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, athough 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, 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.

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.

[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.