6

The International Dimension of EU Energy Law and Policy

6.1 The Shaping of the EU's International Energy Policies: Players, Policy, and Issues

In the past, the EU's focus has often been markedly inward-looking. That is natural for a community of sovereign states engaged in the difficult process of integration and of developing, and accepting, joint institutions. There is little time to look outside when what happens inside is so absorbing. But the EU is not the sole inhabitant of a lonely planet, and this is nowhere less so than in the field of energy. Without energy the EU societies would not function, and most of the energy they use comes from abroad, and mostly from countries which are difficult, volatile, risky, have problems with human rights, the environment, and good governance—in short, not members in good standing of the community of 'civilised nations'.[1]

In the old world of state ownership and monopoly, energy was a strictly national matter, and companies went out as national champions to find coal, and later oil, sponsored and supported by their home government. This mercantilist approach—with governments trying to ensure security of supply by dealing with other governments—informed the energy policy of most EU countries until fairly recently, is visible in most of the EU's external energy actions of the past and is far from disappearing from the mindset of most agencies and people involved. If the going gets tough and energy supply anxieties arise, the state is expected to secure the supply, using all of its powers—the 1991 Gulf War may have had a legitimate basis in the defence of the integrity of an independent state against a neighbour's aggression, but it is unlikely to have happened if the Gulf had not been of principal importance to the energy security of both the US and the EU. But with the energy markets becoming both regional (e.g. electricity and gas) and increasingly global (e.g. oil, but also LNG and coal), the long-established connection between anxiously observed 'energy dependence' and strategic state, or EU-wide, action, to assure 'security of supply' is no longer automatic. Apart from during the two World Wars, serious supply disruptions have been extremely rare,[2] while

[1] As in Article 38 of the Statute of the International Court of Justice.

[2] The 2009 Russia-Ukraine gas crisis being the main example. For the background and consequences of this crisis, see: S. Pirani, J. Stern, and K. Yafimava, 'The Russo-Ukrainian Gas Dispute of January 2009: A Comprehensive Assessment', NG 27 (Oxford Institute for Energy Studies, February 2009)

'energy dependence' has relentlessly increased. Countries with very high degrees of energy self-sufficiency—e.g. the former Soviet Union—on the other hand, have done rather badly.[3]

The EU Green Paper on security of energy supply of November 2000 reflected this transition from a *dirigiste*, intergovernmental, and mercantilistic view of security of supply to a more market-based one. It detailed the energy dependence of the EU and concluded that the future would bring greater dependence on oil and gas imports. It also highlighted the significant contribution that coal (with better environmental technology) and nuclear power (with no effect on climate) could make, and identified the market-oriented steps to be taken to ensure a functioning market, both through market-facilitative institutions and instruments, and through support for investment in significant physical infrastructure (mainly pipelines and interconnectors). But the Green Paper was still mired in the self-absorptive perspective typical of EU institutions. While it identified 'dependence'—i.e. where oil and gas come from and are likely to come from in the future—it failed to make the necessary next step and ask not only what the EU expects, but also what the external parties' interests and constraints are, and how to strike deals based on a reciprocal congruity of interest. This same approach has characterized much of the EU's external energy action throughout the liberalization process. The external dimension of EU energy policy needs to be understood in internal and regional (e.g. eastwards, southwards) terms, as well as in terms of the global state of play of energy production, transport and supply.

Within the EU, the Directorate –General (DG) for Energy represents the technocratic energy focus, with greatest concern over energy flows to the EU, also defending its own international turf against other actors within the European Commission. Together with DG Competition, it is responsible for creating competitive markets, both in the EU and in the wider European territories. There is a special relationship—the application of EU energy law to the EEA countries (mainly Norway) to watch over. EEA countries have to incorporate EU internal market law (e.g. competition, internal trade law and the energy directives) as it evolves, with consultation, but no participation. As the largest oil and gas producer in Europe, but outside the EU, Norway is therefore now subject to EU energy and competition law. This became very clear in the *GFU* case,[4] which forced a significant change in the Norwegian gas trade with EU companies. While previously gas from Norway was traded through the gas negotiation committee, each Norwegian producer must now conclude separate contracts with EU buyers. But Norwegian

and A. Kovacevic, 'The Impact of the Russia-Ukraine Gas Crisis in South Eastern Europe', NG 29 (Oxford: Oxford Institute for Energy Studies March 2009). Unlike the 2006 crisis, the 2009 crisis and the consequent supply cut had severe but variable effects in the South Eastern Europe. In some countries, district heating was disrupted during a period of extreme cold. In other countries industrial activities were halted, with significant financial consequences. See A. Kovacevic, 'The Impact of the Russia-Ukraine Gas Crisis in South Eastern Europe', NG 29 (Oxford: Oxford Institute for Energy Studies March 2009).

[3] J. Mitchell (ed.), *The New Economy of Oil* (London: Earthscan 2001), pp. 176–207.

[4] COMP/36.072—GFU—Norwegian Gas Negotiation Committee.

energy policy has always been strongly statist and protectionist,[5] and its participation in the ECT negotiations focused on maximizing Norwegian carve-outs from the ECT liberalization policies. In addition to ensuring a privileged role for the state in oil and gas, the Norwegian policies on ownership of its greatest source of electricity—hydropower—also aims at ensuring public control over these resources.[6]

The EU's wider-ranging foreign policy interests include building economic collaboration with Russia and the Central Asian/Caucasus countries where energy is again a major factor in economic growth, ever-growing supply interest and investment interest for the EU, but also a source of internal and external tensions over control of oil and gas wealth. The EU's direct interest in border security also extends to those Mediterranean countries which have energy resources but are unstable—particularly Algeria, but also Tunisia and Morocco (oil transit), as well as Syria and Egypt (oil supply). Iran is also a key country in this regard, in terms of regional security, oil and gas supply from Iran direct, and in terms of its political and transit leverage over the countries involved in oil and gas production in the Caspian region (Azerbaijan, Turkmenistan, Kazakhstan, and Uzbekistan). Tensions with the West over nuclear power (and other issues) are complicating supply and providing a window of opportunity to Chinese energy companies. Turkey is a pivotal country, for reasons of regional security and transit from the Caspian, both through the Bosporus and through oil and gas pipelines (BTC oil pipeline but also many other oil and gas pipelines). Its relationship with the EU is unstable because of the uncertain fate of its accession requests. There are serious problems of cultural compatibility, both in terms of the EU's relationship with Turkey and in terms of Turkey's internal political make-up. The Middle East's role as a major supplier to the EU is likely to grow in the medium term and beyond, as North Sea oil and gas supplies fade and to the extent that Russian energy production is absorbed domestically as the Russian economy grows. Unconventional oil and gas will not be able to curb this trend, at least in the medium term. The Middle Eastern countries are all troublesome. Not one oil and gas producer in the Middle East (or the Mediterranean or Caspian region) reflects contemporary Western expectations of good governance, democracy, and respect for human rights. Violently divisive and modernized feudal structures predominate, although this might be changing with the events dubbed the 'Arab Spring'. At the time of writing, it is too early to tell. If there is a linkage between these values and political stability, then any of these countries can be thrown into political turmoil and external conflict, as was witnessed in spring 2011 (the 'Arab Spring'). If the EU takes seriously the resurgence, under a different label, of the 'civilised nation' concept, then it should not be doing business with countries like Syria—which are, however, crucial for the EU's energy supply. Whether Islam is a major risk factor for stable energy trade relations with the EU, or a factor which

[5] S. Anderson, *The Struggle over North Sea Oil and Gas: Government Strategies in Denmark, Britain and Norway* (Oslo: Scandinavian University Press 1993). This type of approach is of course understandable and well in line with many other resource rich countries. Why would you not extract maximum rent for your resources.

[6] Case E-2/06, *EFTA Surveillance Authority v The Kingdom of Norway*, Judgment of 26 June 2007, EFTA Court Report 2007, p. 164.

can stabilize the relationship based on mutual respect is an interesting question.[7] While the EU increasingly relies, with no realistic alternative in the medium term, on these problematic countries as major oil and gas suppliers, one should not forget that these countries themselves rely at least to an equal extent—and probably more so[8]—on exporting their energy. With growing demands from growing populations and with no realistic industrial alternative (although some developments suggest that this might change in the future), the oil and gas producers—whatever their regime and even during civil war, as in Libya—are in much more desperate straits: they do have to export to the market and if they do not or the price is too low, the thin fabric of their countries' institutions is immediately and seriously in peril. Just consider the recent investment wave in the Middle East and Northern Africa (MENA) region, largely initiated as response to unrest among younger members of the population: Saudi Arabia: $160 billion has been spent on new homes, decreasing education costs, stipends for students, 60,000 new jobs, increasing minimum wages; Kuwait: $5 billion cash handouts and free food; Oman: a 40 per cent increase in minimum wages; Algeria: pay increases for public workers, higher subsidies on food, job creation, new homes; and Bahrain: wage increases, increased food subsidies, increased social welfare allowances. All of this requires a high oil price, and exports.[9]

The EU is also involved in energy relations outside this circle of core interest, both of a political and of an energy-based character. West African countries (notably Nigeria and Angola) have acquired a growing role in energy (oil, LNG) supplies which requires nurturing. In Asia, the EU has encountered a large, growing. and competing supply interest (e.g. for Siberian, Central Asian and Middle East oil and gas), but also a market for investment and export of equipment and services. In Latin America, there is both a traditional cultural (Spain) and economic (UK, Germany) interest for the EU. In both Asia and Latin America, there is a strong, not always clearly visible, counter-interest in balancing the overwhelming US interest by developing relations with the more economically-focused and less power-oriented EU. The US itself is one of the relations to consider in energy matters. Traditionally, US international energy policy has been more assertive (e.g. the Gulf War) and more self-confident—i.e. less interested in consensual, multilateral solutions (e.g. the US forced entry into and then made a surprise exit from the Energy Charter Treaty).[10] Throughout the world, EU and US companies, often

[7] N. Oystein, *Oil and Islam: Social and Economic issues* (Research Council of Norway: J. Wiley & Sons 1997); Samuel Huntingdon's clash of culture prediction—S. Huntingdon, *The Clash of Civilisation and the Remaking of World Order* (New York: Simon & Schuster 1997)—is one way of looking at it, but the modern European way would rather tend towards respect and tolerance for Islam; Islam itself is torn between a need to modernize and fundamentalist tendencies which may in due time lead to a modernization of Islam incorporating Islam's traditional respect for property, contract, and trade.

[8] J. Mitchell (ed.), *The New Economy of Oil* (2001), pp. 177 and 203.

[9] P. Stevens, *The Arab Uprisings and the International Oil Markets* (London: Chatham House 2012).

[10] W. Fox, 'The United States and The Energy Charter Treaty: Misgivings and Misperceptions', in T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway forInvestment and Trade* (London: Kluwer 1998).

with home-state and EU support, compete for access to oil and gas acreage, investment, and sale of equipment and services—with US companies often hindered by the use of domestically-motivated US economic sanctions: e.g. against Iran, Libya, Cuba, or North Korea.[11] The US has also played a key role in the Caspian region and was largely behind the success of the BTC oil pipeline. The US involvement in the Nabucco project seems to be much less central, possibly because of the different geopolitical significance of the two projects. China is the most recent major and global participant in the energy game. With strong government backing and less concern for international sanctions, Chinese oil and gas companies have signed deals in places and for products like US shale gas, Canadian oilsands, Australian coalbed methane, Russian oil and gas, but also in more problematic places, including many African countries and Iran.[12]

It would be wrong to portray the relevant actors only within the traditional model of states and their strategies. EU (and US, perhaps even Chinese[13]) foreign policy is very much influenced by non-state actors. These include: non-governmental organizations (NGOs), which now represent themselves as the truest guardians of Western cultural values; multinational companies, which are now obliged to present themselves not only as profit machines, but as 'forces for good';[14] business organizations, which tend to represent the common denominator of corporate interest; and the press, through which the actions of all actors are filtered and magnified. Not all that is seen by governmental actors as good for business (e.g. the MAI negotiations up to 1998 or the ECT) is viewed in the same way by the companies themselves. Close corporate-government relations—e.g. between the former state company Elf and the French government—tend to give way to greater distance as international capital markets exercise more influence on corporate management than their home governments. International organizations in which the EU Member States or the EU itself participate develop at times a dynamic of their own, driven either by the secretariat or by a caucus of like-minded and similarly-oriented government delegates. Within WTO processes, the emphasis is on free trade; within the OECD, the emphasis is on free movement of capital; within the IEA, the emphasis is on identifying current trends and prospects and recommending governmental action, plus consultation with the producing countries; within the World Bank, the traditional emphasis on good project lending has given way to a much more diffuse effort to leverage lending to influence economic (and energy investment/privatization) policies and now the 'hard' imposition of 'soft' cultural policies (in relation to the environment, human rights, participatory democracy, and the eradication of

[11] T. Wälde, 'Managing the Risk of Sanctions in the Global Oil and Gas Industry', 36 *Texas International Law Journal* (2001), pp. 184–230 and K. Talus and M.A. Nunes, 'Regulation of Oil Imports in the United States and the European Union', 2 *OGEL* (2011), <http://www.ogel.org>.

[12] For the activities of Chinese oil and gas companies, and Chinese energy policies more generally, see the articles of Philip Andrew-Speeds on *OGEL* (<http://www.ogel.org>).

[13] For the drivers behind policies of Chinese oil and gas companies, see International Energy Agency, Overseas Investments by Chinese National Oil Companies: Assessing the drivers and impacts (IEA 2011), pp. 25–8.

[14] J. Mitchell (ed.), *Companies in a world of conflict* (London: RIIA 1998), pp. 209 et seq.

poverty).[15] In UN fora (e.g. in particular United Nations Conference on Trade and Development (UNCTAD)), where the EU participates, but is not in a position of strength, the emphasis is rather on defending developing countries against the imposition of economic and now cultural policies mainly representing the Western countries. A critical assessment of liberalization and privatization in markets which may not be ripe for this, and a proposal for *quid pro quo* energy trade deals, is developed here.[16] The financial institutions (the World Bank, mainly under US influence; European Bank for Reconstruction and Development (EBRD)—under European, but not EU influence; European Investment Bank (EIB)—under EU influence) have their own policy contribution to make.[17] In the energy field, their role lies in exercising financing leverage to obtain favourable investment terms and in supporting infrastructure facilities for which private banks are by themselves and without public guarantees not ready. Generally speaking, the Member States prefer to retain their national powers and influence over international institutions like the IMF or the World Bank, and the role of the EU is reduced to that of seeking to reconcile the divergent opinions of its Member States.[18]

With OPEC, the EU has a dialogue (but possibly one of the deaf); both OPEC and EU environmentalist (and tax) interests are in favour of the consumer paying a high oil price, but they differ on who is to collect the rent (OPEC prefers taxes and high prices in favour of the producing country; the EU high consumption taxes in favour of EU Member States). OPEC is, however, politically very useful to the EU. First, it contributes, now perhaps more effectively than in the past, to the maintenance of reasonably high and stable oil prices by better production control. Secondly, because it is outside the jurisdiction of EU law and not vulnerable to internal EU political and public pressure, it serves where necessary as a convenient scapegoat for high energy prices. In a way, it now does the dirty business for consumers and international oil companies, neither of which, for competition law and public opinion reasons, can do it themselves.

Given the multitude of fora and elements in EU international energy policy, and the legal instruments deployed, its approach is not always to achieve a carefully planned outcome of a political process through a unitary actor such as the European Commission. In practice, the policy that emerges is rather the unplanned—and in fact unplannable—result of many players acting both within and outside the EU. The particular measures taken often require consent and involvement by outside actors. In most cases, these measures are generated by coalitions of like-minded actors:[19] e.g. climate change policies by officials from DG Climate Action, DG Energy, and DG Environment, environmental ministries, NGOs and executives from climate-change divisions in major energy companies, international energy

[15] H. Bergesen and L. Lunde, *Dinosaurs or Dynamos? The United Nations and the World Bank at the Turn of the Century* (London: Earthscan 1999).

[16] UNCTAD, *Energy Services in International Trade: Development Implications* (10 April 2001).

[17] For criticism, see in particular the work of Joseph Stiglitz.

[18] D. Chalmers, G. Davies, and G. Monti, *European Union Law* (Cambridge: CUP 2010), p. 639.

[19] R. D. Putnam, 'Diplomacy and Domestic Politics: The Logic of Two-level Games', 42 *International Organization* (1988), pp. 427–60.

policy/legal assistance from linked groups in DG Energy, DGs with international focus (from development to trade to foreign policy), aid industry lobbies, NGOs and institutional and individual beneficiaries in the recipient countries. It is not surprising that the EU's international policy in the energy field is sometimes contradictory, with the transnational environmental coalitions transcending organizational borders producing multilateral environmental agreements (MEA) calling for trade restrictions, while the corporate-Commission trade-focused groups produce treaties and WTO panel-based trade law aimed at excluding MEAs.[20] In this process, certain dominant themes are generally present, though these are often dominant only in their particular arenas. These include energy security for DG Energy, integrated competitive markets for DG Competition, climate change for DG Climate Action and DG Environment, and building stability by economic and energy investment in former Soviet countries[21] and the Mediterranean for the internationally focused DGs. Development aid plays a role here, but EU development aid suffers from lack of focus and the tension between 'selfless' aid, on one hand, and more 'selfish' aid tied to the donor's interest, on the other, with no clear understanding as to which approach is in the final analysis better for both donor and recipient. New themes pervading all other activities relate to the current enthusiasm for exporting Western cultural values to, and imposing them on, countries which do not conform to Western governance concepts—i.e. a revived form of nineteenth century concepts of missionary colonialism and the civilizing mission of the West. There are also more technical imperatives for external EU energy action: some issues (e.g. global warming) require global action, though national and EU-wide policies can serve as a laboratory for global policies (and provide a competitive advantage to EU companies thus forewarned of regulations to come). The chief example of this is the EU emissions trading scheme, though this scheme is used as an example both by those in favour of such a scheme and by those opposing it.[22]

As global energy markets emerge (as is already largely the case for oil and to some extent now for gasoline, LNG, coal and—more slowly—pipeline gas), regulatory solutions have to be found,[23] and EU external energy policy will then be about creating a global regulatory framework. The harbingers of such developments are the—as yet unsuccessful—efforts to create a global investment code. The pooling of regulatory powers in the form of EU economic (including energy) law should only be a first step to pooling global regulatory powers in international institutions, although the resistance observable in the EU is likely to be even more

[20] T. Wälde, 'Sustainable Development and the 1994 Energy Charter Treaty: Between Pseudo-action and the Management of Environmental Investment Risk', in F. Weiss et al. (eds), *International Economic Law with a Human Face* (London: Kluwer Law 1998), pp. 223–71.

[21] T. Wälde, 'International Good Governance and Civilised Conduct among the Caspian Sea States: Oil and Gas Lever for Prosperity of Conflict', in W. Ascher and N. Mirovitskaya (eds), *The Caspian Sea: A Quest for Environmental Security* (London: Kluwer 2000), pp. 29–51.

[22] This has been the case in, for example, Australia.

[23] For an international regime for cross-border pipelines, see C.I.A. Siddiky, *Cross Border Pipeline Arrangement: What Would a Single Regulatory Framework Look Like?* (London: Kluwer Law International 2011).

intensive on a world scale, and thus progress is likely to be very gradual. In the fullness of time and an ideal world, external EU energy law should be nothing but a regional component of international energy law.

6.2 The Legal Instruments and Legal Authority of the EU's External Energy Policy

To pursue its energy goals, the EU primarily uses treaties and money. Treaties create a network of legal—and thus also political and administrative—obligations and procedures with the partner countries. No systematic analysis of the role of energy in such treaties has so far been conducted.[24] While energy is mentioned in most treaties of the economic cooperation type, it is rarely the focus of such a treaty.[25]

For a long time, the 1994 Energy Charter Treaty was the only treaty dedicated to energy to which the EU had acceded, and only in 2005 was the Energy Community Treaty signed. It should be no surprise that the majority of the language in the more general treaties amounts to friendly expressions of goodwill with respect to trade, investment, and the environment—and in the more recent treaties (e.g. the 2000 Cotonou Agreement, etc.), good governance, civil society, and human rights are also mentioned.[26] Specific legal obligations are thin on the ground in these treaties, and mostly relate to trade. Energy trade has only recently become a more significant topic in EU treaty negotiations. One can perhaps understand EU treaty-making as, first, an effort to develop a significant, and acknowledged, foreign policy role, hamstrung by the absence of the traditional levers used to project political and military power abroad. Secondly, it is based on the explicit or implicit strategy to develop 'reasons to talk' with governments of interest to the EU. Treaties thus involve a process of dialogue, from negotiation to the stage of implementation, which in most cases is rather about discussing with governments the general, hortatory principles contained in such treaties.

Traditionally, international law is regarded as a creation made for states by states as the principal actors in international law and international legal relations. The emergence of the EU as a significant actor in international law and policy results from developments at both internal EU level (legal personality with the Treaty on the EU and growing competence to act within those areas specifically conferred to it by the Member States) and international level (the general recognition of the EU

[24] This is particularly so at bilateral level. On the environmental front, this type of study was carried out by Gracia Marin Duran and Elisa Morgera, see G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012).

[25] This is the case even with the major energy exporting countries. See, for example, Euro-Mediterranean Agreement establishing an Association between the European Community and its Member States, of the one part, and the People's Democratic Republic of Algeria, of the other part, OJ L 265/2, 10.11.2005.

[26] Article 9 of Cotonou Agreement refers to human rights, democratic principles, and rule of law. (The Cotonou Agreement was revised in 2005 ([2005] OJ L 209/27).)

as an international actor[27]). The EU[28] has legal personality (Article 47 TEU) and by default also has international legal personality. It can therefore act on the international stage as a state-like actor. This means that it can conclude international agreements without the signatures of Member State representatives—although Member State interests are guarded by the Council of Ministers, which takes decisions alone or jointly with the Parliament (Article 218 TFEU, for common commercial policy, Article 207 TFEU). It can also take trade measures, such as imposing anti-dumping regulations. International agreements concluded by the Union are binding both on the institutions of the Union and on its Member States.[29]

Given the innovative nature of EU as an actor in international stage (not really a federal state—yet, at any rate—but not really an international organization either), triggered some debate at first, but the initial difficulty of the EU acceding to international law instruments has been solved by defining the EU as a 'Regional Economic Integration Organisation'. Today, the EU is a full member of numerous international organizations like the WTO. In other organizations, like the OECD it plays a less formal, but in practice often an influential, role.[30]

The EU's external competences are based either on the explicit authority of the Treaty or are the external manifestation of internal powers ('external/internal parallelism'). Article 216(1) TFEU invests the EU with competence to conclude international agreements where this is necessary in order to achieve one of the objectives of the EU or is provided for in a legally binding act of the EU or is likely to affect common rules or alter their scope.[31] In the *Open Skies* judgments of 5 November 2002,[32] the Court did note that an international agreement was not necessary in these cases and that it had not been demonstrated that the internal competence could effectively have been exercised only at the same time as the external competence. However, in those cases the second option applied—i.e. the EU's exclusive competence arising from a legally binding act of the EU. The judgments in these cases clearly meant that, because the EU had exclusive competence with regard to certain aspects of international air services, Member States could no longer enter into international agreements themselves.

[27] G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), pp. 6 and 7.

[28] More generally, see D. Chalmers, G. Davies, and G. Monti, *European Union Law* (Cambridge: CUP 2010), pp. 630–73.

[29] Article 216 (2) TFEU. This provision has been interpreted to extend to customary international law and general principles of international law (Cases C-T-115/94, *Opel Austria v Council* [1997] ECR II-39 and C-162/96, *Racke & Co v Hauptzollant Mainz* [1998] ECR I-3655).

[30] Supplementary Protocol to the Convention on the OECD of 14 December 1960, the signatory countries agreed that the European Commission should take part in the work of the OECD. European Commission representatives work alongside Members in the preparation of texts and participate in discussions on the OECD's work programme and strategies, and are involved in the work of the entire Organization and its different bodies (see <http://www.oecd.org>).

[31] Case 22/70, *ERTA* [1971] ECR 263.

[32] Court cases C-466–469/98, C-467/98, C468/98, C-469/98, C-472/98, C-475/98, and C-476/98 of 5 November 2002. See also Communication from the Commission on the consequences of the Court judgments of 5 November 2002 for European air transport policy (COM/2002/0649 final).

Articles 2 to 6 TFEU distinguish explicitly between 'exclusive', 'shared', and 'supportive' EU powers. In this context, energy appears as a 'shared' competence (Article 4(2)(i) TFEU), which is specified under title XXI (Energy) and in Article 194 TFEU. With the emergence of more and more detailed and comprehensive EU energy law through the three packages of energy directives and Article 194 TFEU, there are more and more areas where there are strong arguments for exclusive EU competence to conclude treaties with respect to energy. This is clearly the case in certain other areas of energy: mineral oil, natural gas, and even electricity are goods which are subject to trading and can therefore fall within the scope of the Common Commercial Policy under Articles 206 and 207 TFEU. The Common Commercial Policy is an exclusive competence of the Union in the sense of Article 3(e) TFEU. In this context, the European Parliament's involvement in the formulation of the EU's Common Commercial Policy, insofar as its consent is now required, is a significant change brought about by the Lisbon Treaty.[33]

The second major instrument of EU international energy policy is money, mainly funds allocated to technical assistance projects in the energy field. The EU regularly requires a treaty before committing to the provision of technical assistance (the older term is 'development aid') funds. Treaties and money thus complement each other. Technical assistance provided under the manifold and (regrettably) periodically changing EU-typical acronyms, like TACIS, PHARE, SYNERGIE, ALTENER, SAVE, INOGATE and others serve multiple purposes. They are intended to help the recipients obtain expertise which they do not have and cannot pay for themselves. They represent a means of influencing partner countries' policies in the EU direction. They provide work for the large EU consultancy industry. They help this industry and larger EU companies to penetrate new markets, often in competition with US (USAID) technical assistance pursuing a similar strategy. Their main benefit is probably that they facilitate the emergence of knowledge-based networks (consultants, academics, officials, corporate executives, NGO experts, specialized press), privileging the outreach of EU specialists.

Treaties (and money) never deliver what they promise in their high-sounding preambles and press releases. They are often not taken seriously on both sides: their hortatory language, replete with expressions of goodwill, friendship, and morally welcome purposes, lack direct impact. Nevertheless, it would be wrong to deny the usefulness of these instruments. Deployed *en masse*, they project the EU as a prosperous partner with overwhelmingly cooperative and commercial interests. The web of treaties and the professional networks created by technical assistance are a conduit for channelling EU influence through concepts, methods, models, precedents, and best practices to countries which need such models and are unable to develop effective approaches to governance on their own. The EU's influence on partner countries' energy policies is therefore rarely a matter of power and direct pressure, but of persuasion and intellectual osmosis facilitated by trust and the common quest for peace and prosperity. It is not the way of hard power, but rather that of collaborative dialogue.

[33] See Article 218(u) and (v), and Article 207(2) TFEU.

6.3 Technical and Financial Assistance Programmes

With its technical and financial assistance programmes, the EU tries to influence partner countries' energy policies in an EU-friendly direction: liberalization, the opening-up of the energy industries for (preferably EU) investment, increased trade relations (the export of EU equipment and services, import of partner-state oil and gas), better environmental performance—particularly in relation to greenhouse gas emissions and other emissions with a cross-border effect on EU environmental quality (e.g. air pollution, the survival of forests)—and nuclear safety. This sometimes direct, but more often informal, underpinning of EU assistance is not necessarily in conflict with the overall objectives of host states. Most of the countries which have an energy relationship with the EU—i.e. Russia and various countries in Central Asia, the Mediterranean, the Middle East and West Africa—are mired in systems of economic governance which obstruct development: communist organizational structures and attitudes[34] have been inherited and not replaced by a functioning market and a system of institutions and culture which supports the market.[35] The problem with most of these projects is not that they are supposed to preach EU principles and policies, but that their duration and impact is typically short, minimal, and localized. There seems to be no systematic reflection and strategic planning as to what the EU wants to achieve and how it is to be done, given the ever-complex circumstances of post-communist and developing countries where advice (rather than the perquisites of foreign aid) is often not wanted—at least, not by the right people—is not professionally rendered, relies more on the recounting of EU systems than on transposing concepts and experience to the often very different host state context, and is rarely absorbed with lasting effect. This problem affects the grant of all technical assistance in such circumstances (e.g. World Bank, UN, EBRD, bilateral agencies: DFID (Department for International Development) in the UK or GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit) in Germany), but may be particularly acute in the case of the EU, which lacks systematic in-house expertise on the giving of policy and legislative reform advice. While DG Energy (and other DGs) does have energy expertise,[36] it is elusive and not effectively transferred. It is sometimes hard to avoid the impression of a giant funding system operating without a focused and expert mind watching over such activities and learning from them. Managing administrative challenges seems to prevail over the more relevant challenge of thinking seriously about real, rather than purely formalized, objectives.

[34] See T. Wälde and J. Gunderson, 'Legislative Reform in Transition Economies', 43 *International & Comparative Law Quarterly* (1994), pp. 347–79, T. Wälde and C. von Hirschhausen, 'Legislative Reform in the Energy Industry of Post-Soviet Societies', in R. Seidman, A. Seidman, and T. Wälde (eds), *Making Development Work: Legislative Reform for Good Governance* (London: Kluwer 1999).

[35] M. Olson, *Power and Prosperity* (New York: Basic Books 2000).

[36] It is also worth noting that after the Lisbon Treaty the only DG responsible for implementation of instruments of EU external assistance is DG for Development and Cooperation (EuropeAid).

6.3.1 Examples of Earlier Cooperation Programmes

6.3.1.1 SYNERGY, PHARE, and TACIS

SYNERGY was a cooperation programme managed by the DG for Transport and Energy (DG TREN). It financed cooperation activities with non-EU countries relating to the formulation and implementation of energy policy. The scheme was based on earlier energy-related cooperation projects following the oil crises of the 1980s, beginning with the 'EC International Energy Co-operation Programme', which then evolved into the SYNERGY programme. SYNERGY was the international cooperation component of the 'Energy Framework Programme' which ran from 1998 to 2002. SYNERGY's aim was to improve the competitiveness of EU industries, enhance security of supply, promote sustainable development, and improve energy efficiency. Its guidelines[37] stated that the implementation of the programme should refocus on activities related to security of supply and the implementation of the Kyoto Protocol. Unlike other EU programmes, which were of a more general nature and included energy as one of several aims, SYNERGY was a specific energy policy programme covering the external dimension of EU actions in the energy policy sector.

PHARE can be characterized as the main channel for the European Union's financial and technical cooperation with Central and Eastern European countries (CEECs). It focused on preparing the then candidate countries for EU accession. In the energy field, this meant review of the regulatory and institutional situation in the CEEC countries to bring them—by legislative reform, institution-building, and training—into conformity with EU energy law. The EU energy directives, the Energy Charter Treaty and EU competition law were perhaps the most relevant benchmarks for reform of the energy sector in Eastern Europe. Support for a twinning mechanism between partner institutions was also provided.

In the end, these programmes were about creating professional networks, explaining the rationale, methods, and concepts of the energy directives and helping the accession countries gradually to reach a similar stage, first formally, and then, hopefully, also with proper understanding and absorption. The main weakness of most projects was their short-term nature. Developing a relationship of reciprocal understanding between the EU and the CEEC partner takes a year—by which time the project had usually come to an end. The cumbersome nature of the procurement machinery meant that the largest amount of funds and time was not spent on professional communication across often substantial cultural borders, but on dealing with the Commission's departments. The development of long-term partnerships between competent institutions—the only effective way to build a productive professional and intellectual partnership—failed to occur.

[37] Council Decision of 9 April 2001 laying down the new guidelines applicable to actions and measures to be taken under the multiannual programme to promote international cooperation in the energy sector (1998 to 2002) under the multiannual framework programme for actions in the energy sector and connected measures, OJ L/125, 5.5.2001, pp. 24–6.

The EU TACIS programme provided technical assistance to Russia and other post-Soviet countries.[38] The stated objective was to facilitate the transition to a market economy and to reinforce democracy and the rule of law. In the former Soviet Union, the situation was again very different from the accession countries. Here, there were sometimes, or even usually (except in the case of Ukraine), ample national reserves and production. The issue was rather that of how to create a regulatory regime that would encourage investment in upstream oil and gas development, fair access to transportation pipelines, and market-based incentives for efficient production, transport, and consumption. At all levels, these clear objectives were confronted by Soviet-style obstruction, involving: extensive resentment against foreign investment in Russia; an opaque, volatile, and corrupt culture interposed between investor and the government's licensing system; the absence of a culture of trust, commitment, and law; and a very close relationship between business and state, which prevented the state from regulating effectively and prevented business from focusing on commercial and competitive performance. The policy requirements here were very different. The energy directives had only limited usefulness as benchmarking models. The Energy Charter Treaty, with its emphasis on the introduction of a market economy, respect for property, non-discrimination, and access to transit and transport facilities, was probably more relevant at this stage.

Russia did not need to manage the importation and distribution of energy (as did the CEEC countries), but rather to produce and distribute more efficiently. Furthermore, it was not—and never will be—a candidate for EU accession, given that it is very large and has a tradition of perceived supremacy. The EU model should therefore have been offered, not on the basis of the obligation to adopt EU law for accession purposes, but through persuasion on the basis that it was the right model for Russia's needs. While the TACIS programme's funds were substantial, they were not sufficient to exercise financial leverage on Russia to adopt foreign-imported policies. There is, or rather was, also acute competition between the US (or Anglo-Saxon) models that underpinned Russia's early shock reform efforts (also driven by the IMF and the World Bank), and the EU model which contained the flexibility to emphasize more liberal (e.g. the UK) and more statist (e.g. France) versions. This programme ran from 2000 to 2006 and was then replaced by the European Neighbourhood and Partnership Instrument (ENPI)[39] for the period from 2007 to 2013.[40]

6.3.1.2 Europe Agreements

Before moving to the agreements which now exist, an 'in between' group of agreements will be examined: the Europe Agreements. These were the instrument used to prepare Eastern European countries for accession to the EU. At the time of writing, only Bulgaria and Romania still have Europe Agreements.

With the EU as the dominant partner, the Europe Agreements established a programme for preparing the partner countries for eventual accession. They provided the means whereby the EU offered the associated countries the trade concessions and other benefits normally associated with full EU membership. The Europe Agreements aimed to establish free trade in industrial products and in services, limited freedom of movement, introduction of competition law (including state aid rules) over a gradual, transitional period, although the EU opened its markets more quickly than the associated country. As a result, industrial products from the associated countries had virtually free access to the EU from the beginning of 1995. The Agreements also contained provisions regarding the free movement of services, payments, and capital in respect of trade and investment, and the free movement of workers. When establishing and operating in the territory of the other party, enterprises were to receive treatment not less favourable than national enterprises. Under the Agreements, the partner countries also committed themselves to approximating their legislation to that of the EU, particularly in areas relevant to the internal market. Energy was mentioned as one of the areas of economic cooperation and nuclear safety was mentioned as a special concern.[41] The form of the obligations was not specific; they referred to a general policy in the sector (e.g. the opening-up of the energy sector), defined a best-efforts obligation, enabled financial and technical assistance, and defined full approximation as the ultimate target, but without a specific timetable. They also formed the basis for several PHARE projects to assist the accession countries to develop regulatory regimes for energy (including competition) in line with EU law and the energy directives.

Sections 6.4 to 6.6 examine some of the current elements of EU external energy policy. In essence, EU action in this area can be, and often is, multilateral. The EU participates in international efforts in a given area like energy security, access to energy markets, or protection of energy investments. In addition to this, energy cooperation may be integrated in bilateral or inter-regional instruments. In this area, the EU negotiates bilateral legal and policy instruments with a range of developing and developed countries and regions. The chapter first focuses on examples of bilateral mechanisms (although the Cotonou Agreement is, arguably, regional in scope) (see section 6.4), and thereafter provides an overview of the multilateral mechanisms for energy cooperation using the ECT and the Energy Community Treaty as examples (see sections 6.5–6.7).

[38] Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

[39] Regulation (EC) No 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down general provisions establishing a European Neighbourhood and Partnership Instrument, OJ L 310, 9.11.2006, pp. 1–14.

[40] Similarly, the MEDA program in the Mediterranean region was replaced by ENPI from 2007 onwards.

[41] Articles 79 and 80 of the EU-Bulgaria Europe Agreement (Europe Agreements are virtually identical); these provisions mention as areas of cooperation energy efficiency, savings, development, transfer of technology, diversification of supply, transit, environmental impact, and opening up of the sector including modernization. This is an antechamber to full accession in the energy area. Article 81 includes, with a similar intention, environmental (including climate change) obligations.

6.4 Bilateral Aspects of EU External Energy Policy: From Associations to Dialogues

6.4.1 Association and Economic Cooperation Agreements

The EU has concluded several types of economic cooperation agreements. They differ in terms of the level of economic integration aimed at: goodwill discussions only; a basis for development aid and trade preferences involving an intention to move to a customs union; or a customs union plus gradual adoption of EU law by the partner state to prepare for accession. They have no specific energy focus, although energy may be mentioned as an object of development aid, included in a customs union and the adoption of EU law. They also tend to formulate goodwill declarations concerning foreign investment, but do not contain hard and specific legal obligations like those we see in the bilateral investment treaties, which now, post-Lisbon, are concluded by the EU and not by the Member States.

6.4.1.1 Association Agreements

Association agreements are a special case, and have been since the early days of the European Community. The Treaty of Rome invested the EU (then the EEC) with the competence to conclude agreements establishing an association with both third countries and international organizations. Without a formal definition of the objectives and scope of these associations, the EU has used this competence over the years to conclude associations with a large number of countries for very different purposes and objectives.[42] Duran and Morgera distinguish between four categories of association: association as a prelude to EU membership (as is currently the case with Turkey and certain South-Eastern European countries); association as a substitute for EU membership (as is currently the case with Norway and the countries in the Euro-Mediterranean Partnership); association as a development tool (as is the Cotonou Agreement); and association as an instrument for inter-regional cooperation (e.g. the association agreements with Chile and South Africa).[43]

These association agreements can also cover energy, as in the Association Agreement with Albania (which was signed on 12 June 2006 and entered into force on 1 April 2009), Article 107 of which states:

> 'Energy Cooperation shall focus on priority areas related to the Community acquis in the field of energy, including nuclear safety aspects as appropriate. It shall reflect the principles of the market economy and it shall be based on the signed regional Energy Community Treaty with a view to the gradual integration of Albania into Europe's energy markets.'

[42] The current legal basis in Article 217 TFEU seems to suggest that association agreements can be concluded to cover all EU policies and activities. Similarly, see G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), p. 60.

[43] G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), pp. 58 and 59.

Certain factors stand out. First, for those associations that are a prelude to EU membership, the financial assistance offered is often tied to progress made in fulfilling the objectives of the association agreement.[44] The EU monitors progress in the association country in terms of approximation of laws. As such, it is ultimately the EU that evaluates the 'merits' of association countries' 'compliance'.[45] A somewhat similar issue can be raised in the context of EU relations with its neighbouring countries. Article 8 TEU states: 'The Union shall develop a special relationship with neighbouring countries, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union [...].' Examples of this type of neo-colonialism are readily available.

Association agreements can provide preferential access to EU markets, often with a view to a later customs union. There is institutional machinery for dialogue (a Council or Committee), which is increasingly also competent to deal with governance issues: i.e. a way for the EU (but never, in practice, for the partner country) to raise, with some financial, trade, and political leverage in the background, governance issues. There is an emphasis, pushed in particular by the southern EU countries, towards closer relations with the Mediterranean countries. Association agreements exist with most Mediterranean countries,[46] with Turkey being a special case.[47] These agreements were originally implemented by the MEDA programme, which contained a number of projects relating to energy. There are no specific 'energy' agreements in the EU-Mediterranean relationship; some of the countries have looked at the ECT, but felt that the 'hard law' obligation and direct enforcement (by investment arbitration) was not acceptable. This situation reflects the internal political circumstances of most Mediterranean countries: weak governance; religious problems where fundamentalist Islam is challenging governments which provide no significant popular participation; inter-ethnic strife; and suppression of minorities (e.g. Turkey, Israel, Algeria, and Syria). From an energy perspective, these countries are of great importance, in particular to southern Europe: oil and gas investment supply from Syria, Egypt and Algeria and through Turkey, Tunisia, and Morocco. As in the case with Russia and the Caspian/Caucasus countries, the EU wishes for good commercial relations with all of these countries. Through the use of treaties, dialogue, professional community-building, and assistance, it can help positive governance elements to grow, but in essence it cannot, on its own and

[44] Article 112 in the Association Agreement with Albania. Available at <http://ec.europa.eu/enlargement/pdf/albania/st08164.06_en.pdf>.

[45] G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), p. 74.

[46] Just see Decision 2005/690/EC, Decision 2004/635/EC, Decision 2002/357/EC, Decision 2000/384/EC, Decision 2000/204/EC, Decision 98/238/EC, concerning the conclusion of a Euro-Mediterranean Agreement establishing an association between the European Communities and their Member States, of the one part, and, respectively, the People's Democratic Republic of Algeria, the Arab Republic of Egypt, the Hashemite Kingdom of Jordan, the State of Israel, the Kingdom of Morocco, and the Republic of Tunisia.

[47] Council Decision 2008/157/EC of 18 February 2008 on the principles, priorities and conditions contained in the Accession Partnership with the Republic of Turkey and repealing Decision 2006/35/EC, OJ L 051, 26.2.2008, pp. 4–18.

without strong domestic allies, guarantee the creation of stable systems of good and democratic governance.

6.4.1.2 The Cotonou Agreement

The most important partnership agreement between the EU and the developing world is the Cotonou Agreement. Created in 2000, it functions as the framework for the EU's relations with 79 countries from Africa, the Caribbean and the Pacific (ACP). The ACP countries are most of the former colonies of EU Member States (the UK, France, Portugal, Belgium, and Spain), with some important exceptions (e.g. India, and the Latin American countries). It acts to some extent, and in tension with WTO commitments and former colonial preferences, as the legal basis for substantial development aid. Energy, which used to have a section devoted to it in the Lomé Agreement, appears in the Cotonou Agreement only as a series of passing references,[48] mainly to renewable energy. The promotion of investment promotion—relevant to the substantial investment of EU companies, for example, in Nigeria, Trinidad and Angola—is commented on positively, with the prospect of unspecific EU investment guarantees and future specific investment protection treaties. This aspect was also emphasized in the 2005 and 2010 revisions. The Cotonou Agreement is long on hortatory and other general policy declarations in the style of a preamble or UN General Resolutions, but short on specific mechanisms and obligations in the style of a BIT or the ECT. It reflects a neo-missionary revival in Western countries[49] by providing for a consultation procedure for human rights, democratic principles, the rule of law and corruption, but without the specificity of, for example, the OECD Anti-Corruption Convention.[50]

In line with the current trend in international cooperation, the 2010 revisions also highlighted climate change as a new area of cooperation. This is logical, considering that many of the ACP countries are highly vulnerable to the potential negative effects of climate change (including extreme weather or rising water levels). In line with this, renewable-energy-related cooperation now has a more prominent role than before. As the other side of the coin, the new additions also include a specific reference to environmental measures not being used for protectionist purposes.[51]

It is hard to assess the effectiveness of both the very open-ended goodwill obligations and the massive development aid (including finance) for which the agreement

[48] In this context, also the ACP-EU Energy Facility is noteworthy. See Communication from the Commission to the Council and the European Parliament of 26 October 2004 on the future development of the EU Energy Initiative and the modalities for the establishment of an Energy Facility for ACP countries (COM(2004) 711 final).

[49] M. Ottaway, 'Reluctant Missionaries', July–August 2001, *Foreign Policy*, available at: <http://www.foreignpolicy.com/articles/2001/07/01/reluctant_missionaries> (last accessed 6.8.2012).

[50] See generally, L. Low, T. Sprange, and M. Barutciski, 'Global Anti-corruption Standard and Enforcement: Implications for Energy Companies', 3(2) *Journal of World Energy Law and Business* (2010), pp. 166–213.

[51] Second revision, 19 March 2010. Text available at: <http://ec.europa.eu/development/icenter/repository/second_revision_cotonou_agreement_20100311.pdf>.

serves as a legal basis (for the period from 2008 to 2013, the amount allocated for this cooperation is EUR 22.7 billion[52]—not an insignificant amount). One approach is to look at most of the language as a public relations exercise meant to placate the European Parliament and NGOs; the other is to view this as a step towards more effective measures to support good governance. Good governance itself can—if applied and imposed on weaker developing countries—be seen as the right move to make the world a better place, or as the continuation, albeit under different labels, of the economic and cultural dominance over what were formerly colonies, and are now underdeveloped and aid- and finance-dependent countries: i.e. the contemporary format of cultural colonialism with a newly revived, strong missionary element.

6.4.2 Partnership and Cooperation Agreements

Partnership and cooperation agreements envisage neither accession nor a customs union. They provide a basis for economic and trade policy dialogue, as well as for technical assistance. This form has been chosen for the EU's relationship with Russia and most post-Soviet states.[53]

The 1994 Partnership and Cooperation Agreement with Russia is of particular interest from an energy perspective, given Russia's role in relation to the EU's energy supply. It entered into force in 1997, and is a general agreement with objectives ranging from democracy and cultural cooperation to free trade and the transition of the Russian economy to a market-based system.[54] Article 65 deals specifically with energy, cooperation in this field being carried out 'within the principles of the market economy and the European Energy Charter, against a background of the progressive integration of the energy markets in Europe'.[55] The parties agreed to initiate negotiations for a new EU/Russia Agreement to replace the current version at the EU-Russia Summit in June 2008.[56] Negotiations started in July 2008 but the 12 rounds of negotiations that were undertaken by the end of 2012 have not brought these discussions very far.[57] In the field of energy, this instrument has been

[52] Details available at: <http://ec.europa.eu/europeaid/where/acp/overview/cotonou-agreement/index_en.htm>.

[53] Council and Commission Decisions 99/602/EC, 99/614/EC, 99/515/EC, 99/490/EC, 99/491/EC, 98/401/EC, 97/800/EC, 98/149/EC, 99/593/EC, 2009/989/EC on the conclusion of the Partnership and Cooperation Agreement between the European Communities and their Member States, of the one part, and the Republic of Armenia, the Republic of Azerbaijan, Georgia, the Republic of Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Russian Federation, Ukraine, and the Republic of Uzbekistan, Tajikistan of the other part, respectively.

[54] Agreement on partnership and cooperation establishing a partnership between the European Communities and their Member States, of one part, and the Russian Federation, of the other part—Protocol 1 on the establishment of a coal and steel contact group—Protocol 2 on mutual administrative assistance for the correct application of customs legislation—Final Act—Exchanges of letters—Minutes of signing, OJ L 327, 28.12.1997, pp. 3–69.

[55] Article 65(1) of the Agreement on partnership and cooperation.

[56] See 'The Joint Statement of the EU-Russia Summit on the Launch of Negotiations for a New EU-Russia Agreement'. Available at: <http://www.eu2008.si/en/News_and_Documents/download_docs/June/0627_eu_RUS-izjava.pdf>.

[57] Generally, see <http://eeas.europa.eu/russia/>. See also, R. Leal-Arcas, 'The EU and Russia as Energy Trading Partners: Friends or Foes?' 14(3) *European Foreign Affairs Review* (2009), pp. 337–66.

largely mute. This is only logical when compared to the developments in other energy-related cooperation efforts aiming at pushing the ideal of a market economy into the Russian energy markets—the Energy Charter Treaty in particular.

6.4.3 Energy Dialogues

The EU has a number of institutionalized Dialogues in place. These Dialogues are often dominated by EU approaches and EU policies (even if coined as 'shared values' and 'shared objectives'). The approach is often that of persuasion (i.e. the EU persuading the partner countries) instead of real negotiation. The Dialogues with developing countries—which enable EU supervision of third countries in terms of internal, domestic, implementation of the Dialogues based on EU standards and the EU's understanding of sufficient performance—are a good example of this.[58] As noted by Leino-Sandberg, the problem is partly the special nature of the EU as an international actor. Given that the EU's position is created through negotiations and bargaining between its 27 Member States, the EU's approach is often already cemented prior to commencement of the Dialogue.[59] This is particularly problematic when institutionalized Dialogues are used to discuss negotiation positions for, say, climate change negotiations.[60]

The situation is somewhat different in energy Dialogues with producing and supplying countries. Here, the EU cannot impose its solutions and views as it can in some other situations. Think of OPEC as the partner in the Dialogue,[61] or Russia. An Energy Dialogue between the EU and Russia was initiated in October 2000, and covers issues such as energy security, energy efficiency, infrastructure, investment, and trade. In essence, the aim of this quite innovative institution established by EU and Russia is to improve the mutual understanding of the energy policies of the two partners. In some ways, the Energy Dialogue has been a successful institution, despite significant shortcomings.

This cooperation represents a policy level cooperation and the actual decision-making powers of the states involved are of course not affected in any way. The stated objective of this partnership is to promote energy security on the European continent, though its actual contribution remains thin. The main example of a positive effect in this respect, at least on paper, is the so-called Early Warning Mechanism, which requires mutual information-sharing in case of potential oil and gas supply and demand problems, including transit. Such problems may be technical, commercial, or political in nature.[62]

[58] For this, see P. Leino, 'The Journey Towards all that is Good and Beautiful: Human Rights and "Common Values" as Guiding Principles of EU Foreign Relations Law', in M. Cremona and B. De Witte (eds), *EU Foreign Relations Law* (Oxford: Hart Publishing 2008).

[59] P. Leino, 'The Journey Towards all that is Good and Beautiful: Human Rights and "Common Values" as Guiding Principles of EU Foreign Relations Law', in M. Cremona and B. De Witte (eds), *EU Foreign Relations Law* (Oxford: Hart Publishing 2008), p. 679.

[60] G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), p. 231.

[61] For details, see <http://ec.europa.eu/energy/international/organisations/opec_en.htm>.

[62] On this and other developments, see <http://ec.europa.eu/energy/russia/overview/index_en.htm>.

While the Energy Dialogue may cover a wide range of issues, there are clear differences in emphasis between the parties: while the EU is mainly addressing issues of access to Russian markets and security of EU energy supply, Russia appears concerned about investment in export infrastructure. At least in part because of these differences, the success of the Energy Dialogue in the area of natural gas has been limited. The main point that has been resolved through the Dialogue is the resolution of the destination clause issue.[63] In this sense, the Dialogue has produced positive results.

In addition to these differences, there are also less sensitive areas which are therefore treated in more detail. It is important to note that the Dialogue is not only concerned with oil and gas, although it seems that this was the original emphasis of the parties. Electricity markets and electricity trade were included in the agenda at an early stage, and even nuclear issues are addressed as a central part of this cooperation. One area often debated in this context is energy savings.[64] The fact that this is a much less politically sensitive issue than the trade in natural gas, for example, undoubtedly has a bearing. There are many more common concerns and benefits here than in other areas. Similarly, electricity is much less sensitive because, unlike natural resources, it is not considered to be a strategic asset.[65]

While this partnership might be beneficial for both parties, it still faces significant challenges. Some of the current issues affecting the cooperation with Russia include the gradual foreclosure on investment by companies established in one of these areas into another area. Russia has limited foreign investor participation in developing its natural resource base and the EU has, through the Third Country Clause,[66] done virtually the same.[67] It was specifically noted by the Russian representatives at a meeting as a 'potential' issue that could impair further cooperation. Similarly, environmental issues continue to be a difficult area.[68]

In addition to cooperation, the Energy Dialogue is also used as a platform for discussing sensitive issues upon which the opinions of the parties might diverge. However, as mentioned, the tangible results from these discussions are limited. A good example of this is the fate of long-term upstream gas agreements. While discussions on the negative and positive effects of these agreements continue in the EU, the Dialogue has been used to exchange views on this question,[69] without major breakthroughs.

[63] EU-Russia Energy Dialogue, 'The Second Progress Report' (May 2008). Available at: <http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/progress2_en.pdf>.

[64] For the developments in this respect, see A.V. Belyi and K.V. Petrichenko, 'Energy Efficiency Policy in Russia', 1 *OGEL* (2011), <http://www.ogel.org>.

[65] Electricity is a secondary energy source, not primary like natural gas or oil.

[66] For the Third Country Clause and its relation to international law and EU-Russia relations, see A. Willems, J. Sul, and Y. Benizri, 'Unbundling as a Defence Mechanism Against Russia: Is the EU Missing the Point?', in K. Talus and P. Fratini (eds), *EU-Russia Energy Relations* (Rixensart: Euroconfidential 2010) and S.S. Haghighi, 'Establishing an External Policy to Guarantee Energy Security in Europe? A Legal Analysis', in M. Roggenkamp and U. Hammer (eds), *European Energy Law Report VI* (Antwerp: Intersentia 2009).

[67] <http://ec.europa.eu/energy/russia/joint_progress/doc/progress9_en.pdf>.

[68] <http://ec.europa.eu/energy/russia/joint_progress/doc/progress9_en.pdf>.

[69] Interim Report by the Parties of the EU-Russia Energy Dialogue, para. 3. Available at: <http://ec.europa.eu/energy/russia/joint_progress/doc/2006_05_25_interim_report_en.pdf> and The Ninth

There is also a bilateral EU-Norway Energy Dialogue mechanism in place. This Dialogue aims primarily at the coordination of energy policies (including research and technological development in the sector) and relations with other energy-producing countries. The current cooperation between Norway and the EU focuses, among other things, on the internal energy market, renewable energy (offshore wind in particular), and Carbon Capture and Storage projects.[70]

Norway is a special case in many ways. It is in a very different position from other external energy producers. It is regarded as 'politically stable and secure'. EU-Norway relations are governed by the European Economic Area (EEA) Agreement, which covers areas such as the single market legislation, including competition law, public procurement and state aid and the free movement of goods. In these areas, Norway is in many ways much like an EU Member State, despite two negative referendums in 1972 and 1994. This is particularly so in the energy sector. First, Norway is under an obligation to implement the internal energy market legislation and must follow the competition law articles of the EEA Agreement, which are identical to those of the EU competition law provisions. Energy issues are, in particular, dealt with in Annex IV of the EEA Agreement. Secondly, in electricity Norway is an integral part of the common Nordic wholesale electricity market and the Nordpool power exchange. The Norwegian energy market authorities are also part of the Nordreg cooperative organization.

Section 6.5 focuses on the multilateral side of EU external energy relations.

6.5 Multilateral Aspects of the EU's External Energy Policy: From Energy Charter Treaty to Energy Community Treaty

Even with the emergence of the Energy Community Treaty, the ECT is still the EU's primary international (institutional) instrument in the energy area, although its importance for EU decreased significantly (but has not disappeared altogether) after Russia indicated that it would not ratify the ECT and would cease its provisional application.[71]

From its inception, the ECT was conceived, initiated, promoted, and supported by the EU. It expresses the EU interest in safe energy supplies, stable political relationships, and trade and investment along its borders (parallel to TACIS, PHARE,

Progress Report, October 2008. Available at:<http://ec.europa.eu/energy/russia/joint_progress/doc/progress9_en.pdf>.

[70] Commission press release, 'EC-Norway Energy Dialogue: Boosting Cooperation in the Internal Energy Market, Offshore Wind and Carbon Capture and Storage Projects', IP/08/817, 29.5.2008. See also Press Release, 'CCS, Market Liberalisation and Energy Security Dominate the Agenda of the EC-Norway Energy Dialogue', IP/09/849, 28.5.2009 and the Press Release from 22.6.2012, available at: <http://ec.europa.eu/energy/international/bilateral_cooperation/doc/norway/120622_press_announcement.pdf>.

[71] For this, see A. Konoplyanik, 'A Common Russia EU Energy Space (The New EU Russia Partnership Agreement, Acquis Communautaire, The Energy Charter and the New Russian Initiative)', in K. Talus and P. Fratini (eds), *EU-Russia Energy Relations* (Rixensart: Euroconfidentiel 2010).

SYNERGY, cooperation agreements and the establishment of EBRD). Its content is influenced by investment treaty practice, but also by the EU energy policy trends of those days (the Licensing Directive and the first internal energy market directives). With the problems relating to the Transit Protocol and the non-ratification of the ECT by Russia, the nature of the ECT is now changing. Here, a potential problem with the close proximity of the ECT to the EU has been flagged:

> 'One wonders to what extent this Treaty, with an independent Secretariat and Conference, can become a self-sustaining international arrangement able to survive independent of the European Union. There is a public perception that the ECT is a key instrument of EU policy towards the East, and it is perhaps not surprising that the Treaty is still widely, and incorrectly, called the "European" Energy Charter Treaty. One may question whether this proximity will allow the Energy Charter process to evolve outside of the flows of EU energy and Eastern policy.'[72]

This section examines the Energy Charter Treaty as a part of the external elements of EU energy law and policy. In keeping with the approach taken in this book, the focus will be on the development of the ECT over time, rather than on detailed examination of its legal provisions. As it is in many ways a logical extension of the examination of the ECT, the chapter also discusses the Energy Community Treaty.

6.5.1 Energy Charter Treaty: Past, Present, and Future

6.5.1.1 The Evolution of the Energy Markets and the Energy Charter Treaty

Two main factors contributed to the creation of the ECT. The events of the early 1990s—the dissolution of the USSR and the COMECON system, the fall of the Berlin Wall and related events—offered a window of opportunity for East-West cooperation and the possibility to create an international law instrument to facilitate this type of transnational cooperation between former ideological opposites. However, it is quite likely that the ECT would have seen the light of the day without these events. The increasingly international nature of energy markets and energy trade also called, and still calls, for the creation of this type of international institution. The growth of international energy trade is complemented by new international instruments and international institutions supporting this internationalization development.

Energy markets have developed in stages and through a particular logic. The first step involved local markets with one producer and few customers, and within a specific territory or state. At the very first stage, the development of the gas sector usually started with vertically-integrated local companies, which provided limited supplies to the nearby located consumers. The initial investment that had to be made at this stage was smaller than it would be in the later stages. This initial stage was then followed by the process of internationalization, where the geographical

[72] C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008).

markets expanded and the trade became international, or regional. Here, markets evolved to include more complex commercial institutions. This process led first to regional markets, which is largely the current situation. The final stage is that of the future internationalization or even globalization of energy trade. The globalization trend then leads to globalization of the markets for energy products, as has been the case for oil and coal to a certain extent. For gas, there is no international market but only regional markets. However, we can see a trend towards that type of development in the case of LNG. This, however, requires future development and investment.

It is against this background that the ECT is examined. As an investment protection and stimulation mechanism, the ECT represents the limits of the political process in the international arena. At the time of its negotiation, and today, it is the leading multilateral framework in this area. It introduced several innovations and pushed international law relating to this area to new levels.

6.5.1.2 *Why an International Law Instrument—Why the ECT?*

In the first stage, local or national markets, there are two options, the choice depending largely on the maturity of the country's legal and socio-economic situation. In developing or transition economies, stabilization is required in order to attract investment. Given the state of national legislation or political and/or legal institutions, there is a need to create mechanisms which increase stability for large and capital-intensive investment. This type of risk usually requires a project-specific response, which can be included in the investment agreement with the state (by way of production-sharing agreement, concession, host government agreement on pipelines, and so on). At the time of the dissolution of Soviet Union, this situation was characteristic of the Russian legal and political system. The movement from a socialist system towards a market-based economy created transition risks. More generally, this issue affected all the ex-Soviet countries who decided to change their system. However, it must be noted that this type of transition risk is not absent from the more developed market economies. Just consider the progress in the EU energy markets from the first, to the second and to, currently, the third energy market package,[73] or some of the measures adopted to address climate change. These constant legislative changes also create legal uncertainty about future regulation and the impact these changes have on prior investment.[74] The changes in the levels of unbundling are but one example of changes undermining investment stability for long-term energy investment.

[73] Also, the case-by-case antitrust treatment of long-term contracts in the EU significantly increases business risks for the market actors. See K. Talus, 'Just What is the Scope of the Essential Facilities Doctrine in the Energy Sector: Third Party Access-friendly Interpretation in the EU v. Contractual Freedom in the US', 48(5) *Common Market Law Review* (2011).

[74] This risk has been emphasized in K. Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Alphen aan den Rijn: Kluwer Law International 2011).

The second option is then the creation of a predictable and stable domestic legal framework for energy investment. Here, specific investment laws as well as other related laws, on taxation for example, are designed to provide investment stability, and the protection offered does not cover a specific agreement or project but is wider, covering all types of investment activities. These options are available and typically used when the projects are national in scope and energy markets are local or national.

The second stage in the development of the market, brought about through the internationalization of energy markets, creates a need for an international response to international projects and markets. Here, international law instruments come into play. Again, there are two options at this stage. The first is to enter into bilateral agreements with the main commercial partners: bilateral investment treaties ('BITs') and double taxation treaties. Such instruments have a long history and nowadays number in their thousands. However, one problem with this approach is that the relevant instruments date back to different decades and, as such, are the product of different trends in international law and international relations. This is also reflected in their content, which differs in each case (although strong similarities also exist).

The second option is the use of multilateral instruments and treaties. This is a more recent phenomenon. Unlike BITs, a multilateral framework applies to all those countries which have opted to join the framework in the same manner and its application is therefore more predictable. Well-known multilateral legal instruments (which are international treaties) include the WTO and the ECT, but the EU legal system itself can be regarded as a multilateral legal framework. The focus here is on the ECT.

6.5.1.3 *The Energy Charter Treaty and its Origins*

The ECT is an energy-specific multilateral instrument covering issues such as free trade in energy-related products (based on GATT/WTO rules), freedom of transit (as specified in the Transit Protocol—here, certain parallels to the WTO can be seen, although the ECT takes the transit issues much further), the protection and promotion of foreign investment (national treatment/most favoured nation treatment), and dispute settlement (both between states and between investors and states). The ECT's objective is to 'establish a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter'.[75] These principles include secure energy supply and sustainable economic development.[76]

Given the nature of energy investments—which are highly capital-intensive and have long lead times and payback periods—and the internationalization of the energy trade, it is no surprise that this industry-specific investment protection scheme appeared in the 1990s.

[75] Article 2 of the Energy Charter Treaty.

[76] Energy Charter Secretariat, 'The Energy Charter Treaty and Related Documents—A Legal Framework for International Energy Cooperation', p. 13.

The process leading towards this legally binding document dates back to the early 1990s and was from the beginning geared towards securing EU energy supplies.[77] The ECT was signed in 1994 and entered into force in April 1998 after the 30th signature. The initial focus of the ECT process was East-West energy cooperation within Europe[78] and the major stakeholders in the early 1990s were the EU and its Member States, the Russian Federation, and the Energy Charter Secretariat itself. In essence, the need for this international law framework came from the uncertainty created by the fall of the Soviet Union. This was also reflected in the motivations of the parties to the ECT process in the early days.

For the EU, the major driver behind the ECT was the need to use international law to protect existing East-West and anticipated West-East investment flows. The aim to export the Western model of the rule of law and the EU energy *acquis* to the ex-Soviet states was also a motivating factor. This last issue was obviously based on the first EU energy law package, the content of which is strongly reflected in the ECT legal framework.

For Russia, the main driver was the need to compensate for the lack of an adequate legal framework for energy investment (and more generally any investment), which was a result of the transition from the former socialist system to a capitalist system. This compensation was sought through adopting the most advanced international law solutions for energy trade and energy investment protection and stimulation. The idea was of course to bring in much-needed foreign capital and investment.

Both sides believed that the creation of common rules of the game for energy markets and energy investment would bring about the necessary stability for cooperation between the two partners.

The Energy Charter Secretariat was the third stakeholder in the negotiations, and was to a significant extent to thank for their successful conclusion. This issue, while important for the final outcome of the ECT process in the early days, is not discussed here.

6.5.1.4 The Energy Charter Treaty and Energy Charter Process

As mentioned, the Energy Charter Treaty covers various areas of energy cooperation, including investment, trade, energy efficiency, and dispute settlement. It applies to energy materials, energy products, and energy-related equipment. It has a significant group of stakeholders including over 50 Member States, over 20 observer states and over 10 international organizations as observers.[79]

[77] S.S. Haghighi, *Energy Security: The External Legal Relations of the European Union with Major Oil and Gas Supplying Countries* (Oxford: Hart Publishing 2007), p. 188. The process was initiated in June 1990 when the European Council gave the Commission the task of finding the best way to implement the cooperation between ex-Soviet countries and the EU. Further to this request, the Commission proposed that a European Energy Charter be created. This has been seen as the first formal step in the ECT process. (C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008), pp. 145–94.)

[78] Illustratively put in the heading of one of the most significant publications on ECT: T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (London: Kluwer Law International 1996).

[79] For the list of members and observers, see <http://www.encharter.org/index.php?id=61>.

The Energy Charter Process is the name given to the process of implementation of the Energy Charter Treaty, which is based on monitoring procedures with regular reviews of the implementation of ECT provisions in Member States. It is, in essence, a highly specialized forum for advanced discussions (in the working groups) on the evolution of energy markets and new risks for energy projects that might arise from such evolution. Once identified, it attempts to address these risks in cooperation with governments and other stakeholders. As such, it is also a platform for further developments and the preparation of new legally binding instruments to reduce those related risks. In this sense, the role of the Energy Charter Process is to deepen (in terms of moving further on the detail: for example, Article 7 on transit has been complemented by the Transit Protocol which goes into much more detail in terms of transit) and broaden (both in terms of geographical coverage and product scope) the ECT. Given recent developments, with Russia withdrawing from the provisional application, but not from the Energy Charter Process itself, the process can be used to improve the Treaty or to discuss its details.

6.5.1.5 The ECT as the First Multilateral Investment Agreement

The ECT is based on well-established BIT practice, and is clearly influenced by Chapter XI of the North American Free Trade Agreement (NAFTA) (on investment), the now-abandoned OECD project on Multilateral Agreement for Investment, as well as the EU's first energy law package.[80] It represents the combined effect and legal force of more than 1,200 BITs.

The ECT includes two types of investment protection. It contains binding 'hard law' obligations for the post-establishment phase of energy investment (non-discrimination, etc.), and 'soft law' obligations for the pre-establishment phase (the stage of making the investment). It provides protection against certain key political and regulatory risks, including expropriation or nationalization, breaches of individual investment contracts, or unjustified restrictions on the transfer of funds. It provides for most-favoured-nation (MFN) treatment and national treatment. It also prohibits discrimination, etc.

These, and other, substantive rules on investment protection are reinforced by the provision of access to binding international dispute resolution mechanisms. The ECT also provides for both state-to-state and investor-to-state arbitration. The latter mechanism gives the investor direct access to his or her chosen investment arbitration forum: ICSID, ICC Stockholm or UNCITRAL. The awards rendered under these mechanisms are final and directly enforceable.

In terms of legal innovation, Article 10 on the promotion, protection and treatment of investments contains two interesting principles:

(1) *Standstill* in Article 10(5)(a): 'Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to limit to the minimum

[80] But also the Directives on Transit and Hydrocarbons Licensing Directives, Articles 101 and 102 TFEU and notions of special responsibility incumbent on State and private enterprises with a publicly privileged but dominant market position. See C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008).

the exceptions to the Treatment described in paragraph (3) [national treatment and MFN]';

(2) *Rollback* in Article 10(5)(b): 'Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to: progressively remove existing restrictions affecting Investors of other Contracting Parties.'

The standstill provision requires the state not to introduce new restrictions on investment. The rollback provision requires reduction of all investment restrictions. These are not legally binding obligations, as the use of the word 'endeavour' suggests. However, they do reflect the general objective of the provisions of the Treaty on investment protection.

6.5.1.6 The ECT and its Geographical Scope

The initial focus of the ECT process was East-West energy cooperation within Europe, in the widest sense. This was a natural consequence of the widening geographical scope of the energy markets, the internationalization of European energy markets and the developments in the internal arena more generally. While certain OECD countries like the US and Canada participated in the negotiations, they did not ultimately sign up to the ECT.[81] The geographical focus has now been widened significantly[82] to include the Caspian region and even Japan and Australia. The current expansion of observer countries is quite logical, and includes North African, Eurasian, and Australasian countries. This development was initiated by the 2004 Policy Review[83] which directed attention to these geographical areas. These regions and developments reflect the internationalization of the energy markets and the energy value chain.

However, despite the continuing discussions, none of the main suppliers of gas to the EU—i.e. Russia, Algeria, and Norway—have ratified the ECT.[84] More generally, it is rather obvious from the list of Member States that those countries that are keen to adopt the ECT are the consuming countries, not the producing countries.[85] This is without doubt the major shortcoming of the ECT from the

[81] Illustratively put in the heading of one of the most significant publications on ECT, T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (London: Kluwer Law International 1996).

[82] This was specifically noted by the Secretary General of the ECT secretariat: <http://www.encharter.org/fileadmin/user_upload/SG_s_speeches/ECT_10th_anniversary_speech_rev.pdf>.

[83] CC 298 and Summary Record the Fifteenth Meeting of the Energy Charter Conference (CC 294).

[84] Although Russia did apply the ECT provisionally until summer 2009, which meant that Russia applied the ECT 'to the extent that such provisional application is not inconsistent with its constitution, law or regulations', according to Article 45 of the ECT. For the provisional application, see K. Hobér, 'The Energy Charter Treaty—Recent Developments', 5 (2007) 2 *OGEL* or C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008).

[85] D. Doeh, A. Popov, and S. Nappert, 'Russia and the Energy Charter Treaty: Common Interests or Irreconcilable Differences?', 5 (2007) 2 *OGEL*; and C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008).

EU perspective. However, from this EU perspective, it must be noted that the list of Member States includes Ukraine, which is a significant transit country for the EU.[86] While it is significant that some of the most of the ambitious 'emerging oil and gas producers' are part of the ECT community, the Caspian region and Kazakhstan in particular, and that this could prove to be very significant in the future from an EU perspective,[87] it is also possible that these countries will withdraw from the ECT when their economic or political situation so demands.

6.5.1.7 The Development of the Activities of the ECT and the Energy Charter Process in Terms of Focus

Looking at the activities and priorities of the ECT and the Energy Charter Process, it is also possible to see development and movement along the cross-border energy value chain. The activities and priorities of the ECT in the early 1990s were largely focused on production and upstream supply of energy. Towards the end of the 1990s and the early 2000s, the focus shifted to include the whole value chain, including trade and transit, thus facilitating risk-mitigation along the entire supply chain. Energy security also emerged as a major theme during this period. Current activities seem largely concerned with such issues as energy efficiency and environmental protection, thus moving the focus from production and transit to consumption (demand and equipment). This might signal a more permanent shift in focus. Furthermore, the number of topics and areas covered in the Energy Charter Process has been growing over the years, and an increasing number of investment arbitrations are taking place under the ECT framework.

6.5.1.8 Attitudes of the Key Parties: The EU and Russia

6.5.1.8.1 Current Issues from a Russian Perspective

As discussed, Russia has not ratified the ECT. There are various reasons for this. Politically, there has been a quite natural reaction from Russia to the external pressure to ratify the ECT, principally exerted by the EU and the European Commission.

Russia also considers that, from a producer perspective, the balance of the ECT is too consumer-friendly, and does not contain the necessary balance between the consumer and producer countries. In addition to Russia's more valid concerns, there have also been misunderstandings and misinterpretations of the ECT on the Russian side (for instance, that the ECT would force Gazprom to open up gas transportation system to all at the low domestic tariff rates).

The Transit Protocol has been one of the major obstacles to Russian acceptance of the ECT—a more serious obstacle than the other objections against the ECT raised in discussions within Russia. Negotiations on the Transit Protocol were

[86] Ukraine has also ratified the Energy Community Treaty. The Ukrainian Parliament ratified this Treaty on the 15 December 2010.

[87] For a more detailed discussion, see also A. Konoplyanik and T. Wälde, 'Energy Charter Treaty and its Role in International Energy', 24(4) *Journal of Energy and Natural Resources Law* (2007), pp. 523–58.

initiated in 1991. Negotiations on the text of the Protocol started in 2000, and were provisionally suspended in 2003 after it became clear that the text could not be unanimously adopted as it stood.[88] The thorniest issues preventing the adoption of the Transit Protocol related to EU-Russia relations. Before Russia gave notification that it would not ratify the ECT and would cease to apply the ECT provisionally,[89] the most significant issues were: (1) the Regional Economic Integration Organisation (REIO) clause;[90] (2) the issues relating to access to pipelines and tariff-setting procedure;[91] and (3) the right-of-first-refusal on renewal of transit terms for existing users.[92] These issues mostly relate to the ever-widening geographical scope of the EU, and are explained below.

Because of the historical Cold War era division of Europe, the delivery points for Russian gas were previously located on the border of Western Europe and Soviet-controlled Eastern Europe. The choice of delivery point was naturally based on the possibility of influencing or controlling the transmission of gas on either side of the 'Iron Curtain'. The situation changed radically in 2004 (changes had, of course, already taken place prior to this in the 1990s) since the delivery points for Russian gas moved from the EU border to a location within the EU.[93]

These evolutions brought about significant changes, in that title and the related risks were now being transferred to the buyer (or a third party) at the EU border. With the 2004 enlargement, the delivery points were suddenly located in the EU area, and Gazprom found itself in a situation in which its gas was flowing in EU pipelines which were now subject to EU regulation. This change was significant and further complicated the situation with Gazprom's long-term agreements.

The Gazprom gas that reaches the EU customer is, structurally speaking, subject to various contractual arrangements. For the purposes of our discussion, it suffices to separate the agreement to purchase gas from the agreement to purchase transfer capacity in a pipeline. Under the current scheme, the customer (for example, the Italian company ENI) buys an agreed amount of gas from Gazprom, which delivers it to one of the delivery points (for example, Baumgarten). Until delivery, transmission of the contractual amount of gas is Gazprom's responsibility. Prior to reaching

[88] See generally: <http://www.encharter.org>.

[89] For this, see A. Konoplyanik, 'A Common Russia EU Energy Space (The New EU Russia Partnership Agreement, Acquis Communautaire, The Energy Charter and the New Russian Initiative)', in K. Talus and P. Fratini (eds), *EU-Russia Energy Relations* (Rixensart: Euroconfidentiel 2010).

[90] It seems that while the two other points may be overcome through negotiations, the REIO clause is the most difficult item to resolve. The EU refuses to allow the Transit Protocol to be applicable to transport within the EU area.

[91] Auctions as a method of transit capacity allocation and the requirement of cost-reflectiveness of transit tariffs. The Transit Protocol requires that all transit tariffs be cost reflective. Through negotiations that lead to Article 10bis, the issue was largely solved.

[92] For an explanation of these difficulties see, for example, C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds), *Energy Law in Europe* (Oxford: OUP 2008); D. Doeh, A. Popov, and S. Nappert, 'Russia and the Energy Charter Treaty: Common Interests or Irreconcilable Differences?', 5(2) *OGEL* (2007).

[93] A very detailed discussion is provided in A. Konoplyanik, 'Russian Gas to Europe: From Long-term Contracts, On-border Trade and Destination Clauses to ... ?' 23(3) *Journal of Energy and Natural Resources Law* (2005), p. 282.

the Baumgarten delivery point, the gas travels through Slovakia and the Czech Republic, both EU Member States. In order to get the gas to the delivery point, Gazprom must contract with the Slovak and Czech gas pipeline operators to ensure capacity in their pipelines. The problem is obvious: a mismatch in the duration of the two separate agreements and the impossibility of renewing the transportation agreement makes it impossible for Gazprom to fulfil its contractual obligations.[94]

In the past, this mismatch problem did not exist as long-term capacity reservations were concluded for the amount of gas specified in the long-term gas supply agreement (also reflected in the capacity purchase agreement). Today, the situation regarding long-term capacity reservations is more complicated.[95]

The transmission of gas to Europe by Gazprom was not previously affected by competition law concerns. Today, given the efforts to apply competition law in the energy sector and the growing congestion problems, this is an increasing concern for Gazprom.[96] It therefore comes as no surprise that long-term gas supply agreements (the question of the so-called 'right of first refusal') and access to pipelines remain among the principal issues preventing Russia from ratifying the Energy Charter Treaty.[97] And because of these, and other, concerns, Russia notified the Depository of the Treaty in October 2009 that it would not ratify the ECT and would cease to apply the ECT provisionally.[98] It has also suggested the negotiation of a new investment treaty.[99]

These concerns should be taken seriously. It is crucial to recognize that the EU is not alone in the world and must consider the concerns of its partners with an open mind. For Russia eventually to join the ECT, substantiated and valid Russian concerns must be addressed (though at the same time it must be stressed that not all Russian concerns are well-founded or valid—not even close—as discussed).

[94] This approach follows the scheme of a more detailed analysis of the problem: see A. Konoplyanik, 'Russian Gas to Europe: From Long-term Contracts, On-border Trade and Destination Clauses to ... ?'. 23(3) *Journal of Energy and Natural Resources Law* (2005), p. 282.

[95] K. Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Alphen aan den Rijn: Kluwer Law International 2011).

[96] For criticism to the approach of the Commission under general competition law, see K. Talus, 'Just What is the Scope of the Essential Facilities Doctrine in the Energy Sector: Third Party Access-friendly Interpretation in the EU v. Contractual Freedom in the US', 48(5) *Common Market Law Review* (2011).

[97] For an explanation of the current difficulties in the ECT process, see, for example, C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds) *Energy Law in Europe* (Oxford: OUP 2008) and D. Doeh, A. Popov, and S. Nappert, 'Russia and the Energy Charter Treaty: Common Interests or Irreconcilable Differences?', 5(2) *OGEL* (2007). For the provisional application by Russia, see K. Hober, 'The Energy Charter Treaty—Recent Developments', *OGEL* (2007) Vol. 5. For the right of first refusal, see A. Konoplyanik, 'Stiff Competition Ahead—As Russia Moots Ways to Increase Presence on European Gas Market', 2(1) *OGEL* (2004). See also 'Putting a Price on Energy: International Pricing Mechanisms for Oil and Gas' (2007) Energy Charter Treaty Secretariat, p. 174.

[98] For this, see A. Konoplyanik, 'A Common Russia EU Energy Space (The New EU Russia Partnership Agreement, Acquis Communautaire, The Energy Charter and the New Russian Initiative)', in K. Talus and P. Fratini (eds), *EU-Russia Energy Relations* (Rixensart: Euroconfidential 2010).

[99] Before the notification to the contrary, Russia had agreed to apply the ECT provisionally. This meant, according to Article 45 of the ECT, that it applied the ECT 'to the extent that such provisional application is not inconsistent with its constitution, law or regulations'. For an analysis of the proposal and the background see: 'OGEL Special on EU-Russia Relations', 2 *OGEL* (2009), available at <http://www.ogel.org>.

However, Russia should recognize that ratification of the ECT would bring it a number of benefits. It would, first, protect Russian investments abroad. Here, the risk created by the EU's measures to liberalize the energy market is particularly relevant. The fact that it does not seem very likely that Russian efforts to come up with an alternative to the ECT will result in much speaks in favour of Russian ratification of the current ECT. Compared with the early 1990s, when there was a window of political opportunity, the present day political atmosphere is not as favourable to this new Treaty. The Russian side must also distinguish between valid concerns and those which are based on misinterpretation of the ECT, or possibly even voiced without having read the text of the ECT!

6.5.1.8.2 Some Issues from the European Front: It's not all about Russia

Even if it is the Russian Federation that has withdrawn from the provisional application of the ECT, Russia is not the only one causing problems. Arguably, the EU is partially blocking Russian access. Several issues on the EU side have made the negotiations rather problematic, including:

1. long-term monopolization of participation in the Energy Charter Process by DG Energy (formerly DG TREN) at a low level and without adequate coordination with and/or within the EU Member States;
2. absolute priorization of the norms of the *acquis Communautaire* and unwillingness even to discuss the issues relating to the relationship between the EU's energy law and the ECT;
3. unwillingness to resolve the issues relating to intra-EU transit and the REIO clause;
4. attempts to use the ECT as a subordinated instrument of EU external policy; and
5. diminished interest in the Energy Charter Treaty in favour of the Energy Community Treaty.

However, there is also fault on the Russian side. Such difficulties include Russia's negative attitude towards (the political leadership of) the Secretariat after the January 2009 Russia-Ukraine gas crisis—which spread to include the whole Treaty and the Energy Charter Process. The long-term lack of formal internal organization and coordination between Russian State agencies in relation to participation in the Energy Charter Process has also proved problematic. The fact that Russia is not a member of the ECT but only a signatory is not a reason for non-participation in the process (or a reason not to send a negotiation team to the meetings!). Just look at Norway, which is a signatory of the ECT but not a Member State: Norway actively pursues and defends its interests. This is not always the case with Russia. In a situation where Russia is not present, why would the REIO clause be discussed at all?

It seems that the focus is on the Russian attitude to the ECT. In addition to and not instead of this, a more balanced approach reflecting the political and practical realities should be adopted. This would include a discussion of the EU's attitude towards the ECT. Only if this is done, can we move towards a lasting solution.

6.5.1.9 The Growing Gap between the ECT and the EU Energy Acquis

When the ECT was first negotiated in the early 1990s, it was largely based on the approach taken in the first EU energy market directives. There was a clear correlation between the two. Then the second energy market package emerged in 2003 and the level of liberalization between the ECT and the EU energy *acquis* started to diverge. The new unbundling and third party access rules moved EU energy regulation to a deeper and more intrusive level. The third party access provisions under various directives provide an example of this. Regulated third party access is not required by the ECT. Nor was it required under the first energy market directives, which included a choice between regulated and negotiated third party access. This freedom of choice was eliminated from the subsequent directives (in 2003 and 2009). This growing gap in the levels of liberalization between ECT and EU is the first dimension of the problem.

At the same time, the enlargement of the EU in an eastward direction took place, increasing the number of Member States, at first from 15 to 25 and then to 27. In this regard it should also be noted that the EFTA countries also implement most of the EU energy *acquis*, bringing the number of countries applying EU energy laws to 30. In addition, Energy Community Treaty Member States also apply the first and second energy market packages. The potential for conflict between the more liberalized EU energy *acquis* and the ECT as the minimum standard for its Member States (those not members of the EU or the Energy Community Treaty) grows in tandem with the number of Member States in each of the legal systems.

The European Commission's approach seems to be that the EU energy *acquis* is the dominant legal framework and that international law will have to adapt in order to correlate with EU energy law. In line with this, it seems that in the mind of the Commission, any and all conflicts fall under the competence of the ECJ (and not international arbitration). An interesting situation might have arisen had the proposal for mandatory ownership unbundling as a part of the third energy market package in 2009 been accepted by the European Parliament and the Council. In this situation, companies would have been able to initiate arbitral proceedings (under Article 30) against the EU under the ECT (claiming expropriation). Here, the increasing gap between the two legal systems creates a situation where the ECT can provide international law protection against excessive liberalization in the EU.

Interestingly, the relationship between the EU energy *acquis* and the ECT was one of the issues at stake in Case C-264/09, *Commission v Slovak Republic*. In this case, AG Jääskinen was of the opinion that the detailed provisions contained in Directive 2003/54 could not be overridden by the more general provisions contained in the Energy Charter Treaty.[100] He also took the view that EU energy law as it stands under Directive 2003/54 and Regulation No 1228/2003 cannot be considered as failing to achieve the standards required by the Energy Charter Treaty insofar as investments falling within the *ratione temporis* of those legislative acts are

[100] Case C-264/09, *Commission v Slovak Republic*, judgment of 15 September 2011 (not reported at time of writing), para. 61.

concerned. Moreover, with respect to the enjoyment and protection of investments, the general level of protection of fundamental rights provided by EU law affords protection to investors, which fulfils the obligations resulting from Articles 10(1) and 13(1) of the Energy Charter Treaty. Interestingly, the AG adopted the interpretation familiar from the *Kadi*[101] and *Al Barakaat*[102] cases heard in the Court of First Instance (now the General Court)[103] and noted that the capacity reservation contract at stake in that case was protected by Article 307(1) EC (now 351(1) TFEU), instead of the applicable international law instruments (the ECT and a BIT between Slovakia and Switzerland).

6.6 The Exportation of the EU Energy *Acquis*: From the ECT to the Energy Community Treaty

The EU clearly regards the exportation of its energy legislation to third countries as its preferred *modus operandi*. The EU attempts to expand the geographical area of implementation of the energy *acquis* in different ways, using different methods (formal legal methods and softer methods). Harder and more formal methods include the enlargement process and integration of new countries into the EU, the creation of the Energy Community Treaty bringing South East Europe under the umbrella of the EU energy *acquis* and expanding membership of this organization further east (Ukraine, Moldova, and so on). The softer methods include EU neighbourhood policies with North African or CIS countries and various memoranda of understanding with the CIS and Caspian countries. There was an attempt to adopt a similar approach with Russia, but this was abandoned for political reasons. In a similar way, various partnerships have been entered into as a softer method of gradually expanding the geographical scope of the EU *acquis*, including in the energy field.

6.6.1 The Energy Community Treaty

While the ECT was clearly inspired by the approach of the first EU energy market package, further integration and regulation of the markets through the ECT mechanism became—understandably—difficult. The reason for this was that Russia and other resource-rich and powerful nations would not compromise their approach to energy markets. The Energy Community Treaty was the next step in exporting the EU energy *acquis*. Based on various memoranda of understanding from 2002 and 2003, the Energy Community Treaty was signed on 25 October 2005 by the EU and the (nine, at time of wiritng) Member States of the Energy Community.[104]

[101] Case T-315/01, *Kadi* [2005] ECR II-03649.
[102] Case T-306/01, *Yusuf and Al Barakaat* [2005] ECR II-03533.
[103] G. De Burca, 'The EU, the European Court of Justice and the International Legal Order after Kadi', 1(51) *Harvard International Law Journal* (2009).
[104] At the time of writing the members are Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Moldova, Montenegro Serbia, Ukraine, and UNMIK. In addition,

In addition to the substantive provisions, the Treaty formalizes the institutional set up created though the above-mentioned memoranda of understanding and the Tirana Declaration. These institutions mirror those of the EU: there is a Ministerial Council (the role of which is similar to the EU Council), a Permanent High Level Group (much like the European Commission, it prepares Council decisions and ensures follow-up), a regulatory board, gas and electricity fora (which have a similar role to the Florence and Madrid fora), and a Secretariat.[105] The Secretariat reviews the proper implementation of the obligations contained in the Treaty by the Member States and submits an annual progress report to the Ministerial Council. As such, the Secretariat also acts as a 'guardian of the Energy Community Treaty'.[106]

The objectives of the Energy Community Treaty were described by the Commission in the following passage:

> 'Energy Community is about investments, economic development, security of energy supply and social stability; but—more than this—the Energy Community is also about solidarity, mutual trust and peace. The very existence of the Energy Community, only ten years after the end of the Balkan conflict, is a success in itself, as it stands as the first common institutional project undertaken by the non-European Union countries of South East Europe.'[107]

Regardless of its positive impact on trust and peace, it seems that the Energy Community Treaty is essentially inspired by two somewhat related objectives: EU energy security and the strong commitment to the export of the EU energy *acquis* to the neighbouring region. While an analogy can be drawn with the creation of the European Steel and Coal Community, which was the genesis of the EU,[108] it seems that the current focus of the Treaty framework is rather on EU energy security and the export of EU energy laws.[109] This type of approach is also visible on the website of the Treaty Secretariat: 'As of February 2011 [accession of Moldova and Ukraine], the Treaty rather aims at implementing EU energy policy in non-EU countries.'

The substantive provisions of the Energy Community Treaty identify certain EU law instruments which the Member States have to implement. The Treaty refers to the Second Internal Energy Market Package for electricity and gas from 2003.

14 EU Member States are 'participants' in the process (Austria, Bulgaria, Cyprus, the Czech Republic, France, Germany, Greece, Hungary, Italy, the Netherlands, Romania, Slovakia, Slovenia, and the UK) and Georgia, Norway, and Turkey have the status of Observers.
[105] M. Hunt and R. Karova, 'The Energy *Acquis* Under the Energy Community Treaty and the Integration of South East European Electricity Markets: An Uneasy Relationship?', in B. Delvaux, M. Hunt, and K. Talus (eds), *EU Energy Law and Policy Issues* (Brussels: Euroconfidentiel 2010), pp. 51–86.
[106] Report from the Commission to the European Parliament and the Council under Article 7 of Decision 2006/500/EC (COM(2011) 105 final) 10.3.2011.
[107] Report from the Commission to the European Parliament and the Council under Article 7 of Decision 2006/500/EC (COM(2011) 105 final) 10.3.2011.
[108] Press Release, 'The EU and South East Europe sign a historic treaty to boost energy integration', IP/05/1346, 25.10.2005. Clearly, the Balkan region had come from a period of war and conflict prior to the Energy Community Treaty. However, the focus has now moved beyond that region (with accession of Moldova and Ukraine).
[109] This was also underlined in K. Yafimava, *The Transit Dimension of EU Energy Security: Russian Gas Transit Across Ukraine, Belarus and Moldova* (Oxford: OUP 2011), p. 50.

In addition to this, certain directives on environmental protection and the promotion of renewable energy, and the main antitrust and state aid rules, had to be implemented. The subsequent additions and modifications to the EU energy *acquis* were made on the basis of decisions of the Ministerial Council. The directives on security of electricity and gas supply were added in 2007, while those on the energy performance of buildings, energy labelling, and energy end-use efficiency, and energy services were added in 2012.[110] In 2011, the Third Energy Package was added to the list of EU law that the Energy Community Member States had to implement (by January 2015). The contracting parties have moreover agreed to start implementing parts of Directive 2009/28/EC on the promotion of renewable energy and the 'Third Package' on the internal market in electricity and gas on a voluntary basis, as a first step, following recommendations issued by the Ministerial Council.[111]

Coming back to the two objectives (in practice, regardless of references to other objectives contained in the legal instruments) of security and the export of EU law, the accession of Moldova and Ukraine clearly reflect the first objective. By including transit countries within the ambit of EU law (and the EU institutions, since these, the European Commission in particular, have a significant role in the Energy Community[112]) the EU's control over flows of gas is greatly increased.[113] Considering the conflicts between Russia and Ukraine in this respect, it is hardly a surprise that the EU would like to play a stronger role in this country and in its gas trade with Russia. As noted by Yafimava, while there are clear benefits for the EU in the accession of Ukraine and Moldova, the benefits for these two countries from such accession (given the limitation on sovereignty involved) are much less obvious. She suggests that their willingness to sign up may be attributed to their aspirations to join the EU, which they are keen to avoid compromising by stalling on Energy Community membership.[114] In this regard, Hunt and Karova have referred to the 'EU membership carrot'.[115]

As far as export of the EU energy *acquis* is concerned, the first obvious question to be asked is how a legal regime incapable of achieving its intended objective can be exported. The Energy Community was initially based on the 2003 Energy Law Package, which at the time of implementation in the Energy Community countries

[110] Report from the Commission to the European Parliament and the Council under Article 7 of Decision 2006/500/EC (COM(2011) 105 final) 10.3.2011.

[111] Decision on the implementation of Directive 2009/72/EC, Directive 2009/73/EC, Regulation (EC) No 714/2009 and Regulation (EC) No 715/2009 and amending Articles 11 and 59 of the Energy Community Treaty, Ministerial Council Decision D/2011/02/MC-EnC, 5.10.2011.

[112] The EU is not only a party to the Energy Community Treaty but also acts as the the permanent Vice-President of the Energy Community. In addition, it has bilateral relations with the nine Energy Community Member States either in the context of the enlargement process or that of the European Neigbourhood Policy.

[113] K. Yafimava, *The Transit Dimension of EU Energy Security: Russian Gas Transit Across Ukraine, Belarus and Moldova* (Oxford: OUP 2011), p. 51.

[114] K. Yafimava, *The Transit Dimension of EU Energy Security: Russian Gas Transit Across Ukraine, Belarus and Moldova* (Oxford: OUP 2011), p. 51.

[115] M. Hunt and R. Karova, 'The Energy Acquis Under the Energy Community Treaty and the Integration of South East European Electricity Markets: An Uneasy Relationship?' in B. Delvaux, M. Hunt, and K. Talus (eds), *EU Energy Law and Policy Issues* (Brussels: Euroconfidentiel 2010), p. 59.

was already regarded as insufficient to create a properly functioning competitive market. The impact of the third package is still unclear and its ability to establish security of supply will only be seen over the coming years. However, given the shift from the more market-based philosophy of the first and second energy law packages towards more state and public sector control in the second energy law review and the subsequent legal and policy instruments, the export of the second and even the third package seems premature.[116]

One of the problems with the Energy Community Treaty is its actual implementation. This was specifically noted in the Commission report on the Energy Community Treaty: 'Bridging the existing gap between theory (political commitments) and practice (full implementation of the Energy Community *acquis* and enforcement of the rules adopted) remains the main challenge, and the key question is how to prompt Contracting Parties in the region to apply and enforce the rules.'[117]

It is hardly a surprise that a simple export of the EU model, embodied in the energy directives, would not work as envisaged. Liberalization and full competition are often not conducive to building modern new energy facilities, in particular when cross-border competition operates under more favourable conditions. These issues have not been fully appreciated as yet. They may in fact also delay the establishment of an efficient energy industry when full competition meets obsolete and unsatisfactory energy infrastructure. The solution here should be to identify where liberalization and competition will bring benefits, and where time-limited special regimes are necessary to encourage large-scale and long-term energy plant investment, instead of simply importing the EU model wholesale. It needs to be remembered that the implementation of the second package was highly problematic even within the EU. Furthermore, too much attention may have been paid to competitive markets, and not enough to the conditions for investment, including direct financial support, risk guarantees, and viable long-term contracts.

With the gradual expansion of the Energy Community, it must be noted that the South East European countries are, with respect to energy, in a very different situation from the Central Asian, Caucasus, and Caspian states. While the EU, before embarking on a process of liberalization, had an efficient and reliable energy infrastructure in place, this is not the case for Eastern Europe or the Central Asia, Caucasus, and Caspian region. Azerbaijan, Kazahkhstan, Turkmenistan, and Uzbekistan hold significant oil and gas reserves. Their problem was, and to an extent still is, internal political stability and internal as well as external security. They have been used as chess pieces in the post-Cold War rivalry between Russia and the US. Their interest is in depoliticizing energy relations and developing (and to some extent sharing with Russia) oil-based prosperity through investment, transit, and trade. The role of the EU and the TACIS programme in this area should have been to help to create an internal culture of law and order, to facilitate depoliticized and more commercially-oriented neighbourly relationships, and to help create transit

[116] This shift is examined in Chapter 7.

[117] Report from the Commission to the European Parliament and the Council under Article 7 of Decision 2006/500/EC (COM(2011) 105 final) 10.3.2011.

corridors through which to bring oil and gas to the markets, in particular Turkey and South East and East Europe. This emerged late, primarily through Nabucco, and was motivated by the aim of reducing dependency on Russian gas. But even here, the Chinese seem to be ahead in the great Caspian game—while Nabucco has remained a paper project with faith in it increasingly unclear,[118] the Chinese are already importing gas from the Caspian region.

There are significant political, geopolitical, geological, and developmental differences between these states and Western Europe, which means that the 'one size fits all' export model will not work. Instead, a more gradual and flexible approach should be adopted. The degree of flexibility offered by Article 24 of the Energy Community Treaty is likely to be insufficient.

6.7 Finally: Who Steers the Boat? Who Represents the EU? The EU Speaking with One Voice

With the slow emergence of certain elements of the EU's common external energy policy, the European Commission has been asking for a more united front and a more coherent approach to the EU's external energy relations. From 'a need for better coordination of EU and Member States' activities with a view to ensuring consistency and coherence ... with key producer, transit and consumer countries'[119] to the demand that EU Member States *speak with one voice*,[120] the Commission has pushed for more competence to act in respect of external energy relations. These efforts have led to two related developments: some elements of a common external energy policy have emerged and the Commission is establishing itself as the leading actor in this area.

In the early part of 2011, the European Council asked the Commission to prepare a communication on security of supply and international cooperation in order to improve the consistency and coherence of the EU's external action in the energy field.[121] It was thought, in particular, that the EU should take initiatives:

'... in line with the Treaties in the relevant international fora and develop mutually beneficial energy partnerships with key players and around strategic corridors, covering a wide range of issues, including regulatory approaches, on all subjects of common interest, such as energy security, safe and sustainable low carbon technologies, energy efficiency, investment environment maintaining and promoting the highest standards for nuclear safety.'[122]

[118] In addition to the competition from the South Stream project, it faces competiton from EU projects like ITGI (Interconnector Greece-Turkey-Italy) and TAP (Trans-Adriatic Pipeline).

[119] Commission, 'Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy', COM (2006) 105 final, 8.3.2006, p. 14.

[120] Commission Communication, 'An EU Energy Security and Solidarity Action Plan', COM (2008) 781 final, 13.11.2008, pp. 3 and 17.

[121] European Council, 'Conclusions on Energy', 4 February 2011 (EUCO 2/1/11 Rev 1, 8 March 2011), p. 4.

[122] European Council, 'Conclusions on Energy', 4 February 2011 (EUCO 2/1/11 Rev 1, 8 March 2011), p. 5.

In response to this, the European Commission adopted its Communication on security of energy supply and international cooperation—'The EU Energy Policy: Engaging with Partners beyond Our Borders'—on 7 September 2011. As part of the package adopted that day, the Commission proposed that the Parliament and the Council take a decision setting up an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the energy field. The proposal urged that Member States be required to advise the Commission of all new and existing bilateral energy agreements with third countries.[123] (This also relates to the Council meeting in February 2011 which, in addition to this notification and other requirements, also invited the High Representative to take full account of the energy security dimension in her work.[124]) In addition to this notification requirement (increasing transparency), the proposal aims at strengthening coordination when approaching partner countries, adopting a common position in international organizations and developing comprehensive energy partnerships with key partner countries.[125] The stated objective of the proposed mechanism is to 'strengthen the negotiating position of Member States *vis-à-vis* third countries, while ensuring security of supply, proper functioning of the internal market and creating legal certainty for investment'. However, this is hardly the case in practice. In this regard, the second development is clearly visible: strengthening the role of the European Commission. The trend here seems to be in the direction of a more European-style foreign energy policy.[126] In addition to the information required by the Commission, a Member State 'may' request the assistance of the Commission in negotiations with a third country when entering into such negotiations in order to amend an existing intergovernmental agreement or to conclude a new intergovernmental agreement. But there is more: the Commission will also have *ex ante* control over intergovernmental agreements. The Commission may on its own initiative assess the compatibility of the negotiated agreement with EU law before the agreement has been signed. If there is concern over the issue of compatibility, the negotiated but not yet signed draft intergovernmental agreement will be submitted to the Commission for examination. The Member State concerned has to refrain from signing the agreement for a period of four months following the submission of the draft intergovernmental agreement. Finally, the Commission grants itself the right to 'negotiate EU level

[123] Proposal for a Decision setting up an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy, COM(2011)540, 7.9.2011, Article 3.

[124] European Council, 'Conclusions on Energy', 4 February 2011 (EUCO 2/1/11 Rev 1, 8 March 2011), p. 4.

[125] Proposal for a Decision setting up an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy, COM(2011)540, 7.9.2011. See also Commission, Speaking with one voice—the key to securing our energy interests abroad, Press Release IP/11/1005, 7.9.2011.

[126] See the discussion in J.-P. Pielow and B. J. Lewendel, 'Beyond "Lisbon": EU Competences in the Field of Energy Policy', in B. Delvaux, M. Hunt, and K. Talus (eds), *EU Energy Law and Policy Issues* (Cambridge: Intersentia 2011).

agreements with third countries where necessary to achieve the EU core objectives, for example to facilitate large-scale infrastructure projects'.[127]

This is not a merely theoretical possibility, as the Trans-Caspian Pipeline System case shows. Here, the EU mandated the European Commission to negotiate a legally binding treaty between the EU, Azerbaijan, and Turkmenistan to build a Trans-Caspian Pipeline System on behalf of all 27 EU Member States. Related to the EU-backed Nabucco project, this is the 'first operational decision as part of a co-ordinated and united external energy strategy', as proposed in the European Commission's Communication on security of energy supply and international cooperation—'The EU Energy Policy: Engaging with Partners beyond Our Borders'. Commenting on this development, Energy Commissioner Oettinger stated that 'Europe is now speaking with one voice',[128] at least in this particular case.

6.8 The EU and International Energy Trade: Governance, Sanctions, and Ethics

As energy markets internationalize and become part of the global economy, politicization follows. Political conflicts once arose from action taken by national governments, but in the global economy the influence of governments is diluted and that of markets increases. This does not mean that political issues fade away, but rather that political focus moves away from an exclusive focus on governmental action to the action of the actors visible in the global economy—mainly multinational companies, international agencies, and non-state actors such as NGOs and business organizations.[129] As political parties engage mainly in the competition for votes in formal elections, NGOs have taken over a substantial role in politicizing international relations, in particular by focusing on specific situations and value clusters (the environment and human rights, wildlife, indigenous people). These, naturally, represent the core contemporary values of the politically dominant middle classes in the prosperous Western societies. With the collapse of communism and the Cold War, NGOs and 'civil society'—a term encompassing the self-appointed guardians of high moral values of the West—have become the main voice of opposition and criticism. The internet has proved an effective tool for bringing together geographically distanced people and groups more rapidly than was previously possible, and for organizing action aimed at capturing public opinion—as demonstrated, for instance, in the unfolding of the 'Arab Spring'.[130] It has thus helped to influence formal political processes resulting in 'law', and has also, for NGOs engaged in

[127] Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on security of energy supply and international cooperation—'The EU Energy Policy: Engaging with Partners beyond Our Borders', Brussels, 7.9.2011, COM (2011) 539 final.

[128] Commission press release, 'EU starts negotiations on Caspian pipeline to bring gas to Europe', IP/11/1023, 12.9.2011.

[129] S. Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: CUP 1996) and J. Mitchell (ed.), *Companies in a World of Conflict* (London: RIIA 1998).

[130] For the role of internet and modern telecommunications, see P. Stevens, *The Arab Uprisings and the International Oil Markets* (London: Chatham House 2012).

intense competition, served to develop their profiles (i.e. a kind of 'brand value' in the minds of the public), which helps raise funds, drum up support, and coordinate efforts. Political parties, suddenly subject to such competition from outside of the oligopoly of election contests, are compelled to pay attention to and follow NGO campaigns which are proving adept at grabbing public attention. But what does all of this have to do with the external dimension of EU energy law?

The EU institutions, in particular the Commission, have very little political legitimacy, and must therefore take care to be seen to respond to demands from 'civil society' in order not to alienate their supporters. The OECD, for the public a largely faceless talking shop for bureaucrats, has learned through the failure of the Multilateral Agreement of Investments (MAI)[131] that an international organization now has to develop the capability to engage meaningfully with 'civil society',[132] a point which has been taken up with much more vigour by the World Bank and the WTO.[133] NGO pressure therefore works directly on the Commission, but also through the European Parliament (EP), since this institution also, and perhaps to an even greater extent, needs to develop a level of political acceptance that more closely reflects its formal political legitimacy (which is itself in heavy deficit). As energy markets internationalize, political attention, now largely activated by NGOs in conjunction with the educated media,[134] focuses on what international agencies and multinational companies do. As NGOs, in combination with the media, do not make a living out of positive news or support, but rather out of focusing on and highlighting 'scandal', accompanied by outrage, their influence is both negative (i.e. making existing activities more difficult) and positive (i.e. pushing international agencies, in particular, in the desired direction).

The confrontation between NGOs/'civil society' and international energy companies is typically focused on a particular situation. It may also be characterized by fractious relations between federal governments and several, competing local populations, possibly involving breaches of rules of criminal procedure regarded as fundamentally important in Western countries (e.g. the Ogoniland trial and the execution of Ken Saro-Wiwa).[135] Examples of typical cases include the (legal and approved) abandonment of an offshore platform, in the Shell—Brent Spar case; the

[131] Details are provided at <http://www.oecd.org/investment/investmentpolicy/multilateralagreementoninvestment.htm> (last accessed 6.8.2012).

[132] D. Henderson, *The MAI Affair: A Story and its Lessons* (London: RIIA 1999), J. Huner, 'Lessons from the MAI: A View from the Negotiating Table', in H. Ward and D. Brack (eds), *Trade, Investment and the Environment* (London: Earthscan 2000), p. 242.

[133] H. Bergesen and L. Lunde, *Dinosaurs or Dynamos? The United Nations and the World Bank at the Turn of the Century* (London: Earthscan 1999).

[134] It should not be forgotten that a significant influence even on EU external energy policy comes the discussion and interpretation of events in the *Financial Times*, *The Economist*, *Wall Street Journal*, *Le Monde*, *New York Times*, *Frankfurter Allgemeine Zeitung*, and *Neue Zuercher Zeitung*. Political capital dissipated from the MAI negotiations not only because of NGO criticism (as a rule misinformed and emotionally agitated), but because of critical reporting in the *Financial Times* (Guy de Jonquiéres). The Secretary General of the Energy Charter Secretariat was ousted in December 1999 largely because of *Financial Times* criticism.

[135] Shell, Brent Spar case, S. Howarth, *A Century in Oil: The Shell Transport and Trading Company 1897–1997* (London: Weidenfeld 1997), pp. 334–6, 338. See also, <http://www.guardian.co.uk/world/2009/jun/08/nigeria-usa> (last accessed 6.8.2012).

(legal) exploitation of oil in the Nigerian Delta area; exploration for oil in areas populated by indigenous people (Ecuador); the exploitation of minerals in an area characterized by tensions between central government and local people (Ok Tedi and Bougainville, Papua New Guinea); oil development under a (legal) concession from the (legal) government involved in a civil war of secession (Talisman in Sudan); human rights violations by security forces to protect a BP pipeline in Colombia; and the use of forced labour by government services to support infrastructure for an oil pipeline in Burma.[136] In all of these cases, companies were acting legally, in full conformity with national law and with the consent of the national government. The government, however, employed practices regarded as typical of 'underdeveloped' countries (the nineteenth century term was more pejorative: 'uncivilized') in its fraught relations with secessionary movements or local, often indigenous people. NGO campaigns are aimed not only at the companies (where they have an effect), but also at harnessing the regulatory power both of governments and of international organizations such as the EU. The stated aim is to use the financial and political leverage of the EU—as well as that of multinational companies—to improve the 'governance' of the developing countries. Energy—here oil and gas development—is one of the prime targets. The reason for this is that the oil and gas industry seeks to investigate newly discovered geological targets, which tend increasingly to be found in developing countries and remote areas. The EU therefore comes under increasing pressure to take action, or at least to go through the motions of doing so, to combat visible human rights violations and avert environmental disasters in connection with the oil and gas operations of EU-based companies in particular. However, the issue is wider than that. The failure of statist systems in developing countries to supply enough energy for rapidly escalating needs has led to large-scale privatization and opening-up of energy investment opportunities. EU companies—in order not to lose out in global competition (with Chinese and US companies)—have now followed suit and acquired and established power plants, transmission grids, distribution systems, and gas pipelines particularly in resource-rich or energy-hungry large developing countries (Pakistan, India, Indonesia, Argentina, Brazil, and Bolivia). These operations may sometimes have the human rights and environmental implications of the typically more remote-area investment of oil and gas but such investment is principally carried out under conditions of governance which do not correspond to the reality, or ideal, of Western countries. This applies in particular to the widespread corrupt practices required to do business, or at least to the equivalent practice of having to co-opt the local strongman's cronies. As these matters are now common knowledge, pressure is mounting both on companies and on the EU and national governments to introduce national and international regulation to combat such features of bad governance. The new international and national regimes on anti-corruption are just one example of this.[137] The EU is

[136] This was suggested in: <http://www.independent.co.uk/news/world/asia/burmese-villagers-forced-to-work-on-total-pipeline-1771876.html> (last accessed 6.8.2012).
[137] For this, see L.A Low, T.K Sprange, and M. Barutciski, 'Global Anti-corruption Standard and Enforcement: Implications for Energy Companies', 3(2) *Journal of World Energy Law and Business* (2010), pp. 166–213.

certainly responding to these pressures. The inclusion of 'good governance' obligations, reflecting NGO and EP pressure, is now a mandatory feature of international agreements. The rapid recent progress on these matters can be observed by comparing the ECT and the Cotonou Agreement. The ECT, negotiated during 1992–94, includes no specific 'governance' provision. The Cotonou Agreement of 2000 is replete with 'civil society' elements. For instance:

- Article 6 specifically mentions 'civil society in all its forms' and NGOs as 'actors of cooperation';
- Article 8 contains an obligation for there to be 'political dialogue' relating to the arms trade, organized crime, ethnic, religious or racial forms of discrimination, but also human rights, democratic principles, the rule of law, and good governance;
- Article 9 covers human rights and sustainable development, the equality of men and women, and transparent and accountable governance;
- Article 10 mentions the need for the greater involvement of civil society and justice;
- Article 10 deals with the protection of the rights of female children;
- Article 31 deals with women's access to economic and other resources; and
- Article 97 covers corruption.

These provisions give the EU a basis on which to exercise leverage, be it through the dialogue envisaged under the agreement, through formal arbitration (Article 98)—and presumably by withdrawal of financial and technical assistance—and/or also through the significant trade concessions provided for the ACP countries under the Treaty ('appropriate measures', Article 96). In essence, the agreement provides a stick of political, financial, and trade character, which the EU can use to sanction ACP countries (i.e. former colonies) that do not mend their ways. The legal reciprocity of this treaty does not obscure the fact that it is in essence an instrument to legitimize the overwhelming leverage available to the EU against misconduct by developing countries which, by definition, have weak governance structures. For the energy sector, this means that projects which are a governance liability—which is to say, virtually any project in any developing country—is now burdened with the risk of NGO campaigning, reverberating with shareholder pressure and sometimes public-opinion-focused litigation,[138] with economic sanctions by the US government, and now also the prospect of the country in question being blacklisted by the EU and having financial assistance and trade concessions withdrawn. It is not that business cannot continue under these conditions, but that it is likely to become 'rogue business' done in the shadows, with large profit margins for adventurous companies and with an entry-point for international crime.[139]

[138] H. Hongju Koh, 'Transnational Public Law Litigation', 100(2347) *Yale Law Journal* (1991).
[139] This was discussed in the Bingham report on oil supply against UN sanctions to South Africa: T. Bingham and S. Gray, *Report on the Supply of Petroleum and Petroleum Products to Rhodesia* (London: HMSO 1978).

The implication of this emerging international law of 'good governance'—embodied in treaties such as the Cotonou Agreement, the OECD Anti-Bribery Convention, international human rights treaties, numerous guidelines, codes of conduct serving as aid conditionalities, as well as the emerging civil law on the corporate liability of multinational companies—is, *inter alia*, that companies, international organizations and governments cannot rely on the defence of 'compliance with national law'. The strong emphasis on non-intervention into the domestic affairs of another state, enshrined in the UN Charter and the World Bank Convention, are *de facto* superseded, in the eyes of the 'civil society' movement in Western countries, by good governance considerations. The pendulum—which in the 'New International Economic Order' (NIEO) era emphasized an extreme 'absolute state sovereignty', the Calvo Clause, permanent sovereignty over natural resources and economic activity, the inadmissibility of any foreign intervention into national affairs, and the exclusive jurisdiction of host (developing) states—has swung back 180° to its opposite.[140]

An as yet inchoate principle of the international customary or comparative law of major Western countries may be emerging, according to which multinational companies will bear some responsibility for serious breaches of good governance principles when their investment supports the activities of certain governments.

But these developments are not as 'good' or 'godly' as they may appear to activists at first sight. They place the principal targeted actors on the horns of a series of dilemmas: the EU and its Member States depend, increasingly, on energy imports overwhelmingly from states that could easily become the targets of sanctions. Most of the petroleum producers (notably Saudi Arabia) have not acceded to the major human rights conventions; Russian and Chinese practices against secessionist movements are not that different from those practised by Sudan. The *raison d'être* of oil companies is to go out and get the oil where it is located—if this was forbidden, they would go out of business, and Western societies would slip into crisis. The idea that benevolent intervention from outside will solve deep-rooted domestic problems has as a rule not worked in practice. Financial and technical assistance, and trade, are ways to make properly functioning economies more prosperous and civilized, but cannot contribute greatly to the resolution of deep internal government problems. The past decades of development have not eradicated bad governance or poverty, and there is no indication that changing tack towards imposing Western cultural concepts borne out of specifically Western experience would suddenly prove more successful. The current approach adopted both by governments and by the EU (and its Member States) is to emphasize the human rights element as much as possible for public consumption, but to try to avoid taking treaty language formulated primarily for public relations purposes too seriously. While Sudan and Sierra Leone might be suitable targets for trade sanctions, China, Russia, and Saudi Arabia are not. This pattern replicates the internal EU pattern of political

[140] T. Wälde, 'A Requiem for the "New International Economic Order"', in G. Hafner et al. (eds), *Festschrift Ignaz Seidl-Hohenveldern* (The Hague: Kluwer Law International 1998), pp. 771–804.

sanctions—e.g. all well and good against Austria, but not against some other EU countries. A system of partly recognized hypocrisy is of doubtful value, as it downgrades the moral legitimacy both of the values that are pursued hypocritically and of the institutions involved in such pursuit.

There is more to the issue of the pursuit of good governance through treaties. The imposition of Western values via treaties, money, aid, and trade with former colonies may seem workable now. It did not work in the period when there was a balance of power between East and West: developing countries, newly decolonized, then had much more breathing space in which to indulge in exaggerated notions of absolute sovereignty. With the rise of the Asian economies (China in particular) our current good governance mode of relations with the developing countries might at some point be put under pressure. It is hard to deny that the modern-day 'civil society' use of EU, governmental, and market powers to impose values on the weaker countries, albeit intended to be for 'their' benefit, has a heady whiff of the nineteenth century. Then, as now, missionary societies went out, privately funded, but with government support, to civilize the savages. Trade, aid, and missionaries went hand in glove. The essential precondition for this state of affairs was a strong imbalance of power and the absence of an effective opposing force—the colonizing countries may have competed with one another in their carving-up of the globe, but there was no fundamental dissent in the 'concert of the great powers' over the missionary mandate of the colonial powers. Perhaps such a revival of a neo-colonialism which accepts the formal trappings of statehood acquired in the decolonization process, but not the rule of non-intervention, is an inevitable consequence of our era's highly unequal relationships of economic, technological, cultural, political, and military power. But it is not guaranteed to last.

As to the future influence of good governance principles on the EU's external energy policy and law, mainly through treaties based on the EU's economic leverage, these may work better with weaker countries (i.e. not Russia, India, and China), and in countries with no large—and therefore crucial—petroleum potential, than with major oil and gas producers (e.g. Saudi Arabia). In addition, it remains to be seen whether the leverage potential in agreements such as the Cotonou Agreement can realistically be activated. Any imposition from abroad is bound to lead to resistance, as colonial and post-colonial history shows.

Economic sanctions are one of the principal instruments of international coercion, and have been a particular problem for the energy sector, given its need to go into problem countries where energy resources are often to be found. Just consider the current situation with Iran, a country with major oil and gas resources. At an international level, UN sanctions against Iran currently comprise four Security Council resolutions imposing arms embargoes, travel bans on individuals associated with the regime and the freezing of those individuals' assets located in foreign bank accounts.[141] At national or regional level, EU Council Decision 2012/35/

[141] UN Security Council Resolutions 1737 (23 December 2006); 1747 (24 March 2007); 1803 (3 March 2008); and 1929 (9 June 2010). UN Security Council Resolution 1835 (27 September 2008) reaffirms 1737, 1747 and 1803, but does not impose further sanctions. For details see M. Parish and T. Fresquet, 'International Sanctions and How to Evade Them', 3 *OGEL* (2012), <http://www.ogel.org>.

CFSP bans the sale of equipment related to the petroleum industry to Iranian entities or entities controlled by Iranian citizens.[142] Similarly, the United States has added Iranian entities to the list of entities with which US persons and entities are prohibited from dealing.[143] The UK maintains a similar list.[144] As a result, the Chinese companies are moving in and securing large contracts with Iranian companies.

These sanctions bring an additional politicization to commercial relationships which are made more difficult in the first place by internal politics in the host state, the home state, often also in transit states, as well as by international politics in general.[145] Corporate management now faces not only the challenge of managing very complex political risks in the oil and gas rich states, but the new and additional risk of international sanctions, as well as the new type of public relations and market-based sanctions engineered by NGOs. They are still expected to bring the petroleum to market, but are now also held liable for the actions of 'uncivilized' governments, over which companies have little, if any, influence. As part of external EU energy-related law, sanctions have two sides. First, as a sender organization, the EU imposes sanctions.[146] Secondly, the EU itself has not been subject to political sanctions,[147] but oil companies domiciled within its Member States have been subject to US economic sanctions for investment in Cuba, Libya, and Iran: in this regard, the EU is not an imposer of sanctions, but a defender of its own companies against US sanctions. Both sides should be examined more closely.

As an imposer of sanctions (the prohibition of trade and the interruption of services), the EU as a rule participates in sanctions decided by the UN Security Council and binding on Member States under Article 25 of the UN Charter. In addition to the Iran sanctions noted, pertinent sanctions were imposed on Iraq, following the invasion of Kuwait, pursuant to UN Security Council Resolution 661 (1990), which forbade all commercial transactions promoting, *inter alia*, the export of oil or oil products from Iraq.[148] Sanctions were also imposed by dint of

[142] Council Decision 2012/35/CFSP of 23 January 2012 amending Decision 2010/413/CFSP concerning restrictive measures against Iran, Article 4a.

[143] Iranian Transaction Regulations 31 C.F.R. § 560, administered by the U.S. Treasury Department's Office of Foreign Assets Control (OFAC).

[144] Details available at <http://www.hm-treasury.gov.uk/fin_sanctions_index.htm>. For details see M. Parish and T. Fresquet, 'International Sanctions and How to Evade Them', 3 *OGEL* (2012), <http://www.ogel.org>.

[145] On sanctions in oil and gas: T. Wälde, 'Managing the Risk of Sanctions in the Global Oil and Gas Industry', 36 *Texas International Law Journal* (2001), pp. 184–230 and B. Cova, 'The European Response to US Extraterritorial Legislation', 15 *OGTLR* (1997), p. 353.

[146] Like Council Decision 2012/35/CFSP of 23 January 2012 amending Decision 2010/413/CFSP concerning restrictive measures against Iran.

[147] With the exception, naturally, of WTO-based trade sanctions, mainly by the US (i.e. higher tariffs, import restrictions and quota, and anti-dumping measures). EU companies will have been subject to sanctions for dealing with Israel (anti-Israel boycott blacklist by Arab League).

[148] As is generally the case, these sanctions could be circumvented. See M. Parish and T. Fresquet, 'International Sanctions and How to Evade Them', 3 *OGEL* (2012), <http://www.ogel.org>. As noted by the authors: 'The legacy of Iraqi sanctions will forever be associated with the corruption in the 'Oil for Food' Programme, a UN-approved exception to the sanctions regime (The 'Oil-For-Food Programme' was established by UN Security Council Resolution 986, 14 April 1995) in which Iraq would be permitted to sell oil, the purchase price for which would be paid into an escrow account and subsequently released to the Iraqi government to purchase essential approved items for civilian use.

Resolution 748 (1992) against Libya, following the Lockerbie bombing. These were more limited in scope, involving a prohibition against trade in goods and services. A contractor from a sanctioned country who suffers commercial losses is not entitled to compensation.[149] The problem of economic sanctions is that they provide a competitive advantage to companies not subject to sanctions, whether by law or through non-enforcement in their home state. Economic sanctions typically engender a grey and black market for sanction-breakers[150]—such as the subsidiaries of respected international oil companies in the 1970s sanctions against Rhodesia. In most cases, the effective imposition of sanctions requires a multilateral regime, normally initiated by a UN Security Council Resolution, followed by serious enforcement by all UN member countries, and even then sanctions are not full-proof. The closer to being unilateral a sanction is, the less prospect it has of being effective. Conversely, the more multilateral it is, the more universally and more effectively enforced, and the more embedded in public opinion, NGO attention, and corporate management, the better it usually works. Large EU energy companies usually—which was not necessarily the case in the 1970s—comply with sanctions. They are also less likely to participate in the grey and black market of sanction-breaking where the profits to be made usually reflect the level of risk involved—the better the enforcement, the higher the profit premium and the greater the sanction-breaking incentive for risk-taking commercial and criminal operators. One of the consequences that arises when sanctions are inadequately enforced is that the sanctioned country indirectly bears the sanction-breakers' risk premium. There is usually also a quiet race among oil companies to occupy positions within the sanctioned country (e.g. Iraq, Libya, and Iran), thus putting themselves in pole position rapidly to edge out more compliant competitors as far as exploration, production, and exportation are concerned once sanctions are lifted. The oil trade, being much less visible and notoriously difficult to control, is likely to involve many more oil trading firms than the much more visible investment. While sanctions may not achieve their intended objective, they may be more important as a political signal made by the sender countries (e.g. the EU) both to the target state and its allies, and as a symbol of a proper response (even if ineffectual) to domestic political pressures.

The other side of the EU coin on sanctions is where EU companies are penalized by US sanctions affecting non-US citizens and activities in EU territory ('extraterritorial sanctions'). Energy, again, is a primary area of application for such sanctions. The US is the most active imposer of economic sanctions, which largely appear to exist in order to appease its large number of émigré communities harbouring a particular grudge and, more recently, the NGO movement.[151] The problem is that sanctions

Part of the escrowed funds would be withheld to pay Kuwait war reparations and for UN operating costs. It subsequently emerged that skim payments were being withdrawn from the fund and paid to Iraqi and UN officials.'

[149] Case C-237/98 P, *Dorsch Consult v Council and Commission* [2000] ECR I-4549.

[150] On the ways to effectively circumvent the sanctions, see M. Parish and T. Fresquet, 'International Sanctions and How to Evade Them', 3 *OGEL* (2012), <http://www.ogel.org>.

[151] Section 232(b) of the Trade Expansion Act of 1962 (19 USCA § 1862) as amended, has been used to ban importation of oil products from certain embargoed countries, such as Libya in 1982 (47 Fed.

in which the major economic actors do not participate tend to achieve nothing but confer a competitive advantage on companies from countries outside the US. To issue sanctions and then see economic competitors benefit from such action, with little damage to the target, is clearly not very satisfactory in the US political process. Therefore, and also through the tradition of missionary politics[152] and US hegemony,[153] the US has on several occasions over the last 50 years designed sanctions which were applicable to subsidiaries of US companies incorporated abroad (e.g. the *Fruehauf* case), to European companies involved in the purchase of Russian gas and construction of pipelines in the early 1980s, to non-US companies investing in the oil and gas sector in Libya and Iran, and to non-US companies conducting any business in Cuba.[154] The EU considers the extraterritorial reach of such sanctions to be a contravention of international law. However, international law does not condemn extraterritorial regulation per se, since there are several recognized exceptions; in addition, a multilateral, UN-covered sanction regime can probably legitimately affect persons and activities outside the territorial jurisdiction of the sanctioning state. But US sanctions—mainly the imposition of specific sanctions relating to access to the US capital markets for non-US companies—which are unilateral, not covered by a formalized international consensus, and represent a response to actions that do not directly affect US rights, are regarded as incompatible with the international law principle of territorial sovereignty. This view is held almost universally, and even to a large extent within the US international law community. The EU, and various states, have reacted with 'blocking statutes'[155] which forbid compliance with US sanctions and contain certain counter-sanctions applicable to US legal or natural persons trying to enforce, in particular, the Helms-Burton Act rights against non-US citizens conducting business in Cuba. The EU has also initiated proceedings through the WTO dispute settlement system asserting breach of a number of WTO disciplines.

It is difficult to reach a conclusive judgement on the EU's recent opening up to 'civil society' as this is a matter very much in flux. It is hard to distinguish between what is the current fashion of political correctness, and what is a longer-lasting trend towards the application of Western cultural ideas about good governance to non-Western societies, at the instigation of and under pressure from NGOs, which

Reg. 10507 (1982)) and Iran in1979 (44 Fed. Reg. 65581 (1979)). For this, see K. Talus and M.A. Nunes, 'Regulation of Oil Imports in the United States and the European Union', 2 *OGEL* (2011), <http://www.ogel.org>. Extensive literature: T. Wälde. 'Managing the Risk of Sanctions in the Global Oil and Gas Industry', 36 *Texas International Law Journal* (2001), pp. 184–230.

[152] H. Kissinger, *Diplomacy* (New York: Simon & Schuster 1994).

[153] L. Brilmayer, *American Hegemony, Political Morality in a One-superpower World* (New Haven: Yale University Press 1994).

[154] For a pro commentary: A. Lowenfeld, 'Congress and Cuba: The Helms-Burton Act', 90(419) *AJIL* (1996) considering the US legislation illicit; see, contra commentary, B. Clagett, 'Title III of the Helms-Burton Act is Consistent with International Law', 90(434) *AJIL* (1996).

[155] EU Council Regulation No. 2271/96 of 22 November 1996—published with the similar Canadian Foreign Extraterritorial Measures Act and the Mexican Act to Protect Trade and Investment from Foreign Norms that contravene international law are all published with notes in: 36 ILM 125 (1997), 36 ILM 111 (1997), and 36 ILM 133 (1997).

are mainly self-appointed, but which as a conduit for public opinion are often—though not consistently—influential guardians of such values. There are elements of hypocrisy, of missionary proselytizing for values against societies who may not want such values, but are too weak to fight back. There may also be elements which help to make international relations more civilized and indirectly prosperous by providing a social dimension to the otherwise purely economic impact of globalization. It is likely that we will see, on the one hand, minimum rules of civilized governance, and on the other an increasing contradiction between values promoted by quite different interest and quasi-religious value groups. The EU would do well to take a very cautious line. If it embraces the 'civil society' with excessive enthusiasm, it also risks the possibility that its growing legitimacy becomes undermined by the inevitable contradictions between solid interests (e.g. in energy supply and prosperous commercial relationships under a commonly agreed legal order) and the much fuzzier and volatile ideologies of the day. There is an argument for helping societies move to more law, order, and security if they are on that road already and if there are vigorous domestic forces in that direction; but there is little practical argument in favour of trying to foist European values and system on societies which are not prepared, not interested, and which perhaps are even, surprising as this may seem to neo-missionaries, attached to their own, distinct system of values. A safe and civilized international intercourse may be a more reasonable and realistic goal than taking up the 'white person's burden' to better the modern-day 'sullen people'.

Section 6.9 deals with a different but related issue: the impact of international law on trade in energy. The discussion of this topic focuses on environmentally-motivated import restrictions and WTO law.

6.9 The Impact of International Law: Trade in Energy Goods and Services and Environmental Protection

In the 'good old' energy monopoly days, energy trade was not an issue. State-owned or protected monopolies 'exchanged' electricity at times, but only if both they and the states involved wanted to do so—there was no need to rely on international trade law to obtain access, reduce tariffs, eliminate non-tariff trade barriers, combat state aid, and participate in the procurement of energy by public agencies. The oil trade was liberalized in developed countries in the 1980s; since the consuming countries are mostly dependent on oil, there were no tariffs on imported oil (excepting some protectionist measures put in place in the US before the first oil price hike in 1972).[156] Nor were they any significant non-tariff barriers (e.g. regulation, standards, import licensing practices).[157] As first oil, electricity, and then increasingly gas (by

[156] See K. Talus and T. Nunes, 'Regulation of Oil Importation to United States and European Union', *OGEL* (2011).

[157] See K. Talus and T. Nunes, 'Regulation of Oil Importation to United States and European Union', *OGEL* (2011).

pipeline and LNG) started being traded across borders, into increasingly competitive markets, issues relating to tariff and non-tariff barriers inevitably began to arise. First, protectionist sentiments, translating into trade restrictions against imports of primary energy sources, sometimes appeared. This is rare, but has been an issue twice in periods of low oil prices imposed by high-cost US producers against oil imports—arguing that lower oil prices prevailing in the producer countries (Venezuela, Mexico) plus the predominant role of the state with no clear distinction between government and state enterprise budgets indicated either dumping or export subsidies—to be countered by US anti-dumping duties or other import restrictions. The German coal subsidy scheme (including direct subsidies and domestic minimum purchase obligations) can be seen in a similar light as representing protection for German coal against more competitive energy sources and against coal imports.

Trade restrictions typically come into play as more value is added by the producer (thus threatening importer state refining and petrochemical industries), but also as different regulatory and tax regimes change the elusive 'level playing field' to which all theorists aspire. Under GATT, a US import restriction on Venezuelan and Brazilian gasoline was held to be discriminatory. While there was a worthwhile environmental rationale for this, its application was discriminatory and favoured US competitors.[158] Under Chapter XI of NAFTA, trade restrictions on certain chemicals and hazardous waste may have been, according to the plaintiff and at least one arbitral tribunal, an environmental cover for what was in effect protectionist discrimination.[159] These cases illustrate the growing importance of real—and fake—environmental policies used to justify trade restrictions.[160]

Within the EU, the modified EU ETS Directive under Directive 2009/20/EC[161] refers to import restrictions relating to differences in requirements in the EU and other countries:

> 'Energy-intensive industries which are determined to be exposed to a significant risk of carbon leakage could receive a higher amount of free allocation or an effective carbon equalisation system could be introduced with a view to putting installations from the Community which are at significant risk of carbon leakage and those from third countries on a comparable footing. Such a system could apply requirements to importers that would be no less favourable than those applicable to installations within the Community...'

[158] WTO Appellate Body: Report of Appellate Body in US—Standards for Reformulated and Conventional Gasoline, 35 ILM 603 (1996).

[159] *Myers* case, export restriction on hazardous waste to favour a Canadian competitor; *Ethyl* case, trade restriction on hazardous chemical, but without a similar impact on Canadian competitors; *Ethyl Corp v Government of Canada*, 38 ILM 700 (1999) (settled in favour of plaintiff before final award); *Myers v Canada*, <http://www.naftaclaims.com>.

[160] S. Moreno, J. Rubin et al., 'Free Trade and the Environment: The NAFTA, the NAAEC', 12 *Tulane International Law Journal* (1999), pp. 405–58, P. Mavroides, 'Trade and Environment after the Shrimps-turtles Litigation', 34 *Journal of World Trade* (2000), pp. 73–88.

[161] Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community, OJ L 140, 5.6.2009, pp. 63–87.

The obvious question is, of course, whether this type of scheme is in line with the WTO rules.

Over ten years ago, the Commission raised the issue of 'unfair competition' in relation to power plants not subject to strict EU environmental standards and in relation to 'unsafe' export of nuclear plants into the EU. It argued that unlimited access would undermine the basis of the EU energy liberalization process, which requires a 'level playing field'. It also referred in this context to the need for political and environmental acceptance if the view were that such imports would facilitate the continuation of unsafe operations.[162]

What is environmentally beneficial or needed in the name of the environment in practice is, of course, a different question from what appears in legislation on the subject. It is usually quite easy to assert from a self-centred national perspective that the environmental regulation in one's own country is superior to others, but more difficult to sustain this assertion once an objective and balanced assessment has been made. For example, the oft-cited higher quality of German environmental legislation relating to energy must be set against the fact that Germany has by far the highest CO_2 emissions in the EU, and against the fact that for decades it actively subsidized—and fought for EU state aid exemption for—its environmentally extremely damaging coal production, and the mandatory use of this coal for domestic energy purposes. Arguments against 'dirty' foreign energy—such as that produced by East European nuclear plants, for example—do not look at all credible when assessed from a climate change perspective.

Clearly, high environmental standards can be used as protectionist measures ('green protectionism'). Such measures can stop exports from other countries with less developed systems which might simply be unable to meet certain requirements.[163] In this respect, it is worth noting that the 2010 revision of the Cotonou Agreement led to the inclusion of text stating that the parties 'agree that environmental measures should not be used for protectionist purposes'.[164]

The common presumption that energy imports from less regulated countries are by force of necessity more competitive and that 'dirty' energy will thus crowd out 'clean energy', a concept much relied upon in environmentalist argument about 'races to the bottom', is far from proven.[165]

Economists argue that good environmental taxes need to be imposed globally, since otherwise competition will handicap companies subject to such environmentally acceptable fiscal and regulatory regimes.[166] But it is far from proven or universally

[162] Commission working paper, 'Completing the internal energy market' (SEC (2001) 438) March 2001.

[163] For more, see G. Marin Duran and E. Morgera, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions* (Oxford: Hart Publishing 2012), p. 49.

[164] Article 49(3) of the revised Cotonou Agreement.

[165] Even if we accept that unevenly imposed or enforced environmental standards can create a 'race to the bottom', this concern should not be over-exaggerated. In addition to the economic value that this would create, there are also image and reputational questions that have their impact.

[166] Also M. Radetzki, 'Taxation of Energy in an Increasingly Interdependent World: An Introduction', 17(7) *International Journal of Global Energy Issues* (1999).

accepted that higher standards of required quality are undermined by lower standards.[167] Higher standards can encourage technological innovation, lead to better cost control and easier acceptance of products by the markets. Lower standards may often reflect the level of development of an economy: i.e. be appropriate for the particular country. They allow countries with a lower level of general prosperity (e.g. transition or developing countries) to secure market share and move upwards in terms of development and, in tandem with development, quality standards; while higher standards tend to act as a barrier to market access by competitors from less developed societies. There is therefore an element of abuse of market power and economic dominance if higher-standard societies try to impose their standards against competition from other countries. It is also far from certain that purchasing from power plants subject to a different regulatory regime (sometimes lower level, but sometimes only different) helps lower standard operations to survive. Buying from power plants in the CIS countries, for example, may generate cash flow for modernization and upgrading, while denying such income may cause the owners of such power plants to focus on poorer markets, thus contributing to low levels of safety.

A formally level playing field is not always necessary, and sometimes a playing field is level when some of the cards are stacked in favour of the weaker players. Much of the intensity of feeling lies in the convenient combination of both a sentiment of moral superiority combined with a form of protectionism which safeguards not only better environmental standards, but a comfortable way of living. For these reasons, a proper legal assessment of import restrictions under established principles of international trade—mainly WTO law—is both necessary and, in practical terms, justified. This is quite clear in the EU papers where the doubtful legality of import restrictions is implicitly acknowledged and where suggestions are made to bypass WTO law as it stands by means of bilateral agreements—i.e. agreements where the dominance of the EU can be better utilized than on the more level playing field of WTO dispute settlement. WTO rules are not only applicable between EU Member States and non-EU WTO members, but also by way of the reference in the Energy Charter Treaty to WTO rules for relations between EU Member States and states which are not members of the WTO but are members of the Energy Charter Treaty (Article 29). The EU has a difficult task in seeking to justify energy protectionism against poorer countries in the CIS. An analysis of the applicable WTO rules makes this clear. While anti-dumping and safeguard measures may be allowed, the sale of energy produced under a regulatory regime different from the environmentally stricter EU regime does not constitute dumping. On the contrary, it is quite likely that the electricity is exported at a higher price than the domestic price: i.e. rather the opposite of dumping. 'Eco-dumping' is not currently a legal concept under WTO law. There is very little by way of precedent dealing specifically with electricity under the GATT/WTO system, as electricity was not competitively traded across borders until more recently. In this

[167] For a review of the discussion: R. Stewart, 'Environmental Regulation and International Competitiveness', 102(2039) *Yale Law Journal* (1993).

regard, recent disputes on the requirement to use local/domestic products in order to qualify for a green energy subsidy are of interest. The Canadian scheme—the Ontario Green Energy and Economy Act—accepts solar projects only if at least 40 per cent of their initial development is made up of Ontario products and services.[168] These types of measures can be seen as prohibited subsidies under Article 3(1)(b) of the WTO Agreement on Subsidies and Countervailing Measures, which rules out subsidies 'contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods'. They also raise questions regarding possible less favourable treatment in the sense of Article III:4 of GATT 1994, investment-related measures (TRIMs), and the WTO Plurilateral Agreement on Government Procurement. The energy trade receives no specific special treatment under the WTO: energy goods, including electricity, are treated in the same way as any other goods.[169] The EU does not apply any duty with regard to electricity imports, although some Member States may.[170] The national treatment rule contained in GATT (Article III:4) means that once it has entered the EU, it must be treated as electricity produced in the EU.[171]

Import restrictions are forbidden under GATT Article XI as a 'quantitative restriction'. There is no doubt that electricity has to be considered as a 'good' under WTO law.[172] The relevant question is that of whether the exceptions contained in Article XX, in particular section (b)—'necessary to protect human... life or health'—apply. Reports from the GATT and WTO panels and the WTO Appeal Body[173] seem to establish the following sequence of tests for Article XX: import restrictions must be based on legitimate environmental objectives, without discrimination, and selecting the least restrictive measure. The measure must primarily be based on environmental harm coming from the product itself—not the

[168] See the WTO case J. von Reppert-Bismarck, 'EU challenges Canadian green power rules at WTO' (Reuters, 11 August 2011), available at <http://www.reuters.com/article/2011/08/11/us-eu-canada-trade-idUSTRE77A2WU20110811>.

[169] There is however still an ongoing discussion on whether electricity is to be considered as a good under the WTO regime. The recent cases on green energy subsidies suggest that it is. This is also the approach under EU law.

[170] Case C-213/96, *Outokumpu* [1998] ECR I-1777.

[171] Commission working paper, 'Completing the Internal energy market' (SEC (2001) 438) March 2001, p. 67

[172] UNCTAD, 'Energy Services', p. 7; WTO, 'Energy Services, Background Notice by the Secretariat', S/C/W/59 of 9 September 1998.

[173] GATT Panel Report, United States—Restrictions on Imports of Tuna, 3 September 1991 and GATT Panel Report, United States—Restrictions on Imports of Tuna, 16 June 1994, WTO Appellate Body Report, United States—Import Prohibition of certain Shrimp and Shrimp Products (DS 58) ('US–Shrimp'), 12 October 1998, WTO Appellate Body Report, Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef (DS 161/DS 169) ('Korea–Beef'), 11 December 2000 and WTO Appellate Body Report, Brazil—Measures affecting imports of retreaded tyres (DS 332) ('Brazil–Tyres'), 3 December 2007. For detailed discussion: J. Cameron and K. Gray, 'Principles of International Law in the WTO Dispute Settlement Body', 50(248) *ICLQ* (2001), pp. 264–8 and G. Marceau and J. Wyatt, 'Trade and the Environment: The WTO's Efforts to Balance Economic and Sustainable Development', in R. Trigo Trindade, H. Peter, and C. Bovet (eds), *Liber Amicorum Anne Petitpierre-Sauvain: Economie Environnement Ethique de la Responsabilité Sociale et Sociétale* (Zurich: Schulthess Editions Romandes 2009), pp. 225–35.

production process. Electricity is not in itself environmentally harmful, so there is no product-based justification for import restriction. Article III GATT makes it clear that allowing the import of electricity from, say, France or Poland, but then excluding electricity produced by nuclear plants from the CIS would constitute discrimination.[174] The issue to be settled here is whether such restrictions can be based on the fact that the 'production process' occurs abroad. If countries were allowed to use trade sanctions based on production processes occurring abroad, they would in essence acquire a trade sanction based on extraterritorial regulatory power over conduct in foreign countries. This would mean that strong economies would be able to impose their standards on weaker ones dependent on access. That seems in principle prohibited, except for narrow exceptions, under general international law.[175] WTO law is based on 'regulatory competition' and *de facto* on mutual recognition of standards.[176] A country cannot, under WTO law, impose its standards by extraterritorial reach outside its own territory. But both the *Tuna-Dolphin* panel reports and the *Shrimp-Tuna* Appellate Body decision have left an opening: if there is a tangible impact on the importing state, then import restrictions could be justified if there is a good environmental reason, sound scientific evidence, and reasonable prior efforts to reach a bilateral or multilateral agreement and if the least restrictive measure necessary for the purpose is chosen.[177] It makes sense to leave decisions on environmental policies to the exporting state if there are no cross-border externalities—while careful regulation of the role of the importing state by reference to procedural and substantive rules makes more sense if the production process has extraterritorial effects.[178] Unilateralism combined with an extraterritorial reach for such trade sanctions tends to indicate incompatibility with Article XX GATT; while the existence of recognized international standards (best in an environmental treaty to which both countries are parties), together with a serious effort to find a consensus-based solution, tends to indicate compatibility. This WTO-specific formulation is not that far from the 'protective' principle which is often used in general international law to justify extraterritorial regulation. Furthermore, reliance on and conformity with relevant environmental agreements—i.e. those effective between the parties—or with universally accepted multilateral guidelines can justify such trade sanctions, again provided that there is no protectionist intention and effect,

[174] See here also the detailed discussion of the problems the EU had in making its import restriction against furs from animals caught by leghold traps GATT-compatible: J. Scott, *EU Environmental Law* (London: Longman 1998), pp. 95–6. The internal conclusion was that short of a multilateral agreement or recognized guideline to rely on, such import restrictions based on the production process rather than on the product itself were infringing the GATT obligations of the EU and its member states.

[175] T. Wälde. 'Managing the Risk of Sanctions in the Global Oil and Gas Industry', 36 *Texas International Law Journal* (2001).

[176] J. Weiler, 'Epilogue: Towards a Common Law of International Trade', in J. Weiler (ed.), *The EU, the WTO and the NAFTA* (Oxford: OUP 2000), pp. 201, 230, 231.

[177] The first Tuna/Dolphin report considered it relevant that the US had 'not demonstrated that it had exhausted all options reasonably available to it to pursue its dolphin protection objectives, in particular through the negotiations of international cooperative arrangements'. The report is available at: <http://www.worldtradelaw.net/reports/gattpanels/tunadolphinI.pdf> (accessed 9.8.2012).

[178] See H. Ward and D. Brack (eds), *Trade, Investment and the Environment* (London: RIIA 2001).

no discrimination and the least restrictive method necessary for the purpose is chosen.[179] One can perhaps infer from the sequence of WTO decisions that, once a country uses trade sanctions to impose its standards on others, it bears a heavy burden of proof as to legitimacy of principle, solid scientific evidence of risk, conformity with accepted international guidelines or environmental agreements effective between both states, and evidence of serious efforts to reach an agreed solution. This set of tests requires some reasonable assessment of the likely impact of the measure proposed (and the proposal of alternative and less restrictive measures commensurate with the risk) for the objective. These standards are very reasonable: they take into account that each country (or the EU) will find its own standards superior to others, represent rather the morally superior environmental intention then the more basic protectionist effect and are blind towards environmental damage caused within the country while being extra sharp-eyed as regards the eco-faults of the other country.

In short, the WTO standards act as a countervailing force to the arrogance of economic power blinded by an ideology of self-superiority. One needs to realize, though, that while the WTO standards may afford legal protection to weaker countries against the leverage exercised by stronger economies, the economic pull of standards in a powerful market will, whatever the legal situation, exercise strong pressure on the importing country producers to conform. The instruments of pressure are consumer expectations, increasingly formalized in labelling and other forms of mandatory or voluntary information, importer specifications and many other forms of pressure and types of conditionality. But that should not lead to the imposition of globally harmonized standards at the level of the most powerful import market, as such harmonization would deny the weaker economies the chance to exploit the few comparative advantages left open to them.

The EU's legitimate environmental objective cannot be to compel non-EU countries to adopt their own, better standards in order to create a level playing field. It must be that import restriction is the only way to prevent serious environmental harm to the EU—and in this case, given the extraterritorial reach undermining the sovereignty of the export state, serious efforts at reaching a cooperative agreement must have been tried and reliance on accepted guidelines must have been sought. Lower environmental standards in power production may, for example, have an effect through the emission of noxious (SO_2) gases migrating westwards, basically through low-standard burning of coal and fuel oil. A low-standard nuclear plant may constitute a risk of accident with serious implications (like Chernobyl in 1986) for an EU country. The question then is whether import restriction is necessary to manage that risk, and whether it is the least restrictive method available. But it is likely that under the impact of an import restriction the electricity would instead

[179] This is a very short summary of a much more complex and much discussed issue. See F. Weiss, 'The Second Tuna Gatt Panel Report', 8(1) *Leiden Journal of International Law* (1995), pp. 135–50 and F. Abott, 'The North American Integration Regime', in J. Weiler (ed.), *The EU, the WTO and the NAFTA* (Oxford: OUP 2000), pp. 189 and 200. Both the second Tuna-Dolphin panel and the AB in the Shrimp-Turtle case were ready to interpret Article XX GATT in light of environmental agreements.

be sold to lower-tariff-paying customers in East Europe. That would not reduce the environmental risk for the EU, but possibly even increase it—as less revenue would be available for upgrading. The same applies to the nuclear power plant. Shutting nuclear power producers out from a wealthy export market is unlikely to lead to closure, but rather to further deterioration. The Chernobyl accident did not happen because the Soviet plant could export to the EU, but perhaps rather because it could not, and was therefore not connected to the safety culture (resources) of prosperous energy export markets. The right solution, rather than extraterritorial compulsion by the economically and politically stronger country, would be to seek to develop or rely on common guidelines (for nuclear safety and the filtering of coal-based electricity production) which do not have to be those of the EU, but may be drawn from a more neutral source; and also to seek either to provide finance, or to maximize electricity imports to raise finance for such upgrading to better environmental quality and nuclear safety. Protection of the global climate against CO_2 emissions might also be a reasonable environmental justification, based on the Kyoto Protocol. However, an importing country such as Germany cannot rely on climate change considerations when its own policies and industry are much more damaging to the global environment than, for example, nuclear electricity imports, which in fact substantially reduces German coal- or oil-based emissions.[180]

A simple import restriction would be likely to contravene GATT and cannot be justified under its Article XX. Such contravention would also arise if WTO rules were to be applied via Article 29 of the ECT (e.g. to Ukrainian or Russian electricity). Energy investors from ECT member countries operating in the import-restricting country would also be able to invoke Article 26 ECT on investment arbitration if the import restriction could be seen as protectionist discrimination—i.e. if domestic companies could import electricity from their established sources, but the foreign investor could not. It would make a difference if the trade sanction were primarily used to enforce a multilateral agreement (to which both countries must be parties). Such agreements (ratified, effective) with both the EU and the CEEC countries (plus Russia and Ukraine) which impose minimum safety standards on nuclear plants or minimum environmental standards on power plants do not currently exist.

[180] There is another parallel to the Tuna-Dolphin, Shrimp-Turtle cases: while the US imposed its standards of proper production on other countries, it was of the five countries involved in the shrimp dispute the one with the lowest record of ratification of multilateral environmental treaties, reference by Arden-Clarke in H. Ward and D. Brack (eds), *Trade, Investment and the Environment* (London: RIIA 2001), p. 184.

6.10 Concluding Thoughts: The Emergence of the EU as an International Player

Given the challenges of the integration process, and in particular the delayed, much-resisted, and technically difficult integration of EU energy markets, it is perhaps not surprising that the external dimension of EU energy law started to emerge relatively late, and is still largely absent. But the EU's energy supply is more dependent than most other areas on the smooth functioning of international trade—and the energy trade is as a rule conducted with volatile, high-risk and, from a governance perspective, problematic countries close to the eastern and southern fringes of the EU. This dependency should be reflected in its approach to its partners. The current approach is too EU centered and should be replaced by a more balanced one where the interests of the producing countries is genouinly taken into consideration when making decisions impact the trading partners. This is particularly so with gas markets.

Energy is affected by most of the EU's economic cooperation treaties. In most cases, the move towards customs union, the principles of investment promotion, sustainability, and environmental attention include the energy sector. But these references and instruments have something intangible about them. There are replete with high-sounding intentions and objectives, but, apart perhaps from trade, short on tangible and specific mechanisms. The EU has not, so far, and apart from the ECT, achieved a tangible, creative mechanism which goes beyond marginal and moral support to facilitation of trade and investment. There is no innovative institution, no working mechanism, to bring Russian and Central Asian gas to Europe (clearly, the EU-Russia Energy Dialogue is not a valid example here), no clear-cut result in making former Soviet nuclear reactors safe, no deal with OPEC involving prices, taxes, production, and climate change (though this is now becoming more feasible), but rather a lot of words, good intentions, and aid funds disbursed by a directorate general without a clear (energy) focus. Why is that so? Perhaps it reflects the fact that the EU has not yet fully grasped the fact that many of the challenges of energy supply are in building solid structures with the supplier countries, and that one has to look not only at one's own interests and constraints (of which there are many) but also at the interests and constraints of the supplier countries to find workable deals. That requires a dramatic change in mental outlook—from the inside to the outside—which may be hard for an organization such as the EU and its services to make. One might also point to a leadership vacuum, reflecting the general difficulty of conducting foreign policy in an inchoate federal system where national jealousy—emanating in particular from former imperial countries—hinders the exercise of leadership. National power and leadership potential seems to have gone, but rather into a black hole than into the Commission and the other EU structures. That is possibly the price to be paid for having a federation, and not a European 'Super State'. Who can

speak with authority and strike a deal? It seems that this is increasingly the task of the European Commission. Here, the 'old world' with strong state involvement in the energy sector seems to be returning, but the role of the state is often taken by the European Commission. This ideological shift, from the state to the markets and back, is the subject of Chapter 7.

7

From State to Market and Back

The Changing Role(s) of Markets and States in the EU

Energy market governance in the EU is undergoing another paradigm shift. While the contemporary ideology behind energy market regulation in most western nations over the last couple of decades has been that the introduction of competition will create well-functioning markets and contribute to security of supply, the current paradigm shift leads us back towards a market model more driven by the state and by the public sector.

The past ideology was based on the idea that energy, like other sectors of the economy, responds to the economic rules of the market, going where the prices are highest, with its use, substitution, and investments responding to prices. As is discussed in more detail in this chapter, recent thinking and empirical evidence in this area indicate that the issue might not be this simple. Drawing on the recent economic literature and the experience in the EU, this chapter discusses this paradigm shift and focuses on the question of whether international competition and free markets can deliver investment and security of supply or whether public intervention and control is necessary.

7.1 The 1980s and the Movement from a State-Driven to a Market-Driven Approach to the Energy Markets

European electricity and gas market liberalization is a relatively recent phenomenon. While application of Treaty law was always possible, it was only in the 1980s that things started to move, but not in a European vacuum. The EU was not alone in its move away from state-driven markets to competition-led markets. Similar examples from around the world might be mentioned and the EU could, and did, look for examples from other countries.

The system of energy monopolies served Europe well in the phase of rebuilding the national economies after World War II. However, this system, driven by a public sector populated by national monopolies, had by the 1980s lost its purpose and political legitimacy. The idea that energy could be run privately in competitive markets was generally speaking unthinkable—except in the minds of economic theoreticians—before the 1980s. With models from the US and UK, the EU Member States saw the opportunity to break out from the old 'conceptual and