TRADE IN ENERGY

WTO Rules Applying under the Energy Charter Treaty

ENERGY CHARTER SECRETARIAT

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Energy Charter Secretariat
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Notes

THE ENERGY CHARTER TREATY

The Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and entered into legal force in April 1998.

To date the Treaty has been signed or acceded to by fifty one states.

The Treaty was developed on the basis of the European Energy Charter of 1991. Whereas the latter document was drawn up as a declaration of political intent to promote East-West energy cooperation, the Energy Charter Treaty is a legally-binding multilateral instrument, the only one of its kind dealing specifically with inter-governmental cooperation in the energy sector.

The fundamental aim of the Energy Charter Treaty is to strengthen the Rule of Law on energy issues, by creating a level playing field of rules to be observed by all participating governments.

The Treaty's provisions focus on five broad areas: the protection and promotion of foreign energy investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable); stable and predictable framework for trade in energy materials, products and energy-related equipment, based on WTO rules; freedom of energy transit through pipelines and grids; mechanisms for the resolution of State-to-State and Investor-to-State disputes; and energy efficiency and related environmental aspects.

SIGNATORIES OF THE ENERGY CHARTER TREATY

Albania, Armenia, Austria, Australia, Azerbaijan, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Cyprus, Denmark, Estonia, the European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, Netherlands, Norway, Poland, Portugal, Romania, the Russian Federation, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, the Former Yugoslav Republic of Macedonia, Turkey, Turkmenistan, Ukraine, Uzbekistan, United Kingdom

PREFACE

It is widely recognized that trade, together with foreign direct investment, is a major engine of economic growth. Since the energy sector provides the basic infrastructure for any human activity, the importance of open and competitive energy markets for our societies cannot be underestimated.

Transparent, stable and predictable conditions for East-West energy commerce are, no doubt, fundamental for the creation of open energy markets in the Eurasian continent.

One of the major achievements of the Energy Charter process has been the adoption by its member states of the principles and rules of the multilateral trading system. The Energy Charter Treaty now incorporates for the energy sector the major rules of the World Trade Organization that govern trade in goods. This significantly contributes to creating a transparent, stable, predictable and non-discriminatory trading environment for East-West energy commerce. Equally important is that by adhering to the Treaty's WTO-based trade rules, ECT Signatory countries that are not yet members of the WTO will carry out domestic trade reforms in the energy sector that greatly contribute to the advancement of their accession to the World Trade Organization.

For many years, the Energy Charter Secretariat has provided trade-related technical assistance to our Signatories that are not yet members of the WTO. As part of this assistance, our Work Programme 2000 called for the Secretariat to provide increased transparency about the application of the WTO rules on trade in goods with regard to energy materials and products with a view to assisting in particular non-WTO members in their efforts to comply fully with the trade provisions of the Energy Charter Treaty. This work has resulted in the present study, the purpose of which is to help governments, firms and interested individuals to better understand how the rules of the multilateral trading system apply to trade in energy.

Ria Kemper
Secretary-General

Brussels, 18 October 2001

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I. INTRODUCTION

A. SCOPE OF THE PAPER

1. The Energy Charter Treaty ("ECT") contains a variety of provisions on, amongst others, trade, transit, investment, competition, all of which are crucial to the energy sector. This paper is limited to trade in energy.

2. The paper is further confined in two respects. Firstly, it only deals with WTO rules that have been incorporated in the ECT (not with the ECT rules on trade-related investment measures in Article 5, nor with the ECT disciplines on customs duties and other charges in Article 29). Secondly, it is aimed to focus on trade in energy materials and products, even though the same WTO rules apply also to trade in energy-related equipment under the ECT. Indeed, whereas trade in energy materials and products represents important distinguishing features and gives rise to new questions, trade in energy-related equipment falls under the more mainstream trade in industrial products. Nevertheless, special attention will be given to trade in energy-related equipment, whenever required.

B. WHY IS THERE A NEED FOR THIS PAPER?

3. Many textbooks exist on the WTO and its complex legal regime. Within the ECT as well, a document has already been made that sums up the WTO rules, which have been incorporated in the ECT.

4. However, it remains unclear to many people in the energy sector what these WTO rules mean when applied to trade in energy. Indeed, trade in energy has so many peculiarities (unique physical characteristics of many energy products and the way they move across borders; a history of state-owned and vertically integrated operators that controlled, or still control, the sector; the existence of natural monopolies; etc.) that WTO rules, as they apply to trade in energy, require special attention and remain open for discussion also within the trade community. Contracting Parties to the Energy Charter Treaty have, therefore, called on the Secretariat to provide a paper that would help them understand the application of the WTO rules to trade in energy materials and products, thereby, assisting them, in particular those which are not yet members of the WTO, in their effort to comply with the trade provisions of the ECT.

5. With this objective in mind, the Secretariat has prepared the present paper. It addresses the WTO provisions and principles applicable under the Energy Charter Treaty and in particular the implications of these rules for trade in energy materials and products. It also reviews WTO provisions that are not applicable under the ECT but which are very relevant to trade in energy. This publi-

cation is not intended to constitute any official or unofficial interpretation of WTO rules and practices described therein and in no way prejudges the position of any Contracting Party/Signatory to the ECT concerning the interpretation of WTO rules and practices, which are or may become relevant in the ECT context. Only WTO members and/or ECT Contracting Parties can provide such formal interpretations. The paper's objective is to clarify certain basic principles and, where ambiguities arise, to point out the problem and possible solutions. In doing so reference will be made to relevant GATT/WTO dispute settlement reports where some of these GATT/WTO rules have been applied to particular situations by GATT/WTO panels and/or the Appellate Body of the WTO. It should be recalled, however, that as a matter of law such reports do not have a precedental value, but in practice they are often referred to, both by WTO members and in subsequent Panel and Appellate Body reports.

C. STRUCTURE OF THE PAPER

6. Before examining any of the specific WTO rules as they apply in the energy context, it is crucial to first address two general matters. Firstly, the paper sets out why trade in energy is so special as compared to trade in other (manufactured or agricultural) goods. Secondly, the paper tries to discard any misunderstanding as to what the WTO and its legal disciplines stand for and aim at.

7. Once this framework is built, the paper will, in a third chapter, address the relevant WTO rules. It will do so agreement by agreement, starting with the General Agreement on Tariffs and Trade ("GATT") 1994 (a section that will take up most of this paper) and addressing subsequently the Agreement on Technical Barriers to Trade, the so-called trade remedies agreements on dumping, subsidies and safeguards and, lastly, the more technical agreements on market-access (import licensing, rules of origin, customs valuation and preshipment inspection).

8. The fourth and last chapter of the paper elaborates on a WTO agreement that was not incorporated in the ECT: the General Agreement on Trade in Services ("GATS"). It does so because (1) many elements in energy trade are, indeed, categorized under trade in services; and (2) ECT Contracting Parties may at some point in the future want to incorporate also parts of GATS, which is crucially important for energy trade. This fourth chapter first outlines the energy products *versus* energy services debate and then sums up the basic principles of GATS.

II. WHY IS TRADE IN ENERGY SPECIAL?

A. REGULATORY DECISIONS IN THE ENERGY SECTOR OFTEN INVOLVE A VARIETY OF POLICY OBJECTIVES

9. Perhaps more than for any other products, any debate on energy production, supply and consumption brings to the fore a multitude of concerns and sensitivities. Whereas liberalising trade in most manufactured products may find obvious support in broad sections of the population (except for domestic competitors, of course), liberalising the market and trade in energy is likely to face obstruction from many corners. National sovereignty and social welfare concerns as well as environmental protection often have to be weighed against the economic importance of energy and the benefits liberalising the energy sector would bring about.

10. There is, first of all, the political dimension. Energy is still seen as a factor of political stability and an element of national sovereignty. Countries want to ensure the security of their energy supply, particularly so in the recent past where energy was generally considered as a scarce product. Also today, the recent increase in oil prices reminded many countries of the political importance of a steady and stable energy supply.

11. Furthermore, energy plays an important economic role. Most, if not all, sectors of the economy need energy as an input. Reducing energy prices can thus boost all other sectors of the economy. At the same time, however, regularity and quality of the energy supply to economic operators may be as important as its price.

12. A third, and increasingly important consideration in setting energy policies, is the environmental degradation caused when producing and consuming certain energy products. Some are more environmentally friendly than others, even though their production may cost more. With the signing of the Kyoto Protocol to the UN Framework Convention on Climate Change, countries made legally binding reduction commitments for the six main greenhouse gases, including carbon dioxide (CO_2). Thus, when introducing energy policies, countries also need to take account of their international environmental obligations.

13. Finally, given the importance of energy to consumers and households, energy policies are also called upon to fulfil a social function: to ensure that everyone, rich and poor, young and old, employed and unemployed, has a secure access to energy at a reasonable price.

14. In many instances the four objectives set out above (political, economic, environmental and social) can be equally fulfilled and complement each other. For example, economically efficient energy production is likely to best ensure also the social demands of low prices and regularity and quality of supply, elements that are important also in political and economic terms. Moreover, if such production internalises the environmental costs into its price, the protection of the environment can also be ensured. In other situations a conflict between these objectives may arise and choices have to be made.

15. Given this multitude of factors, it is clear that some countries could not commit themselves to a complete opening up to competition of the energy sector. In any case, liberalisation of the sector may be accompanied in some countries by high and strict regulation of the sector and control by public authorities Governments would do well, it would seem, to take some distance from the sector and open it up to competition. But at the same time governments also have an important role to play when it comes to upholding certain public goods, a role that may not always be fulfilled by pure market forces.

16. To keep in mind these tensions between different objectives and the correlation between liberalisation and government regulation is crucial when examining WTO rules as they apply to trade in energy.

B. THE PAST: STATE-OWNED AND VERTICALLY INTEGRATED

17. Until recently, trade in energy between private operators was a rare event. The energy sector has long been monopolized by state-owned companies that fully controlled the energy cycle, from energy generation to energy transmission and distribution to final consumers. Trade occurred, but between public entities. A notable exception may have been oil trade where many countries relied on imports. Still, in all sectors, energy was considered as a scarce product to which the GATT's trade liberalisation rules were not supposed to apply (or if such rules applied, for which exceptions allowing for protectionist measures were available).

18. The structure of the energy sector (state-run and vertically integrated) combined with the strategic importance accorded to energy as a scarce product, long meant that no competition whatsoever existed between countries, let alone within countries. As a result, trade in energy products, and how to liberalise such trade, was not a real issue.

19. Given the monopoly position of energy suppliers as price setters, it was not difficult to reconcile the four objectives set out above, albeit sometimes at the expense of economic efficiency. This situation has changed in recent years.

C. THE FUTURE: LIBERALISATION AND "UNBUNDLING"

1. The trends

20. In recent years, more and more countries have opened up their energy markets to competition.

21. This is mostly done gradually, for example, by allowing private operators to generate energy, granting them access to the transmission network, and then providing for competition between energy distributors to a selected, but increasing, number of final consumers who can pick and choose their distributor.

22. To avoid that the long standing state-owned companies abuse their position against new market entrants, more particularly, to ensure competition in each of the main activities in the energy value-added chain (such as generation, transmission and distribution), it often became necessary also to force these former monopolies to split up their accounting or even management control between each of these main activities. This is what is often referred to as "unbundling". Unbundling aims at preventing that former monopolies cross-subsidize between the different activities in which they remain active.

23. The wave of privatisation and unbundling resulted in increased competition within countries but also among countries, with trade between countries becoming one of the viable, sometimes necessary, options.

24. Trade in energy was further spurred by technological innovations that made the long distance transmission of energy — by means of interconnecting different networks — feasible. Trade liberalisation was also encouraged by the growing realisation that energy may, after all, not be that scarce a resource, so that importing it and thus making oneself dependent on other countries, was no longer considered a threat to national sovereignty (with the notable exception, perhaps, of oil, as illustrated recently). Indeed, in many countries the feeling grew that after all trade in energy may be very much like trade in any other product. Consequently, the application of GATT/WTO trade liberalisation rules became less of a taboo.

2. The ensuing challenges

25. At the same time, however, the opening up to competition in the energy sector often increased the level of public intervention. Indeed, liberalization of the sector has to be combined with government regulatory involvement to ensure the fulfilment of the environmental, consumer protection and social objectives set out earlier. The tension between trade liberalisation and other non-trade values, so common in GATT/WTO debates, thereby, also find application to the energy sector.

26. However, environmental protection in the energy sector may lead also to increased trade, instead of trade protectionism. Indeed, the substitution of environmentally "unfriendly" energy sources with green (but often more costly and less available) energy production may necessitate more and more imports to maintain the total energy supply. Environmental protection is, in this sense, bound to stimulate trade in energy.

27. Another trade-specific problem arose: what if one country liberalises its market more rapidly than another? Is the risk of unfair competition enough for a more liberalised country to ban from its market foreign competitors of less liberalised economies? This raises the so-called "reciprocity" debate.

28. The undeniable result of all of these factors is that trade in energy has become an issue, for which GATT/WTO rules are now highly relevant. The wholesale incorporation of these rules as they apply to other products is, nevertheless, not self-evident. Trade in energy, even in today's context, raises specific complications.

D. TRADE IN ENERGY: ADDITIONAL COMPLICATIONS

29. Trade in energy may have become a reality, even a necessity. But many hurdles remain. There is not only the problem of a multiple of, sometimes conflicting, objectives that need to be reconciled.[1] Trade in energy and the rules that should apply to it, is further complicated for reasons inherently linked to the very nature of energy products and their chain of supply.

30. First, when it comes to trade in electricity and natural gas, certain physical limitations arise. Electricity and gas do not cross borders like other goods.[2] They cannot normally be stored and transported like other goods. They need to be transported through grids (electricity) or pipelines (gas). As a result, trade in these goods remains largely a regional exercise, restricted to those countries that are interconnected by compatible networks.

31. Consequently, removing all possible barriers to trade between countries under the traditional negative GATT approach (prohibition to impose certain barriers to trade) is simply not enough. Positive action is required to physically enable trade flows to occur, such as the construction of inter-connectable networks and pipelines, harmonisation of transmission standards.

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1 See *supra* paras. 9 ff.

2 As a result, some have argued that electricity is not a good. This is discussed in para. 46 below.

32. Second, and linked again to the physical limitations of transporting electricity and gas, trade in electricity and gas involves certain natural monopolies, such as transmission over high voltage transmission networks from the production site to distributors who then distribute to final consumers on lower voltage lines or cables. It would not make economic sense for each operator to have its own transmission network. One transmission network may suffice. But non-discriminatory access to this one network needs to be ensured for competition to flourish. In other words, liberalisation as such — in the sense of simply removing certain barriers — will again not be enough. To avoid that the one operator which owns the transmission network does not abuse its position, positive rules will need to be introduced to regulate fair access and competition.

33. Third, the value added chain from energy production to energy consumption is long and complicated. Traditionally, no distinction has been made within this chain between energy products and energy services. This was so because of the vertically integrated nature of the industry. One supplier simply performed all energy related economic activities, from the production of energy to its distribution to the final consumer. However, with GATT/WTO rules becoming increasingly relevant, a line needs to be drawn between energy *goods* and energy *services*. Governmental measures affecting trade in goods are covered by GATT/WTO rules on trade in goods; while those affecting trade in services by the relatively new GATS rules on trade in services. In WTO jurisprudence, it was, moreover, found that a measure could fall under both GATT and GATS disciplines (see *infra* para. 293). While some countries consider, on the basis that energy itself is a good and not a service, the production of energy to be manufactured and, therefore, out of the scope of the service sector, others construe trade in energy services so as to include also activities related to energy production (e.g. liquefaction and regasification of gas, operation of power generating equipment and refinement).[3] No one disputes however that energy transmission and distribution are services.[4]

34. This goods *versus* services debate obviously complicates the explanation of GATT/WTO rules as they apply to trade in energy products. It begs the question of what these products are and whether government measures in the energy sector are affecting goods or services, and consequently fall under GATT (and other rules on trade in goods), GATS or both.[5]

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3 Communication from the United States on Energy Services to the WTO Council for Trade in Services, 20 October 1998, S/C/W/58, pp. 2-3 and Communication from the United States on Classification of Energy Services to the WTO Committee on Specific Commitments (under GATS), 18 May 2000, S/CSC/W/27.

4 Background Note by the WTO Secretariat on Energy Services, 9 September 1998, S/C/W/52, para. 9.

5 This matter is further addressed in paras. 46 ff. below.

III. WHAT DOES THE WTO STAND FOR?

A. BACK TO THE BASICS

35. Often to the surprise of people, the WTO does not stand for "free trade". Indeed, the WTO aims at promoting trade. But it does so to achieve higher aims. The WTO puts forward trade as an instrument, not as an end in itself. It believes that this instrument, i.e. trade, will increase global welfare. It makes clear that this should happen within a framework of sustainable development, respecting at the same time the environment and the need for economic progress in less developed countries. The first preamble to the Marrakesh Agreement Establishing the WTO sets this out as follows:

> "[WTO members'] relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development".

36. To promote trade[6] between WTO members, the WTO adopts an almost exclusively negative approach[7]: it outlaws the imposition of certain — but not all — barriers to trade. As of today, it does not normally require governments to take positive steps, for example, to promote competition or to privatise certain industries.[8] [9]

37. Moreover, only certain barriers that are imposed by governments — not trade restrictive practices of private operators — are prohibited under the WTO.

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6 Unless otherwise specified, the word "trade" in this paper refers to trade in goods, excluding trade in services.

7 The WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS) is the main exception to this negative approach. Under the TRIPS Agreement, WTO Members are obliged to meet certain minimum standards in protecting the intellectual property rights of nationals of other WTO Members.

8 A notable exception is the so-called "Reference Paper" that many WTO Members incorporated in their GATS commitments under trade in telecommunications services. This Reference Paper includes a series of basic regulatory principles, aimed at ensuring fair competition (e.g. access to telecom networks), that are of a more positive nature. Some countries have called to adopt a similar approach in respect of trade in energy services (Communication from the United States on Classification of Energy Services, op. cit., para. 22).

9 Furthermore, it may be observed that in recent Protocol of Accessions, certain transition economies have undertaken specific commitments in the area of privatisation, even though privatisation measures are not covered by GATT/WTO rules.

38. The general principle of the WTO is that members must eliminate trade-distorting governmental measures, especially trade barriers that discriminate between WTO members or between domestic products and imports. However, some barriers may be maintained. WTO members can maintain trade barriers, either because the lifting of such barriers was never promised (for example, "unbound" customs duties or the levying of customs below the "bound" level), or are introduced as trade remedies against unfair trade practices by exporter, or because such barriers serve a legitimate objective (such as health or environmental protection or economic development in less developed countries) and fall under the exception clauses.

39. The WTO does not impose minimum or maximum standards for any of these legitimate non-trade objectives. The WTO does not, for example, oblige its members to reach a certain minimum level of environmental protection. Nor does it prohibit its members to go beyond a certain maximum level. Within the WTO context, it is for each member to decide upon the level of environmental protection that it wants to achieve, even if this were to involve serious barriers to trade. All the WTO aims at is that once a given level of protection is set, members choose an instrument to achieve this level which does not constitute arbitrary or unjustifiable discrimination nor a disguised restriction on trade.

B. THE BASICS IN THE LIGHT OF TRADE IN ENERGY

40. Applying these basic principles to trade in energy, it is crucial to realize that WTO rules only discipline governmental measures taken in the energy sector. Not activities by private operators, such as restrictions imposed by a private operator on access to a transmission network owned by that private operator or the abuse of market position by former state-owned monopolies that have been privatised and compete with other private operators.[10]

41. Moreover, WTO rules are not there either to do away with the inherent barriers to energy trade referred to earlier (e.g. to ensure the building of appropriate networks).

42. WTO rules as applied in the ECT are even further limited in that they only apply to governmental measures that constitute non-tariff barriers to energy trade. Indeed, the issue of reducing customs duties and other charges is dealt with in Article 29 of the ECT (currently, a "best endeavours" obligation only). The more stringent WTO rules on tariff barriers — where each WTO member has bound most of its customs duties to a certain maximum — do not apply.

43. Nevertheless, the WTO rules that do apply in the ECT context remain of great importance to facilitate the trade in energy. They relate to transparency and non-discrimination in government regulation. They aim at avoiding unnecessary technical barriers to trade imposed by governments and try to ensure fair trade by outlawing certain forms of dumping and subsidies.

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[10] See, however, paras. 139 ff. below on state trading enterprises.

IV. MAIN WTO RULES APPLYING UNDER THE ECT TO TRADE IN ENERGY

A. PRELIMINARY REMARKS

44. Three preliminary issues should be kept in mind.

45. Firstly, WTO rules as incorporated in the ECT only apply to trade between ECT Contracting Parties at least one of which is not a WTO member. In the ECT context, they do not apply between WTO members. In other words, WTO rules as incorporated in the ECT apply as between the Russian Federation and the European Communities and between the Russian Federation and Kazakhstan. They do not apply, however, as between Hungary and the European Communities.

46. Secondly, in the WTO there remains discussion as to whether trade in all energy products, and in particular trade in electricity, is covered by WTO rules on trade in goods. In other words, it is still debated by some countries whether electricity is really a good (and not a service) to which WTO agreements on trade in goods apply.[11] Since these agreements do not explicitly set out the products to which they apply, there remains room for discussion within the WTO. In the ECT, however, this debate became moot. Indeed, the ECT explicitly defines the "Energy Materials and Products" to which it applies. The list includes electricity. As a result, trade in electricity is covered by ECT rules, including WTO rules made applicable in the ECT context.[12]

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[11] When drafting the original GATT 1947, the New York Drafting Committee Report noted "as it seemed to be generally accepted that electric power should not be classified as a commodity, two delegates did not find it necessary to reserve the right for their countries to prohibit the export of electric power" (GATT, Analytical Index: Guide to GATT Law and Practice, Updated 6th Edition (1995), p. 585). In 1990, one author still concluded: "Although the evidence on this score is not incontrovertible, on balance it suggests that GATT trade rules do not apply to electricity" (Plourde, A., *Canada's International Obligations in Energy and the Free-Trade Agreement with the United States*, 24(5) Journal of World Trade, 35 at 36. In a Background Note by the WTO Secretariat, dated 9 September 1998 (op. cit., para. 8), the following was remarked on this matter: "The non-storabilty of electricity might have been a factor which led the drafters of the GATT to assume that electric power should not be classified as a commodity. Most Contracting Parties have later regarded electricity as a commodity and some of them have also undertaken bindings on it ... The optional nature of the electrical energy entry in the HS classification [World Customs Organization Harmonized Commodity Description and Coding System] might reflect the fact that some countries do not regard it as a commodity but as a service".

[12] This means that if it would finally turn out that WTO rules on trade in goods in the WTO context do not apply to electricity, the ECT would be wider in product scope — for trade between parties at least one of which is not a WTO Member — than the WTO itself (for trade between WTO Members). In other words, the ECT would then have a "WTO plus" element.

47. Thirdly, the "Energy Materials and Products" subject to WTO rules as applied in the ECT are, broadly classified as follows:

- nuclear energy
- coal
- natural gas
- petroleum and petroleum products
- electrical energy
- other energy (fuel wood and charcoal)

48. Pursuant to Annex G to the ECT, most trade in nuclear energy is covered not by WTO rules as incorporated in the ECT, but by other agreements referred to in Declarations in the Final Act of the European Energy Charter Conference of 1994; this exception was retained in Annex W of the Trade Amendment of 1998.[13] Therefore, this paper will, not specifically address trade in nuclear energy except where WTO rules themselves provide for specific rules in this field.

49. Furthermore, for the reasons mentioned earlier[14] especially trade in electrical energy and natural gas seems to require further clarification. This paper will, therefore, focus on these two types of trade. Only to the extent that trade in any of the other categories — trade in coal, petroleum and petroleum products or fuel wood and charcoal — gives rise to special considerations reflected in WTO rules, will WTO rules in these other areas of trade be specifically addressed.

B. GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

1. GATT 1947 *versus* GATT 1994

50. GATT 1994 should not be confused with GATT 1947. GATT 1947 is the original GATT agreement as modified over the years (28 articles altogether). In contrast, GATT 1994 consists of the provisions of GATT 1947 (except the Protocol of Provisional Application) and also includes other pre-1995 documents, i.e. (1) the instruments where country specific tariff concessions are set out, (2) protocols of accession to GATT 1947, (3) decisions on waivers granted under GATT 1947, (4) other decisions (such as the "Enabling Clause" in favour of developing countries) and, finally, (5) a number of Understandings specific to some GATT Article that were negotiated in the Uruguay Round.

51. References below to "GATT" are references to "GATT 1947" as incorporated in "GATT 1994".

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13 The Final Act of the European Energy Charter Conference of 1994 includes bilateral Declarations by the EC jointly with Kazakhstan, Kyrgyztan, the Russian Federation, Tadjikistan and Uzbekistan. Also with respect to the Trade Amendment, concluded in April 1998, a Joint Declaration by the Russian Federation and the European Union was made, confirming that "the Partnership and Cooperation Agreement between the Russian Federation, the European Union and its Member States [of December 1997] is the appropriate framework to deal with [the issue of trade in nuclear materials]".

14 *Supra* paras. 30-33.

2. Most-Favoured-Nation treatment (GATT Article I)

(a) The principle

52. Whenever an ECT Contracting Party imposes border measures (customs duties, other charges or any import or export formalities or rules) or internal measures (internal taxation or other regulation of products) that confer any advantage or privilege to energy products from any given country, then that advantage or privilege also has to be conferred – immediately and unconditionally — to the like product from any other ECT Contracting Party.

- This means that in respect of any policy affecting trade, no discrimination can be made between imports on the basis of their origin or between exports on the basis of their destination.
- In this respect, all products that are "like" (see Box 1 *below*) – irrespective of their origin or destination — need to be treated equally.
- Such equal treatment has to be granted "immediately and unconditionally".
- Only energy products from ECT Contracting Parties can claim this "MFN treatment" (non-ECT countries may be discriminated against[15]). However, also advantages accorded to non-ECT countries need to be accorded to all ECT Contracting Parties.
- The fact that the ECT currently only provides for a "best endeavours" tariff-standstill (combined with an obligation of notification and to consult in case of tariff increases), does not affect the MFN-principle. Indeed, ECT Contracting Parties are not under a strict legal obligation to keep their tariffs at current levels. But whatever level of tariffs they impose, they have to do so equally for all imports, irrespective of origin. The latter is a legal obligation, not a "best endeavours" clause.

[15] At least in the ECT context. Not so, of course, in the WTO context. There, an ECT Contracting Party that is also a WTO Member can obviously not discriminate another WTO Member even though that Member is not an ECT Contracting Party. See footnote 30 below.

Box 1 Are different energy products "like products" to be treated equally?

The classic GATT statement on the factors to consider in deciding whether two products are "like products" – and should therefore be treated equally — is found in a GATT working party report of 1970. That report states in respect of "like or similar products":

"[t]he interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a 'similar' product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar': the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality" (Working Party Report on Border Tax Adjustments*, adopted on 2 December 1970, BISD 18S/97, para. 18, emphasis added).*

*It should be noted also that the term "like product" is found in several WTO provisions but may not have the same meaning in each of these provisions. As the Appellate Body noted: "The concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the WTO Agreement are applied" (*Japan – Alcoholic Beverages*, WT/DS8/AB/R, adopted on 1 November 1996, para. 114. See also para. 66 below). The issue of likeness under Art. III (national treatment) is further addressed below (para. 66).*

The most notorious GATT dispute that addressed this question of "likeness" under the MFN-principle *involved coffee (Panel Report on* Spain – Tariff Treatment of Unroasted Coffee*, adopted on 11 June 1981, BISD 28S/102). In that case, Spain had split its single tariff line for coffee into five tariff lines for different types of coffee, dutiable at two different rates. The effect of the change was apparently to lead to comparatively higher duties on stronger coffee beans. Brazil, which considered itself to have been adversely affected by this reclassification, brought a case against Spain. The panel ruled that unroasted coffee is unroasted coffee, i.e. that it was not possible to distinguish between types of unroasted coffees for tariff purposes. Factors such as differences in taste and aroma resulting from the geographical origin of the coffee, cultivation methods and processing of the beans as well as genetic factors, were not considered to be sufficient to make the products "not like". Spain was thus obliged to impose the same duty on (stronger) Brazilian coffee and (weaker) coffee from other countries.*

It is generally accepted, however, that the method of tariff classification can be used as one of the elements *to determine whether products are "like". It would thus seem fair to state that given their different tariff classification, as well as different "properties, nature and quality", electricity is not "like" natural gas nor is nuclear energy "like" coal (notwithstanding their similar end-uses). It would, therefore, seem possible for ECT Contracting Parties to treat, say, electricity from the EC differently than natural gas from Kazakhstan.*

A problem could arise, however, in case an ECT Contracting Party were to impose different custom duties for different types of electricity depending, for example, on how the electricity has been generated (e.g., by nuclear power or renewable sources). There, not only the end-use (and, most probably, tariff classification) but also the physical characteristics of the two products would be identical. It would be impossible to physically distinguish the two. They would, therefore, stand a serious chance of being considered to be "like". If so, any differential treatment would be a violation of the MFN-principle. We will explain below that such violation may be justified under Article XX of GATT for reasons of health or environmental protection.

(b) The principle as applied to trade in energy

53. MFN for energy trade means that all ECT Contracting Parties, in all areas of their energy policy, cannot discriminate energy products based on the origin of these products. Similarly, in respect of customs duties or taxes on exports, no distinction can be made depending on the destination of the energy product.

54. As seen below, there are exceptions to this rule, most notably the exception under Article XXIV of GATT that allows partners of a free trade agreement or customs union to favour mutual trade over other trade.

55. Equal treatment under the MFN-clause needs to be accorded "unconditionally". Thus, conditioning a lower tariff or other market access on "reciprocity" would need to respect GATT Article I and other WTO provisions as applicable. It is, for that reason, impossible for country A to open its energy market only to country B, which has a level of market liberalisation similar to that of country A; but not to country C which still has a more protected market than country A.

56. This is, of course, the whole idea of non-discrimination. It assumes that a market opening, albeit a unilateral one, will – through increased efficiency and lower consumer prices — benefit also the country offering the opening. A reciprocal opening would further increase overall welfare but is not a requirement. To avoid that only strong trading partners negotiate bilateral concessions with each other, all ECT Contracting Parties benefit from all of the market openings offered by any ECT Contracting Party to any other country. The belief is that trade conducted on an equal footing for all — not on the basis of a myriad of bilateral agreements brokered as a result of economic power struggles – will increase transparency, avoid inefficiencies and stimulate trade so as to achieve overall higher standards of living.

Box 2 "Unconditional MFN"

Article I of GATT establishes an unconditional MFN obligation. An advantage given to State A must be accorded to all ECT Contracting Parties, whether or not they meet any conditions met by State A. Thus, any notion of conditioning an advantage on reciprocity would normally run afoul of Article I.

In an early GATT panel report on *Belgian Family Allowances*, tax exemptions for products purchased by public bodies made conditional on the existence of a certain system of family allowances to be in force in the exporting country, were found to be inconsistent with the unconditionality principle in Article I:1 (Panel Report on *Belgian Family Allowances*, adopted on 7 November 1952, BISD 1S/59, para. 3).

More recently, a WTO panel concluded that the grant by Indonesia of customs and tax advantages to cars produced by one company in Korea violated Article I:1 because those advantages were conditional, *inter alia*, on the existence of a contractual relationship between an Indonesian company and the Korean company. According to the panel, advantages granted by a WTO Member cannot be made conditional on, nor even be affected by, the existence of private contractual obligations, such as the existence of a deal between a domestic company designated by the government and a foreign company. Advantages accorded to products of one country (in that case, to Korean cars and parts and components thereof) need to be granted to imported like products from all other WTO Members "immediately and unconditionally" (Panel Report on *Indonesia—Certain Measures Affecting the Automobile Industry*, adopted on 23 July 1998, WT/DS54/R, paras. 14.143 - 14.148). On the same matter, see the Panel and Appellate Body reports on *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R and AB/R, adopted on 19 June 2000, respectively at paras. 10.18-30 and paras. 64-86).

3. National Treatment (GATT Article III)

(a) The principle

57. The obligation to provide "national treatment" to imported products means that imports cannot be discriminated as against domestic products.

- In other words, whereas the benchmark for treatment of imports under the MFN-clause is the best possible treatment provided to <u>any other imports</u>, the benchmark for treatment of imports under the national treatment principle is the best possible treatment provided to <u>domestic products</u>.

- Whereas the MFN-clause applies to all trade policies — both measures imposed at the border and within the market — the principle of national treatment only applies once products have cleared customs and entered the market of the ECT Contracting Party in question.

- Whereas the MFN principle applies to both imports and exports, the discipline of national treatment <u>only favours imports, not exports</u> because exports from the country which has to grant national treatment are, from the point of view of Article III, "domestic products" and thus must not be favoured. It is thus possible under Article III to tax products for export

higher than products for domestic consumption. The other extreme is also allowed: it is perfectly possible for an ECT Contracting Party to exempt products from internal taxes when these products are exported. This more favourable treatment for exports is explicitly allowed for in GATT Article VI:4 where it is stated also that such exemption for exports cannot give rise to the imposition by the importing country of anti-dumping or countervailing duties (to offset subsidies).[16]

58. The prohibition to treat imports less favourably than domestic products does not, of course, prevent ECT Contracting Parties to tax imports or to subject imports to internal regulations. What is required, however, is that the same tax applies to imports and domestic products and that other internal regulations do not negatively affect the competitive opportunities of imports vis-à-vis domestic products by treating the former less favourably than the latter.

59. National treatment outlaws discrimination against imports. Nowhere is positive discrimination, in favour of imports, prohibited. Thus, to impose higher taxes on domestic products than on imports is consistent with GATT Article III.

(i) National Treatment in respect of internal taxation (GATT Article III: 2)

Tax differentials between "like products"

60. Article III:2 of GATT addresses national treatment in respect of internal taxes or other charges that ECT Contracting Parties apply to imported products. Under the first sentence of this provision, these taxes and other charges cannot be "in excess of" those applied to "like" domestic products. Even a *de minimis* tax difference between imports and "like" domestic products cannot be tolerated.[17]

61. The decision as to whether products are "like" has, in case law, been made on a case-by-case basis considering mainly the physical characteristics of the products, their end-uses, consumers' tastes and habits and tariff classification (see Box 1 *above*). In the end, what counts is whether the distinction made between two products affects the competitive relationship in the marketplace between the two products to the detriment of imported products. For this to be the case, the two products must be in a certain degree of competitive relationship. This degree of competition between the two products is the decisive element in a decision on whether the products are "like".

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16 Note that the exception applies only in respect of taxes on products such as VAT or sales taxes; not in respect of income taxes for which companies would be exempted simply because they export their products. The latter could amount to an export subsidy prohibited under the Subsidies Agreement (see *below* footnote 30 and paras. 252 ff.).

17 Appellate Body report on *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted on 1 November 1996, p. 23.

62. In an early WTO case, for example, Japan was condemned because it imposed lower taxes on shochu (a traditional Japanese liquor) than on vodka. Even though both domestic and imported shochu (from Korea, for example) were taxed the same, and also domestic and imported vodka were taxed equally, Japan's tax regime was still found to be in violation of the national treatment principle. This was so because *domestic* shochu was found to be "like" *imported* vodka. As a result, both (domestic) shochu and (imported) vodka had to be taxed at the same rate.[18]

Tax differentials between "directly competitive or substitutable products"

63. The second sentence of Article III: 2, read together with the Ad Note to it, has been interpreted in GATT/WTO jurisprudence as prohibiting tax differences, not between "like products", but between the broader category of "directly competitive or substitutable products". Thus, even if two products are too different to be "like", the economic reality of these products being "directly competitive or substitutable" means that ECT Contracting Parties cannot impose "dissimilar" taxes on these two products. To impose a *de minimis* difference is tolerated (in contrast to the requirement for complete equality in respect of "like products").[19] Moreover, dissimilar taxation between imports and domestic products that are "directly competitive or substitutable" will run afoul of the national treatment principle if it is proven that the difference in taxation is applied "so as to afford protection to domestic production".[20] The latter is not an issue of subjective "intent" on behalf of the legislator or regulator, but rather a question of how the measure is applied. It requires a comprehensive and objective analysis of the structure and application of the measure at issue on domestic as compared to imported products.[21]

64. This additional element, for there to be a violation in respect of "directly competitive or substitutable products" (application "so as to afford domestic protection"), is not required in respect of "like products" (there, once it is shown that products are "like" and imports are taxed even slightly higher than domestic products, a violation will be found). In sum, once products are proven to be "like", it will be much easier to substantiate a claim of violation of Article III, then when products are only "directly competitive or substitutable".

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18 Ibid., pp. 19-23.
19 Ibid., pp. 26-27.
20 Ibid., pp. 27-31.
21 See, for example, Appellate Body report on *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted on 1 November 1996, pp. 27-31.

(ii) National Treatment in respect of other (non-tax) internal regulations (GATT Article III:4)

65. Article III:4 addresses all other internal measures — other than tax measures — affecting the sale, purchase, transportation, distribution or use of products.

66. The national treatment obligation in respect of these other internal regulations is, however, limited to imports that are "like" domestic products. In a recent Appellate Body report the four general criteria in analysing "likeness", referred to above in *Box 1*, were confirmed: "(i) the properties, nature and quality of the products; (ii) the end-uses of the product; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products".[22] The Appellate Body stressed, however, that these four criteria are "neither a treaty-mandated nor a closed list of criteria" and that the framework of these four criteria "does not dissolve the duty or the need to examine, in each case, *all* of the pertinent evidence".[23] It found, in particular, that also the health risks associated with the products compared is to be taken into account under the criteria of physical properties and consumers' tastes and habits (thereby reversing the panel report which had found that such risks cannot be looked at under "likeness").[24] As a result, the fact that one product poses more risks than the other (in terms of human health or environmental protection) may lead to the two products being considered as "not like" so that treating them differently would not amount to discrimination. In the same report, the Appellate Body also found that the scope of "like" in Article III: 4 is broader than the scope of "like" in Article III.2, first sentence.[25]

67. Once products are proven to be "like", then imports cannot be accorded less favourable treatment. There is no additional obligation — as there is for taxation in respect of "directly competitive or substitutable products" — to prove that the differential treatment is provided for protectionist reasons ("so as to afford protection to domestic production").[26] However, in respect of other internal regulations, no disciplines apply for products that are only "directly competitive or substitutable". This category of products is only relevant for tax measures.

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22 *EC - Measures Affecting the Prohibition of Asbestos and Asbestos Products*, complaint by Canada, circulated on 12 March 2001, WT/DS135/AB/R, para. 101

23 Ibid., at para. 102

24 Ibid., at para. 113.

25 Ibid., at para. 99.

26 Appellate Body report on *EC – Regime for the Importation, Sale and Distribution of Bananas*, adopted on 25 September 1997, WT/DS27/AB/R, paras. 215-216.

(b) Why is the principle there?

68. The *raison d'être* of national treatment is to prevent governments from negatively affecting the competitive opportunities of imported products to the advantage of domestic products. It is believed that market forces, and through them the theory of comparative advantage, not government intervention, should determine the outcome of competition between imports and domestic products. This should ensure fair competition, economic efficiency and bring down consumer prices. As a result, overall welfare should increase.

69. It should be kept in mind, however, that national treatment applies only once products have cleared customs (i.e., in respect of internal measures, not border measures).[27] Market protection — and thus providing a competitive advantage to domestic products – is tolerated at the border by means of customs duties (as long as these duties remain at or under the negotiated "bound" ceiling, a ceiling which is currently lacking in the ECT where no binding tariff commitments have been made so far).[28]

70. National treatment is, in addition, a logical complement to tariff bindings (i.e., negotiated ceilings in respect of customs duties) made under Article II of GATT. Indeed, it would be all too easy for a WTO member to first bind its customs duties on, for example, imports of natural gas, to zero (thus creating legitimate expectations with gas exporters that they obtained duty free market access to the WTO member concerned) and then, once gas has cleared customs, to impose a VAT of 50 % on imported gas, whereas only a VAT of 10 % is levied on domestic gas (or to allow competition in the internal market between private domestic operators, but exclude imported gas, for example, from getting access to internal distribution networks). Such discrimination in the internal market would make any tariff bindings at the border irrelevant. To avoid this, the principle of internal non-discrimination, or national treatment, was added.

71. Given that there is only a "best endeavours" clause for tariffs in the ECT context for the time being, this last *rationale* is less relevant for ECT purposes. Nevertheless, it will become relevant as soon as tariff commitments are made, as foreshadowed in the ECT trade amendment.

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27 On the distinction between "border" and "internal" measures see further paras. 119-121 below.

28 In the WTO, customs duties are clearly favoured over discriminatory internal measures simply because they are far more transparent and predictable. Customs duties also provide revenue to the government in contrast to discriminatory sales or distribution regulations which, instead, impose an additional compliance cost on exporters, a cost that would not be to the benefit of anyone (so-called "dead-weight cost"). See para. 124 below.

(c) The principle as applied to trade in energy

(i) Taxation

72. All internal taxes (VAT, excise duties, etc.) have to be the same for domestic energy and imported energy. Domestic electricity is to be taxed at the same rate as imported electricity. The same applies for domestic gas and imported gas and any other energy product and its imported equivalent.

73. As was the case for the MFN principle, the notion of "like product" will, again, be crucial. If it is shown that products are not "like", then one is allowed to treat them differently. However, once products are found to be "like products", then they have to be treated the same.

74. As pointed out earlier (see *Box 1*), it would seem difficult to argue that any of the basic energy products are "like products". Thus, for example, to tax electricity differently than gas or petroleum would not seem to be inconsistent with GATT Article III:2, first sentence.

75. A problem may arise, however, when different types of one given energy product are made subject to differential treatment. For example, to impose an extra tax on electricity generated with non-renewable energy sources would seem a tax discrimination between two types of electricity that are "like products" (an environmentally friendly one, and one that is not; but physically and in terms of end-uses both are identical and thus would seem to be "like products"). Given their "likeness", an exporter of environmentally unfriendly electricity could then claim that his imported electricity is being discriminated against (taxed higher), as opposed to domestic environmentally friendly electricity (subject to a lower tax). On that ground, a violation of GATT Article III could be sustained.[29]

76. In respect of internal taxation, the possibility that distinctions between different types of, for example, electricity are found to be contrary to national treatment is higher. As pointed out, in the tax area the national treatment obligation also applies to "directly competitive or substitutable" products. Thus, even if two types of electricity were not found to be "like", they could still be considered to be "directly competitive or substitutable". Indeed, it could even be argued that although electricity and gas are not "like products", perhaps they are nevertheless "directly competitive or substitutable". Once this is proven, any "dissimilar" taxation (a more than *de minimis* difference), which is in addition proven to be imposed "so as to afford protection to domestic production", could be found to be contrary to GATT Article III: 2, second sentence.

[29] It should, again, be recalled, however, that this discrimination may nevertheless be justified under Article XX of GATT, which allows for certain trade barriers for environmental purposes (see *Box 1*).

77. In the WTO, it is unclear whether income tax provisions could violate the national treatment provision in respect of products.[30] One could imagine, for example, that a tax credit is given to taxpayers each time they purchase X amount of domestic products and no such credit is given for purchases of imported products. Imported goods would clearly be discriminated against. In the ECT context, however, it seems that no ambiguity remains in that any such measure would not be inconsistent with the ECT. Indeed, Article 21, paragraph 4, of the ECT states, that Article 29 (2) to (6) of the ECT — the ECT provisions that incorporate the GATT's national treatment principle — "apply to Taxation Measures other than those on income or on capital".

Box 3 Are different energy products "directly competitive or substitutable" products?

A decision on whether products are "directly competitive or substitutable" will, as is the case for "like products", involve reference to matters such as physical characteristics, common end-uses and tariff classifications. In addition, competition in the market-place will need to be examined (Appellate Body report on *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted on 1 November 1996, p. 25).

In the referenced case, for example, Japanese shochu, whisky, brandy, rum, gin, genever and liqueurs were all found to be "directly competitive or substitutable" in the Japanese market (ibid., pp. 25-26).

A recent panel report stated that "an assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste" (Panel Report on *Korea – Taxes on Alcoholic Beverages*, adopted on 17 February 1999, WT/DS75/R, para. 10.40).

In addition, the Appellate Body confirmed that "potential competition" between two products may be sufficient for them to be "directly competitive or substitutable": "the wording of the term 'directly competitive or substitutable' implies that the competitive relationship between products is *not* to be analyzed *exclusively* by reference to *current* consumer preferences. In our view, the word 'substitutable' indicates that the requisite relationship *may* exist between products that are not, at a given moment, considered by consumers to be substitutes but which are, nonetheless, *capable* of being substituted for one another" (Appellate Body report on *Korea – Taxes on Alcoholic Beverages*, adopted on 17 February 1999, WT/DS75/AB/R, para. 114).

The fact that if two products are two "alternative ways of satisfying a particular need or taste" they may be found to be "directly competitive or substitutable" products — in respect of which the national treatment obligation for internal taxation applies – could be used as an argument in favour of prohibiting tax differentials between two types of a given energy source (say, green and non-green electricity) or even between two different energy sources all together (say, electricity and gas). The fact that "potential competition" between the two products may be sufficient for them to be "directly competitive or substitutable" may further strengthen the argument. However, even if the argument were valid, it could only lead to a violation of GATT Article III:2, second sentence if it were proven also that the tax differential is there "so as to afford protection to domestic production". For example, if electricity were taxed twice as much as gas and only gas is domestically produced and not electricity, one could imagine that the discrimination was introduced "so as to protect" local gas producers.

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30 GATT Analytical Index, p. 144. Income tax exemptions have, however, given rise to findings of violation under the Subsidies Agreement (see Appellate Body report on *US – Tax Treatment for "Foreign Sales Corporations"*, adopted 20 March 2000, WT/DS108/AB/R).

(ii) Other internal regulations

78. In addition to tax measures, all other internal energy regulations imposed by the government have to treat imported energy products the same way as they treat domestic energy products. This obligation applies in respect of "all laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use" of energy products.

79. Thus, all government measures setting minimum prices for energy products or the way such prices are to be calculated, defining environmental standards (for example, against air pollution by petroleum products), imposing charges for the use of transmission networks, regulating access to transmission or distribution channels or subsidising energy prices for certain categories of people, all have to make sure that imports are not treated less favourably than domestic products.

80. Another standard type of regulation that is outlawed by Article III:4 are those that link an advantage (say, a subsidy, the right to import or the right to give a certain name to a product) to a minimum amount of local content in the products concerned. Such local content requirements — for example, a subsidy for electricity if such electricity is produced for 20% with local coal or local renewable energy — clearly stimulate the purchase of domestic products over imported products, thereby negatively affecting the competitive opportunity of imports. They are prohibited under Article III.[31]

81. In this respect, it should be noted also that Article III:5 of GATT explicitly outlaws "internal quantitative regulation relating to the mixture, processing or use of products in specified amount or proportions" which include domestic content requirements. In other words, mixing, processing or usage requirements in respect of energy products may not, directly or indirectly, require that certain inputs come from domestic sources as opposed to imports.

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[31] See, in particular, Article III:5 which provides: "No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources". See, in this respect, the WTO Agreement on Trade-related Investment Measures, Annex, para. 1 (a), an agreement that is *not* incorporated in the ECT (but finds its equivalent in ECT Article 5) and the Panel Report on *Indonesia – Certain Measures Affecting the Automobile Industry*, adopted on 23 July 1998, WT/DS54. See also paras. 252 ff. *below* on "prohibited export subsidies".

(d) "Best" or "worst" of national treatments?

82. The national treatment obligation also applies to measures taken by sub-federal entities. Such regional measures may, for example, favour products from within a province, as opposed to all products originating outside the province (that is, foreign imports and domestic products from other provinces). Given that domestic products themselves are being treated differently (extra-provincial are discriminated as against intra-provincial), the question then arises whether imports can claim the "best" of national treatments (that is, intra-provincial treatment) or should, in contrast, content themselves with the "worst" of national treatments (extra-provincial treatment).

83. Two GATT panels have decided that the "best" of national treatments has to be accorded also to imports.[32] It should be noted, however, that the national treatment that can be claimed for an imported product is the "best" of the treatments that is being accorded *in the territorial entity in question*. It is not possible, for example, to request that a provincial authority treats your imports the same way as another provincial authority does. The point of comparison is the best treatment accorded to domestic products *in that specific territory*; not the best treatment given to domestic products *anywhere* in the country.

84. But here again, even if in principle the obligation to provide national treatment were violated, GATT Article XXIV can, in certain circumstances, justify such violation.[33]

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32 Panel Reports on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, DS17/R, BISD 39S/27, 75 and on *United States - Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, DS23/R, BISD 39S/206, 274, para. 5.17.

33 See paras. 193 ff.

Box 4 Canada and US liquor cases: the obligation to provide the "best" of national treatments

A 1992 panel report on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies* (complaint by the United States), examined measures taken by provincial liquor boards in Canada. The provincial measures in question applied both to beer originating outside Canada and beer from other provinces of Canada. They did not apply to beer originating inside the province that introduced the measure, thereby favouring provincial beer. The panel found that the measures were discriminatory, contrary to the national treatment provision. A footnote to the panel findings makes clear what is to be understood by national treatment as accorded to domestic products:

> "Throughout these findings the reference to domestic beer is a reference to the domestic beer which receives the most favourable treatment by Canada in the province in question, that is in most instances the beer brewed in that province" (Panel Report, adopted 18 February 1992, DS17/R, BISD 39S/27, 75, note to finding in para. 5.4 applying Article III:4).

The fact that other Canadian beer (outside of the province in question) was treated the same way as imported beer, did not withhold the panel from finding that Canada had breached Article III.

In the same year (1992), a similar case arose against the United States (complaint by Canada). The same conclusion was reached. The panel report on *United States - Measures Affecting Alcoholic and Malt Beverages* observed the following with respect to differential excise taxes levied by US states which it found to be in violation of Article III:

> "The Panel did not consider relevant the fact that many of the state provisions at issue in this dispute provide the same treatment to products of other states of the United States as that provided to foreign products. The national treatment provisions require contracting parties to accord to imported products treatment no less favourable than that accorded to any like domestic product, whatever the domestic origin. Article III consequently requires treatment of imported products no less favourable than that accorded to the most-favoured domestic products" (Panel Report, adopted on 19 June 1992, DS23/R, BISD 39S/206, 274, para. 5.17).

(e) Some exceptions to be found in Article III itself

85. Pursuant to Article III: 4, second sentence, a differential in transmission or distribution charges for energy products that is imposed by the government is justified as long as the differential is "based exclusively on the economic operation of the means of transport and not on the nationality of the product concerned". In other words, if there are economic reasons that justify a higher charge for transport of imported products, Article III will not be violated.

86. Another, more important, exception to national treatment is provided in paragraph 8(b) of Article III. This provision states that Article III

> "shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of [Article III] and subsidies effected through governmental purchases of domestic products".

87. In other words, paying subsidies exclusively to domestic *producers* (not domestic *products*) and not to foreign producers, is allowed. This is so even if such subsidies may have a carry on effect on the price and competitive opportunities of the domestic products produced by the subsidized domestic producer.

88. To avoid that this provision empties Article III of much of its meaning, paragraph 8(b) has been interpreted restrictively. Only subsidies to domestic producers, not subsidies to domestic purchasers of the goods produced, are allowed.[34] Only subsidies provided exclusively to producers, not those that also benefit — albeit partly — processors, are exempted.[35] Finally, a distinction is made between outright tax exemptions for domestic producers and payments to domestic producers with taxes previously collected in a non-discriminatory way. Tax exemptions — a form of subsidy — are permitted. Payments to domestic producers only, after non-discriminatory tax collection, are justified under the exception. A 1992 panel report explained the reasons for this distinction as follows:

> "This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which different interests involved can be balanced".[36]

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34 Panel Report on *Italian Discrimination against Agricultural Machinery*, L/833, adopted on 23 October 1958, BISD 7S/60, 64, para. 14.

35 Panel Report on *EEC - Payments and Subsidies paid to Processors and Producers of Oilseeds and related Animal-Feed Proteins*, L/6627, adopted on 25 January 1990, paras. 136/137.

36 Panel Report on *US - Measures Affecting Alcoholic and Malt Beverages*, adopted 19 June 1992, BISD 39S/206, 273, para. 5.10. In the panel report on *US - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, DS44/R, adopted 4 October 1994, para. 109, an example can be found of a measure that was justified under Article III:8(b), namely the payment of a subsidy to domestic US tobacco producers only (under a price support programme) out of the proceeds of a levy imposed on both domestic and imported tobacco.

89. Therefore, it would seem that, for example, exempting electricity generated with renewable energy from VAT could violate Article III in that it discriminates imported non-renewable electricity against domestic renewable electricity (as pointed out, both products seem "like", see *Box 1*). Even though Article XX (environmental exception) could justify such Article III violation, the Article III violation would originally be there. If, in contrast, both types of electricity were taxed the same, but with the tax money, the government were to directly subsidize only domestic producers of renewable electricity, not foreign producers, such subsidy would seem to be valid at least under GATT Article III:8(b). The subsidy should, however, also be examined under the Subsidies Agreement, discussed below.

4. Freedom of Transit (GATT Article V)

(a) Definition of transit and the notion of "Freedom of Transit"

90. Article V of GATT introduces the principle of freedom of transit. It establishes the GATT definition of traffic in transit, namely "when the passage [of goods] across [the territory of a member] … is only a portion of a complete journey beginning and terminating beyond the frontiers of the [member] across whose territory the traffic passes" (Article V:1).

91. Article V: 2 states that "there shall be freedom of transit through the territory of each [member], via the routes most convenient for international transit, for traffic in transit to or from the territory of other [members]". Thus, an ECT Contracting Party cannot refuse goods crossing its territory in transit in case these goods either *come from* another ECT Contracting Party, or if they *are going to* another ECT Contracting Party. It would not seem necessary that the good comes from an ECT Contracting Party and goes to an ECT Contracting Party. Either of the two (coming from or going to an ECT Contracting Party) would seem sufficient for the principle of freedom of transit to apply.

92. In addition, pursuant to Article V: 2, it is not sufficient to just grant any form of transit; it has to be transit "via the routes most convenient for international transit".

(b) Possible charges or formalities in respect of transit

93. Article V: 3 provides further that "...except in cases of failure to comply with applicable customs laws and regulations, [traffic in transit] coming from or going to the territory of other [members] shall not be subject to any unnecessary delays or restrictions and shall be exempt from customs duties and from all transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered" (emphasis added).

94. In other words, in case, for example, natural gas crosses the territory of an ECT Contracting Party through pipelines installed in that Contracting Party and the natural gas is either coming from, or going to, another ECT Contracting Party, then the former Contracting Party is *not* allowed to impose either (1) customs duties on this natural gas passing in transit, or (2) any other duties or charges for transit, with the exception of charges that adequately represent the cost of transportation, administrative expenses or other services rendered in respect of the natural gas in transit.

95. Thus, the Contracting Party concerned is barred from imposing, say, the usual 10 per cent customs duty it normally levies for imports or exports of natural gas. But it is, however, allowed to charge a fee for the use of its pipelines (cost of transportation) and other administrative or service-related expenses which it has to bear for the natural gas to cross its territory (e.g., costs for maintaining a statistical database or costs incurred for ensuring safe transit). However, any such fee has to be "commensurate with" the actual expenses entailed. If not, the fee is inconsistent with Article V.

96. In this respect, Article V:4 further provides that any such fees or charges have to be "reasonable, having regard to the conditions of the traffic".

97. In respect of other regulations (not entailing the imposition of a charge but, for example, prescribing safety requirements or notification or licensing requirements), the same "reasonableness" criterion applies (Article V: 4). In addition, such regulations may not lead to "unnecessary delays or restrictions" (Article V: 3).

98. Article V also contains a double MFN obligation.

(c) No discrimination among goods in transit

99. First, equal treatment has to be given to traffic in transit without distinction based on "the flags of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or other means of transport" (Article V:2). Put slightly differently, with respect to all charges or formalities in connection with transit to or from an ECT Contracting Party "treatment no less favourable than the treatment accorded to traffic in transit to or from any third country" has to be ensured (Article V: 5).

100. Pursuant to these provisions, traffic in transit to, or from, an ECT Contracting Party may thus not be accorded less favourable treatment than the treatment accorded to traffic in transit to, or from, any other country (even if this third country is not itself an ECT Contracting Party). Thus, an ECT Contracting Party is not allowed to impose, for example, *higher charges* for the use of its pipelines or grids for traffic in transit coming from one ECT Contracting Party than the charges it imposes in respect of traffic in transit to, or from, any other country (unless, of course, the higher charge results from actual higher costs of transit).

101. It is also interesting to note that Article V: 2 not only prohibits discrimination on the basis of origin or destination of the actual good in transit (as Article I of GATT on MFN does), but also outlaws discrimination on the basis of the ownership or flag of the vessel or other means of transport which ensures the transit. Thus, even if a charge or formality in respect of transit of, say, oil, were to be neutral in respect of the origin or destination of the oil, but were to discriminate on the basis of the ownership of the vessel or truck transporting the oil (owners of one ECT Contracting Party being discriminated against owners of any other country), Article V: 2 would still outlaw this type of discrimination.

102. It should be recalled here that internal transportation charges for traffic in transit, in case they are government imposed, could arguably fall also under Article III (national treatment) of GATT.[37] If so, the charges imposed on foreign goods in transit would not be allowed to exceed those imposed on domestically produced goods.

(d) No discrimination between direct imports and imports that went through transit

103. Second, equal treatment has to be given to products from a given ECT Contracting Party irrespective of whether they were imported directly or were previously in transit in another ECT Contracting Party (Article V: 6)

104. It is, therefore, inconsistent with GATT Article V for an ECT Contracting Party to favour goods imported directly from another ECT Contracting Party, as opposed to goods that first transited through a third Contracting Party. To take the example of electricity, an ECT Contracting Party is not allowed to impose, say, a lower customs duty for electricity coming directly from its neighbour, than for electricity also coming from this neighbouring country but which has transited first through the grids of a third ECT Contracting Party.

105. So far not a single GATT or WTO panel has made findings under Article V. The case that came closest to examination by a panel was the 1990 dispute between Austria and the Federal Republic of Germany. There, Germany had enacted a measure banning the circulation of 212.000 Austrian lorries during night hours in the entire territory of the Federal Republic. This measure was applied only against Austrian trucks. It was enacted in response to a 1989 Austrian measure that limited traffic of certain heavy trucks during night hours in Tyrol, a measure that applied to trucks of all nationalities, including Austrian trucks. Austria claimed that the German measure was inconsistent with, *inter alia*, GATT Article V. One author remarked in this respect that "[i]t is incomprehen-

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[37] In favour see the discussions held in the context of the Interpretative Note *Ad* Paragraphs 3, 4 and 5 of Article 33 of the Havana Charter where it was stated that "transportation charges on traffic in transit … were subject to the provisions of paragraph 2 of Article 18 [now III of GATT]", GATT Analytical Index, 1995, p. 215. Note, however, that Article III protects goods "imported into the territory" of an ECT Contracting Party, not necessarily goods "in transit".

sible how anyone could pretend that Article V was in full force for road transit traffic in Europe, whereas a system of trip authorisations underpinned by a network of bilateral road transport agreements between European Countries has been in force for a very long time … it would have been inevitable for a panel to express itself on the point whether Article V had not fallen into desuetude for road traffic in Europe, given the constant practice of European countries".[38]

106. More recently a request for consultations was filed by the European Communities in the case Chile - Measures Affecting the Transit and Importation of Swordfish (WT/DS 193/1). This request, dated 19 April 2000, concerns the prohibition on unloading of swordfish in Chilean ports established on the basis of Article 165 of the Chilean Fishery Law (Ley General de Pesca y Acuicultura), as consolidated and extended by Decrees. There, the EC asserted that its fishing vessels operating in the South East Pacific were not allowed under Chilean legislation to unload their swordfish in Chilean ports either to land them for warehousing or to transship them on to other vessels. The EC considers that, as a result, Chile makes transit through its ports impossible for swordfish. The EC claims that the above-mentioned measures are inconsistent with the GATT 1994, and in particular Articles V and XI thereof.

(e) GATT Article V *versus* ECT Article 7

107. It is clear that there are overlaps between GATT Article V and the more extensive Article 7 of the ECT which also deals with transit. Especially paragraph 1 of Article 7 refers in rather general terms to «the principle of freedom of transit» and prohibition on «unreasonable delays, restrictions or charges». To give meaning to these broad terms, reference could be made to Article V.

108. The other paragraphs of ECT Article 7 seem to add elements that may not be present in GATT Article V. Article 7(3), for example, introduces a type of national treatment obligation, namely that a transit country may not treat energy materials and products in transit in a less favourable manner than such materials and products originating in or destined for its own area. Article 7(6) and (7) set out dispute settlement provisions, not present either under GATT Article V.

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[38] Kuijper, P.J., *The Law of GATT as a Special Field of International Law, Ignorance, further refinement or self-contained system of international law?*, Netherlands Yearbook of International Law, Vol. XXV (1994), 227, at pp. 231-232.

5. Fees and formalities connected with importation and exportation (GATT Article VIII)

109. The basic premise of Article VIII is that all fees and charges (other than import and export duties covered by Article II and taxes covered by Article III) imposed on or in connection with importation or exportation of energy products "shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes". Article VIII also provides that minor breaches of customs regulations or procedural requirements shall not be subject to substantial penalties.

- Article VIII applies to all fees and charges levied by the government at the border (except tariffs and charges which serve to equalize internal taxes) even if the product concerned is not subject to a tariff binding.[39] In the ECT context this is important since too date no tariff bindings have been made. Notwithstanding the lack of tariff bindings, the said fees and charges have to meet the requirements of Article VIII.

- The fees and charges concerned have to be related to the cost of a service. The concept of a "service" was defined as "government activities closely enough connected to the processes of customs entry that they might, with no more than the customary artistic licence accorded to taxing authorities, be called a 'service' to the importer in question".[40]

- The fee or charge has to be "limited in amount to the approximate cost of services rendered". This has been interpreted to refer to the approximate cost of customs processing *for the individual entry in question*. Consequently, the *ad valorem* structure (based not on the quantity of goods but on their value) of a US merchandise processing fee was found to be inconsistent with Article VIII.[41] This approach was confirmed in a more recent WTO dispute where an Argentinian *ad valorem* tax of 3 per cent on imports to cover the cost of a statistical service to inform foreign trade operators – without minimum or maximum – was found to be inconsistent with Article VIII. The panel considered the tax not to be a service to individual importers and further observed: "An *ad valorem* duty with no fixed maximum fee, by its very nature, is not 'limited in amount to the approximate cost of services rendered'. For example, high-price items necessarily will bear a much greater tax burden than low-price goods, yet the service accorded to both is essentially the same".[42]

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39 Panel Report on *US – Customs User Fee*, adopted on 2 February 1988, L/6264, BISD 35S/245, 273, para. 69.
40 Ibid., para. 77.
41 Ibid., para. 86.
42 Panel Report on *Argentina – Measures Affecting imports of Footwear, Textiles, Apparel and Other Items*, adopted on 25 November 1997, WT/DS56/R, para. 6.75.

110. Applying these principles to fees or charges that ECT Contracting Parties may impose in connexion with the importation or exportation of energy products, the following can be deduced. First, GATT Article VIII will only apply if such fees or charges are portrayed as fees or charges *other than* customs duties — for which there are no legal bindings yet in the ECT – and *other than* internal taxes, subject to GATT Article III. Second, any such fees or charges can only be imposed if they compensate the costs of a service that was rendered (for example, a statistical service or a certification or inspection service relating to the quality or properties of petroleum products). A fee or charge calculated on the basis of the value of the energy product (*ad valorem*) is unlikely to pass this test, as interpreted in the case law referred to above.

6. Marks of origin (GATT Article IX)

111. Article IX introduces an MFN obligation with regard to marking requirements. ECT Contracting Parties are allowed to require that the origin of energy products be marked. But in doing so they have to treat energy products from all ECT Contracting Parties the same, without discrimination.

112. Compliance with marking requirements should not entail serious damage to the products or materially reduce their value, or unreasonably increase their cost.

113. Article IX only deals with marks of origin, for example, a label on petroleum products stating where they originate from. Article IX does not deal with labels informing the consumer about facts other than origin, e.g., safety or process characteristics.[43] Such other labelling requirements may be covered by the Agreement on Technical Barriers to Trade (see *below*). In addition, discriminatory labelling requirements would also be covered by Article III:4 of the GATT. To date, not a single WTO panel made findings under Article IX.

7. Publication and administration of trade regulations (GATT Article X)

114. Article X is the GATT's most important transparency provision. It requires that all laws, regulations, judicial decisions and administrative rulings of general application that affect trade be published "promptly" and "in such a manner as to enable governments and traders to become acquainted with them" (Article X:1). Such measures may not be enforced before they have been officially published (Article X:2).

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[43] This was confirmed in the 1991 unadopted panel report on *US – Restrictions on Imports of Tuna*, where the panel noted that "Article IX does not contain a national-treatment but only a most-favoured-nation requirement, which indicates that this provision was intended to regulate marking of origin of imported products but not marking of products generally" (DS21/R, 3 September 1991, BISD 39S/155, para. 5.41).

115. In addition, ECT Contracting Parties are under a general obligation to administer such measures "in a uniform, impartial and reasonable manner". The Appellate Body clarified that this obligation does not apply to the laws, regulations, decisions and rulings *themselves*, but rather to their *administration*. To the extent they are *themselves* discriminatory such discrimination is not to be examined under Article X (but under MFN or national treatment provisions).[44]

116. ECT Contracting Parties also have to maintain or institute an impartial domestic review system that can review administrative actions relating to customs matters (Article X: 3).

117. It should be noted that here again an overlap may exist with Article 20 of the ECT. In this respect, however, it would seem that Article 20 is more limited than Article X.

8. General elimination of quantitative restrictions (GATT Article XI)

(a) The Principle

118. In addition to MFN and national treatment, the third key principle of GATT is the general prohibition to impose quantitative restrictions on the importation or exportation of (energy) products.

- In principle, all quantitative restrictions on import and export are outlawed.
- Article XI outlaws, more particularly, all "prohibitions or restrictions … made effective through quotas, import or export licenses or other measures"
- Article XI only applies to quantitative restrictions (for example, an outright ban on imports of electricity or an import or export quota of X tonnes of oil only). It does not apply to price-based restrictions, i.e., "duties, taxes or other charges". These fall under Article II on tariff bindings or Article III on internal taxes.
- Outright bans, quotas and licenses are obvious examples of quantitative restrictions. But other measures are also covered. For example, case law confirmed that a system prohibiting imports or exports of a product *below a certain price* (minimum import or export prices) limits the quantity of imports or exports that will take place (by keeping out imports that are, for example, cheaper than domestic products or preventing exports to be made at a competitive price on world markets so as to contain the product within the country).[45] As a result, such minimum import and export prices were found to be contrary to Article XI.

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44 Appellate Body report on *EC – Regime for the Importation, Sale and Distribution of Bananas*, adopted on 25 September 1997, WT/DS27/AB/R, paras. 200-201.

45 In respect of minimum import prices, see the Panel Report on *EEC – Programme of minimum Import Prices, Licenses and Surety Deposits for Certain Processed Fruits and Vegetables*, adopted on 18 October 1978, L/4687, BISD 25S/68, 99, para. 4.9. In respect of minimum export prices, see the Panel Report on *Japan – Trade in Semi-conductors*, adopted on 4 May 1988, L/6309, BISD 35S/116, 153, para. 105.

- Note here that ECT Contracting Parties are not allowed either "to seek, take or maintain voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side", pursuant to Article 11.1(b) of the Safeguards Agreement, a specific WTO agreement incorporated also in the ECT and further discussed below. In other words, ECT Contracting Parties are prohibited, for example, from putting pressure on foreign exporters of energy products to limit their exports to that party in an attempt to protect the domestic energy producers of that party. Examples of similar measures include "export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import licensing schemes, any of which afford protection".[46]

(b) The relationship between MFN, tariff bindings, national treatment and the prohibition on quantitative restrictions

119. Article XI applies only to (quantitative) border measures. In that sense it complements Article II dealing with (price-based) border measures, namely customs duties and other charges, a provision that was *originally not* incorporated in the ECT but which may become increasingly relevant following future Charter Conference decisions and for which an alternative is also set out in Article 29 of the ECT.

120. The difference between Articles XI and II is that whereas all quantitative border measures are, in principle, prohibited; customs duties are allowed but, at least in the WTO, only up to the level that was "bound" by the country in question for the product concerned.

121. In contrast to Articles II and XI (both dealing with border measures), national treatment (Article III) only applies to internal measures, imposed once products have cleared customs. The decision as to whether a measure falls under Article III or Article XI is critical. If it falls under Article III as an internal regulation, then it is acceptable as long as it does not discriminate imports as against "like" domestic products. If it falls under Article XI as a quantitative border measure, then it is, in principle, invalid (without there being a need to examine whether imports and domestic products are "like" products or whether imports are being discriminated) and exceptions need to be invoked.

122. An Ad Note to Article III clarifies the relationship between quantitative restrictions (Article XI) and internal measures (Article III). It states that even if a law, regulation or requirement affecting the sale, purchase, transportation, distribution or use of a product is enforced in the case of imports at the time or point of importation – so even if it is a measure that is, for imports, imposed at the border – the measure is nevertheless to be regarded as an

[46] Footnote 4 to the Safeguards Agreement.

internal measure subject to Article III (national treatment) if, and only if, the measure also applies to the like domestic product (and not only to imports). In other words, a measure regulating imports will only be subject to Article XI if it applies to imports and not to domestic products. Import bans (without an equivalent ban on domestic products), import quotas and import licenses are some examples of measures subject to Article XI. However, when faced with a product regulation that applies to all products brought on the market of the ECT Contracting party concerned (for example, environmental standards in respect of petroleum products, both domestic and imported), then – even if, for imports, compliance with these standards is checked at the border – the regulation will be subject to the more lenient Article III (national treatment), not the stricter Article XI.

123. Finally, in contrast to Articles II, III and XI, which deal only with certain types of trade measures, the MFN obligation in Article I applies across the board (i.e., to all trade measures mentioned in Article I, both those imposed at the border and internally in the market).

(c) Why is the principle there?

124. From the foregoing, it becomes apparent that the drafters of the GATT realized that trade protectionism may still be necessary but that, if such protection is necessary, the least distortive instruments should be used. The GATT classifies these trade instruments as follows. A clear preference is given to non-discriminatory tariffs because of their transparency, predictability and equal effect on all imports. Domestic production is, indeed, protected but at least some of the efficiency costs of protectionism (for example, higher consumer prices and the waste of limited resources through continued domestic production that is not efficient) are being recouped through government revenues from tariffs. This explains why tariffs are, in principle, tolerated.[47]

125. At the other extreme, GATT has placed quantitative restrictions, in particular discriminatory quotas. They are considered to be less transparent for traders and, especially if discriminatory on the basis of origin, their related efficiency costs of protectionism are likely to be much higher (less efficient exporters may obtain more quota than they should). In addition, quantitative restrictions do not bring in revenues for the government. Indeed, most benefits of a quota system (the so-called “quota rents”) go to the foreign exporter who will be able to sell his (cheaper) products at a higher price in the protected market, a higher price that is maintained by only allowing a limited number of imports.

126. This explains why Article XI sets out an outright prohibition on quantitative restrictions and favours instead the imposition of tariff barriers.

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[47] On the WTO’s preference for tariffs over internal discrimination, see footnote 28.

(d) Some Exceptions in Article XI Itself

127. There are several exceptions to the general prohibition in Article XI. In Article XI itself two exceptions, that may be relevant to trade in energy, are provided for:

- Export prohibitions or restrictions that are "temporarily applied to prevent or relieve critical shortages of … products essential" to the exporting ECT Contracting Party, are allowed (GATT Article XI:2(a)). This exception could be invoked, for example, to justify an export ban or quota on oil, or any other energy source, if it can be shown that oil or the other energy source is or threatens to be in critical short supply. It can, indeed, be assumed that most energy products will, for most countries, be "essential products". Any such restriction can, however, only be applied "temporarily".

- Import and export prohibitions or restrictions "necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade" are also allowed (GATT Article XI:2(b)). This exception has been interpreted rather narrowly. According to a GATT panel, in respect of export restrictions, it does not cover "all regulations that facilitate foreign sales but only those that apply to the marketing as such … The drafters of Article XI:2(b) agreed that this provision would cover export restrictions designed to further the marketing of a commodity by spreading supplies of the restricted product over a longer period of time".[48]

9. (Quantitative) Restrictions allowed to safeguard balance-of-payments (GATT Article XII)

128. An additional exception to GATT Article XI is provided for in GATT Article XII which allows ECT Contracting Parties to restrict the quantity or value of energy products permitted to be imported in the event this is done to safeguard the external financial position and balance-of-payments of the country. In other words, if an ECT Contracting Party does not have sufficient foreign currency in reserve (due to, for example, too many imports), it may be allowed to impose import restrictions on, *inter alia*, energy products.

129. However, such restrictions may not exceed those necessary (i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or (ii) to achieve a reasonable rate of increase in reserves in case the country has very low monetary reserves (GATT Article XII: 2).

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[48] Panel Report on *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon*, adopted on 22 March 1988, L/6268, BISD 35S/98, 112, para. 4.3. As an example that does fall under Article XI:2(b), the drafters made reference to an Australian butter marketing scheme which utilised export licenses to spread exports of butter over time but which was not used to restrict exports over the period of the operation of the scheme (GATT Analytical Index, p. 326).

130. It should be noted, in addition, that restrictions for balance-of-payments reasons have to be taken on an MFN basis and should, in principle, affect imports of all products. There is, however, an exception for so-called "essential products". ECT Contracting Parties may, indeed, decide not to impose import restrictions, or lighter ones, on products that are more essential to them (GATT Article XII:3(b)). The WTO Understanding on the Balance-of-Payments provisions of GATT specifies that the term "essential products" shall be understood to mean "products which meet basic consumption needs or which contribute to the member's effort to improve its balance-of-payments situation, such as capital goods or inputs needed for production".[49]

131. On that basis, it would seem that WTO members/ECT Contracting Parties are allowed to impose import restrictions for balance-of-payments purposes but in doing so to exclude all or certain energy products as "essential products" for which no such restrictions will apply.

132. The WTO Understanding on the Balance-of-Payments provisions of GATT made another important clarification. Under GATT Article XII one could get the impression that only quantitative restrictions (for example, import bans, quota's or minimum prices) are allowed for balance-of-payments purposes. The Understanding makes it clear, however, that also price-based measures (such as surcharges or import deposit requirements) can be imposed. It goes even further and states that such price-based measures should be the preferred solution because they have the least disruptive effect on trade.[50]

133. There are many reports of the Balance-of-Payments Committee addressing particular aspects of GATT Article XII.[51] So far only one dispute settlement panel (and the Appellate Body) dealt with a balance-of-payments dispute.[52]

10. Non-discriminatory administration of quantitative restrictions (GATT Article XIII)

134. Article XIII requires that in those cases where an exception to Article XI is made — i.e., where quantitative restrictions on import or export can exceptionally be taken (including tariff quotas) – similar restrictions be imposed on imports from, or exports destined to, all countries. In other words, even if a quantitative restriction falls under one of the exceptions, it can only be justified if it is imposed on an MFN basis.

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49 Understanding on Balance-of-Payments, para. 4.
50 Understanding on Balance-of-Payments, para. 2.
51 GATT Analytical Index (1995), op. cit., Vol. I, pp. 355-395.
52 Panel and Appellate Body Reports on *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial products*, WT/DS90, complaint by the US, adopted on 22 September 1999.

135. This MFN principle may sound obvious in theory, but in practice it may be difficult to implement. Wherever practicable, (tariff) quotas representing the total amount of permitted imports are to be fixed, whether allocated among supplying countries or not (Article XIII:2(a)). There is, therefore, no obligation to allocate (tariff) quotas among supplying countries. But in case such allocation is made, i.e., if, for example, an import quota on natural gas could exceptionally be taken and it is allocated among supplying countries, in many cases it would not make sense to allocate the same quota share to all ECT Contracting Parties in order to impose the restriction on an MFN basis. One country (say, the Russian Federation) may traditionally export natural gas in much larger quantities than another (say, Switzerland), which may, perhaps, not at all be involved in the trade of gas. To give the same quota to both countries would not serve efficiency.

136. This is why Article XIII:2 provides that when applying import restrictions, ECT Contracting parties "shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various [ECT Contracting parties] might be expected to obtain in the absence of such restrictions". Thus, to allocate different quota amounts to different ECT Contracting Parties would not go against the MFN principle, as long as the quota allocation were to represent the shares in trade that ECT Contracting Parties would have had in the absence of any restrictions. Articles XIII:2(a) to (d) and XIII:3-5 provide for further details in this respect.

11. Exceptions to the rule of non-discrimination

137. Article XIV allows for discriminatory restrictions contrary to Article XIII in the event those restrictions are taken for balance-of-payments reasons (under Article XII, see *above*) *and* the discrimination can be justified under certain provisions of the Articles of Agreement of the International Monetary Fund (IMF)

12. Subsidies

138. Article XVI of the GATT, which regulates subsidies is dealt with below in Section IV C 3(c).

13. Limitations imposed on State Trading Enterprises (mainly GATT Article XVII)

139. As pointed out earlier, GATT/WTO rules only apply to governmental measures.[53] They do not generally restrict the conduct of private operators. But what happens with in-between situations like conduct of enterprises owned by the state? What limitations do WTO rules as incorporated in the ECT impose, for example, on a state-owned electricity trading company?

[53] See para. 36.

140. In order to avoid that ECT Contracting Parties circumvent their obligations in respect of governmental energy policies, disciplines are imposed also on actions taken by so-called state trading enterprises. Indeed, if no restrictions would apply to such enterprises, an ECT Contracting Party could easily delegate all of its policy-making powers to such an enterprise, in effect still control this enterprise, but avoid having to comply with WTO rules.

141. It should be noted up-front, however, that the WTO does not in principle prohibit its members from maintaining state monopolies nor prevent them from engaging in commercial activities. Nevertheless, when WTO members do so, certain disciplines have to be respected.

(a) State agencies or entities laying down regulations for private trade *versus* state trading

142. In case an ECT Contracting Party simply delegates its regulatory power to an agency or sub-federal entity, allowing that agency or entity to regulate private energy trade, then the regulations passed by that agency or entity will be considered as normal governmental measures, subject to all of the GATT provisions set out above.

143. This situation, where the state entity does not itself engage in trade but regulates trade conducted by others, has to be distinguished from state trading, where the state entity itself purchases and sells energy products. Such state trading is governed by less stringent disciplines.

144. One and the same state entity may exercise both functions (regulating and trading). If this is the case, each action has to be considered under the respective GATT obligations: regulations being subject to all GATT obligations; state trading being subject only to the special provisions on state trading enterprises. These special provisions are examined next.

(b) Import monopolies (GATT Article II:4)

145. Article II:4 provides an important restriction on what an import monopoly – which an ECT Contracting Party «maintains or authorizes, formally or in effect» — can do. Such state controlled or authorized import monopoly, say of electricity, cannot operate so as to afford protection to domestic producers of, in this case, electricity «on the average in excess of the amount of protection provided for in» the of commitments under Article 29(4) to (7) of the ECT made by the ECT Contracting Party in respect of customs duties or other charges on electricity imports.

146. This may, to date, be of little relevance in the ECT since no strict tariff commitments have been made by ECT Contracting Parties. But once an ECT Contracting Party were, for example, to put a maximum ceiling or “binding” of 5 per cent customs duties on imported electricity and were to maintain a state owned or authorized import monopoly, then this monopoly would not be allowed to provide protection to domestic electricity producers in excess

of the 5 per cent customs duties. In other words, when selling the imported electricity in the local market, it would not be allowed to do so at a price higher than the actual import price plus the 5 per cent customs duty *unless* the excess or so-called "mark-up" would represent transportation, distribution or other expenses incident to the purchase or sale or would represent a reasonable margin of profit or internal taxes imposed also on domestically produced electricity.[54]

147. Obviously, if import monopolies were to be allowed to impose any level of "mark-ups" on the price of imported electricity, given their monopoly status, they could easily block the market access that maximum tariff levels or "bindings" could have provided.

(c) Import/export purchases or sales by "State Trading Enterprises" (GATT Article XVII)

148. Article XVII provides for further obligations not only in respect of state owned or authorized import monopolies but for the wider category of "state trading enterprises". These include (1) state enterprises (for example, agencies of the government engaged in purchasing or selling); and (2) enterprises to which the government grants, formally or in effect, exclusive or special privileges (for example, an import monopoly or an exclusive licence). A working definition for purposes of notifying the existence of state trading enterprises is set out in the Understanding on the Interpretation of Article XVII also incorporated in the ECT.[55]

149. Such enterprise "shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment" prescribed in the GATT for governmental measures. Thus in their trading conduct, state trading enterprises are not allowed to discriminate between different imports of energy products, depending on their origin (MFN principle). In addition, it would seem that in their trading conduct they cannot discriminate either between domestic energy products and imported energy (national treatment).[56]

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54 These mark-ups are allowed pursuant to the Ad Note to Article II:4 which refers, in turn, to Article 31 of the Havana Charter. Article 31.4 explicitly allows for these mark-ups. This was confirmed, *inter alia*, in the panel report on *Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, BISD 39S/27, 80-82.

55 This definition of "state trading enterprises" reads: "Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports".

56 In favour: Panel Report on *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, circulated on 31 July 2000 (currently under appeal), WT/DS161 and 169/R (complaints by the US and Australia), para. 753 and Panel Report on *Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, adopted on 22 march 1988, BISD 35S/37, para. 4.26. Contra: Panel Report on *Canada – Administration of the Foreign Investment Review Act*, adopted on 7 February 1984, L/5504, BISD 30S/140, para. 5.16.

150. These non-discrimination obligations are further clarified in Article XVII:1(b) as meaning that state trading enterprises shall make their purchases or sales involving either imports or exports

> "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other [ECT Contracting Parties] adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales".

Box 5 When do State Trading Enterprises act against "principles of non-discriminatory treatment" or "commercial considerations"?

So far, only one WTO panel examined the concepts of "principles of non-discriminatory treatment" and "commercial considerations" (Panel Report on *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, circulated on 31 July 2000, WT/DS161/R, complaints by the US and Australia). It found as follows:

> "the terms 'general principle of non-discrimination treatment prescribed in this Agreement' (Art. XVII:1(a)) should be equated with 'make any such purchases or sales solely in accordance with commercial considerations' (Art. XVII:1(b)). The list of variables that can be used to assess whether a state-trading action is based on commercial consideration (prices, availability etc…) are to be used to facilitate the assessment whether the state-trading enterprise has acted in respect of the general principles of non-discrimination. A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on 'commercial considerations', would also suffice to show a violation of Article XVII".[1]

On that ground, the Panel (at para. 769) found *inter alia*, that when a Korean state trading enterprise, an agency having the exclusive right to import 30 per cent of all beef imports into Korea: (1) delayed its sales of imported goods (beef) into the Korean market while having important stocks; and (2) refused during a certain period of time to call for tenders for (beef) imports, it was not acting "in a manner consistent with the general principles of non-discriminatory treatment" referred to in Article XVII:1(a). The Panel fond that no "economic justification" existed for these practices to occur (paras. 732-744).

The Panel report is currently under appeal. However, the Panel's findings under GATT Article XVII were not challenged before the Appellate Body.

(d) Restrictions "made effective through" state-trading operations (Ad Note to GATT)

151. An Ad Note to GATT Articles XI, XII, XIII, XIV and XVIII states that throughout these articles the terms "import restrictions" or "export restrictions" include "restrictions made effective through state-trading operations".

152. Thus, even if an ECT Contracting Party does not impose governmental import or export restrictions contrary to Article XI (prohibition on quantitative restrictions), the fact that one of its state trading enterprises, in effect, does so through its regulations or purchases or sales, will still mean that the ECT Contracting Party violates Article XI.

153. This means that Article XI also covers and, in principle, prohibits restrictions made effective through an import monopoly (unless allowed under Article II:4, it would seem). An example could be quotas on imports of natural gas, imposed by a state-owned or state-authorized import monopoly.

154. In case law it was pointed out that where a state trading enterprise enjoys a monopoly of both importation and distribution in the domestic market, also internal measures restricting distribution will lead to a restriction on importation contrary to Article XI.[57] Indeed, if the monopoly operator refuses, for example, to distribute the imported electricity, there is no way to get it distributed by other means. As a result, it is of no use to import the electricity in the first place. Thus, internal discriminatory practices or restrictions in these circumstances could also run afoul of Article XI (traditionally reserved for border measures only).

14. Safeguards

155. Article XIX (Safeguards) is dealt with below under Section IV C 3(d).

15. General Exceptions (GATT Article XX)

156. Article XX offers a number of general exceptions allowing for trade restrictions contrary to, for example, the MFN principle, national treatment or the prohibition on quantitative restrictions.

157. Under the GATT, Article XX was traditionally interpreted in a rather narrow way. Even in WTO case law, it remains an exception to be invoked by the defendant and for which the defendant bears the burden of proof. Nevertheless, in WTO jurisprudence a tendency arose to give a wider meaning to Article XX. For that reason, the focus should be on WTO jurisprudence.

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57 Panel Report on *Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, adopted on 22 march 1988, BISD 35S/37, para. 4.24. See also the Panel Report on *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, op. cit., para. 751.

158. It should be noted from the outset that in respect of technical regulations or standards laying down product characteristics or their related processes and production methods, Article XX is further specified in the new WTO Agreement on Technical Barriers to Trade (TBT, discussed *below*).

159. Article XX consists of two parts. First, the so-called chapeau or introductory language. Second, ten paragraphs which set out specific policy objectives for which exceptions are available. When examining whether a measure is justified under Article XX, one should first address the specific paragraphs, i.e., check whether the measure *as such* is justified on the basis of the objective it pursues. Only in a second instance should one turn to the chapeau of Article XX in order to determine whether the manner in which the measure is *applied* meets the conditions set out in the chapeau.[58] Only if a measure is *as such* justified under a specific paragraph and meets the chapeau in terms of its *application*, will a measure be allowed under Article XX.

(a) The specific paragraphs in Article XX

160. Article XX includes not less than ten different exceptions. Three of those are directly relevant to energy trade and will be discussed in more detail below. We deal with the *chapeau* to Article XX in paras. 181 ff.

Box 6 GATT Article XX exceptions most relevant to energy trade

- Measures "necessary to protect human, animal or plant life or health" (Article XX(b))
- Measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption" (Article XX(g))
- Measures "necessary to secure compliance with laws or regulations which are not inconsistent with [GATT]". Examples of such measures are "those relating to customs enforcement, the enforcement of monopolies [operated consistently with GATT provisions, see *above*], the protection of patents, trade marks and copyrights, and the prevention of deceptive practices" (Article XX(d))

[58] Appellate Body report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 may 1996, WT/DS2/AB/R, p. 22.

161. A fourth exception may be relevant to energy trade but is strictly limited (not further addressed below), namely:

- Measures "involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan" (GATT Article XX(i)). Such measures can, however, only be justified if they do not operate to increase (1) the exports of the domestic processing industry; (2) the protection afforded to that industry; and (3) are non-discriminatory.

Under this provision, an ECT Contracting Party could thus impose an export ban or export quotas on energy products, say, oil, (renewable) electricity or natural gas, if it can show that the restriction is there (1) to ensure that essential quantities of the energy source can be provided to domestic industries using the energy source as an input; and (2) is taken as part of a governmental price stabilization plan to keep domestic energy prices below world market prices. In addition, the ECT Contracting Party would also need to show that the export restriction is not there to (3) boost exports of the domestic industry using the (cheaper) energy source as an input, nor (4) to protect that industry. Finally, (5) the export restriction would need to be imposed on an MFN basis.[59]

162. Three other types of exceptions may have some relevance to energy trade but are so specifically targeted that in practice they may be difficult to resort to.

- Firstly, measures "relating to the products of prison labour". An ECT Contracting Party could for instance impose a complete import ban (*contra* Article XI) or a discriminatory tax (*contra* Article III:2) against imports of oil or electricity that has been drilled or generated with prison labour. Such measure could be justified under Article XX(e).

- Secondly, measures taken under an "intergovernmental commodity agreement" which, *inter alia*, needs to conform to criteria set by WTO members/ ECT Contracting parties. Even though some energy products could be classified as primary commodities to which this exception applies (for example, crude oil), given that not a single "international commodity agreement" has been formally submitted to the GATT/WTO membership and, therefore, no criteria in this respect have been set,[60] Article XX(h) is of little practical importance.

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59 Drafting history shows that New Zealand introduced this exception to allow it, for example, to impose export restrictions on leather so as to ensure that the domestic footwear industry has enough leather available to it at the low New Zealand price (GATT Analytical Index, pp. 591-592).

60 GATT Analytical index, p. 591.

- Thirdly, measures "essential to the acquisition or distribution of products in general or local short supply". Such measures have to be consistent with the principle that all ECT Contracting Parties are entitled to an equitable share of the products in question and need to be discontinued as soon as the conditions giving rise to them cease to exist (Article XX(j)). In case of a major crisis in energy supplies one could imagine that ECT Contracting Parties can resort to this exception in order to limit their exports to certain countries only or to prevent exports altogether. The exception was, however, introduced to deal with the post-war transitional period and later maintained to cover also, for example, short supplies because of natural disaster.[61]

163. Finally, the three remaining exceptions under Article XX seem to be of little or no relevance to energy trade: Article XX(b) on public morals; Article XX(c) on gold and silver; and Article XX(f) on national treasures.

164. The three exceptions most relevant to trade in energy, referred to in para. 160, are next examined in more detail.

(b) Measures "necessary to protect human, animal or plant life or health" (Article XX(b))

165. Article XX(b) makes it clear that health "trumps" trade. ECT Contracting Parties are allowed to impose trade restrictions if they do so to protect health. One major condition is required, however: the restriction must be "necessary" to achieve the health protection objective.

166. In other words, if it becomes apparent that the restriction is not concerned at all with health or does not affect health protection, it cannot be imposed. Moreover, even if there is a legitimate health objective, the instrument chosen to achieve that objective has to be "necessary". This "necessity" requirement has been interpreted in GATT case law as follows:

> "a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' … if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions".[62]

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61 Ibid., pp. 592-593.

62 Panel Report on *US – Section 337 of the tariff Act of 1930*, adopted on 7 November 1989, L/6439, para. 5.26. This quote related to the necessity test under Article XX(d) but the Panel Report on *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, adopted on 7 November 1990, DS10/R, BISD 37S/200, paras. 74-75, made this quote applicable also to Article XX(b).

167. In other words, when an ECT Contracting Party wants to protect health in the energy sector, it first has to examine whether in order to so protect health it is reasonably possible to employ an instrument that is *consistent* with GATT provisions (for example, to negotiate a multilateral agreement to combat air pollution or to impose higher but non-discriminatory taxes on gasoline). If the health objective cannot be achieved through a GATT consistent instrument, the ECT Contracting Party is allowed to choose one that is GATT *inconsistent* but it is bound to choose – among those reasonably available — that one which entails the *least degree of inconsistency* with GATT, i.e., which least *restricts trade* (for example, instead of an outright import ban, perhaps a label stating that certain imported petroleum products or electricity are not "green" may also be enough to achieve the health objective).

Box 7 The Thai Cigarettes case: restrictions "necessary" to protect health

In a 1990 GATT case, an import ban imposed by Thailand on foreign cigarettes was not found to be "necessary" to avoid an increase in the total sales of cigarettes (which were allowed for production and sale within Thailand but not for import) so as to protect human health against smoking. The panel considered that there were less trade restrictive alternatives reasonably available to Thailand – other than a complete import ban – to restrict, *inter alia*, the quantity of cigarettes consumed (for example, a ban on advertisements) or to ensure the quality of cigarettes consumed (for example, non-discriminatory labelling and ingredient disclosure regulations) (Panel report on *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, adopted on 7 November 1990, DS10/R, BISD 37S/200, paras. 76-80). The panel concluded as follows:

> "In sum, the Panel considered that there were various measures consistent with the [GATT] which were reasonably available to Thailand to control the quality and quantity of cigarettes smoked and which, taken together, could achieve the health policy goals that the Thai government pursues by restricting the importation of cigarettes inconsistently with Article XI:1. The Panel found therefore that Thailand's practice of permitting the sale of domestic cigarettes while not permitting the importation of foreign cigarettes was an inconsistency with the [GATT] not 'necessary' within the meaning of Article XX(b)" (ibid., para. 81).

168. Article XX(b) has so far been subject to findings of only two WTO panels and one Appellate Body report, where the above referenced GATT case law was confirmed.[63] This is partly explained on the ground that a new WTO agreement explicitly addresses health issues in the food safety area and the area of pests and diseases. This Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) – under which several disputes have been decided – has, however, not been incorporated in the ECT (for lack of relevance to the energy sector).

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63 Panel Report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, paras. 6.20-6.29 and Panel and Appellate Body reports on *EC - Measures Affecting the Prohibition of Asbestos and Asbestos Products*, complaint by Canada, WT/DS135/R and AB/R.

(c) Measures "relating to the conservation of exhaustible natural resources" (Article XX(g))

169. This exception has been the subject of two high profile WTO disputes brought by developing WTO members against the United States.[64] To successfully invoke this exception three distinct and cumulative elements have to be met: (1) the product subject to protection needs to be an "exhaustible natural resource"; (2) the protection measure needs to "relate to" the conservation of the exhaustible natural resource in question; and (3) made effective "in conjunction with restrictions on domestic production or consumption". Only if all three of these requirements are fulfilled can a measure qualify under the Article XX(g) exception.

Box 8 US environmental standards for gasoline were found to be inconsistent with GATT

The first dispute brought to a WTO panel involved a complaint by Venezuela and Brazil. They challenged the fact that the US Clean Air Act imposed stricter standards on imported gasoline than on US domestically produced gasoline.

A violation of Article III:4 of GATT was found (national treatment in respect of internal regulations) on the ground that the US treated "like products" – imported and domestic gasoline – differently. Domestic refiners had to maintain, on an annual average basis, the relevant gasoline characteristics at levels no worse than their "individual baseline" (the annual average levels achieved by that refiner in 1990). Importers, in contrast, had to use a "statutory baseline", derived from the average characteristics of all gasoline consumed in the US in 1990. This was found to provide "less favourable treatment" to imported gasoline, inconsistently with Article III:4 (Panel report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, paras. 6.5-6.16).

The US, in defence, did not succeed in justifying its measure under Article XX. Its main defence was built around Article XX(g), arguing that the gasoline standards were "related to the conservation of exhaustible natural resources". The Appellate Body agreed that the US standards were so related, namely to protect against the depletion of clean air. But it found that the US standards constituted an unjustifiable discrimination and a disguised restriction on trade because alternative solutions were available to the US to protect clean air, other than imposing discriminatory standards based on the origin of the gasoline. The US standards were found to be contrary to the chapeau of Article XX and, for that reason, the violation of Article III:4 was not found to be justified under Article XX (Appellate Body report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, pp. 22-29).

[64] The disputes on *US – Standards for Reformulated and Conventional Gasoline* and on *US – Import Prohibition of Certain Shrimp and Shrimp Products*.

(i) Is the product subject to protection an "exhaustible natural resource"?

170. It has never been questioned that minerals, such as petroleum, are exhaustible natural resources. They are clearly finite resources, subject to exhaustion.[65] It seems even that Article XX(g) was originally negotiated to allow a country to impose export restrictions on minerals. Thus, ECT Contracting Parties are allowed to impose trade restrictive measures to conserve their domestic stocks of petroleum — and arguably also of electricity and other energy resources — by imposing, for example, export restrictions, as long as they meet the other conditions in Article XX(g) and its chapeau.

171. Through an evolutionary interpretation technique used in case law, it is now established that also living resources, especially if they are threatened with extinction (for example, sea turtles), can be an "exhaustible natural resource".[66] Clean air, as well, has been considered as a natural resource that could be depleted.[67] The fact that a resource is renewable was not found to be an objection.

172. Thus, when ECT Contracting Parties want to protect living resources (animals and/or human beings that can be affected by "non-green" energy products) or clean air (that could be depleted by non-green energy products) they can do so under Article XX(g) by introducing, for example, high environmental standards and banning all imports that do not meet these standards. Under GATT Article III such standards may discriminate between products that are "like" (arguably, domestic "green" energy and imported "non-green" energy) and hence violate Article III. But under Article XX this violation can be justified on the ground that the discrimination is imposed not to protect domestic production, but to protect or conserve health or clean air.

173. It is unclear whether ECT Contracting Parties are allowed to impose restrictions in order to protect exhaustible natural resources (or, for that matter, the health of human beings, animals or plants under Article XX(b)) *outside of their territorial jurisdiction*.[68] Recent case law requires a "sufficient nexus" between the country imposing the measure and the resource protected.[69]

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65 Appellate Body report on *US – Import Prohibition of Certain Shrimp and Shrimp Products*, adopted on 6 November 1998, WT/DS58/AB/R, para. 128.

66 Ibid., paras. 129-132. The GATT panel report on *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon*, adopted on 22 March 1988, BISD 35S/98, para. 4.4 found that even renewable stocks of salmon could constitute an exhaustible natural resource. The same was found in respect of dolphins in the unadopted panel report on *US – Restrictions on Imports of Tuna*, circulated on 16 June 1994, DS29/R, para. 5.13.

67 Panel Report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, para. 6.37.

68 In favour: the so-called Tuna I report (unadopted Panel Report on *US – Restrictions on Imports of Tuna*, dated 3 September 1991, DS21/R, 39S/155, paras. 5.26 and 5.33); against: the so-called Tuna II report (unadopted Panel Report on *US – Restrictions on Imports of Tuna*, dated 16 June 1994, DS29/R, paras. 5.15-5.17).

69 Appellate Body report on *US – Import Prohibition of Certain Shrimp and Shrimp Products*, adopted on 6 November 1998, WT/DS58/AB/R, para. 133.

174. In respect of energy this problem will not normally arise since there the resources to be protected are mostly present in the country imposing the measure (for example, clean air or human beings, animals or plants in the importing country).

175. Extra-territoriality could become an issue, however, if an ECT Contracting Party were to ban, for example, imports of nuclear energy, or electricity produced from nuclear energy, in order to protect the health of human beings (say, workers at the nuclear energy plant) or environment *in the country of origin*. Even if such extra-territorial protection would not be justified (an issue that is still left open in case law), the party imposing the measure could always attempt to establish a "sufficient nexus" between the "non-green" energy and its own territory, for example, by pointing at the cross-border effects of nuclear disasters on its own nationals and on the air they breathe.

(ii) Does the measure "relate to" the conservation of exhaustible natural resources?

176. Article XX(g) does not impose a "necessity test" as Article XX(b) does. The test under Article XX(g) seems less stringent. The measure can be justified as soon as it "relates to" the conservation of exhaustible natural resources (even if it is not "necessary" to that effect). In GATT case law, "related to" was rather strictly interpreted as meaning "primarily aimed at". In WTO case law, it seems that a softer approach was taken: what is required is a "substantial" or "close and genuine" relationship (that is reasonable and not disproportionate) of ends and means between, on the one hand, the "end" or objective of conservation and, on the other, the "means" or trade restriction imposed to achieve conservation.[70]

(iii) Is the measure made effective "in conjunction with restrictions on domestic production or consumption"?

177. It would not make sense to allow ECT Contracting Parties to block imports of certain energy in order to preserve clean air if, at the same time, they would not be doing anything similar in respect of domestic energy production or consumption. This clause of Article XX(g) has been defined as one of "even-handedness". Identical treatment of domestic and imported products is, however, not required.[71]

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70 Ibid., paras. 135-142.

71 Appellate Body report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, pp. 20-21.

(d) Measures that are necessary to secure compliance with laws or regulations which are GATT consistent (Article XX(d))

178. Article XX(d) allows for trade restrictions that are, *per se*, inconsistent with, for example, the MFN clause, but that are imposed in order to *enforce* other laws or regulations that *are* GATT consistent. It may allow, for example, for an import ban on counterfeited goods, i.e., imposed in order to enforce the protection of patent rights.

179. More relevant to energy trade, trade restrictions imposed to maintain a monopoly — that meets the requirements of other GATT provisions, in particular Article XVII discussed *above* – may also be justified. Indeed, import monopolies, for example, are allowed under GATT. To ensure such monopoly, restrictions on imports by other traders have to be imposed. Such restrictions are justified under Article XX(d).

180. Article XX(d) imposes a "necessity test" like the one imposed in Article XX(b). Only those restrictions "necessary" to enforce another GATT consistent law or regulation can be justified. If there are either (1) GATT consistent alternatives or (2) GATT inconsistent alternatives that are less trade restrictive than the one imposed and which are at the same time reasonably available, then the measure imposed will *not* be justified.[72]

(e) The introductory requirement or chapeau of GATT Article XX

181. As pointed out earlier, even if the conditions set out in any given paragraph of Article XX are met (for example, even if an import ban can be justified as a measure "relating to the conservation of exhaustible natural resources" under Article XX(g)), the measure may still not find justification under Article XX. This is so because also the requirement in the chapeau of Article XX – dealing with the *application* of the measure – has to be fulfilled.

182. The chapeau of Article XX requires that measures provisionally justified under any of the paragraphs of Article XX not be

> "applied in a manner which would constitute a means of arbitrary or unjustified discrimination between countries where the same conditions prevail, or a disguised restriction on international trade" (emphasis added).

183. This requirement was introduced to prevent that Article XX exceptions be abused (for example, by introducing so-called health measures that are, in effect, applied to restrict trade). It requires, in essence, that exceptions under Article XX be applied reasonably.[73] Note, indeed, that the "discrimination" referred to in the chapeau of Article XX is of a different nature than the

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72 Panel Report on *US – Section 337 of the tariff Act of 1930*, adopted on 7 November 1989, L/6439, para. 5.26.

73 Appellate Body report on *US – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, p. 22.

differential treatment of like products violating Articles I (MFN) or III (national treatment). The presence of the former type of discrimination (MFN or national treatment) does not prevent that the provisions in the chapeau of Article XX to be met (i.e., that there is *no* "discrimination" under the chapeau of Article XX). If this was not the case, Article XX would not be an exception to Articles I and III.

184. In two of the three WTO cases that so far addressed Article XX, the contested measure was found to fall under one of the specific paragraphs of Article XX; but fell short of meeting the chapeau of Article XX.[74] In the first case (*US – Gasoline*), this was so because there were alternative courses of action available to achieve the same objective (see *Box 8*). Support was also found in the fact that the country imposing the restriction had not pursued the possibility of entering into cooperative arrangements with the complainants in order to work out common standards.

185. In the second dispute (*US – Shrimp/Turtle*, see *Box 9*), the chapeau was construed as an application of the principle of good faith and against abuse of rights. A measure was said to be inconsistent with the chapeau of Article XX if it amounts to an abuse or misuse of an exception of Article XX, i.e., when the detailed operating provisions of the measure prescribe arbitrary or unjustifiable activity or when a measure is actually applied in an arbitrary or unjustifiable manner.[75] In that particular case, the fact that the restriction applied essentially the same policy, in a very inflexible way, to all exporting countries – a policy that required exporting countries to adopt essentially the same standards as those applied domestically by the US – even though the conditions in exporting countries may be very different, was found to constitute an unjustifiable and arbitrary discrimination.[76] The fact that the US had given different phase-in periods to meet its standards to different exporting countries and had made different levels of effort in transferring the technology to meet these standards to specific countries, further supported the Appellate Body conclusion of discrimination in the sense of the chapeau of Article XX.

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74 In the third case, *EC – Asbestos,* the Appellate Body found that the EC measure was not inconsistent with Art. III: 4 and was, in any event, justified under Art. XX. See footnote 63.

75 Appellate Body report on *US – Import Prohibition of Certain Shrimp and Shrimp Products*, adopted on 6 November 1998, WT/DS58/AB/R, para. 160.

76 Ibid., paras. 161-186.

Box 9 US import ban on shrimp to protect sea turtles

In one of the most important WTO cases so far, Malaysia, Pakistan and Thailand challenged a US ban on importation of shrimp and shrimp products from these countries. The US conceded that its import ban violated Article XI (prohibition on quantitative restrictions) but tried to justify it under Article XX(g).

The US argued that its ban was justified as one "relating to the conservation of exhaustible natural resources", namely sea turtles. The US submitted that its ban was in place to avoid that turtles would be killed in shrimp fishing nets. The complainants did not have turtle protection mechanisms in place similar to those applied in the US. To induce them to adopt such standards, the US refused their shrimp.

The Appellate Body accepted that the US measure as such was justified under Article XX(g), sea turtles being an exhaustible natural resource threatened with extinction. But it condemned the way the US applied its protective measure under the chapeau of Article XX. It did so, *inter alia,* because the US applied its measure in such a rigid way, not adapted to the particular circumstances of each exporter, that it constituted an "unjustifiable and arbitrary discrimination". The violation of Article XI was, therefore, not found to be justified under Article XX (Appellate Body report on *US – Import Prohibition of Certain Shrimp and Shrimp Products*, adopted on 6 November 1998, WT/DS58/AB/R).

(f) Prologue to the environmental exceptions under GATT in the context of the ECT

186. When addressing trade restrictions that are allegedly taken for environmental reasons account must be had also to certain ECT specific provisions. The ECT in much more explicit ways refers to the importance of protecting the environment in the energy sector.

187. Refer, for example, to Article 18 of the ECT on "Sovereignty over Energy Sources", explicitly stating the right to "regulate the environmental and safety aspects" of energy exploitation and development; and Article 19 of the ECT on "Environmental Aspects", which in a very detailed way elaborates on the obligation of ECT Contracting Parties' to "strive to minimize in an economically efficient manner harmful Environmental Impacts occurring".

16. Security Exceptions (GATT Article XXI)

188. Apart from GATT Article XX, there is another type of general exceptions available to ECT Contracting Parties that may allow them to deviate from other GATT provisions. These exceptions relate to an ECT Contracting Party's national security.

189. Article XXI(b) is most relevant to the energy sector, more particularly, trade in nuclear energy products. It allows ECT Contracting Parties to take action

> "which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived (ii) relating to the traffic in … implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment" (emphasis added).

190. On the basis of these exceptions, ECT Contracting Parties can, for example, impose export restrictions on nuclear energy and arguably certain other energy products also, if they can be proven to be exported for the purpose of supplying a military establishment.

191. Article XXI(b)(iii) and Article XXI(c) are more general in nature and not limited to nuclear energy or products of war. Article XXI(b)(iii) allows for trade restrictions, not limited to certain products, which an ECT Contracting Party "considers necessary for the protection of its essential security interests … taken in time of war or other emergency in international relations". It could be argued, for example, that this provision could justify export restrictions on energy products in the event of war or an international energy crisis.

192. Article XXI(c), in turn, allows ECT Contracting Parties to take action pursuant to its obligations under the United Nations Charter for the maintenance of international peace and security (Chapter VII of the UN Charter). If the UN Security Council imposes, for example, an oil embargo on a country, then an ECT Contracting Party is allowed to implement that embargo by banning all imports of oil from that country. Any violation of Article XI (prohibition of quantitative restrictions) would then be justified under Article XXI(c).

17. Exceptions provided to members of Customs Unions or Free-trade Areas (GATT Article XXIV)

193. As pointed out earlier, the GATT and its MFN principle imply that opening markets to foreign products increases efficiency and overall welfare, even if such opening is offered on a unilateral basis. At the same time, the GATT presumes that all WTO members will engage in negotiations and that all will, to one extent or the other, open their markets. Market access cannot be conditioned on reciprocity but if MFN were driven to the extreme a problem of so-called "free-riders" may occur, "free-riders" being countries that do not offer any market access themselves, but reap the benefits of all market access offered by other WTO members through the MFN principle.

194. This problem may particularly arise in case a limited number of WTO members want to speed up trade liberalisation to a much greater extent than other WTO members. To avoid that these other members "free-ride" on the market access offered by this limited number of "like-minded" countries, the latter are allowed to liberalize trade at a higher speed among themselves, without being obliged to extent such liberalisation to other WTO members. This clearly involves an exception to the MFN principle. But it is there to allow certain WTO members to *accelerate* trade liberalisation effort among themselves, there where other members are not ready for it; not to *slow down* their effort towards third countries.

195. This explains why Article XXIV allows for the formation of customs unions or free-trade areas and for the adoption of an interim agreement necessary for such formation. Indeed, there is no strict need to implement such regional arrangement overnight. Article XXIV:5(c) allows for interim agreements, as long as a plan and schedule for eventual formation *within a reasonable length of time* is set out.[77] As a result of the Uruguay Round negotiations an Understanding on the Interpretation of Article XXIV of GATT 1994 was added. Only paragraph 13 of that Understanding was incorporated into the ECT (Annex W (A)(1)(a)(i)).

(a) When is there a valid "customs union" or "free-trade area"?

196. A customs union is defined as the substitution of a single customs territory for two or more customs territories. For a single customs union to exist, two elements are required:

- First, "duties and other restrictive regulations of commerce" (with some exceptions) have to be eliminated with respect to "substantially all the trade" between the parties of the union (or at least trade in products originating in such parties). This means that "substantially all the trade" *between the parties* has to be free (Article XXIV:8(a)(i)).

- Second, "substantially the same duties and other regulations of commerce" apply in each of the parties of the union to trade with non-parties. This means that substantially the same trade policies have to apply in the entire union *with respect to trade with non-parties* (Article XXIV:8(a)(ii)).

197. In contrast, for a free-trade area to exist only the first condition above has to be met: "substantially all the trade" *between the parties* of the area has to be free (Article XXIV:8(b)). There is no requirement that the parties also align their trade policies *vis-à-vis third countries*.

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77 The relevant paragraphs of the Understanding on the Interpretation of Article XXIV do not apply in the ECT context, but it should be noted that paragraph 3 of this Understanding states that the "reasonable length of time" referred to in Article XXIV:5(c) "should exceed 10 years only in exceptional cases".

198. The notion of "substantially all the trade" has not been further clarified and a lot of controversy exists as to what it means. In a recent WTO case, the Appellate Body acknowledges this but added:

> "It is clear, though, that 'substantially all the trade' is not the same as *all* the trade, and also that 'substantially all the trade' is something considerably more than merely *some* of the trade".[78]

199. Reference could be made also to preambular paragraph 4 of the Understanding on the Interpretation of Article XXIV (not incorporated in the ECT) which states that the contribution of regional agreements to the expansion of world trade "is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished *if any major sector of trade is excluded*" (emphasis added). This indicates that no major sector should be excluded from liberalisation. The problem, of course, is that there is no agreed definition of "major sector" and the obligation is essentially exhortatory not mandatory. So a comprehensive Customs Union or FTA that excluded trade in energy products might meet the benchmark, but an "energy sector-only" agreement could not realistically claim to be consistent with Article XXIV of the GATT.

200. In other words, for ECT Contracting Parties to create a customs union only in respect of energy products, to the exclusion of all other products, would not seem to meet the definition of "substantially all the trade" (only some trade would be covered); unless in the improbable case, where energy trade is of such importance between the parties in question that it represents "substantially all the trade". In contrast, a valid customs union may still exist even if within that union not all trade in energy products is liberalised, as long as most other trade is free (not all trade would then be covered, but substantially all).

201. In addition to the "legal" tests explained above, GATT Article XXIV:5 also imposes an "economic test" for assessing whether a specific customs union or free-trade area is compatible with Article XXIV.

202. Article XXIV:5 requires that the "duties and other regulations of commerce" imposed by the customs union – or in the case of a free-trade area, by each of the constituent parties – *vis-à-vis trade with non-parties* be "not on the whole higher or more restrictive" than those imposed *prior* to the formation of the customs union or free-trade area. In other words, the effects of the trade measures and policies resulting from the regional arrangement may not be more

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[78] Appellate Body report on *Turkey – Restrictions on Imports of Textile and Clothing Products*, adopted on 19 November 1999, WT/DS34/AB/R, para. 48.

trade restrictive, overall, than those of the constituent parties *prior* to the arrangement. This refers back to the point made above, namely that regional arrangements "should facilitate trade within the [region], but it should *not* do so in a way that raises barriers to trade with third countries".[79] Paragraphs 2 and 3 of the Understanding on the Interpretation of Article XXIV (not incorporated in the ECT) includes a description of how the "before and after" evaluation of changes in the incidence of duties and non-tariff regulations of commerce should be carried out.

203. For a customs union or free-trade area to be consistent with Article XXIV all other paragraphs of that article must be satisfied as well (not just Articles XXIV:5 and 8). Paragraph 1 of the Understanding on the Interpretation of Article XXIV refers to "*inter alia*, the provisions of paragraphs 5, 6, 7 and 8".

(b) What measures otherwise inconsistent with GATT can be justified under Article XXIV?

204. In the circumstances of one particular dispute, the Appellate Body found that GATT Article XXIV can only justify otherwise GATT inconsistent measures,

(1) if those measures are introduced *upon formation* of a customs union or free-trade-area that *fully meets the requirements* in Article XXIV; and

(2) only to the extent that this formation would be *prevented* if the introduction of the measure in question were not allowed.[80]

205. Thus, to justify an otherwise GATT inconsistent measure under Article XXIV, an ECT Contracting Party will first need to prove that the measure was taken to form a customs union or free-trade area. To do so, it will need to show that the regional arrangement meets both the legal and economic tests set out above. Thereafter, the ECT Contracting Party will need to prove that without the measure in question it would have been prevented from forming a regional arrangement consistent with Article XXIV.

206. One could thus imagine that when an ECT Contracting Party imposes a zero import duty on energy products from within a customs union, but a 20 per cent duty on the same products from outside the union, such MFN violation is necessary to achieve a customs union, i.e., to free up trade within the union. This could be different if the ECT Contracting Party were to impose new quota restrictions on energy products from third countries (contrary to Article XI of GATT) allegedly in order to avoid that such products enter its market and, through it, freely enter the market of its regional partners; thereby circumventing the quota restrictions on these products imposed by its partners for third country imports. Such additional quota restrictions may, indeed, stream-

[79] Ibid., para. 57.
[80] Ibid., paras. 46 and 58.

line the trade policies of the union vis-à-vis third countries. But they may not be *necessary* for the formation of the customs union. Indeed, a GATT consistent alternative could be to adopt rules of origin, allowing the third country energy products to enter the market in question but from that market to only allow unrestricted exports to the other members of the union of energy products effectively originating in that market, not those imported from third countries. Since a GATT consistent alternative would be available, the measure could then arguably not be justified under Article XXIV.[81]

207. At the same time, it may be pointed out that Article XXIV:5, discussed above, implicitly recognises that the formation of a customs union may lead to a specific duty or non-tariff regulation of commerce becoming more trade-restrictive than beforehand in one or the other participant. What counts is the overall trade-restrictive impact. Article XXIV:5 does not require harmonisation on the least-restrictive prior situation.

(c) The relationship between WTO law and the law of a customs union/ free-trade area

208. For WTO purposes, no substantial difference is made between a piece of Norwegian legislation and an EC directive. Both are measures imposed by a WTO member and can thus be examined by a WTO panel for their conformity with WTO rules. The European Communities is a fully fledged WTO member, so its legislation is subject to panel scrutiny like any other piece of domestic law of any other WTO member. In principle, the WTO sees no hierarchy between, say, Belgian legislation and an EC directive. Of course, WTO panels may be called upon to interpret the Belgian legislation and in doing so may need to refer to the EC directive which, under Belgian law, may prevail over the Belgian legislation. But in principle, when considered separately and for purposes only of their WTO conformity, both have equal standing, namely the standing of domestic legislation that needs to be consistent with WTO law. The same would seem to apply in the ECT context.

209. EC measures can also be challenged under obligations incumbent on the individual member states of the EC, as was done exclusively in the GATT days (when the EC was not a Contracting Party). Furthermore, individual Member States of the EC remain bound by their obligations resulting from their own WTO membership. Hence, WTO members have the choice of starting a procedure against the EC as such or against one or more particular EC member states.[82] If the latter occurs, pursuant to internal EC rules, the EC will nevertheless defend the case.

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81 This was, in fact, the situation dealt with and condemned by the Appellate Body in *Turkey – Restrictions on Imports of Textile and Clothing Products*.

82 See e.g. the complaint by the United States on "Certain Income Tax Measures Constituting Subsidies" against France (WT/DS131/1), Belgium (WT/DS127/1), Ireland (WT/DS130/1), Greece (WT/DS129/1) and the Netherlands (WT/DS128/1).

210. Regulations of a customs union or free-trade area that is (unlike the EC) not in itself a WTO member will not as such be subject to WTO scrutiny since such regulations would not constitute the domestic law of a WTO member. Nevertheless, if the union or area consists of WTO members, these members will presumably have an internal instrument in place that gives effect to these regulations in their domestic legal system. These domestic instruments, implementing the regional regulation, will be subject to examination by WTO panels and can be found to be inconsistent with WTO law.[83] This would again seem to be the case also in the ECT context.

(d) The GATT applies also to measures taken by "sub-federal" authorities

211. GATT Article XXIV:12, read together with paragraph 13 of the WTO Understanding on the Interpretation of GATT Article XXIV, makes it clear that the GATT also applies to measures taken by regional and local governments and authorities within an ECT Contracting Party.

212. An ECT dispute settlement panel may thus examine such "sub-federal" measures and find that they are inconsistent with ECT rules. When found to be inconsistent with GATT rules, the ECT Contracting Party concerned has to take "such reasonable measures as may be available to it to ensure observance" of GATT by the sub-federal authority. Whenever such observance is impossible to achieve, the provisions on compensation and retaliation shall apply.

18. Exceptions in favour of developing countries

213. The GATT itself has a series of exceptions in favour of developing countries, such as GATT Article XVIII and GATT Part IV. These have not been incorporated into the ECT. A 1979 Decision taken by the GATT Contracting Parties, part also of GATT 1994, was, however, partly incorporated into the ECT.[84]

214. This 1979 Decision is commonly referred to as the "Enabling Clause". Paragraphs 1 to 4 of the "Enabling Clause" have been incorporated also in the ECT. This allows, in essence, developed ECT Contracting Parties to give tariff preferences to developing countries without being obliged to extend these preferences also to other (developed) ECT Contracting Parties. In addition, special treatment may be accorded to the least developed among developing countries.

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83 Panel Report on *Turkey – Restrictions on Imports of Textile and Clothing Products*, adopted on 19 November 1999, WT/DS34/R, para. 9.44.

84 Annex W, section A, para. 2(a) to the ECT. This 1979 Decision can be found in the GATT BISD Series Supplement 26, p. 203.

215. In other words, an ECT Contracting Party may have a so-called "General System of Preferences" ("GSP") in place granting special tariff reductions to developing countries (mostly not ECT Contracting Parties), for example, for imports of natural gas or oil originating in these developing countries. Pursuant to the MFN principle, other ECT Contracting Parties could claim the same tariff reduction. The Enabling Clause allows, however, such preferences to continue and to be restricted only to developing countries. It provides for an exception to the MFN principle.

C. OTHER WTO AGREEMENTS ON TRADE IN GOODS AS INCORPORATED IN THE ECT

1. GATT *versus* other WTO Agreements on trade in goods

216. GATT, the agreement outlined in the previous section, constitutes the main part of Annex 1A to the Marrakesh Agreement Establishing the WTO. In addition to GATT, this Annex 1A (entitled "Multilateral Agreements on Trade in Goods") also includes 12 other and more specific agreements on trade in goods. Eight of these 12 agreements have been partially incorporated in the ECT. The highlights of these agreements, as they may affect trade in energy, are set out below.

217. A General Interpretative Note to Annex 1A states that in the event of conflict between GATT and another, more specific, agreement on trade in goods in Annex 1A, the other, more specific, agreement will prevail to the extent of the conflict. In other words, in case an ECT Contracting Party were faced with contradictory rights or obligations under GATT and any other agreement on trade in goods (say, the Agreement on Technical Barriers to Trade), the right or obligation under the latter, more specific, agreement prevails. Conversely, if it is possible to comply with both the provisions of the GATT and of the relevant Annex 1A agreement, WTO members have to respect both.

2. The Agreement on Technical Barriers to Trade ("TBT Agreement")

(a) Why was the TBT Agreement negotiated?

218. With the gradual elimination of tariff-barriers through successive rounds of negotiations under the auspices of the GATT, existing non-tariff-barriers became more apparent as elements that restrict trade. With countries being prohibited to raise their customs duties above a certain ceiling, certain countries also imposed new technical barriers, not in an attempt to regulate trade, but in an attempt to protect domestic producers under the guise of technical standards. In other words, technical regulations, standards and conformity assessment procedures became a major trade disruptive factor.

219. One of the main objectives of the TBT Agreement is to root out those technical standards that are not genuinely enacted to protect health or safety or set objective product characteristics, but are introduced for protectionist purposes (for example, high standards on cleanliness of imported gasoline, allegedly taken to protect the environment, but actually introduced to keep out imported gasoline in order to protect domestic gasoline producers). At the same time, WTO members wanted to confirm the right of WTO members to impose technical measures in order to protect health or the environment or achieve other legitimate objectives.

220. In addition, as noted earlier[85], removing government restrictions on trade in energy products the way GATT prescribes it, will often not be sufficient to allow such trade to flow freely. In particular in the case of trade in electricity and gas, certain physical barriers remain that are inherently linked to the mode of transport of these products (grids or pipelines). Harmonisation of certain technical standards across borders, such as transmission standards, would thus be a major step ahead in stimulating trade in these products. In this respect, the fact that the ECT covers also energy-related equipment is crucial and harmonising technical measures in this field may significantly contribute to trade in energy.

221. This objective of harmonisation of technical standards is another important driving force behind the TBT Agreement. It was recognised that international standards and conformity assessment procedures can improve the efficiency of production and facilitate the conduct of international trade.

(b) When does the TBT Agreement apply?

222. The TBT Agreement applies to government measures that are either

(1) technical regulations (defined as a "document which lays down product characteristics or their related processes and production methods … with which compliance is mandatory")[86];

(2) standards (defined as a "document approved by a recognized body, that provides, for common and repeated use, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory)[87]; or

(3) conformity assessment procedures (defined as "any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled").[88]

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85 See paras. 30-31above.

86 Paragraph 1 of Annex 1 to the TBT Agreement (emphasis added), which continues: "It may also include or deal exclusively with terminology, symbols, packaging, marketing or labelling requirements as they apply to a product, process or production method".

87 Paragraph 2 of Annex 1 to the TBT Agreement (emphasis added), which continues: "It may also include or deal exclusively with terminology, symbols, packaging, marketing or labelling requirements as they apply to a product, process or production method".

88 Paragraph 3 of Annex 1 to the TBT Agreement.

223. TBT Articles 2 and 3 deal with technical regulations, Article 4 and Annex 3 (the so-called "Code of Good Practice") with standards, Articles 5-9 with conformity assessment procedures.

224. In terms of energy products and materials, it would seem that environmental standards on, for example, the maximum degree of pollution that can be caused by gasoline, are "technical regulations" subject to the TBT Agreement since laying down mandatory "product characteristics" to be met by imports of gasoline. The same could be said about mandatory requirements relating to the composition of natural gas or the flammability of petroleum products and related labelling requirements.

225. At this juncture one may recall that the ECT applies also to energy-related equipment. Especially in this respect, ECT Contracting Parties may impose technical regulations or standards may prevail. These may be different from one Contracting Party to another, thus constituting restrictions to trade in this type of equipment. Mandatory requirements setting out how energy-related equipment is to look like, be composed or operate may hence fall under the TBT Agreement. Technical specifications for the transmission or distribution of electricity or gas may also be covered. Although such specifications do not set out product characteristics of the electricity or gas itself, they may relate to the energy-related equipment involved.

226. The Appellate Body recently found that "[t]he heart of the definition of a 'technical regulation' is that a 'document' must 'lay down' – that is, set forth, stipulate or provide – 'product *characteristics*'", pointing out that such characteristics "might relate, *inter alia*, to a product's composition, size, shape, colour, texture, hardness, tensile, strength, flammability, conductivity, density, or viscosity". The Appellate Body also stressed that product characteristics "include, not only features and qualities intrinsic to the product itself, but also related 'characteristics', such as the means of identification, the presentation and the appearance of a product".[89] It noted also that product characteristics may be prescribed or imposed with respect to products in either a positive or a negative form, in the sense that products "must possess" or "must not possess" certain characteristics.[90] If a measure simply bans a product in its natural state, the Appellate Body noted that it might not constitute a "technical regulation".[91] On the other hand, it is not necessary that a technical regulation applies to given products which are actually named, identified or specified in the regulation, although it must be applicable to identifiable products.[92]

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89 *EC - Measures Affecting the Prohibition of Asbestos and Asbestos Products*, complaint by Canada, circulated on 12 March 2001, WT/DS135/AB/R, para. 67.

90 Ibid., para. 69.

91 Ibid., para. 71.

92 Ibid., para. 70.

227. It remains unclear, however, to what extent the TBT Agreement applies to "process and production methods", say, a restriction on the sale of electricity that is generated by nuclear power plants. Such restriction does not lay down "physical characteristics" to be met by electricity (electricity does not physically alter depending on the way it is generated). The regulation would seem to specify the "production method" to be followed in case electricity is to be allowed for sale on the market. One could argue that it hence lays down "product characteristics or their related … production methods", as specified in the TBT definition of a "technical regulation" in Annex 1, paragraph 1, and, therefore, the TBT Agreement applies to the regulation. On the other hand, one could submit that the regulation does not fall under this TBT definition since the "production method" in question, generation by means other than nuclear energy, is not "related to" product characteristics, as it would seem required in the Annex A, paragraph 1, definition.

228. It should be noted that all energy regulations and standards that do not fall under any of the three definitions above, are not subject to the TBT Agreement (although they may still be subject to the more general GATT, in particular GATT Article III:4). For example, pricing mechanisms in respect of electricity may, in effect, constitute a "technical" barrier to trade in energy for certain producers. However, since they do not relate to the electricity itself (not a product characteristic, nor a process or production method), the TBT Agreement does not apply.

229. The TBT Agreement applies to TBT measures introduced by central government bodies. In addition, WTO members are under an obligation to take such reasonable measures as may be available to them to ensure that also TBT measures enacted by local government and non-governmental bodies comply with the TBT Agreement.[93]

230. A non-governmental body is defined as a body "other than a central government body or a local government body, including a non-governmental body which has legal power to enforce a technical regulation" (TBT Annex 1, paragraph 8). Thus also technical regulations enforced by private organisations, say, privately run electricity or gas regulators, may fall under the TBT Agreement.

231. It should be recalled here that also the more general GATT applies to TBT measures but that in the event of conflict, the TBT Agreement prevails.

[93] TBT Articles 3, 4, 7 and 8.

232. So far only one dispute settlement panel examined the TBT Agreement. At the panel stage it was found, however, that the TBT Agreement did not apply to the measure at hand.[94] On appeal, the Appellate Body reversed this finding, concluding that the TBT Agreement did apply to the measure in question, but considered that it did not have an adequate basis to properly examine Canada's claims under the TBT Agreement so that it, in turn, provided no conclusions on Canada's claims under the TBT Agreement.[95]

(c) Basic rights and obligations under the TBT Agreement

(i) Non-Discrimination

233. TBT measures may not discriminate between domestic and imported products (obligation of "national treatment"), nor between one source of imports and another source of imports (obligation of "most-favoured-nation treatment").[96] In other words, a technical regulation prescribing how gasoline is to be composed may not be stricter for imports than it is for domestic gasoline, nor stricter for some imports as compared to other imports of gasoline. The same applies in respect of, for example, technical specifications imposed on pipes, containers, hydraulic turbines or electric generators covered in Annex EQ I as energy-related equipment falling under ECT provisions (including the TBT Agreement as incorporated).

(ii) Not more trade-restrictive than necessary

234. In addition, technical regulations may not be "more trade-restrictive than necessary" to fulfil a "legitimate objective". These "legitimate objectives" explicitly include: "national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment" (TBT Article 2.2). The list is, however, not exhaustive. For similar provision in respect of standards and conformity assessment procedures see, respectively, TBT Annex 3, para. E and TBT Article 5.1.2.

235. In other words, ECT Contracting Parties have a right to impose TBT measures and in doing so a right to choose for themselves what level of health, safety or environmental protection they want to achieve. It is not for the WTO to set this level. WTO rules recognise the right of WTO members to set their level of protection at the level they deem appropriate. But when ECT Contracting Parties select an instrument to achieve their objective, they have to make sure that it is not more trade-restrictive than necessary. For example, instead of specifying product requirements in terms of design or descriptive characteristics (for example, gasoline can include only a maximum of X percentage of ingredient Y),

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94 Panel Report on *EC - Measures Affecting the Prohibition of Asbestos and Asbestos Products*, complaint by Canada, circulated on 18 September 2000, WT/DS135/R.

95 *EC - Measures Affecting the Prohibition of Asbestos and Asbestos Products*, complaint by Canada, circulated on 12 March 2001, WT/DS135/AB/R, paras. 59-83.

96 TBT Articles 2.1 and 5.1.1 and para. D, Annex 3.

ECT Contracting parties could specify this requirement rather in terms of performance (for example, gasoline when consumed may not exceed ceiling X in terms of pollution or flammability; if it meets that ceiling it can be imported, irrespective of its ingredients).

(iii) Harmonisation and equivalence

236. The TBT Agreement further requires ECT Contracting Parties to use international standards "as a basis" for their technical regulations "except when [they] would be an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued".[97] There is no full consensus among WTO members on what constitutes an international standard. However, the TBT Committee recently agreed a set of principles for the development of international standards - these are transparency, openness, impartiality, consensus, effectiveness, relevance, coherence and the "development dimension".

237. The Agreement further encourages the granting of "equivalence" to another member's TBT measures. In other words, ECT Contracting Parties have to give positive consideration to accepting another Party's technical regulations, say, on gas or gasoline, even if these regulations differ from its own regulations as long as these other regulations would also adequately fulfil the environmental, safety or other objectives pursued.[98]

(iv) Transparency provisions

238. The TBT Agreement also includes a series of so-called "transparency" provisions.

239. A first set requires ECT Contracting Parties to inform other Parties of certain new TBT measures they plan to enact (by means of notification to the WTO/ECT) and to provide other Parties the opportunity to comment on these plans. This notification is only required if the measure may have a significant effect on trade and is not needed in case the measure is in accordance with international standards. In case of urgency, this "comments phase" prior to enactment of the measure may be conducted after enactment of the measure.[99]

240. A second set of provisions requires ECT Contracting Parties to explain or give justification for certain TBT measures, be they in preparation, adopted or already applied. For example, to explain at the request of another Party why it has chosen to deviate from international standards (TBT Article 2.5).

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97 TBT Article 2.4 and, similarly, in respect of standards and conformity assessment procedures TBT Articles 5.4 and Annex 3, para. F.

98 TBT Article 2.7. For conformity assessment procedures, there is a limited legal obligation (TBT Article 6).

99 TBT Articles 2.9-2.10 and 5.6-5.7 and Annex 3, paras. L-N.

Each Party is, more generally, required to set up a so-called Enquiry Point where information on TBT measures and matters can be obtained (TBT Article 10). ECT Contracting Parties are also obliged to publish TBT measures so as to enable other members to become acquainted with them.[100]

3. Trade remedy agreements: Anti-Dumping, Subsidies and Safeguards

(a) Overview

241. Notwithstanding the series of WTO rules, explained above, that oblige ECT Contracting Parties to open up their markets to trade with foreign countries, there may be situations where imposing trade restrictions (better referred to as "trade remedies") – other than those under the GATT exceptions set out earlier – are justified. There are essentially three types of situations that allow for such "trade remedies" to be imposed by ECT Contracting Parties. All three are covered in a specific GATT provision and have been further elaborated in Agreements in Annex 1A to the Marrakesh Agreement Establishing the WTO

242. Note that there is no *obligation* on ECT Contracting Parties to impose any of these "trade remedies". It is their *right* to do so (i.e., to impose anti-dumping or countervailing duties or to introduce safeguard measures). However, when Parties do decide to impose such remedies, they have to comply with WTO rules.

243. The three "trade remedy" regimes are outlined in Box 10 below.

[100] TBT Articles 2.11, 5.8 and Annex 3 para. O.

Box 10 Trade remedies

Anti-Dumping

Certain producers in ECT Contracting Parties may export their products to other Contracting Parties at a price below the "normal value" for such products. Since such practice, referred to as dumping, can hurt local producers in the importing country, that country is, under certain circumstances, allowed to impose "anti-dumping duties" on these "under-priced" imports. The right to impose these extra duties is the "trade remedy" provided to ECT Contracting Parties against dumping. This additional trade remedy is justified on the basis of "unfair trade" concerns.

Anti-dumping is dealt with in Article VI of GATT and in the WTO Agreement on Implementation of Article VI of the GATT, also referred to as the "Anti-Dumping Agreement".

Subsidies

In certain circumstances, subsidies are prohibited outright; in other cases they are only actionable**.** The most insidious forms of subsidies (namely, export subsidies and subsidies contingent on the use of domestic goods over imports) are prohibited ("red subsidies") and subject to countermeasures. Other subsidies ("actionable") are those, which can be maintained by ECT contracting parties, but are open to challenge by other ECT contracting parties if it is determined that they cause a trade distortive effect in that they allow the subsidized producers to sell their products on the local and/or world market at a much cheaper price thereby causing adverse effects to the interests of other Parties. (This adverse effect may be "serious prejudice", "injury" or "nullification or impairment of benefits".) On that basis, these other ECT Contracting Parties are authorized to impose "trade remedies" against those so-called "actionable" subsidies. These "trade remedies" may take the form of dispute settlement procedures before the WTO/ECT under which the subsidizing country, if the claim is accepted, may either withdraw the subsidy or remove the adverse effects caused by it. The "trade remedy" may also take the form of extra duty charged by the importing country on the subsidized products to offset the subsidy, referred to as "countervailing duties". Much like anti-dumping duties to offset dumping, this additional trade restriction is justified on the basis of "unfair trade" concerns. Originally there was a third, residual category of subsidies in the Agreement on Subsidies and Countervailing Measures, namely those that were considered as unlikely to cause harm to trade (the so-called "green" subsidies"). However, the operation of the provisions on this latter category has lapsed since 1 January 2000.

Subsidies and countervailing duties are dealt with in Articles VI and XVI of GATT and the WTO Agreement on Subsidies and Countervailing Measures.

Safeguards

A situation may arise where, as a result of unforeseen developments and WTO trade liberalising obligations, an ECT Contracting Party's market is being "inundated" by imports of particular products to such extent that it seriously affects domestic producers. For those situations, the "trade remedy" provided is the right to impose so-called safeguard measures on the particular product that is being imported in increased quantities. These safeguard measures may take the form of quantitative restrictions on imports of the product concerned (for example, quota's) or price-based measures (such as increased duties).

Safeguard measures are dealt with in Article XIX of GATT and the WTO Agreement on Safeguards.

244. The salient points of the three "trade remedy" agreements as they apply to energy (using the example of electricity) are as follows. The bottom-line question under the example is:

> "What can an importing ECT Contracting Party do against an influx of foreign electricity that would seem to harm local electricity producers?"

(b) Anti-dumping

245. The electricity in question may be "dumped". If there is "dumping" and it causes "injury" to the domestic industry in the importing ECT Contracting Party, then that Party may impose "anti-dumping duties" on the imported electricity, i.e., additional duties over and above customs duties, to an amount not exceeding the dumping margin.

246. To find out whether these two elements ("dumping" and "related injury") are met, a technically and procedurally complex investigation has to be initiated and conducted.

247. "Dumping" is defined as sale below "normal value". But what is "normal value"? The agreement narrows down the range of possible options. It provides three methods to calculate a product's "normal value".

248. The main one is based on the price in the exporter's domestic market. In other words, whether electricity is being dumped in one's market is not determined by the price of electricity in one's own market but rather the price of electricity asked in the domestic market of the exporter (hence, the fact that imported electricity is cheaper than domestic electricity does not mean that the imported electricity is being "dumped").

249. Since the benchmark to determine whether there is dumping is normally the exporter's domestic market, arguments related to "environmental dumping" are difficult to sustain. Imported electricity may be cheaper than domestic electricity because of a difference in environmental standards upheld in the importing *versus* exporting country. However, the "environmental cost" not calculated into the imports will not normally be calculated either into domestic electricity prices in the exporting country. Since the latter price is the benchmark to determine whether the former constitutes dumping, all things being equal, no dumping would then seem to take place.

250. When this first method cannot be used, two alternatives are available — the price charged by the exporter in another country, or a calculation based on the combination of the exporter's production costs, other expenses and normal profit margins.

251. Anti-dumping duties are imposed on a country-specific basis, with the possibility of specific duties for individual companies They are inherently inconsistent with the MFN principle, but justified if introduced consistently with GATT Article VI and the Anti-Dumping Agreement. Anti-dumping duties can only be imposed as long as they are necessary to offset dumping that causes injury. After five years they have to be withdrawn unless it is shown that their expiry is likely to lead to continuation or recurrence of dumping and injury.

(c) Subsidies

252. The Subsidies Agreement only applies to "subsidies" in the sense of a financial contribution by the government, or a form of income or price support, that confers a benefit to a specific enterprise or industry. In that sense, a government subsidy provided to all industries or individuals in difficulty, say, a lower tax on, or price for, certain energy products, would not seem to be a "specific" subsidy that falls under the Subsidies Agreement and hence be perfectly consistent with WTO subsidy rules.

253. The Agreement classifies subsidies into three categories. Firstly, those that are simply prohibited. These so-called "red" or "prohibited" subsidies are those linked to export performance or contingent on the use of domestic goods over imports. They can be challenged before the WTO dispute settlement system or be off-set by particular Contracting Parties by means of so-called "countervailing" duties to be imposed on imports thus subsidised (the latter can be done only in case the subsidy causes injury to the domestic industry of the importing party, see *infra* para. 255).

254. Thus, to come back to the example of imports of electricity, if the importing ECT Contracting Party can show that the imports of electricity are made possible by export subsidies granted by the exporting Party, then this subsidy is inconsistent with WTO rules and needs to be withdrawn. No proof of injury caused to the domestic industry is required. The mere fact that the subsidy is export-contingent suffices. If the subsidy is, indeed, the cause of the imports, then the withdrawal of it should increase the price of these imports (or stop imports all together). Subsidies provided by a Contracting Party contingent on the use of domestic over imported electricity inputs, thereby out-competing imports of electricity in that Party's market, are also prohibited. Again, no proof of injury to the domestic industry of the opposing Party is required. The subsidy is prohibited *per se*.

255. The second type of subsidies are those that are tolerated by the Subsidies Agreement but for which ECT Contracting Parties may be obliged to pay additional "countervailing" duties. These so-called "actionable" subsidies, if creating adverse effects to the interests of another ECT Contracting Party (for example, "injury" to the domestic electricity industry or "serious prejudice" to the interests of that Party), give a right to the other Party to either (1) get the subsidy condemned before the WTO/ECT dispute settlement mechanism (so that the subsidy needs to be withdrawn or compensation needs to be paid for its adverse effects), or (2) to impose countervailing duties on imports of elec-

tricity that have been so subsidized, to an amount not in excess of the subsidy. In other words, if the electricity in question was subsidized in the country of origin by a subsidy causing adverse effects on the importing country, then the importing ECT Contracting Party may impose countervailing duties to offset that subsidy. This should mean that the price of the imported electricity increases and hence the injury caused to domestic producers is alleviated.

256. It should be emphasized that in order for the subsidy to be actionable, it is not necessary that the subsidization cause trade distortion through importation of subsidized electricity. Indeed, according to Article 6 of the Subsidies Agreement, serious prejudice is deemed to exist when (1) the total ad valorem subsidization of electricity exceeds 5 per cent, or (2) subsidies are granted to the electricity industry to cover operating losses or (3) when there is forgiveness of government-held debt or and grant to cover debt repayment. In addition, serious prejudice may arise in any of the following cases:

(a) the effect of the subsidy is to displace or impede the imports of electricity of another ECT Contracting Party into the market of the subsidizing ECT Contracting Party;

(b) the effect of the subsidy is to displace or impede the exports of electricity of another ECT Contracting Party from a third country market;

(c) the effect of the subsidy is a significant price undercutting by the subsidized electricity as compared with the price of electricity of another ECT Contracting Party in the same market or significant price suppression, price depression or lost sales in the same market;

(d) the effect of the subsidy is an increase in the share of the subsidizing ECT Contracting Party in the international electricity market as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

257. Finally, the Subsidies Agreement originally foresaw a third type of subsidies, the so-called “green” or “non-actionable” subsidies. These were not only tolerated (like “actionable” subsides, but unlike “prohibited” subsidies); they could not be subject either to a negative finding in dispute settlement, nor to countervailing duties. There were basically three types of “green” subsidies: certain assistance (1) for research activities, (2) for disadvantaged regions and (3) to promote adaptation of existing facilities to new environmental requirements.

258. If, in other words, the imports of electricity were being subsidised with any of these “green” subsidies — for example, a lump sum subsidy granted by the government to electricity producers generating electricity with nuclear energy to adapt their generation process to new safety standards (in compliance with Article 8.2(c) of the Subsidies Agreement) — then the imports could not be made subject to “countervailing duties”.

259. Importantly, this third type of subsidies ("green" or "non-actionable" subsidies) no longer exists since 1 January 2001. Indeed, pursuant to Article 31 of the Subsidies Agreement, the articles pertaining to "green" subsidies (Articles 8 and 9) were to apply for a period of five years (starting on 1 January 1995) after which a decision to extend or modify these articles had to be taken. No such decision was taken so that the operation of these articles lapsed. Consequently, as of 1 January 2000 all specific subsidies are now either prohibited or actionable.

260. Although the expiration of these articles in the Subsidies Agreement was not explicitly incorporated into the ECT, it can be assumed that for ECT purposes as well these articles have lapsed. This lapse is not the result of an amendment to WTO rules. It is simply the result of WTO rules themselves, as incorporated in the ECT. Even if an analogy with WTO amendments could be made, pursuant to paragraph 10 (b) of Annex W, WTO amendments relating to incorporated provisions apply automatically in the ECT unless an ECT Contracting Party requests the Charter Conference, within six months of the circulation of a notification by the ECT Secretariat, to disapply or modify such amendment by a three-fourths majority decision.

(d) Safeguards

261. The sudden influx of electricity, under the example used here, may also be countered by so-called "safeguard measures". However, for the importing ECT Contracting Party to have a right to impose such measures, say, an extra duty on imports of electricity or even a quota on electricity imports, several conditions have to be met.

262. The product in question, here electricity, needs to be imported in such increased quantities and under such conditions as to cause or threaten "serious injury" to domestic (electricity) producers. The influx must also occur as a result of "unforeseen developments" and be the effect of WTO/ECT obligations notably those obliging the importing country to liberalize its (electricity) market.[101]

263. As in respect of dumping, safeguards can only be imposed once an investigation has been validly initiated and completed.

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101 So far four Appellate Body and panel reports have addressed the Safeguards Agreement: *Korea - Definitive Safeguard Measure on Imports of Certain Dairy Products*, complaint by the EC, WT/DS98**;** *Argentina - Safeguard Measures on Imports of Footwear*, complaint by the EC, WT/DS121**;** *United States — Safeguard Measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, WT/DS177/R, DS178/R, DS177/AB/R and DS178/AB/R; and *United states — Definitive safeguard measures on imports of wheat gluten from the European communities*, Complaint by the European Communities, DS166/R.

264. Unlike anti-dumping or countervailing duties, safeguard measures are not imposed on a company or even country specific basis. Safeguards are there to "safeguard" the domestic industry against a sudden increase in import quantities. They have to be imposed against imports of all origins, on an MFN basis. The instrument used (e.g., a tariff or quota) must be necessary (i.e., not more trade restrictive than required) to prevent or remedy serious injury and to facilitate adjustment. Certain measures cannot, however, be taken, as "safeguards", in particular the so-called "voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side".[102]

265. Safeguards are temporary and can be maintained only to the extent necessary to prevent or remedy serious injury. They should not normally be maintained for more than four years, unless it is shown that they continue to be necessary.

4. Market access agreements: Import Licensing, Rules of Origin, Customs Valuation and Preshipment Inspection

266. The remaining four specific WTO Agreements that have been incorporated into the ECT are mainly of a technical nature but have important practical consequences relating to the access to foreign markets for energy products.

(a) Agreement on Import Licensing Procedures

267. The Agreement on Import Licensing Procedures requires ECT Contracting Parties to keep their licensing procedures for the importation of energy products simple, transparent and predictable. The Agreement only applies to licensing procedures. These procedures are normally there to enforce a substantive trade restriction, such as a quota. The Agreement does not address the legality of the trade restriction itself (the quota).[103] It only aims at avoiding that the licensing procedure itself becomes a trade restriction.

268. Licensing procedures have to be neutral in application and administered in a fair and equitable manner. For example, the agreement requires governments to publish sufficient information for traders to know how and when the licences are granted. It also describes how countries should notify the WTO/ECT when they introduce new import licensing procedures or change existing procedures. The agreement offers guidance on how governments should assess applications for licences.

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102 See para. 118, last bullet-point, above.

103 See the Appellate Body Report on *EC - Regime for the Importation, Sale and Distribution of Bananas*, adopted on 25 September 1997, WT/DS27/AB/R, paras. 192-198.

269. Some licences are issued automatically, i.e., the licence is granted in all cases as long as the administrative formalities attached to it are met. Automatic licenses are allowed under the Agreement if certain criteria are fulfilled (if not, they are deemed to have trade-restricting effects and prohibited). For example, applications for automatic licenses when complete have to be approved within a maximum of 10 working days.

270. Other licences are not issued automatically. Here, the agreement tries to minimise the importers' burden in applying for licences, so that the administrative work does not in itself restrict or distort imports. The Agreement provides, for example, that the agencies handling licensing should not normally take more than 30 days to deal with an application — 60 days when all applications are considered at the same time.

271. Applying these rules to trade in, for example, natural gas, it may be that an ECT Contracting Party wants to monitor who is actually importing and how much. To that effect, it may require importers to apply for a licence with, say, the competent ministry or board. Such licence, where the only requirement to obtain it is to fill in certain data, would seem to be an "automatic licence", subject to the disciplines in Article 2 of the Agreement (for example, issuance of the licence within a maximum of 10 working days).

272. In contrast, an ECT Contracting Party may also have regulations in place that ban imports of certain types of natural gas or impose certain product specifications on natural gas imports. These regulations are substantive trade restrictions subject to the GATT and/or the TBT Agreement, discussed above. However, to enforce these regulations, importers may be required to fill in papers in order to control that imports actually meet the substantive regulations. This type of licensing would not be "automatic licensing". It is subject to Article 3 of the Licensing Agreement. There, the substantive regulation will not be examined. Rather, the disciplines of Article 3 apply to the paper work to be submitted in order to prove that one meets these regulations. This paper work or licensing procedure may not become a trade restriction in and of itself (for example, processing applications for the licence should not normally take more than 30 days).

(b) Agreement on Rules of Origin

273. "Rules of origin" are the criteria used to define where an (energy) product was made. They are an essential part of trade rules because a number of policies (validly) discriminate between countries: quotas, preferential tariffs, anti-dumping actions, countervailing duties and more. Rules of origin are also used to compile trade statistics and for "made in ..." labels that are attached to products.

274. The WTO Agreement on Rules of Origin only applies to rules of origin used in non-preferential commercial policy instruments. Countries setting up a customs union or free trade area are allowed to use different rules of origin for products traded within the union or under their free trade agreement.[104]

275. For the non-preferential instruments subject to the Agreement, the Agreement requires ECT Contracting Parties to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard (in other words, they should state what *does* confer origin rather than what does not).

276. For the longer term, the Agreement aims for common ("harmonized") rules of origin among all WTO members/ECT Contracting Parties. The Agreement establishes a harmonization work programme, which should have been completed by July 1998, based upon a set of principles, including making rules of origin objective, understandable and predictable. The work is being conducted by a Committee on Rules of Origin in the WTO and a Technical Committee under the auspices of the World Customs Organization in Brussels. The July 1998 deadline has been extended several times and work has still not been completed at the timing of writing.

277. The outcome will be a single set of rules of origin to be applied under non-preferential trading conditions by all WTO members/ECT Contracting Parties in all circumstances. The guiding principle for this harmonization exercise is that the country of origin is either "the country where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out" (Article 3(b) of the Agreement on Rules of Origin).

278. In respect of some energy products, the origin may be obvious since the product (say, coal, fuel wood or charcoal) will mostly be "wholly obtained" in one country. In respect of other energy products, specifying the origin may be more complex, namely in case the product, say, petroleum, was drilled in one country but further transformed in another. As soon as more than one country is involved in the production of a good, the rule is that the country where the "last substantial transformation" took place will confer origin. But what is a "substantial transformation"? This is what negotiators are deciding in the harmonization work programme. They are working out rules on a product by product basis.

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104 An Annex to the Agreement sets out a "common declaration" dealing with the operation of rules of origin on goods which qualify for preferential treatment (so-called "preferential rules of origin" not subject to the provisions of the Agreement itself).

279. In the most recent version of the "Integrated Negotiating Text for the Harmonization Working Programme", dated 13 March 2000[105], under Chapter 27 of the Harmonized System covering "Mineral fuels, mineral oils etc.", rules are provided, for example, on how to decide on the origin of "coal", "petroleum oils, crude", "natural gas" and "electrical energy". For the first three types of energy products the country of origin is that where the "coal", "petroleum oils, crude" or "natural gas" is "obtained in its natural or unprocessed state". For "electrical energy", it is the country in which "the electrical energy is generated".

280. In respect of many other energy products, such as "oils and other products of the distillation of high temperatures coal tar" and "petroleum oils and oils obtained from bituminous minerals, other than crude", "propane", "petroleum jelly", "petroleum coke", discussions are continuing with a view to decide which process should confer origin.

281. In addition, for some energy products, such as electricity or gas, it may be physically difficult to keep track of the origin of the product, given that the product may be put together in a transmission network or pipeline with physically identical products originating in different countries. However, given the physical identity of the different products it may not be necessary, in order to enforce origin-based trade policies, to actually keep track of the origin of each and every specific electron or gas molecule. What may be more important is to keep track of the origin of overall inputs in, and outputs from, the transmission network or pipeline and on that basis make overall assessments on, for example, customs duties to be imposed on a particular gas or electricity exporter.

(c) Agreement on Customs Valuation

282. For traders, the process of estimating the value of an (energy) product at customs presents problems that can be just as serious as the actual duty rate charged. Indeed, a 10 per cent customs duty on imports of natural gas may differ dramatically in absolute terms depending on how the value of natural gas is assessed by the customs authorities of the importing ECT Contracting Party.

283. The WTO Agreement on Implementation of Article VII of GATT 1994 (the so-called "Customs Valuation Agreement") aims for a fair, uniform and neutral system for the valuation of goods for customs purposes — a system that conforms to commercial realities, and which bans the use of arbitrary or fictitious customs values.

284. The primary basis for customs value of energy products under the Agreement is the "transaction value" of the good, that is "the price actually paid or payable for the goods when sold for export to the country of importation" (Article 1.1 of the Agreement on Customs Valuation).

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[105] WTO Committee on Rules of Origin, G/RO/41, JOB (00)/1573.

(d) Agreement on Preshipment Inspection

285. Preshipment inspection is the practice of employing specialized private companies (or "independent entities") to check shipment details — essentially price, quantity and quality — of goods ordered overseas. Used by governments of developing countries, the purpose is to safeguard national financial interests (prevention of capital flight and commercial fraud as well as customs duty evasion, for instance) and to compensate for inadequacies in administrative infrastructures.

286. The Agreement recognizes that GATT principles and obligations apply to the activities of preshipment inspection agencies mandated by governments. The obligations placed on governments which use preshipment inspections include non-discrimination, transparency, protection of confidential business information, avoidance of unreasonable delay, the use of specific guidelines for conducting price verification and the avoidance of conflicts of interest by the inspection agencies. The obligations of exporting members towards countries using preshipment inspection include non-discrimination in the application of domestic laws and regulations and prompt publication of those laws and regulations.

287. The Agreement establishes an independent review procedure. It is administered jointly by an organization representing inspection agencies and an organization representing exporters. Its purpose is to resolve disputes between an exporter and an inspection agency.

288. In respect of energy trade, it would seem that preshipment inspection, conducted in the country of origin of the energy product, will be relevant mostly to shipments of coal, petroleum and petroleum products, fuel wood and charcoal. In the event an ECT Contracting Party which imports such energy products uses private entities to conduct preshipment inspection in the exporting country, that importing Contracting Party, as well as the exporting Contracting Party, are bound by the obligations set out in the Agreement.

289. Given the physical characteristics of electricity and natural gas, in particular the fact that they cannot normally be stored, preshipment inspection would not seem to be an issue for these two energy products.

V. THE FUTURE? - TRADE IN ENERGY SERVICES AND GATS

A. RECALLING THE PRODUCT *VERSUS* SERVICES DEBATE IN THE ENERGY SECTOR

290. The problem of where to draw the line between energy goods and energy services was already referred to in paragraph 33 above.

291. This distinction is important also in the ECT context. What if an ECT Contracting Party enacts rules for the operation of the local transmission network by foreign companies? Is such a regulation affecting electricity as a good (since lack of access to the transmission network may mean also less imports of electricity) or is it rather a matter of trade in services, namely the transmission of electricity by foreign service suppliers? If the latter is true, the measure may fall outside the scope of current ECT trade rules since WTO rules on trade in services (GATS) have not been incorporated into the ECT.

292. For WTO purposes as well, it is crucial to know whether a measure is one affecting trade in goods or trade in services, or both. If it is trade in goods, GATT rules will apply. If it is a question of trade in services the more recently developed GATS will be relevant.

293. In this respect, it should be noted that the Appellate Body concluded that one and the same measure may fall under both GATT and GATS. There may, in other words, be overlaps between GATT and GATS, the two agreements not being mutually exclusive: "Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good".[106]

294. In the next section a brief description of GATS is provided. At some point in time, ECT Contracting Parties may also want to incorporate those rules, which are highly relevant to the energy value added chain.

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106 Appellate Body report on *EC – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted on 25 September 1997, para. 27. For a more recent WTO case dealing with the GATT/GATS overlap (confirming previous findings) see the Appellate Body Report on *Canada – Certain Measures Affecting the Automotive Industry*, complaints by Japan and the EC, adopted on 19 June 2000, WT/DS139/AB/R.

295. However and although GATS fully applies to trade in energy services, so far in the WTO few country-specific commitments have been made for this sector. Some countries, in particular the EC and the United States, have called for clarification with regard to the classification of energy services under GATS.[107] Pursuant to the built-in agenda for further negotiations in the services field, further negotiations for enhanced market access for energy services have started in January 2000.

B. BASIC PRINCIPLES OF THE WTO'S GENERAL AGREEMENT ON TRADE IN SERVICES ("GATS")

296. GATS (contained in Annex 1B to the Marrakesh Agreement Establishing the WTO) constitutes one of the three pillars of the WTO, besides the agreements on trade in goods and the agreement on trade-related aspects of intellectual property rights (respectively, Annex 1A and Annex 1C to the Marrakesh Agreement Establishing the WTO). For a country to become a WTO member it needs to accept all three of these agreements. In this sense, the WTO is a "single undertaking" and no opting out of any of these three agreements is tolerated. One either accepts all or one does not become a WTO member.

297. The legal structure of GATS is as follows. GATS itself includes 29 articles. Annexed to it are 8 annexes, most of them dealing with specific services sectors (such as telecommunications and financial services). Both GATS and its eight annexes (which form an integral part of GATS) are binding on all WTO members. In addition, each WTO member has its own schedule of specific commitments in which its market access, national treatment and additional commitments are set out. These commitments are specific to each WTO member but form an integral part of GATS. Finally, since the establishment of the WTO in 1995, four protocols have been added to GATS, dealing with financial services, the movement of natural persons and basic telecommunications.[108] These protocols are the result of continued negotiations called for in the annexes to GATS. The actual substance or results of these negotiations finds reflection not so much in the protocols themselves but rather in added commitments in the member-specific schedules.

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107 See, for example, Communication from the United States on Classification of Energy Services to the WTO Committee on Specific Commitments (under GATS), 18 May 2000, S/CSC/W/27.

108 The numbering of these protocols starts with two so that the last protocol to GATS (on financial services) is the fifth protocol. There is no first protocol to the GATS.

1. When does GATS apply?

298. GATS covers in principle all services sectors, including energy services, and all measures affecting trade in services. For practical WTO purposes all services are classified under one of 12 sectors (ranging from business and professional services, to distribution services and tourism, to "other").[109] There is no special category called "energy services" so that energy services are normally sub-divided under a range of service sectors. Measures affecting trade in services are those affecting one of four "modes" of supply (Article I):

(1) **cross-border supply**: services supplied from the territory of one WTO member to the territory of another (e.g., a consulting firm in country A providing advisory services related to energy management and efficiency to an electricity generator in country B)

(2) **consumption abroad**: services supplied in the territory of one member to the consumers of another (e.g., provider of tourism services in country A supplies his services, in country A, to consumers from country B)[110]

(3) **commercial presence**: services supplied through any type of business of one WTO member in the territory of another (e.g., a company of country A specializing in the transmission or distribution of energy services setting up a branch in country B)

(4) **temporary presence of natural persons**: services supplied by nationals of one WTO member in the territory of another (e.g., an engineer or other expert, national of country A, providing services to a company in country B in the field of energy resource identification, such as site investigation, site preparation or seismic studies).

2. Basic principles of GATS

299. Obligations under GATS consist of

(1) a set of general rules that apply to all WTO members across the board to all measures (and all four modes) affecting trade in services; and

(2) sector-specific commitments, for example, in the area of energy services or construction services, that may apply only to certain modes of supply, depending on the WTO member in question.

300. In addition, GATS sets out a number of exceptions, rules on further negotiations and institutional provisions (including provisions on dispute settlement).

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109 This classification, which was developed during the Uruguay Round of Multilateral Trade Negotiations, is contained in document MTN.GNS/W/120. Even though applied by most WTO Members for the purposes of scheduling their individual specific commitments under the GATS, this classification bears no legal status.

110 It is difficult to see the relevance of this mode of supply to energy services unless energy-related equipment were to be send abroad for repair or maintenance so that the foreign services provided in respect of the equipment are, in fact, consumed abroad.

(a) Main principles applying "across the board": MFN and transparency

301. The two main rules applying across the board, are: (a) the obligation to provide MFN treatment to all foreign services and foreign service suppliers, irrespective of their origin (GATS Article II); and (b) transparency (publication of measures and changes thereto, obligation to set up enquiry points, GATS Article III).

302. Departure from the MFN principle is only permitted for the measures listed in, and meeting the conditions of GATS Annex on Article II (MFN) Exemptions. A so-called "negative list" approach was taken: MFN applies across the board unless explicit exceptions were made by the member concerned at the time it became a WTO member. No exemptions can be added to that list once a country has acceded to the WTO (at that point MFN exemptions can only be obtained through a waiver under Article IX of the WTO Agreement).[111] All of the MFN exemptions in the Annex have to be reviewed (for the first time in 2000, a process currently under way) and should in principle not exceed a period of 10 years.

303. In addition, GATS includes general provisions, applying "across the board", on increasing the participation of developing countries (GATS Article IV), domestic regulation (imposing an obligation to have appropriate review mechanisms in place for administrative decisions that affect trade in services, GATS Article VI:2) and monopolies and exclusive service suppliers and private restrictive business practices (GATS Articles VIII and IX).

(b) Country and sector-specific commitments: Market Access, National Treatment and additional commitments

304. The country-specific commitments on market access, national treatment and additional commitments are at the core of GATS. Their impact does not so much depend on the provisions of GATS itself, but rather on the country-specific commitments made by each WTO member in its "schedule", i.e., the document attached to GATS for each WTO member setting out the specific and additional commitments that member has committed itself to in the Uruguay Round negotiations and thereafter.

305. In the service activities inscribed in a country's schedule, foreign services and service suppliers benefit from certain "market access" (GATS Article XVI), "national treatment" (GATS Article XVII) and/or "additional commitments" (GATS Article XVIII) in a number of specified sectors, subject to the limitations set out in the schedule.

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111 In addition, certain MFN violations can be justified under the GATS, like under the GATT, for reasons of health, national security, the creation of a customs union, etc, see *infra* para. 310.

306. In this respect, a "positive list" approach (only the sectors mentioned are committed) is combined with "negative list" aspects (only the limitations set out in the schedule apply). In other words, a member is only bound to provide "national treatment", e.g., to treat foreign suppliers of energy services the same way it treats domestic suppliers of energy services, if it has explicitly made such commitment in that specific sector and mode of supply in its schedule. The same applies to "market access". Only to the extent "market access" has explicitly been granted in the schedule for a specific sector and mode of supply, can it be claimed by foreign service suppliers. Both in respect of national treatment and market access, the limitations set out in the schedule apply, but only those limitations thus set out can be imposed ("negative list").

307. WTO members can also make so-called "additional commitments" with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters (for example, a commitment to follow international standards in respect of qualification and standards in a given services field).

308. In respect of "national treatment" there is guidance as to the required non-discriminatory treatment (proscribing *de jure* as well as *de facto* discrimination), but it is not further specified what substantive types of measures are prohibited in case commitments are made. By contrast, for "market access", GATS contains an exhaustive list of restrictions which members, which have made commitments in the field, are prohibited from making, unless such specific measures are mentioned as exceptions in the country's schedule. These market access restrictions are limitations on

(1) the number of service suppliers (e.g., only 5 foreign electricity distributors may operate in country A);

(2) the value of service transactions or assets;

(3) the total number of service operations or the total quantity of service output;

(4) the total number of natural persons that may be employed;

(5) types of legal entity; and

(6) foreign equity participation (e.g., a maximum equity participation in companies exploring oil).

309. In areas where specific commitments have been made, further GATS obligations are activated, such as those relating to domestic regulation (e.g., the obligation of reasonable, objective and impartial administration of measures of general application affecting trade in services, GATS Article VI:1), monopolies and exclusive service suppliers (GATS Article VIII) and payments and transfers for current transactions and capital transactions (GATS Article XI).

(c) Exceptions and further negotiations

310. GATS also contains provisions allowing for economic integration (GATS Article V, similar to GATT Article XXIV), labour markets integration agreements (GATS Article V bis), mutual recognition agreements (GATS Article VII) and restrictions to safeguard the balance of payments (GATS Article XII).

311. General exceptions and security exceptions, similar to those in GATT Articles XX and XXI, are set out in GATS Articles XIV and XIV bis.

312. Further negotiations are called for in the area of domestic regulation (GATS Article VI: 4), emergency safeguard measures (GATS Article X:1), government procurement (GATS Article XIII) and subsidies (GATS Article XV).

313. Pursuant to Part IV of GATS on progressive liberalisation, successive rounds of general GATS negotiations are also called for. The first of these rounds is currently under way.

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