the European Energy Charter of 1991, thereby endorsing the principles of the Energy Charter through a political declaration, soon pulled out of the negotiations process and was not a signatory of the ECT of 1994.

In Russia, while the oil industry, in desperate need of foreign direct investment (FDI), lobbied the Russian government to ratify the Treaty, the Russian gas industry retained scepticism right from the outset. Gazprom and its lobbyists in the Russian Duma constructed a domestic image of the ECT which projected the Treaty as a European-ruse intended to secure Central Asian gas for EU markets. By ratifying the ECT, Russia’s role in the project would be reduced to little more than that of a transit state for Turkmen gas, it was argued.

Whether such perception was actually the case may now be somewhat academic, since by 2009, gas transit, from both a technical and political angle, virtually brought the Charter to its knees. Russia threatened to withdraw from the near-two-decade long Charter Process, claiming that the ECT was largely irrelevant since it was incapable of guaranteeing ‘freedom of transit’ (of Russian gas transiting via Ukraine to Europe) following Moscow’s high profile gas supply dispute with Kiev in January 2009, and the political fallout that followed. Energy Charter old-hands familiar with the internal mechanics of the Charter Process, however, felt that other factors may have been more pre-eminent in Moscow’s subsequent (June 2009) announcement of its intention of ‘not to become a member’ the ECT and withdraw from its undertakings to the Treaty’s provisional application. Such factors ranged from ‘technical drawbacks’ in which the Charter process became entangled, in particular the (eventually) failed negotiations on the ECT (additional) Transit Protocol, to the more conspiratorial thesis of Moscow’s concern in facing legal sanctions under the ECT in relation to the ‘Yukos case’.15

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14 Russia’s involvement with, and commitment towards, the Energy Charter has, for the most part, appeared rather ambiguous. Russia is one of five Energy Charter member countries to have signed the ECT but never ratified it, meaning that it only applies the Treaty on the basis of Provisional Application. In legal terms this essentially refers to the fact that Russia is bound by the provisions of the Treaty only to the degree that such provisions are compatible with Russian domestic legislation. However, there has not been an investor-state arbitration case within Russia to test the nature of Russian provisional application under the ECT. It is therefore at this stage not possible to judge as to the degree that Russia applies the Treaty or has applied it in the past. That said, with Russia’s announcement of withdrawal from Provisional Application in 2009, Moscow has furthered the perception that Russia is now, for all intensive purposes, outside of the ECT legal regime and is thus not bound by its provisions. Whether this is the case or not, is the subject of legal debate and interpretation.
Russia’s June 2009 announcement sent ‘shock waves’ through the stuttering Charter Process. After a period of soul searching within the ECT constituency, a way was eventually paved for the Energy Charter Conference, the primary decision making body of the Process, to issue a mandate for reform. Reform, more aptly referred to as ‘modernisation’ of the Energy Charter, is currently under way. The Energy Charter reform process is based on a preliminary Road Map (for modernisation) mandated by the Charter Conference Rome meeting (December 2009) and primarily involves an effort to ‘update’ the original principles upon with the Energy Charter was founded in 1991.

Namely, it is accepted by ECT member countries that the context of global energy has changed substantially during the last 20 years and the Charter needs to reflect those changes more explicitly in its projection of itself as an institute of global energy governance. In short, the Energy Charter needs to rise up to, and reflect, present day global energy challenges. This applies particularly to the Charter (inclusive of the ECT) having to equally represent the energy security concerns of energy producing countries, as well as energy consuming states: thus advocating a wider definition of energy security and thereby promoting the interest of all its members more evenly.

Reform Achievable and Could Have Wider Implications

Implementation of reform (of the Energy Charter) has, thus far, been exceedingly slow and for the most part, short of any notable progress. Nevertheless, reform (modernisation) is ongoing and is mandated by the Charter constituency – including key constituents: the EU, as well as the Russian Federation, which now appears to be less the ‘dissenting child’ in the family. This situation, of slow but mandated reform, should be seen as an encouraging development from the perspective of global governance reformers, however. While structural reform of the IEA, as implied above, is unlikely, and where the wider global governance landscape remains dominated by competing interests, the process of (ongoing) reform of the Energy Charter may just provide a ray of hope in demonstrating that global energy governance reform is possible.

Indeed, the present day experience of the Charter provides us with the one clear example of an international constituency of (highly diverse) energy supply chain countries agreeing that the reform of their ‘governor’ is both desirable and sorely needed. Thus the current case of the ‘modernisation of the Energy Charter’ offers us the most practical, as well as audacious opportunity of a global energy governance reform test case available today. As a pilot project of global energy governance reform, Energy Charter modernisation could have resonant implications for the wider international governance landscape and therefore deserves our attention.

But Much Is to Be Done

Two fundamental impediments arise immediately when contemplating the Charter as a reform test case, however. The first is the question of political ownership. While the likes of the IEA are largely (although not unilaterally) US-driven, and whilst the Kingdom of Saudi Arabia provides OPEC with a typically ‘soft’ leadership driver, during the past decade the Charter has drifted into the wilderness somewhat when it comes to the question of ‘political sponsorship’. At the outset, the Energy Charter was owned politically by Dutch Prime Minister Lubbers, who championed the Charter initiative at the highest political level. Later, the Charter would be passed on to the hands of the EU – the European Commission more specifically. While the EU, also a signatory of the ECT, has continued to provide a level of public endorsement for the Charter project, in recent years it has shown a distinct lack of appetite for empowering the Charter with any real political muscle, or institutional leadership. Although there may well be justifiable reasons for the EU to have acted in this manner, the affect has been detrimental for the Energy Charter as an organisation and for the Charter Process.

16 Adding further to the ambiguity of the Russian position towards the Energy Charter, is, despite the perception of Russian ‘withdrawal’ from the ECT, the fact that Russian government officials continue to participate in the overriding majority of Energy Charter Group meetings and Moscow retains a voice in the wider Energy Charter Process.
As the years have gone by, lack of external political drivers capable of giving forward momentum has resulted in the Energy Charter losing ground to other EU-driven energy cooperation projects which have emerged in parallel, in particular the Energy Community Treaty and the Third Energy Package. Without such political drivers, the Charter likewise appeared to drop off the radar of senior decision makers from across the ECT constituency, while regular working group meetings of the Charter Process became (for the most part) the domain of junior government officials.

Clearly, as one Charter Process country delegate mentioned in a recent Energy Charter Strategy Group meeting, “we need to pitch to a much higher (political) level and ensure that we (the Charter) reappear as an ‘in-tray’ item for our decision makers. Another long-term Process participant, recently referred to the Energy Charter as the EU’s ‘black sheep’, a child initially loved but eventually unwanted and disinherited by its parents. Similar to an enterprise looking for an investor in order to bolster its productivity, the Energy Charter needs to find (or re-discover) a political patron ready to ‘argue its merits’ vis-à-vis other global energy governors. While there are some recent signs that the EU – particularly its core institutions such as the European Commission and the Council of the European Union – is once again starting to stand firmer behind the Energy Charter, much more works needs to be done if the Charter is to be rejuvenated with the sort of political ambition once accorded the organisation by Ruud Lubbers.17

The second impediment standing in the way of realisation of the Energy Charter as a reform test case is the fact that there is no clear consensus about how to better utilise the experience and instruments of the Energy Charter in the global energy context. A degree of support exists within the ECT constituency for the idea that the Energy Charter should be expanded in terms of its geographic coverage: that it should convert observer countries into members, and further attract new observer countries. Expansion is predicated on the view that the Energy Charter needs to outreach into MENA18 and Asia, since the Charter’s instruments (including the ECT) are bound to be of relevance for the developing, rapidly growing countries of these vast region.

This may well be the case. However, it is yet to be proven on the basis of any empirical evidence. The Energy Charter is hardly known in MENA/Asia and the Energy Charter Secretariat hardly knows MENA/Asia. Although Energy Charter Secretariat officers have a good sense of appreciation of some of their ‘core products’, much due diligence is needed in order to actually establish that these products – including energy transit, arbitration-based investment protection, ECT dispute settlement measures – are actually in acute demand in the countries targeted by the Charter expansion campaign. Furthermore, an acute perception exists within the energy administrations of many oil producing developing countries in MENA/Asia that the Energy Charter, and the ECT in particular, offers little in providing adequate protection for their “economic and strategic interests with respect to their oil and gas resources”.19

The degree of scepticism towards the ECT from the oil producing countries of MENA remains strong. It needs to be overcome if the Charter is to outreach more effectively into these regions. Despite the fact that Article 18 of the ECT refers to “the recognition of state sovereignty and sovereign rights over energy resources”, MENA oil producers continue to view the Treaty with suspicion. This is clearly seen in the fact that Libya, Algeria, Iran, Kuwait, Nigeria, Saudi Arabia, the UAE and Venezuela have not signed the Treaty.20 It would be hard to imagine that this state of affairs is likely to change at any time soon. As part of the reform and wider-rebranding process of the Charter, therefore, more work is needed in order to better

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17 Recent signs of EU support for the Charter include the presence of top European Commission energy officials at Energy Charter high level political conferences, while the Council of the European Union has visibly called for the “reinforcement of the ECT and to make better use of the Energy Charter’s potential in the core areas of trade, transit, investment and dispute resolution” within the context of strengthening the external dimension of EU energy policy.

18 MENA: Middle East and North Africa.


20 Ibid.
understand the nature of the concerns that MENA oil producers have towards the ECT if the road towards Charter enlargement is to be paved effectively.

Furthermore, strong sentiment exists within the ECT constituency that there should be much closer contact between the Energy Charter and Asia’s growing energy giants, China and India. That said, the Charter Secretariat should seek to likewise understand these countries in much greater depth, in parallel to seeking to sell them ‘Energy Charter products’. A basis for conducting research is already in place since the Energy Charter has a track record of providing some level of technical assistance inputs to its member and observer countries in Central Asia, particularly in the area of regional electricity sector integration activity. Countries such as Pakistan are reportedly coming closer to the Energy Charter, while Afghanistan became the newest member of the ECT in June 2013, when it completed formal procedures in order to accede to the Treaty.

That being said, efforts by the Energy Charter Secretariat to promote ECT instruments and regional ‘gas sector’ cooperation in the Arab Mashreq have been seemingly less successful, underscoring MENA’s rather circumspect attitude towards the Charter as already implied above. Thus, if the Energy Charter is to find a role for itself and add value beyond the geographic proximity of its traditional country constituency, a much clearer understanding is required as to whether the Charter’s instruments would be as useful in these regions as those of us selling them would like to believe. It is only in this manner that we will be able to better appreciate whether the Energy Charter will be able to provide new benchmarks for global energy governance reform.