



The World Trade Organization and Energy: Fuel for Debate

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The WTO can no longer afford to neglect energy. While out of focus for many decades, the realization that the Organization needs a discourse on energy has finally sounded through to the WTO itself. During the first ever workshop on the issue at the WTO headquarters in Geneva, former Director-General Pascal Lamy emphasized the necessity of a dialogue on energy trade in the WTO.¹ Questions pertaining to the legal aspects of energy trade in the WTO can be expected to emerge with increasing frequency. But is the WTO ready and capable of addressing these issues and provide clear answers?

This ESIL Reflection will first briefly show that the GATT/WTO legal framework has in fact always – at least *de jure* – covered trade in energy. Then, it will discuss some of the major legal challenges that the regulation of energy trade poses to the WTO legal framework. It will also touch upon the relevance of the Energy Charter Treaty (ECT) for solving some of these problems.

HISTORICAL CONTEXT

It is widely believed that trade in energy for a long time was at least *de facto*, and perhaps even *de jure*, excluded from GATT/WTO coverage. This was the result of a

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¹ See WTO, WTO News, 'Lamy Calls for Dialogue on Trade in Energy in WTO' <http://wto.org/english/news_e/sppl_e/sppl279_e.htm> and Energy Charter Secretariat, 'Workshop on the Role of Intergovernmental Agreements in Energy Policy - 29 April 2013' <<http://www.encharter.org/index.php?id=595&L=0>> <<http://www.encharter.org/index.php?id=595&L=0>>

combination of several factors.² First of all, the main petroleum producing and exporting countries were not original parties to the General Agreement on Tariffs and Trade 1947 (GATT 1947).³ Second, the reigning so-called 'Seven Sisters' oil company cartel dominated the petroleum industry from the 1940's until the 1970's and preferred to settle its business outside the global trading system.⁴ Third, as a strategic commodity, energy was a particularly sensitive topic in international trade, a view poignantly reflected in the 1962 UNGA Resolution 1803 on Permanent Sovereignty over Natural Resources. With this in mind, a 1998 Background note by the WTO Secretariat concluded that '*energy goods have been treated for a long time as being outside the scope of the reach of GATT rules, by relying on the general exception relating to the conservation of exhaustible natural resources (Article XX(g) GATT) and on the national security exception (Article XXI GATT)*'.⁵

However, there is nothing in the provisions of the GATT 1947 or WTO Agreements stipulating that trade in energy is actually excluded from their scope. Quite to the contrary: tariffs on fossil fuels, such as crude oil, have been present in Members' Schedules of Concessions (Article II(a) GATT 1947) from the start and ever since. Crude petroleum and derived products also have their own chapter in the Harmonised System (HS) Convention, which classifies virtually all globally traded goods and on which Members to the WTO base their Schedules of Concessions.⁶ It is true that tariff concessions on crude petroleum are often 'free' or 'unbound', meaning that the WTO Member in question did not take on any commitment to bind its tariff. In theory, the WTO Member could thus apply as high a custom duty as it pleases on the imported good. But this does not alter the fact that WTO Members in their Schedules are not allowed to agree on treatment that is inconsistent with the basic GATT obligations; Article III (National Treatment) applies to bound as well as unbound items (except for Article III.8).

In sum, *de jure*, trade in energy is, and has always been, covered by the disciplines of the GATT/WTO. But *de facto*, energy trade has been treated as mostly outside of the GATT for several decades. For this reason, difficult questions concerning the relation between energy and trade could be ducked in the GATT/WTO forum.

² See e.g. United Nations Conference on Trade and Development (UNCTAD), *Trade Agreements, Petroleum and Energy Policies*, UNCTAD/ITCD/TSB/9, (United Nations, New York and Geneva 2000) 15; Also note that the existence, scope and content of the alleged gentlemen's agreement excluding energy is highly debatable. No written form of proof whatsoever of a gentlemen's agreement excluding energy trade from the GATT/WTO forum exists in GATT negotiating history. Even extensive searches by the author through the negotiating history and verbatim in the Stanford University GATT Digital Library 1947-1994 <<http://gatt.stanford.edu/page/home>> do not point to any evidence.

³ Key energy producing and exporting countries like Saudi Arabia, the United Arab Emirates (UAE), China, the Russian Federation and Venezuela were not original GATT 1947 members. Consequently, their trade with other nations, including trade in energy, was not regulated by the GATT.

⁴ The 'Seven Sisters' were originally comprised of: Royal Dutch Shell, Exxon, Gulf, Texaco, BP, Mobil, and Standard Oil of California (today's Chevron).

⁵ WTO, Council for Trade in Services, 'Energy Services – Background Note by the Secretariat', Doc S/CW/52, 9 September 1998.

⁶ See the Harmonised System Convention, Chapter 27 'Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes'.

This is now no longer possible. After the establishment of the World Trade Organization in 1995 a shift in perceiving energy from 'out of' to 'within' the scope of the WTO forum occurred: By the start of the Doha Development Agenda (DDA) 'energy services' emerged as a separate topic on the negotiating agenda.⁷ But the realization that WTO legal framework does indeed cover trade in energy has opened up a Pandora's box of unresolved issues.

UNRESOLVED ISSUES

Fitting energy goods and services into the WTO system is anything but a simple task. The problem is that although the WTO Agreements evidently cover trade in energy, they were simply not drafted with the realities of energy in mind. This leaves us with the question whether the WTO legal framework as it is now is capable of adequately regulating the complexities of trade in energy.

Several unresolved issues can be identified. For instance, the list of 'energy services' is only provisional and so far there is no definition of 'energy goods' in the WTO. A related point is that it might be difficult to distinguish between the 'goods' and 'services' aspects of trade in the energy sector – most globally traded energy is likely to possess elements of both. In EU law, electricity is considered a 'good' and not a 'service', but there is still no conclusive categorisation of electricity in the WTO.⁸ And what are 'like' energy products?⁹ Are non-renewable energies 'like' renewables? Another consequence of the absence of clear definitions is that it is undecided whether GATT Article V.1 on the freedom transit of goods covers fixed infrastructures such as gas pipelines as a 'means of transport'.¹⁰ If it does, it is not unthinkable that the WTO could serve as a forum to resolve potential gas transit disputes between Members.

To add to this, energy is clearly not an isolated matter in international trade. Besides 'energy services', the closely related 'environmental goods' and 'environmental services' have also made their way as a negotiating topic on the Doha Agenda.¹¹ Examples of environmental goods such solar panels and equipment for biogas production can be directly linked to clean energy production and energy efficiency. The larger debate on climate change thus unveils how energy and the environment are intertwined and in addition raises important questions regarding the legality of so-called green and

⁷ The Doha Round (2001 – present), also known as the Doha Development Agenda (DDA) is the latest round of trade negotiations among the WTO membership. With regard to energy, it should be mentioned that the Doha Round shows an overall tendency to commit on energy at the border level (i.e. lower tariffs) rather than at the domestic level (non-discrimination).

⁸ In ECJ Case C-393/92 *Almelo v Energiebedrijf IJsselmij* [1994] ECR-I-1477 [28] and Case C-158/94 *Commission v Italy* [1997] ECR I-5789 [17], the European Court of Justice has ruled that electricity, despite its intangible character, should be treated as a 'good'.

⁹ See Article III:2 and III:4 of the GATT..

¹⁰ Article V.1 'Freedom of Transit', GATT 1947; See on this issue generally D Azaria, 'Energy Transit under the Energy Charter Treaty and the General Agreement on Tariffs and Trade' (2009) 27 *Journal of Energy and Natural Resources Law* 559.

¹¹ See WTO, 'Negotiations on Trade and the Environment'

<http://www.wto.org/english/tratop_e/envir_e/envir_negotiations_e.htm> (accessed 12 September 2013);

renewable energy subsidies. Could such subsidies be justified under the WTO legal framework as an incentive to promote green energy or do they risk being abused by WTO Members as a form of disguised protectionism?¹² In the recent Appellate Body (AB) Report in *Canada–Feed-in Tariffs*, the AB did not want to go down a slippery slope and provide decisive answers on the matter.¹³ But with a new string of renewable energy disputes waiting to be settled in the WTO, it seems that the AB cannot keep evading these issues any longer.¹⁴

Concerning subsidies on traditional energy products, i.e. fossil fuels, the age-old debate on energy dual pricing and export taxes is no less of an issue now than it was during the Oil Crisis forty years ago. In brief, 'dual pricing' entails that countries sell their fossil fuels on the world market for a higher price than they do on their own domestic market, on which prices for energy are kept artificially low.¹⁵ Through dual pricing, energy-exporting countries attempt to maximise the revenues of their energy trade. Mainly major fossil fuel-importing countries like the EU and the US continue to oppose to this practice. They argue that dual pricing, because of the allegedly export-restrictive effect, is trade distortive and inconsistent with the obligations set out in Article XI GATT on Quantitative Restrictions. Additionally, they claim it might be a form of 'inverted subsidies' contrary to the SCM Agreement: as a result of dual pricing, domestic producers can be favoured over foreign ones by access to cheaper input materials (i.e. cheaper energy leading to lower production costs).¹⁶ This example shows one of the peculiarities of energy as a tradable good and the nature of the rules of the WTO in that respect. There is a *market access* bias in the WTO, i.e. the goal is to reduce *import* barriers between nations. While in global energy trade, the problem is rather linked to *export* taxes and *export* restrictions. The matter of energy dual pricing and export taxes remains undecided in the WTO until this day.

¹² See on this issue Chapter 17, 'Trade and the Environment' in: M Trebilock, R Howse and A Eliason, *The Regulation of International Trade – 4 edn* (Routledge: New York 2013) 691 ff and R Howse and Eliason, 'Domestic and International Strategies to Address Climate Change: An Overview of the WTO Legal Issues' in: T Cottier, O Nartova and SZ Bigdeli (eds), *International Trade Regulation and the Mitigation of Climate Change* (CUP: Cambridge 2009).

¹³ WTO, *Canada – Measures Relating to the Feed-In Tariff Program – Appellate Body Report* (6 May 2013) WT/DS426/AB/R and *Canada – Certain Measures Affecting the Renewable Energy Sector – Appellate Body Report* (6 May 2013) WT/DS412/AB/R.

¹⁴ See e.g. Request for Consultations by the United States, *India – Certain Measures Relating to Solar Cells and Solar Modules*, (Feb. 11, 2013) WT/DS456/1, G/L/1023 G/TRIMS/D/35, G/SCM/D96/1; Request for Consultations by the United States, *China – Measures Concerning Wind Power Equipment* (Jan. 6, 2011) WT/DS419/1, G/L/950, G/SCM/D86/1; Request for Consultations by Argentina, *European Union and Certain Member States – Certain Measures On the Importation and Marketing of Biodiesel and Measures Supporting the Biodiesel Industry* (May 15, 2013) G/L/1027, G/SCM/D97/1, G/TBT/D/44, G/TRIMS/D/36, WT/DS459/1; Request for Consultations by China, *European Union and Certain Member States – Certain Measures Affecting the Renewable Energy Generation Sector* (Nov. 7, 2012) WT/DS452/1; G/L/1008; G/SCM/D95/1; G/TRIMS/D/34.

¹⁵ WTO, World Trade Report 2010, 'Trade in Natural Resources' (WTO, Geneva 2010) 173 ff.

¹⁶ Y Selivanova, *The WTO and Energy – WTO Rules and Agreements of Relevance to the Energy Sector* (ICTSD Programme on Trade and Development: Geneva 2007) 29; Also see R Quick, 'Chapter 18 – Dual Pricing', in: J Pauwelyn (ed), *Global Challenges at the Intersection of Trade, Energy and the Environment* (The Graduate Institute: Geneva 2010) 193, 194.

Albeit in a different way, disputes over export taxes on raw materials continue to pose new, and perhaps unintended, challenges to both the WTO and public international law. Since the controversial outcome of the AB report in *China–Raw Materials*, even the previously seemingly sacred notion of Permanent Sovereignty over Natural Resources is now debatable in the WTO forum. As a rule, Members tend to use the Article XX(g) exception to justify otherwise GATT-inconsistent measures for the conservation of their exhaustible natural resources (such as oil and gas).¹⁷ Following the judgment, however, China is not allowed to invoke the same GATT Article XX(g) exception with regard to commitments on export taxes made in its Accession Protocol.

These unresolved issues have practical consequences. Russia, the major Eurasian energy producing and exporting country, acceded to the Organization in August 2012, after protracted negotiations of almost two decades. But, perhaps owing to the absence of consensus on many energy-related issues (such as dual pricing) among the Members of the WTO, Russia was able to negotiate the accession with almost no ‘WTO-plus’ commitments in the energy sector.¹⁸ As a result, Russia’s state-owned energy exporter, Gazprom, is practically free of trade barriers and free to apply export taxes when exporting their energy (raw mineral materials and fuels) abroad.¹⁹

From key definitions of energy good and services, to transit, to renewable energy subsidies, to dual pricing, to sovereignty over natural resources – it is clear that the list of energy issues in need of further elaboration in WTO law is extensive.

WTO AND ECT: CROSS-FERTILIZATION?

Should the WTO maybe ‘learn’ from other treaties in the field? A more specialized international law instrument, tailored to regulate trade and investment in the energy sector, does exist: the Energy Charter Treaty (ECT). The ECT was born as an alternative to the wish of energy net-importing countries in the West to conclude an energy specific agreement within the GATT/WTO framework after the Cold War had ended.²⁰ The trade provisions of the ECT draw largely upon the GATT, but are better adapted to the needs of energy trade, for instance by providing extensive definitions of

¹⁷ WTO, *China – Measures Related to the Exportation of Various Raw Materials – Appellate Body Report* (30 January 2012) WT/DS395/AB/R [7.124] – [7.129]; See also D Crosby, ‘Energy Discrimination and International Rules in Hard Times: What’s New This Time Around, and What Can Be Done’ (2012) 5 *Journal of World Energy Law and Business* 325, 330 – 331.

¹⁸ WTO, *Report of the Working Party on the Accession of the Russian Federation to the World Trade Organisation – Restricted* (17 November 2011) WT/ACC/RUS/70, WT/MIN(11)/2; In some other sectors, Russia consented to bind and reduce its export duties (i.e. on lumber, fish, crabs and leather), however, on raw mineral materials and fuels Russia reserved its right to continue applying export taxes.

¹⁹ DG Tarr, ‘Chapter 5 – The Economic Impact of Export Restraints The Economic Impact of Export Restrictions on Raw Materials on Russian Natural Gas and Raw Timber’ in *OECD Trade Policy Studies – The Economic Impact of Export Restrictions on Raw Materials* (OECD: Paris 2012) 131, 132.

²⁰ See R Leal-Arcas and A Filis, ‘The Fragmented Governance of the Global Energy Economy’ (2013) 6 *Journal of World Energy Law and Business* 1, 24.

energy products and services and clearly incorporating gas pipelines as a means of transport in Article 7 ECT on Transit.²¹

It is to be added that the ECT is not of more help than the WTO in regulating the energy section of Russia at present. The Russian Federation, the major Eurasian energy producing and exporting country, has not ratified the Treaty. Moreover, it has also stepped back from provisional application of the Treaty in 2009, allegedly in connection with the controversial pending *Yukos* arbitration case.²²

But apart from this, compared to the ECT, the WTO regime seems to be lagging behind in almost every aspect when it comes to energy trade regulation. The WTO has only woken up now and realized that a great task lies ahead. Perhaps it does not seem too far-fetched to examine the possibilities to negotiate energy and the environment as a separate sector in the WTO, following the model of the Framework Agreements on Agriculture and Textiles.²³ Such an agreement could potentially better address the complexities of the sector, e.g. by setting clear rules on the permissibility of (green) energy subsidies. The Energy Charter Treaty could be a particularly helpful instrument in this regard. Although the ECT deals with investment in addition to trade, and the regulation of investment has thus far been largely absent in the WTO, it should be explored to what extent the provisions of the ECT could serve as a basis for a potential Framework Agreement.

The global trading landscape is changing and with that, the international terms of trade: An increasing number of energy producing and exporting countries has either recently joined the WTO (Saudi Arabia, China, Russia, Oman, Ukraine) or is currently negotiating accession (Kazakhstan, Azerbaijan, Iraq, Iran and Algeria). Apart from that, we are witnessing rapid changes in the type of energy we trade and how we trade it (one can think of the unexpected Liquefied Natural Gas (LNG) 'boom' in past years). Questions pertaining to the legal aspects of energy trade in the WTO can be expected to continue to provide substantial fuel for debate, one which has been undeservedly marginalized in the WTO up until now.

²¹ Article 7 (10) (b) ECT.

²² Note however, that in *Hulley Enterprises Limited v the Russian Federation* (PCA Case No AA226), *Yukos Universal Limited v the Russian Federation* (PCA Case No AA227) and *Veteran Petroleum Limited v the Russian Federation* (PCA Case No AA228), Interim Awards on Jurisdiction and Admissibility, 30 November 2009 (also known as the *Yukos* cases) the Tribunal decided that Russia undeniably provisionally applied ECT, and was therefore bound to it in its entirety until October 19, 2009, stating: *'Accordingly, the Tribunal has concluded that the ECT in its entirety applied provisionally in the Russian Federation until 19 October 2009, and that Parts III and V of the Treaty (including Article 26 thereof) remain in force until 19 October 2029 for any investments made prior to 19 October 2009.'*

²³ T Cottier, G Malumfashi, S Matteotti-Berkutova, O Nartova, J de Sepibus and SZ Bigdeli, in 'Energy in WTO Law and Policy' in T Cottier and P Delimatsis (eds), *The Prospects of International Trade Regulation – From Fragmentation to Coherence* (CUP, Cambridge 2011) 212.