

Prospects for a transit regime on energy in the WTO

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Introduction

Undoubtedly trade in energy resources such as oil and gas represents a significant part of world trade flows. For instance, fuels alone represented 77% of the world natural resources exports (USD 2.9 trillion) in 2008.¹ Its relevance will increase in the coming years driven chiefly by emerging economies. Indeed, the International Energy Agency (IEA) projects that oil demand will increase 1% per year, while gas demand 1.5% per year by 2030².

Unfortunately, not all countries possess their own energy resources and they therefore need to import such resources from remote regions. Transit has, hence, always been considered a major issue for the energy sector, which by its nature develops at the international level.

Nonetheless, political volatility in transit States constantly threatens trade flows in the energy market. In addition, the absence of a reliable international legal framework and contradictory domestic laws make it difficult, if not impossible, to invest in transit activities on a long-term basis.

As a result, governments currently acknowledge the urgent necessity of an international regulatory framework on the transit of energy goods. These governments are conscious that increased global integration requires measures on an international scale.

Although the World Trade Organization (WTO) Agreements, particularly the General Agreement on Tariffs and Trade (GATT), were not specifically designed to

¹ WORLD TRADE ORGANIZATION. *World Trade Report 2010: Trade in Natural Resources*. Geneva: WTO, 2010, at 54-56.

² INTERNATIONAL ENERGY AGENCY. *World Energy Outlook 2009*. Paris: IEA, 2011, at 51.

address energy matters *per se*, their provisions are still applicable to trade in energy.³ Nevertheless, WTO disciplines may not perfectly suit the energy sector's features. The WTO system mainly addresses import barriers rather than export barriers. In other words, the main objective of the WTO has been market access of domestic products abroad. Conversely, trade restrictive practices in the energy sector are primarily encountered on the export side.⁴

The purpose of this study is to sketch the essential elements for elaborating a transit regime on energy in the WTO framework. For this purpose, it will analyze the current treatment granted to the transit of energy goods at the international level, highlighting their weaknesses and proposing improvements.

The first section presents an overview of the energy market. Moreover, the birth and evolution of the freedom of transit principle will be explained through three international conventions: i) the Barcelona Convention; ii) the Convention on Transmission in Transit of Electrical Power; and iii) the United Nations Convention on the Law of the Sea. The real meaning of the *freedom of transit* principle cannot be understood without a reference to its background.

In the second and third sections, the WTO and the Energy Charter Treaty (ECT) provisions on transit will be analyzed. The aim is to provide a comprehensive understanding of the most pertinent rules since these provisions will be the grounds for a future transit regime on energy at the multilateral level. In this regard, their features and interaction will be closely examined.

The fourth section addresses issues regarding the transit of energy goods under current debate. Special attention will be placed on: i) the classification of electricity as a good or as a service; and ii) the regulation of fixed means of transport.

Finally, this study will provide an update of the ongoing discussion on transit under WTO accession processes and Doha negotiations. It will also point out the mechanisms for the implementation of transit regulation in the WTO. Last but not least, the essential provisions for a future regulatory body will be sketched out and analyzed.

³ MARCEAU, Gabrielle. "The WTO in the Emerging Energy Governance Debate". In Joost Pauwelyn (ed.). *Global Challenges at the Intersection of Trade, Energy and the Environment*. Geneva: Graduate Institute of International and Development Studies, 2010, at 25.

⁴ COSSY, Mireille. "Energy Transport and Transit in the WTO". In Joost Pauwelyn (ed.). *Global Challenges at the Intersection of Trade, Energy and the Environment*. Geneva: Graduate Institute of International and Development Studies, 2010, at 113.

Section I: The energy sector and the freedom of transit principle

This section aims to set the stage for this study. The various contours of the energy sector will be outlined, followed by an analysis of the basic Conventions that enshrine the freedom of transit principle in the international arena.

A. Energy market: setting the scene

1. *Energy resources and products in transit*

Focus will be placed on the transit of three leading energy commodities: oil, gas and electricity, which are classified as follow:

a) *Primary energy*

Also called *energy resources or raw fuel*, it involves exclusively the extraction or capture of sources before the energy embodied in them can be transformed into heat or mechanical work.⁵ This concept covers:

Oil: It is the energy resource with the highest demand worldwide. In 2008, fuels alone represented 77% of the world natural resources exports (USD 2.9 trillion).⁶ Regarding its means of transport, oil may reach international markets by ships or through pipelines.

Natural Gas: gas demand currently arises from residential and commercial sectors. However, in the coming years it will become the preferred fuel in the power industry for economic and environmental reasons.⁷ Gas is transported through pipelines or by ships when it is turned to liquid natural gas (LNG)⁸. Almost three-quarters of trade in gas are carried out through pipelines, but LNG transportation is growing at significant rates.⁹

⁵ UNITED NATIONS. *Concept and Methods in Energy Statistics, with Special Reference to Energy Accounts and Balances: A Technical Report*. New York: United Nations, 1987, at ix URL. http://unstats.un.org/unsd/publication/SeriesF/SeriesF_29E.pdf

⁶ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 54-56.

⁷ SELIVANOVA, Julia. *The WTO and Energy: WTO Rules and Agreements of Relevance to Energy Sector*, ICTSD Trade and Sustainable Energy Series Issues Paper N° 1. Geneva: International Centre for Trade and Sustainable Development, 2007, at 3.

⁸ As trade in gas is dependent to a large extent on transportation *via* pipelines, it has been subject to regional trade i.e. Canada exports gas to the U.S.; Argentina exports gas to Chile, Brazil and Uruguay; Bolivia exports gas to Brazil.

⁹ ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES. *World Oil Outlook 2010*. Vienna: OPEC, 2010, at 51.

b) Secondary Energy

Also called *energy products*, this term covers all source of energy created from the transformation of primary energy, such as electricity.¹⁰

*Electricity*¹¹ is the energy product with the fastest-growing rate of total global energy demand. In fact, consumption is expected to increase by over 115% between 2007 and 2050.¹² Because of its physical features and infrastructure dependency, electricity is traded on a regional basis through grids.

2. Principal energy actors

a) Main export States

The largest supplier of energy resources is Russia with exports of USD 341.2 billion (9.1 % of world trade in natural resources) only in 2008.¹³ It produces 10.3% of the world's primary energy of which 45% is exported and 55% is consumed domestically.¹⁴

As of 2008, the Middle East was the biggest oil-producing region with 59.9% of the proved oil reserves worldwide.¹⁵ Moreover, OPEC countries¹⁶ hold 69% of the world reserves, with Saudi Arabia being the leading producer with 21% of the world proven reserve. The largest non-OPEC oil suppliers include, Russia (6.3%), the U.S. (2.4%), Canada (2.3%), China (1.2%), Mexico (0.9%), Norway (0.6%) and the United Kingdom (0.3%), see Annex 1.¹⁷

Although natural gas is more widely spread than oil, about 55% of the proven gas reserves¹⁸ are located in just three countries: Russia, Iran, and Qatar.¹⁹ It is noteworthy that Turkmenistan has experienced the largest growth in reserves over the past

¹⁰ UNITED NATIONS. *Concept and Methods in Energy Statistics, with Special Reference to Energy Accounts and Balances: A Technical Report*, at X.

¹¹ Electricity may be produced from geothermal, hydro, nuclear, solar, tidal, wave and wind generation (See UNITED NATIONS. *Energy Statics: Definitions, Units of Measure and Conversion Factors*, Series F N° 44. New York: United Nations, 1987, at 6. http://unstats.un.org/unsd/publication/SeriesF/SeriesF_44E.pdf).

¹² INTERNATIONAL ENERGY AGENCY. *Technology Road Map-Smart Grids*. Paris: OECD/IEA: 2011, at 10.

¹³ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 59.

¹⁴ PAPAYA, Vladimir *et al.* *Energy Trade and Cooperation between the EU and CIS Countries*. Warsaw: Center for Social and Economic Research-CASE, 2009, at 31.

¹⁵ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 206.

¹⁶ Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

¹⁷ SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 2.

¹⁸ At the end of 2008, these gas reserves totaled more than 180 tcm globally- the equivalent to about 60 years of production at current rates.

¹⁹ INTERNATIONAL ENERGY AGENCY. *World Energy Outlook 2009*. *Op. cit.*, at 51.

decade.²⁰ At regional levels, 42% of the world gas reserves are located in Europe and the Former Soviet Union (FSU), 34% in the Middle East, 15% in Africa and the Far East, 4% in Central and South America and 3% in the U.S. (see Annex 2).²¹

The leading producer of electricity is the U.S. with 21.5% of the world total in 2008. Nevertheless, France is the main exporter followed by Paraguay and Canada²² (see Annex 3).

b) Main import States

The European Union (EU) is the leading importer of energy resources worldwide. In 2008, the EU imported 23.6% of the world fuel exports.²³ In fact, its dependency on imports is projected to grow up to 95% for oil and 84% for natural gas, representing an overall import dependency of 67% by 2030.²⁴ The second importer is the U.S. with an import rate of 19.1% of the world trade in fuel.²⁵ Although the U.S.'s import dependency concerns mainly oil, natural gas imports made up 16% of consumption in 2008.²⁶

The IEA prognosticates that energy consumption will rise by nearly 50% from 2009 to 2035. Most of this growth occurs in emerging economies such as China and India by 118%²⁷, Middle East by 82%, Africa by 63%, and Central and South America by 63%.²⁸

By 2030, oil demand is projected to grow by 1% per year. The production will increase from 85 million barrels per day in 2008 to 105 million in 2030.²⁹ This increase comes from non-OECD regions³⁰ i.e. China alone accounts for 42% of the overall increase.

²⁰ ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES. *Op. cit.*, at 51.

²¹ *International Energy Annual 1999 (IEA99)*, cited by Julia SELIVANOVA. *The WTO and Energy. Op. cit.*, at 3.

²² INTERNATIONAL ENERGY AGENCY. *Key World Energy Statistics*. Paris: OECD/IEA, 2010, at 27.

²³ WORLD TRADE ORGANIZATION. *World Trade Report 2010. Op. cit.*, at 214

²⁴ PAPAYA, Vladimir *et al. Op. cit.*, at 13.

²⁵ WORLD TRADE ORGANIZATION. *World Trade Report 2010. Op. cit.*, at 214

²⁶ CLEELAND, Belinda. *The Nature of Climate Change and Energy Security Policy, Interactions: Synergies or Trade-offs?* Dissertation, Graduate Institute of International and Development Studies, 2008, at 20.

²⁷ According to IEA, China and India are the main drivers of the non-OECD growth of demand. China accounts for 39% of the global increase in primary energy use, its shares of total demand jumping from 16% in 2007 to 23% in 2030. India accounts for 15% of the global increase, with its shares of total expanding from 5% to 8%.

²⁸ INTERNATIONAL ENERGY AGENCY. *Annual Energy Outlook 2009. Op. cit.*, at 44.

²⁹ *Ibid.*

³⁰ ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES. *Op. cit.*, at 67.

Even though the top two consumers of natural gas are currently the U.S. and Russia,³¹ the biggest increases in demand will take place in the Middle East, China and India by 1.5% per year in 2007-2030. Nonetheless, the U.S., Russia and Europe will remain as the leading consumers by 2030.³²

Likewise, world electricity demand is projected to grow at an annual rate of 2.5% by 2030. Over 80% of this growth takes places in non-OECD countries,³³ particularly China³⁴.

c) *Main transit States*

The foremost feature of energy resources is their uneven geographical distribution.³⁵ Consequently, trade in energy highly depends on means of transport and transit routes. For instance, electricity, unlike oil and gas, can only reach a particular destination if there is adequate infrastructure capacity.³⁶

Energy resources, in their transportation to import markets, need to pass through third States. Therefore, these transit States play a paramount role in energy trade. By way of illustration, significant volumes of gas from Turkmenistan reach Ukraine through the Russian territory. Another example is that Azerbaijan's oil reaches Turkey through Georgia (see Annex 4).³⁷

Furthermore, Russian oil reaches the EU and other markets mainly *via* the Baltic Sea and Black Sea. Likewise, Russian gas reaches the EU market *via* Ukraine, and Belarus. Nonetheless, Russia has been recently trying to diversify its gas export routes to the EU, promoting two large pipeline projects: *Nord-Stream*³⁸ and *South-Stream*³⁹, in order to decrease its reliance on the existent transit routes.⁴⁰

3. *Economic importance of transit in the energy sector*

Global energy demand will increase in the coming decades driven by population growth and emerging economies. Thus, vast investments in transport infrastructures will be required in order to satisfy this demand. According to the IEA, approximately USD 26 trillion will need to be invested to meet global projected energy demands

³¹ *Ibid.*, at 51.

³² INTERNATIONAL ENERGY AGENCY. *Annual Energy Outlook 2009*. *Op. cit.*, at 75.

³³ *Ibid.*

³⁴ China electricity demand grew by 14% from 2000 and 2007.

³⁵ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 48.

³⁶ PAPAYA, Vladimir *et al.* *Op. cit.*, at 24.

³⁷ *Ibid.*, at 59.

³⁸ The Nord-stream goes from West Siberia under the Baltic Sea.

³⁹ The South Stream goes from the Caspian region under the Black Sea.

⁴⁰ PAPAYA, Vladimir *et al.* *Op. cit.*, at 43.

by 2030.⁴¹ As such, transit will become a cornerstone in the energy sector for the following reasons:

- Carriage of energy goods requires costly investments, which may be equivalent to the funds needed for production.⁴² These investments are dictated on a long-term basis; thus they are subject to high political risks.⁴³
- Gas transportation *via* pipelines is sensitive to economies of scale. In spite of their capital-intensive construction, they are cost effective transportation systems.⁴⁴
- Transit facilities increase competition among transit and import States, which reduces transit tariffs benefiting final consumers. For instance, neighbouring States of the North Sea faced competition from the Southern European States when transit became feasible between both regions. In this case, the transit facilities reduced the bargaining power of the Northern States, decreasing final prices.⁴⁵

One of the main challenges of the energy sector is to find cost-effective transit routes that mitigate the high costs of negotiating with transit States. Currently, export and import States prefer more expensive alternative routes in order to avoid disputes with transit States.⁴⁶ For instance, Russia built the *Yamal* line through Poland with the aim of bypassing Ukraine. In addition, Russia has proposed two new lines *Nord-stream* and *South-stream*. Both are high-pressure marine lines and thus expensive alternatives to a direct Ukrainian route. Another example is that India has favoured LNG imports instead of using the existing Iran-Pakistan-India pipeline.⁴⁷

⁴¹ INTERNATIONAL ENERGY FORUM. *The Maturing Producer-Consumer Dialogue, 12th IEF Ministerial-Background Paper* (30-31 March 2010, Cancun Mexico), at 4.

⁴² CLARK, Bryan. "Transit and the Energy Charter Treaty: Rhetoric and Reality". *Web Journal of Current Issues*, 1998, at 2. <http://webjcli.ncl.ac.uk/1998/issue5/clark5.html>

⁴³ SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 4.

⁴⁴ JENSEN, James T. "Natural Gas-The Problem Child of Energy Transport and Trade". In Joost Pauwelyn (ed.). *Global Challenges at the Intersection of Trade, Energy and the Environment*. Geneva: Graduate Institute of International and Development Studies, 2010, at 127.

⁴⁵ KEYKAVOUSSI, Maneli. *Legalities of Energy Transit between the Newly Independent States and the European Union*. Master Dissertation. Institute d' Hautes Etudes Internationales, September, 2004, at 4.

⁴⁶ Despite the elimination of trade barriers, domestic markets are still presenting considerable amount of protection when transportation expenses are high relative to the value of goods (See Richard N. COOPER. "National Economic Policy in an Interdependent World Economy". *The Yale Journal*, 76(7), 1967. <http://www.jstor.org/stable/794824?seq=1>).

⁴⁷ JENSEN, James T. *Op. cit.*, at 130-131.

In conclusion, the transaction costs of negotiating with transit States and the investment risks have restrained the growth of transportation networks. The outcome is the encouragement of more costly alternatives.

B. Birth of the freedom of transit principle

This subsection explains the origin and evolution of the freedom of transit principle. First, its historical background will be examined, followed by its content. Afterwards, an analysis of the tension with the principle of State sovereignty as well as its current status in international law will be conducted. Finally, its evolution will be presented through three treaties materializing this principle.

In the XVII century, Grotius argued that States ought to allow transit across their territory in the fulfilment of an obligation to the community of States.⁴⁸ Later, Pufendorf and Vattel confirmed the existence of a right of passage, albeit subject to the requirement not to inflict harm on transit States.⁴⁹ While Vitoria affirmed the freedom of high seas based on freedom of communication, Grotius based his statement on freedom of commerce.⁵⁰

Nowadays, the right of transit must be justified by reference to considerations of necessity⁵¹ or convenience. Furthermore, the exercise of this right should not cause harm or prejudice to transit States.⁵² The latter is entitled to impose transportation charges and regulations strictly related to transit.⁵³

Despite its wide recognition, the freedom of transit principle has been constantly in tension with the principle of State sovereignty. The latter grants the right to exclude aliens and prevents the construction or use of infrastructures. In *Portugal v. India Right of Passage*, Judge Chagla in his Dissenting Opinion affirmed that “prima facie a State enjoying territorial sovereignty has the right to allow or to prohibit a right of passage or transit under such terms and conditions as [it] thinks proper”.⁵⁴

⁴⁸ LAUTERPACHT, E. “Freedom of Transit in International Law”. In *Problems of Public and Private International Law* (Grotius Society, Vol. 44, London 1958-1959) at 320 in which Lauterpacht makes reference to Grotius’ work *De Jure Belli ac Pacis*, II, 2, 13, as translated in “Classics of International Law” (1925), at 196-197.

⁴⁹ *Ibid.*

⁵⁰ LAPIDOTH, Ruth. “Freedom of Navigation-Its Legal History and Its Normative Basis”. *Journal of Maritime Law and Commerce*, 6(2), at 271.

⁵¹ In this respect, it seems that the concept of necessity is a wider and more flexible notion than necessity in the sense of immediate or overwhelming urgency.

⁵² LAUTERPACHT, E. *Op. cit.*, at 332-340.

⁵³ *Ibid.*, at 342.

⁵⁴ *Ibid.*, at 317-318.

Therefore, freedom of transit can be considered neither an absolute right⁵⁵ nor customary international law. Regarding States practice, it has developed through a long series of treaties, albeit it is controversial to recognize them as a sort of *jus constituendum*.⁵⁶ Concerning *opinion iuris*, States will barely accept the existence of a right of transit in the absence of treaty. Therefore, Lauterpacht classified freedom of transit as an imperfect principle to the extent that it is not enforceable without an agreement.⁵⁷

International agreements on transit have emerged in the aftermath of political instability periods, i.e. World Wars and the breakup of the FSU, as a desire to improve the economic situation by stimulating international trade.⁵⁸ In this regard, the major treaties are the following:

1. *The Barcelona Convention and the Statute on Freedom of Transit*

The Barcelona Statute on Freedom of Transit (hereinafter “the Barcelona Convention”) was the first multilateral instrument on transit.⁵⁹ After World War I, the League of Nations required the international community to secure and maintain freedom of transit in order to foster international trade.⁶⁰ Hence, the *First General Conference on Communication and Transit* adopted the Barcelona Convention,⁶¹ on April 20th, 1921.⁶²

Its aim is to guarantee free transit of persons, baggage, goods and vessels by rail or waterway across territories of the parties. Thereby, the parties must facilitate freedom of transit on convenient routes, provided that it does not jeopardize public health and security.

Furthermore, it establishes the non-discrimination principle. Thereby, the transit States shall not make distinctions based on nationalities, the flag of vessels, place of origin, departure, entry, exit, destination, or on any circumstance relating to the ownership of goods or of vessels, coaching, stock, or other means of transport. However, parties are permitted to apply reasonable charges on a non-discriminatory basis.

⁵⁵ CLARK, Bryan. *Op. cit.*, at. 3.

⁵⁶ LAUTERPACHT, E. *Op. cit.*, at 323

⁵⁷ *Ibid.*, at 346-347.

⁵⁸ ROGGENKAMP, Martha M. “Transit of Network-bound Energy: the European Experience”. In Thomas W. Wälde (ed.). *The Energy Charter Treaty*. London: Kluwer International Law, 1996, at 499.

⁵⁹ United Nations Conference on Trade and Development, *Right of Access of Land-locked States to and from the Sea and Freedom of Transit, Legislative history of part X, Article 124 to 132 of the United Nations Convention on the Law of the Sea*. New York: United Nations, 1987, at 5.

⁶⁰ Article 23 of the Covenant of the League of Nations, signed on 28 June 1919.

⁶¹ Other three Conventions were adopted during the same Conference; these Conventions regulate the regime of water ways, railways and the transmission of transit of electric power.

⁶² UPRETY, Kishor. “From Barcelona to Montego Bay and Thereafter: A Search for Landlocked States’ Rights to Trade through Access to the Sea – A Retrospective Review”. *Singapore Journal of International & Comparative Law*, 7, 2003, at 206.

Notice that the Barcelona Convention concerns solely water and rail transport, hence it does not apply to non-rail overland or fixed infrastructure.⁶³ In addition, there is still great emphasis on the sovereignty of the parties and their discretionary powers to grant transit rights and set the applicable conditions.⁶⁴

2. *The Convention on the Transmission in Transit of Electric Power*

This Convention was signed on December 9th, 1923, during the *Second Barcelona Conference on Communications and Transit*, and entered into force on July 26th, 1926. Unlike the Barcelona Convention, it is not based on the principle of freedom of transit.⁶⁵ Although the original aim was to create an international regime regarding trade in electricity, the convention only obliges States to enter into transit negotiations.⁶⁶

According to the Convention, electricity shall be considered transmitted in transit when it crosses other party's territory by means of conductors erected for this purpose alone without being wholly or in part produced, utilized or transformed within such territory. Then, if electricity is transformed in one stage of the journey, it is not anymore considered in transit. Nevertheless, this definition has slight practical impact nowadays considering the significant technological developments.⁶⁷

3. *The United Nations Convention on the Law of the Sea*

The UNCLOS entered into force on November 16th, 1994. Pursuant to Article 17, States enjoy the right of *innocent passage* through the territorial sea. Nonetheless, coastal States preserve the rights, *inter alia*, to regulate this passage; to safeguard the safety of navigation; to control the maritime traffic; to protect facilities, installations, cables and pipelines; and to preserve the environment.

Another outstanding provision is Article 79, which allows States to install and to operate pipelines in the continental shelf, provided that the coastal State authorizes the delineation of such pipelines. However, the latter can establish requirements for the constructions and operations of such pipelines as well as exercise jurisdiction over them.⁶⁸

⁶³ *Ibid.*

⁶⁴ KEYKAVOUSSI, Maneli. *Op. cit.*, at 12.

⁶⁵ ROGGENKAMP, Martha M. "Transit of Network-bound...". *Op. cit.*, at 504.

⁶⁶ Article 1.- Each contracting State undertakes, on the request of any other contracting State, to negotiate, with a view to the conclusion of agreements for ensuring the transmission in transit of electric power across its territory (...).

⁶⁷ ROGGENKAMP, Martha M. "Transit of Network-bound...". *Op. cit.*, at 504.

⁶⁸ REDGWELL, Catherine. "International Regulation of Energy Activities". In M. Roggenkamp (ed.). *Energy Law in Europe: national, EU, and international regulation*. Oxford: Oxford University Press, 2007, at 61-64.

In conclusion, the freedom of transit is a conditional principle, which is not part of customary international law as long as it always needs transit States' consent. Then, the question about the right of transit and the duty of the transit States to allow passage across their territory remains as an unresolved issue in international law.⁶⁹ Indeed, this debate is more intricate when it involves transit of energy resources through fixed infrastructures.

Section II: Transit in the WTO Agreements and trade in energy

Trade in energy is not specifically addressed in the WTO Agreements. Despite the fact that the Havana Charter initially included provisions related to quantitative control of primary commodities exports or imports and prices regulation,⁷⁰ these provisions were not finally incorporated into the GATT 1947. The main reasons were the non-participation of energy producing countries and the strategic nature⁷¹ of energy resources.⁷²

During the Uruguay Round, some attempts were made to include trade in energy issues into the Negotiating Group on Natural Resource-Based Products, particularly restrictive practices of energy exporters such as export taxes or dual pricing.⁷³ However, States could not reach an agreement on these matters, because resource-endowed countries were reluctant to adopt binding rules on trade in energy.⁷⁴

Notwithstanding, it is commonly agreed that the WTO Agreements are fully applicable to trade in energy.⁷⁵ In this respect, the relevant provisions for the transit of energy goods are the following:

⁶⁹ United Nations Conference on Trade and Development. *Technical Note No. 8-Freedom of Transit*, (February 2009). http://r0.unctad.org/ttl/technical-notes/TN08_FreedomofTransit.pdf

⁷⁰ Article 27 (Special Treatment of Primary Commodities) and Article 28 (Undertaking regarding Stimulation of Exports of Primary Commodities) of the Havana Charter.

⁷¹ Indeed, it is said that a "gentleman's agreement" existed among the major trading countries not to discuss petroleum issues in the GATT, for fear of politicizing the debate because of the strategic nature of petroleum trade and the importance of security concerns in respect of petroleum products. (See GIBBS, Murray. "Energy Services, Energy Policies and the Doha Agenda". In *Energy and Environmental Services: Negotiating Objectives and Development Priorities*. UNCTAD/DITC/TNCD/2003/3. New York and Geneva: United Nations, 2003, at 4.

⁷² SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 11.

⁷³ United Nations Conference on Trade and Development. *Trade Agreements, Petroleum and Energy Policies*. UNCTAD/ITCD/TBS/9. New York: UN, 2000, at 15. http://www.unctad.org/en/docs/itcdtsb9_en.pdf

⁷⁴ SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 11.

⁷⁵ As a matter of fact, there were WTO disputes concerning energy resources such as *United States- Gasoline* (See Appellate Body Report, *United States-Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted on 20 May 1996, DSR 1996: I, 3).

A. Transit under GATT Article V

To the extent that energy resources and products are considered goods, GATT Article V is applicable. This Article reaffirms the *freedom of transit principle* laid down previously by the Barcelona Convention.⁷⁶ Indeed, the latter was taken into consideration during GATT negotiations.⁷⁷ This sub-section will principally base its findings upon a close textual analysis of Article V and the only panel report handed down on this matter.

1. Scope of coverage

Article V applies to “traffic in transit” which covers, pursuant to Paragraph 1, passage of goods, and their means of transport, across the territory of a WTO Member (transit States) provided that this passage is only a portion of a complete journey beginning and terminating beyond the frontier of the transit State. Likewise, this Article covers transit between two points of the same country when passing through another country.⁷⁸ It does not matter whether there is trans-shipment, warehousing, breaking bulks as well as whether there is a change in the mode of transport.

Notice that this provision covers both goods and vehicles transporting these goods.⁷⁹ Thus, not only goods are deemed to be in transit across the territory of the transit States, but also their means of transport such as ships and lorries amongst others. Article V does not give an exhaustive list of means of transport. Consequently, it may cover network-bound infrastructures, which are the principal means of transportation for oil and gas (see Section IV).

In other respects, Article V is legally binding within the territory of each WTO Member as long as the traffic in transit is from or to another WTO Member. Then, at least two of the concerned countries must be WTO Members for the application of this principle. Thereby, the transit State should always be a WTO Member while at least one of either the State of origin or the State of destination should be a WTO Member.

⁷⁶ SINJELA, Mpazi. “Freedom of Transit and the right of access for land-locked States: The evolution of principle and law”. *Georgia Journal of International Law*, 12(1), at 31-52.

⁷⁷ *Report of the Technical Sub-Committee of the United Nations Conference on Trade and Employment*, E/PC/T/C.II/54/Rev.1 (28 November 1946), at 7.

⁷⁸ JACKSON, John H. *World Trade and the Law of GATT*. Indianapolis: The Bobbs-Merrill Company, 1969, at 508.

⁷⁹ It is noteworthy to mention that the original version of this Article covered transit of “persons”. However, it was deleted at the New York Drafting Committee Session because the negotiators considered that transit of persons was subject to immigration laws and may properly be the concern of another international agency (See Report of the Drafting Committee of the Preparatory Committee of the United Nations Committee on Trade and Employment, E/PC/T/34, on New York, 5 February 1947, at 12).

Therefore, Article V is inapplicable when energy goods are transported through a non-WTO Member. Such a scenario is commonplace in the context of trade in energy i.e. oil and gas are transported from Central Asia or Eastern Europe to Western Europe through non-WTO Members such as Azerbaijan, Belarus, Kazakhstan, Russia, Tajikistan and Uzbekistan. Hence, the freedom of transit is a crucial issue in the accession processes of these States to the WTO.⁸⁰

It is noteworthy that Paragraph 7 exempts aircrafts in transit from the application of Article V, albeit the air transit of goods is covered (including baggage). The negotiators considered that the *Provisional International Civil Air Organization* already covered aircraft in transit.⁸¹

2. Applicable rules

a) The freedom of transit principle

Paragraph 2 states that there shall be freedom of transit through the territory of the transit State, *via* the most convenient routes for international transit, and for traffic in transit to or from the territory of other contracting parties.

The Panel in *Colombia-Port of Entry* affirmed that Paragraph 2 should be read in light of Paragraph 1, which defines “traffic in transit”. In this sense, “freedom of transit must thus be extended to all traffic in transit when the goods’ passage across the territory of a Member is only a portion of a complete journey beginning and terminating beyond the frontier of the Member across whose territory the traffic passes. Freedom of transit must additionally be guaranteed with or without trans-shipment warehousing, breaking bulk, or change in the mode of transport.”⁸²

Additionally, the Panel noted that “freedom” is not defined in the GATT, however it means the “unrestricted use of something” according to its ordinary meaning.⁸³ Thereby, freedom of transit requires extending unrestricted access *via* the most convenient routes for the passage of goods in international journey.

Furthermore, a WTO Member is not required to guarantee transport on necessarily any or all routes within its territory, but only on the ones most convenient for

⁸⁰ WORLD TRADE ORGANIZATION. *World Trade Report WTO 2010. Op. cit.*, at 167.

⁸¹ *Report of the Technical Sub-Committee of the United Nations Conference on Trade and Employment*, E/PC/T/C.II/54/Rev.1 (28 November 1946) at 7.

⁸² Panel Report, *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R and Corr.1, adopted on 20 May 2009, paragraph 7.396.

⁸³ *The New Oxford Dictionary of English*. 2nd Ed. Oxford: Clarendon Press, 2001. <http://oxforddictionaries.com/definition/freedom>

transport.⁸⁴ Currently, there is no guideline on the interpretation of “routes most convenient”; however time and cost are likely key variables.⁸⁵

As a result, customs authorities of transit States shall not impose charges, formalities or other regulations on goods passing through their territory *en route* to foreign destinations without a valid reason.⁸⁶

b) Most Favoured Nation (MFN)

The MFN principle appears in three different paragraphs of Article V.

i) Paragraph 2

This paragraph states that “no distinction shall be made which is based on, [inter alia], the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstance relating to the ownership of goods, of vessels or of other means of transport”.

According to the Panel in *Colombia-Ports of Entry*, MFN treatment shall be extended to traffic in transit as defined in Paragraph 1, even if this term does not appear in the sentence.⁸⁷ Likewise, this MFN provision requires that goods from all WTO Members must be ensured an identical level of access and equal conditions when proceeding in international transit.⁸⁸ Finally, it is worth mentioning that this paragraph does not only refer to the origin of goods or nationality of means of transport, but also to their ownership.

ii) Paragraph 5

WTO Members shall accord to traffic in transit to or from the territory of any other WTO Member *treatment no less favourable* than the treatment accorded to traffic in transit to or from any third country, with respect to all “charges, regulations and formalities” in connection with transit.

⁸⁴ Panel Report, *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R and Corr.1, adopted on 20 May 2009, paragraph 7.401.

⁸⁵ BHALA, Raj. *Modern GATT Law: a Treatise on the General Agreement on Tariffs and Trade*. London: Sweet & Maxwell, 2005, at 472.

⁸⁶ ABBOTT, M. “Seizure of Generic Pharmaceuticals in Transit Based on Allegations of Patent Infringement: A Threat to International Trade, Development and Public Welfare”. *World Intellectual Property Organization Journal (WIPO)*, 1, 2009, at 45-46. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1535521&download=yes

⁸⁷ Panel Report, *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R and Corr.1, adopted on 20 May 2009, paragraph 7.397.

⁸⁸ *Ibid.*, paragraph 7.402.

According to this provision, MFN protection only covers discriminatory measures related to “charges, regulations and formalities in connection with transit”. As a result, it leaves open the possibility for other discriminatory acts such as different treatments regarding infrastructure access.⁸⁹

Moreover, the MFN principle applies to “like products” according to the Interpretative Ad Note to Article V, which states that:

with regard to *transportation charges*, the principle laid down in Paragraph 5 refers to like products being transported on the same route and under like conditions. (emphasis added)

At first glance, the “likeness” test would only apply regarding transportation charges;⁹⁰ while the same test would not be required regarding regulations and formalities. An alternative and more coherent interpretation is that the “likeness” test refers to transportation charges, regulations and formalities, but for transportation charges, two additional conditions are indispensable: “same route” and “like circumstances”.

Neither Article V nor its Ad Note explains what should be understood by “same routes” and “like conditions”. Does “same routes” mean identical? What is a condition? Would economic or environmental factors be a condition?⁹¹ Unfortunately, there has not been a dispute on these issues yet to clarify them. Thus, one should be cautious in speculating as to the meaning.

iii) Paragraph 6

Products which have been in transit through the territory of any other Member shall be accorded treatment no less favourable than that which would have been accorded to such products had they been transported from their place of origin to their destination without going through the territory of such other Member.

Unlike the rest of Article V, this paragraph applies to Members whose territory is the final destination of goods in international transit.⁹² The Panel in *Colombia-Ports of Entry* noted that the phrase incorporates the present perfect tense of the verb

⁸⁹ HERMAN, Lawrence L. “Beyond the WTO: Regional and Bilateral Rules Affecting Energy and Energy Investments”. In Joost Pauwelyn, (ed.). *Global Challenges at the Intersection of Trade, Energy and the Environment* (Geneva: Graduate Institute of International and Development Studies, 2010), at 46.

⁹⁰ The costs of transit can however vary. If the actual costs of transit are higher in some instances, difference in charges can be justified. (See SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at. 18.)

⁹¹ BHALA, Raj. *Op. cit.*, at 472.

⁹² Panel Report. *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, adopted on 27 April 2009, paragraph 7.475.

“to be”, thus it may apply to goods which have recently been in transit.⁹³ Moreover, the second sentence⁹⁴ refers to “*direct consignment*”⁹⁵ that only applies once the goods have been imported.⁹⁶

Therefore, Paragraph 6 extends MFN protection from discrimination based on the geographic course of goods in transit until reaching their final destination.⁹⁷ Then, all treatment granted to goods transported from their place of origin to their destination without going through a transit State, must be extended to goods that have been transported from their place of origin and passed through a Transit State as traffic in transit prior to reaching the final destination.⁹⁸ In this case, the MFN obligation would be broader than the freedom of transit rule since the former will apply to imported products entering the State of destination.

c) Charges, regulations and formalities

Transit States may require that traffic in transit enter the proper custom house according to Paragraph 3. Even if goods in transit do not enter to the stream of domestic commerce, transit States are allowed to keep a transit entry record.⁹⁹ Additionally, traffic in transit shall not be subject to any unnecessary delay or restriction and shall be exempt from customs duties, all transit duties or other charges imposed in respect of transit.

Notwithstanding, transit States may impose regulations and charges on traffic in transit provided that the latter are commensurate with administrative expenses entailed by transit or with the cost of services rendered as set forth in Paragraph 4. Thus, there are two kinds of legitimate charges related to: a) transportation and b) administrative expenses caused by transit or services rendered.¹⁰⁰ Furthermore, both regulations and charges must be reasonable as regards the conditions of the traffic.

⁹³ *Ibid.*, paragraph 7.454.

⁹⁴ The second sentence of Article V (6) states “Any contracting party shall, however, be free to maintain its requirements of *direct consignment* existing on the date of this Agreement, in respect of any goods in regard to which such direct consignment is a requisite condition of eligibility for entry of the goods at preferential rates of duty or has relation to the contracting party’s prescribed method of valuation for duty purposes.” (emphasis added)

⁹⁵ Direct consignment is prerequisite for the eligibility for entry of goods at preferential rates of duty or that relate to that Member’s method of valuation for duties purposes.

⁹⁶ Panel Report. *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, adopted on 27 April 2009, paragraph 7.454.

⁹⁷ *Ibid.*, paragraph 7.467.

⁹⁸ *Ibid.*, paragraph 7.454.

⁹⁹ BHALA, Raj. *Op. cit.*, at 473.

¹⁰⁰ WTO Secretariat, Council for Trade in Goods. *Article V of GATT 1994- Scope and Application*, G/C/W/408 (10 September 2002), at 8.

Notice that “charges” in Paragraph 3 refer to taxes on transit activities, whereas “charges” in Paragraph 4 refers to fees for transportation by government owned infrastructure¹⁰¹ or administrative expenses¹⁰².

B. Transit under the General Agreement on Trade in Services (GATS)

In broad brushstrokes, the GATS covers all measures by Members affecting trade in services, which can involve cross-border services¹⁰³ (i.e. pipeline and maritime transport), consumption abroad¹⁰⁴ (i.e. ships repaired abroad), commercial presence¹⁰⁵ (i.e. foreign investment in oilfield services or distribution of gas) or movement of natural persons¹⁰⁶ (i.e. the entry of aliens to provide exploration or other oilfield services).

The GATS contains a set of general rules which apply to the four modes of supply described above such as MFN¹⁰⁷ and Transparency.¹⁰⁸ Unlike the GATT, departure from the MFN principle is permitted under the GATS insofar as these measures are listed and meet the conditions of the Annex to Article II (Exemptions).

In contrast, the application of national treatment (NT) and market access provisions depends on the specific commitments undertaken by each Member under the term, limitations and conditions agreed and specified in its schedule. For instance, in the commitments undertaken in market access, Members may specify limitation on, *inter alia*, the number of service suppliers, the total value of service transactions or assets, the total number of natural persons that may be employed in a particular sector, specific types of legal entities or joint ventures, and foreign equity participation.¹⁰⁹

¹⁰¹ *Report of the Technical Sub-Committee of the United Nations Conference on Trade and Employment*, E/PC/T/C.II/54/Rev.1 (28 November 1946) at 10.

¹⁰² *Report of the Technical Sub-Committee of the United Nations Conference on Trade and Employment*, E/PC/T/C.II/42 (5 November 1946) at 4.

¹⁰³ Services supplied from the territory of one Member into the territory of another.

¹⁰⁴ Services supplied in the territory of one member to the consumers of another.

¹⁰⁵ Services supplied through any type of business or professional establishment of one Member to the territory of another.

¹⁰⁶ Services supplied by nationals of one Member in the territory of another.

¹⁰⁷ Article II: Most-Favoured-Nation Treatment

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country. [...]

¹⁰⁸ Article III: Transparency

1. Each Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this Agreement. International agreements pertaining to or affecting trade in services to which a Member is a signatory shall also be published [...]

¹⁰⁹ GATS Article XVI.

1. *Energy services*

Although the GATS defines neither services nor energy services, this section will try to clarify the term *energy services* based on the range of activities that it may include. For this purpose, it is useful to distinguish between *energy services* and *services related to energy*.

On the one hand, *energy services* contain activities which can be regarded as the core¹¹⁰ of the energy industry such as exploration, drilling, processing and refining, transportation, distribution, waste management and disposal.¹¹¹ The chief and common feature is that these services exclusively belong to and are essential for the energy industry.

On the other hand, *energy related services* cover activities important for the energy sector, but not exclusive. These services, which intervene in the energy value-added chain, are found in the whole range of services sectors i.e. research and development, engineering, construction, management consultancy, environmental, financial and distribution services.¹¹²

2. *Energy services in the GATS*

All services related to natural resources such as energy services are subject to GATS' provisions, unless they are provided in the exercise of governmental authority.¹¹³ Nevertheless, neither the CPC¹¹⁴ nor the W/120¹¹⁵ used during the Uruguay Round includes a distinct section for the energy sector.¹¹⁶ It is important to bear in mind that W/120 is a non-legally binding document, thus Members can decide whether to consider it as expressive of their commitments.¹¹⁷

¹¹⁰ There were discussions of merits to distinguish between core and non-core services. An activity would be considered as "core" if the service was an essential part of the chain of supply if the sector (See SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 20-21).

¹¹¹ United Nations Conference on Trade and Development. *Trade Agreements, petroleum and energy policies*. Geneva: UNCTAD, 2000, at 39-40.

¹¹² TACOA-VIELMA, Jasmin. "Defining Energy Services for the GATS: an issue under discussion". In *Energy and Environmental Services: Negotiating Objectives and Development Priorities*, UNCTAD/DITC/TNCD/2003/3. Geneva: UNCTAD, 2003, at 74-75.

¹¹³ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 162.

¹¹⁴ The 1991 UN Provisional Central Product Classification.

¹¹⁵ The Services Sectoral Classification List MTN.GNS/W/120 (W/120) consists in a list of service sectors based on the CPC of the United Nations of 1991. It divides all services into 12 broadly defined sectors, which are further divided into some 150 sub-sectors (See TACOA-VIELMA, Jasmin. *Op. cit.*, at 71).

¹¹⁶ It is important to bear in mind that WTO Member until now have to agree on a unique classification that must be used by all members in the context of the negotiating and inscribing sector-commitments (See TACOA-VIELMA, Jasmin. *Op. cit.*, at 71).

¹¹⁷ TACOA-VIELMA, Jasmin. *Op. cit.*, at 71.

The primary reason for this absence is that energy services were largely perceived as non-tradable since the energy sector was largely controlled under State-owned enterprises.¹¹⁸ The latter was vertically integrated and performed all energy-related activities, including transportation. Hence, energy services constituted a mere value added to energy goods.¹¹⁹

Nonetheless, the energy sector is not completely absent from the W/120 as three sub-sectors make a direct reference to energy:¹²⁰ services incidental to mining, pipeline transport (upstream segment) and services incidental to energy distribution (downstream segment).¹²¹

In addition, the absence of all relevant activities along the energy chain does not mean that they are not actually covered by the GATS. In the end, the problem is mainly one of visibility.¹²² For instance, important energy related services, such as transport, distribution, consulting and construction, are covered by other horizontal categories of the W/122.¹²³

3. *Transportation of energy goods in the GATS*

The transportation of energy goods involves the following modes of supply¹²⁴:

- Cross-Border transmission of electricity and gas through grids and pipelines;
- Commercial presence of build-operator-transfer; and
- Movement of skilled professionals who deliver technical and managerial services i.e. construction and upgrading of grids.

Among the three energy services covered by the W/120, pipeline transportation is of paramount importance for the transit of energy goods. It includes the “*Transportation*

¹¹⁸ COSSY, Mireille. “The Liberalization of energy services: are PTAs more energetic than the GATS”. In Juan A. Marchetti and Martin Roy (eds.). *Opening Markets for Trade in Services*. New York: Cambridge University Press, 2008, at 410.

¹¹⁹ United Nations Conference on Trade and Development. *Trade Agreements, petroleum and energy policies*. Geneva: UNCTAD, 2000, at 39-40.

¹²⁰ The Annex I of CPC also provides a compendium of energy related products listed under different headings, including energy related services (See United Nations Conference on Trade and Development. *Trade Agreements, petroleum and energy policies* at 39-40).

¹²¹ WORLD TRADE ORGANIZATION. *Service Sectoral Classification List, MTN.GNS/W/120* (10 July 1991), URL, http://www.wto.org/english/tratop_e/serv_e/mtn_gns_w_120_e.doc

¹²² COSSY, Mireille. “The Liberalization of energy services ...”. *Op. cit.*, at 410.

¹²³ United Nations Conference on Trade and Development. *Trade Agreements, petroleum and energy policies*, at 39-40.

¹²⁴ United Nations Conference on Trade and Development. *Managing “Request-Offer” Negotiations under the GATS: the Case of Energy Services*, UNCTAD/DITC/TNCD/2003/5 (23 May 2003).

via pipeline of crude or refined petroleum and petroleum products and of natural gas".¹²⁵ Nevertheless, the level of obligations is subject to the specific commitments undertaken by Members. Currently, only fifteen Members have undertaken specific commitments in this subsector.¹²⁶

4. Shortcoming for energy services in the GATS

The lack of clear nomenclature for energy services may pose the following drawbacks:

- it may turn out to be a hindrance in market access negotiations, especially in a positive-list system;¹²⁷
- Former monopolies may retain a dominant position in the market and have preferable access to the infrastructure,¹²⁸ impeding new entrants;¹²⁹
- The access conditions are unclear and unpredictable affecting suppliers who need access to a large number of relevant services since the energy industry is composed of inter-related activities.¹³⁰
- Lack of coverage of new services, which have arisen because of the structural changes experienced by the energy market i.e. new technologies.¹³¹

Thus, the fragmentation of activities related to energy services unnecessarily complicates trade in energy since operators need to go through different sub-headings. It should be noted that the energy industry is a chain of interconnected activities where one cannot function without the other.¹³² Finally, the absence of government procurement provisions is also a hindrance in a sector where public entities still play a significant role.¹³³

¹²⁵ CPC 7131, Explanatory Notes for the Services Listed in CPC.

¹²⁶ Australia, Brazil, Cambodia, Croatia, Macedonia, Hungary, Japan, Kyrgyz, Lithuania, Moldova, Nepal, New Zealand, Saudi Arabia, Ukraine and Vietnam.

¹²⁷ COSSY, Mireille. "The Liberalization of energy services...". *Op. cit.*, at 410.

¹²⁸ For the time being, GATS Article VIII, dealing with monopolies and exclusive suppliers, is the only available basis for dealing with competition issues in the energy sector.

¹²⁹ COSSY, Mireille. "The Liberalization of energy services...". *Op. cit.*, at 415-416.

¹³⁰ ZARRILLI, Simonetta. "International Trade in Energy Service and the Developing Countries". In *Energy and Environmental Services: Negotiating Objectives and Development Priorities*, UNCTAD/DITC/TNCD/2003/3. Geneva: UNCTAD, 2003, at 48.

¹³¹ TACOA-VIELMA, Jasmin. *Op. cit.*, at 75.

¹³² COTTIER, Thomas *et al.* *Energy in WTO Law and Policy*. NCCR Working Paper N° 2009/25. Bern: World Trade Institute, 2009, at 10.

¹³³ COSSY, Mireille. "The Liberalization of energy services...". *Op. cit.*, at 415-416.

C. Transit in the regional integration context

Article XXIV applies to all GATT disciplines, including Article V. Hence, it is essential to examine the relationship between both Articles as well as the current practice in some relevant Regional Trade Agreements (RTA).

1. Implications of GATT Article XXIV in energy transit

This sub-section analyzes the outcomes for energy transit of applying Article XXIV.

a) Article XXIV's function

Broadly, Article XXIV allows Members to adopt measures inconsistent with WTO Law, in the context of the pursuit of regional economic integration.¹³⁴ Thereby, Members grant to their regional partners more preferable treatment than the treatment offered to the rest of the world, in deviation of the MFN principle. Thus, it provides an exception for trade in goods and a defence for WTO-inconsistent measures.¹³⁵

The main purpose of RTAs is to facilitate trade between the constituent territories and not to raise barriers to trade of other Members.¹³⁶ Article XXIV governs the formation of the following trade integration schemes:

i) Free trade area (FTA)

Regional partners agree to eliminate tariff and non-tariff trade barriers on substantially all trade within the FTA.¹³⁷ The North American Free Trade Agreement (NAFTA) is an example of a FTA between the U.S., Mexico and Canada. Moreover, FTAs have to fulfil the following requirements:

- The duties and other regulations maintained by each party, to trade with non-FTA parties, shall not be higher or more restrictive than the existing duties and regulations prior to the FTA.¹³⁸
- The duties and other restrictive regulations of commerce should be eliminated on substantially all the trade between the FTA parties in products originating within such parties.

¹³⁴ BOSSCHE, Peter Van Den. *The Law and Policy of the World Trade Organization*. 5th ed. Cambridge: Cambridge University Press, 2007.

¹³⁵ Appellate Body Report, *Turkey-Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, adopted on 19 November 1999, DSR 1999: VI, 2345, paragraph 45.

¹³⁶ Article XXIV (4) of the GATT.

¹³⁷ Article XXIV (8)(b) of the GATT.

¹³⁸ Article XXIV (5)(a) of the GATT.

ii) Customs union (CU)

Members must eliminate tariff and non-tariff barriers within the CU. Furthermore, Members should establish *substantially the same* duties and other regulations for external goods imported into the CU. The CU's partners must comply with the following requirements:

- The duties and other regulation in respect of trade with non-CU parties should not be on the whole higher or more restrictive than those applicable prior to the CU formation.
- The CU must apply substantially the same duties and other regulations of commerce to non-CU Members.¹³⁹
- The duties and other restrictive regulations of commerce must be eliminated with respect to substantially all trade between the parties.¹⁴⁰

b) Relationship between Article XXIV and Article V

As aforementioned, Article V(3) allows the imposition of transportation charges insofar as they are commensurate with the administrative expenses or with the cost of the services rendered. Moreover, these charges should be reasonable considering the conditions of traffic. Then, any charge that generates a profit would breach Article V. Thus, legitimate charges under Article V would not qualify as customs duties *per se*.

Likewise, the regulations and formalities allowed under Article V do not enter the category of "other restrictive regulation of commerce" under Article XXIV. As mentioned, these measures aim to facilitate transit of goods fostering trade liberalization, consequently they cannot be considered as trade restrictions.

In conclusion, charges, regulations and formalities permitted under Article V in respect of traffic in transit are not required to be eliminated under Article XXIV to the extent that they are not customs duties or restriction to commerce.

c) Shortcoming for energy transit through fixed infrastructures

Even if regional partners are not obliged, *per se*, to eliminate legitimate transit measures, they may deliberately do so, provided that it does not affect third parties. In other words, the elimination of a transit measures in regional schemes should not increase the restrictions placed upon third WTO Members.¹⁴¹

¹³⁹ In *Turkey-Textiles*, the AB stated that "substantially" implies "something closely approximating sameness," although parties still enjoy "a certain degree of flexibility" in the creation of a common external trade policies (see Appellate Body Report. *Turkey-Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, adopted on 19 November 1999, DSR 1999: VI, 2345, paragraph 49-50).

¹⁴⁰ Article XXIV (8)(a)(i).

¹⁴¹ Article XXIV (5) (a) (b).

This scenario is likely to occur in the context of transit through fixed infrastructures such as pipelines and grids. Unlike other means of transport, pipelines and grids have limited capacity, thus not all States can access them at the same time and in equal proportion. Consequently, any preferential access granted to regional partners may affect the transit of energy goods from or to third countries.

Imagine that after the accession of Ukraine to the EU, the former may increase by 20% the EU's access to gas pipelines. This increase diminishes by 20% the access of a prior non-EU user. Moreover, this preferential access may grant a privileged position to the CU in certain markets affecting competition and consumers. In this example, the preferential access clearly affects third WTO Members, breaching the MFN principle. Then, Article XXIV cannot act as a defence. However, Ukraine may argue that the preference was necessary to the accession to the CU.

This finding seems to restrain the capacity of WTO Members to grant preferential conditions to their regional partners. As mentioned above, transit, particularly transit through fixed infrastructures, is closely linked to the State sovereignty principle, whereby States have the right to dispose of their infrastructures (under the hypothesis that the State or State enterprises are the owners). Therefore, any limitation on this right may jeopardize their sovereignty.

Even outside the scope of Article XXIV, any contractual change in the percentage of access may be considered discriminatory. This may represent a significant limitation in the capacity to negotiate and contract of transit States.

Notice that Article V does not contain any provision related to the construction of new or additional fixed infrastructure when the existing infrastructure is not sufficient. Conversely, the ECT lays down this right (see Section III). This provision is extremely pertinent in the situation analyzed above since it will prevent the detriment to third WTO Members. However, this inclusion seems not to be feasible for the time being, as the current negotiations on Article V do not include any proposal in this regard (see Section V).

2. Treatment of energy transit in RTAs

RTAs have become a very prominent feature of the Multilateral Trading System. As of 15 May 2011, some 358 RTAs were notified under Article XXIV of the GATT 1994.¹⁴² RTAs practice will be significant as a guideline for some uncertain issue like the transit of good, in particular energy transit.

¹⁴² WORLD TRADE ORGANIZATION. "Regional Trade Agreements", http://www.wto.org/english/tratop_e/region_e/region_e.htm (accessed on 20 June 2011). At the same date, 36 RTAs were notified under

According to the RTAs surveyed, it seems that there are few preferential terms of transit (See Annex 5). These Agreements do not go beyond GATT Article V. The most interesting developments are in trade in services, in particular cross border services that include transportation services. Nonetheless, the latter is outside the scope of coverage of GATT Article V insofar as these improvements fall under trade in services disciplines.

Section III: Transit of energy goods in the ECT

The ECT, based on the European Energy Charter,¹⁴³ was signed in December 1994 and entered into force in April 1998. Up to the present time, forty-nine contracting parties have ratified the ECT (see Annex 6) while five States have signed but not yet ratified it.¹⁴⁴ Note that none of the major oil and gas producers in North Africa and the Gulf States are signatory of the ECT.¹⁴⁵

The fundamental aim is the liberalization of cross-border investment, transit and trade flows in the energy sector.¹⁴⁶ Hence, it establishes exhaustive binding rules to foster favourable conditions in these three disciplines.

Nowadays, the ECT has a unique role as the only multilateral agreement in the energy field.¹⁴⁷ Moreover, it adds value to existing general or bilateral agreements, primarily to investment and transit disciplines. Besides, it is a suitable forum for dialogue between different energy stakeholders: consuming, producing and transit States.¹⁴⁸

the Enabling Clause; and 95 under Article V of the GATS. In total, 489 RTAs, counting goods and services notifications separately, have been notified to the GATT/WTO, 297 agreements were in force.

¹⁴³ The Dutch Prime Minister, Ruud Lubbers, launched the proposal of the European Energy Community on 25 June 1990. The major aim was to provide greater diversification of energy flows to the EU, while offering new opportunities for investment in the oil and gas sectors in FSU countries. The European Energy Charter was signed in December 1991 in The Hague, and constituted a political declaration.

¹⁴⁴ Australia, Belarus, Norway, Iceland and the Russian Federation have not ratified the ECT yet. Until 2009, the Russian Federation applied provisionally the Treaty, albeit it communicated to the depositary of the agreement its unwillingness to become a party of the ECT. Such notification resulted in Russia's termination of its provisional application. (Energy Charter, "Status of Ratification of the Energy Charter Treaty", http://www.encharter.org/fileadmin/user_upload/document/ECT_ratification_status.pdf (visited on 4 July 2011)).

¹⁴⁵ However, transit in these regions is highly important for world energy security (See LIESEN, Rainer, "Transit under the 1994 Energy Charter Treaty". *Energy and Natural Resources Law*, 56, at 72, URL, www.heinonline.com

¹⁴⁶ KONOPLYANIK, Andrei and Thomas WÄLDE. "Energy Charter Treaty and its Role in International Energy". *Journal of Energy & Natural Resources Law*, 24(4), 2006. <http://konoplyanik.ru/ru/publications/Articles/410-JENRL-11.2006.pdf>

¹⁴⁷ DORÉ, Julia and Robert DE BAUW. *The Energy Charter Treaty*. London: The Royal Institute of International Affairs, 1995, at 5.

¹⁴⁸ SELIVANOVA, Julia. *Challenges for Multilateral Energy Trade Regulation: WTO and Energy Charter*, Working Paper 2010/20, at 11-12. <http://www.ssrn.com/link/SIEL-2010-Barcelona-Conference.html>

A. Provisions on transit in the Energy Charter framework

1. Article 7 of the ECT

This provision was based upon GATT Article V. Nonetheless, the latter was not considered satisfactory to tackle the complexity of the energy sector, particularly network-bound transit.¹⁴⁹ Thus, the ECT seeks to improve those weaknesses as follows:

a) Scope of coverage

Its scope of coverage includes transit of Energy Materials and Products as well as Energy Transport Facilities. According to Annex EM, *Energy Material and Products* include nuclear energy, coal, natural gas, petroleum, electrical energy, fuel wood and charcoal amongst others.¹⁵⁰ Likewise, *Energy Transport Facilities* consist of fixed infrastructures for handling *Energy Materials and Products*, including high-pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil and oil products pipelines.¹⁵¹

Furthermore, the definition of *Transit* is twofold pursuant to Paragraph 10 (a) and includes:

- (i) the carriage through the territory of the transit State of *Energy Materials and Products* originating in another State and destined for a third State, so long as either the other State or the third State is a party; or
- (ii) the carriage through the transit State of *Energy Materials and Products* originating in another party and destined for that other party (unless the parties concerned decide otherwise and record their decision by a joint entry in Annex N).¹⁵²

Different criteria apply for both transit situations. Whereas the first case supposes the passage through at least two different borders, the second implies the passage of the same border twice. Likewise, either the State of origin or the State of destination may not be an ECT party in the first case, while both States must be ECT parties in the second case.

¹⁴⁹ *Ibid.*, at 9.

¹⁵⁰ The list of energy materials and products contained in Annex EM of the ECT was based on the Harmonized System of the Custom Co-operation Council and the Combined Nomenclature of the European Communities, pursuant to Article 1 (Definitions).

¹⁵¹ Article 7 (10) (b) of the ECT.

¹⁵² In spite of the fact that Canada and the U.S. have not ratified the ECT yet, these States made the reservation that at least three States areas should be involved in a transit agreement. The major reason is the treaty body between both States ruling the transit of petroleum from the U.S. to Alaska through Canadian territory.

b) Freedom of transit

As set forth in Paragraph 1, each party shall take the necessary measures to facilitate the transit of *Energy Materials and Products* consistent with the principle of freedom of transit. Unlike the GATT, the ECT does not emphatically establish this principle, which may bring some implications. As discussed above, freedom of transit does not form part of customary international law, thus it is better to explicitly lay down this principle rather than take it for granted.

Notice that Paragraph 1 does not mention *Energy Transit Facilities*. Hence, the freedom of transit reference would apply to the transit of energy goods regardless of their means of transport.

c) Non-discrimination

Both the MFN and NT principles are set out in article 7 as follows:

i) MFN principle

The necessary measures to facilitate transit shall be taken without distinction as to origin, destination or ownership of energy goods or discrimination as to pricing (Paragraph 1). In summary, parties may not refuse transit or the construction of a new network capacity solely on the basis of the origin, destination or ownership of the energy goods.¹⁵³

It is noteworthy to mention that Article 7 does not formulate MFN in its traditional wording by proscribing “treatment less favourable than the treatment accorded to traffic in transit to or from any third country”.

ii) NT principle

Regarding transport and use of network-bound facilities, an ECT party shall treat energy goods in transit in no less favourable manner than the treatment granted to energy goods originating in or destined for its own territory.¹⁵⁴ This provision is exclusively relevant for energy goods transported *via* fixed infrastructure since domestic and transit energy goods use the same network and discrimination opportunities may arise. Conversely, this provision is redundant when energy goods are transported by mobile means of transport as long as these goods do not enter into the domestic market and compete with domestic goods.

¹⁵³ ENERGY CHARTER SECRETARIAT. *The Energy Charter Treaty a Reader's Guide*. Brussels: Energy Charter Secretariat, 2002, at 30.

¹⁵⁴ Article 7 (3) of the ECT.

d) Construction of transit facilities

Pursuant to Paragraph 4, if the transit of energy goods cannot be achieved on commercial terms by means of the existing network-bound facilities, the transit State shall not place any obstacle to the construction of new facilities, except as may be provided in applicable legislation. An Understanding appended to the Final Act of the Negotiating Conference states that environmental protection, land use, safety or technical standards qualify as applicable legislation.¹⁵⁵

Thereby, the ECT gives priority to previous commercial negotiations. If these negotiations fail, interested parties have the right to build transit facilities. Notwithstanding, transit States may impede the construction or modification of network-bound facilities when these endanger the security or efficiency of transit States' energy systems, including the security of supply (Paragraph 5). To sum up, only when new or additional transit infrastructure has a negative impact are objections to transit acceptable.¹⁵⁶ Then, the ECT reaffirms, *prima facie*, the fundamental principle of State sovereignty.¹⁵⁷

At first glance, it seems that there is an apparent contradiction between Paragraphs 4 and 5. Nonetheless, the purpose of both paragraphs is to grant transit States some discretion, in support of the State sovereignty principle, as to the particular mode of network-bound facilities to be built.¹⁵⁸

Finally, paragraph 9 complements this interpretation, transit States which do not have a certain type of transport facility are not obliged to take any measure with respect to that deficiency. Nevertheless, they are still obliged to allow the construction of new facilities.

e) Non-interruption of transit

As set forth in Paragraph 6, transit States shall not, in the event of a dispute over any matter arising from transit issues, interrupt or reduce existing flows of energy materials and products prior to the conclusion of the dispute settlement procedure explained below.

This provision is of utmost importance in terms of energy security since it guarantees the continuous flow of energy goods even if there is a transit dispute i.e. disagreement

¹⁵⁵ ENERGY CHARTER SECRETARIAT. *Energy Charter Treaty and Related Documents*. Brussels: Energy Charter Secretariat, 2004, at 27.

¹⁵⁶ LIESEN, Rainer. *Op. cit.*

¹⁵⁷ CLARK, Bryam. *Op. cit.*, at 5.

¹⁵⁸ *Ibid.*

on transit tariffs among FSU.¹⁵⁹ Notwithstanding, the parties may obstruct energy flows regarding non-transit disputes i.e. a transit State would not contravene its ECT obligations by interrupting energy flows in the event of a political dispute. In conclusion, the ECT does not totally prevent the interruption or reduction of energy transit.¹⁶⁰

f) Dispute Settlement Mechanism

The ECT provides an *ad hoc* dispute settlement mechanism for disputes over any matter arising from transit. First, the disputing parties must exhaust all relevant contractual or other previously agreed dispute remedies. By default, the disputing parties may refer the dispute to the Secretary General who will appoint a conciliator prior to an agreement of the disputing parties.

The conciliator shall seek a satisfactory agreement between the disputing parties; if his fails to materialize, the conciliator shall decide on an interim solution. Disputing parties shall observe an interim resolution for 12 months while working to resolve definitely the dispute (see flowchart in Annex 8).

As mentioned, this proceeding only addresses disputes over “*any matter arising from transit*”. Hence, other disputes, such as denegation of a transit request or the stipulation of unacceptable conditions, may be settled through either investor-State arbitration (Article 26) or inter-States dispute settlement proceeding (Article 27).

2. Protocol on Transit

In 1998, the G8 leaders, the EU Council, and the Presidents of Azerbaijan, Georgia, Kazakhstan, Turkey and Uzbekistan, acknowledged the necessity of strengthening and enlarging the ECT transit provision. The aim was to create an attractive environment for investments in energy network-bound transit.

In 1999, the Energy Charter Conference (ECC) launched the negotiations on a Transit Protocol in the Transit Working Group. The negotiations are still under way, albeit the ECC decided to close the current texts except on three issues: right of first refusal of transit capacities for existing transit shippers, the application of the Regional Economic Integration Organization clause and a mechanism for the establishment of transit tariffs.¹⁶¹ Despite multiple attempts, the EU and Russia could not reach an agreement on these matters, which are at the same time crucial

¹⁵⁹ FATOUROS, A.A. *Op. cit* at 355-446.

¹⁶⁰ LIESEN, Rainer. *Op. cit*

¹⁶¹ BAMBERGER, Craig and Thomas WÄLDE. “The Energy Charter Treaty”. In M. Roggenkamp, M. (ed.). *Energy Law in Europe: national, EU, and international regulation*. Oxford: Oxford University Press, 2007, at 61-64.

elements in the bilateral negotiations of the Russian accession to the WTO. As a result, the Protocol negotiations are temporarily suspended.¹⁶²

It is important to bear in mind that the Protocol shall not derogate Article 7. Conversely, it aims to complement, supplement or amplify this provision. Broadly speaking, the Protocol's coverage excludes non-fixed transit facilities and includes energy swap agreements.¹⁶³ Moreover, it guarantees that private operators under transit States' jurisdiction will negotiate in good faith and grant on a non-discriminatory and transparent basis access and use of network-bound facilities. Finally, it ensures that tariff charges will be objective, reasonable and non-discriminatory.

B. Relationship between transit provisions under the GATT and the ECT

1. Interaction between the GATT and the ECT

The cornerstone of the ECT is non-derogation from the WTO Agreements. Indeed, the ECT is designed to extend WTO provisions to non-WTO Members regarding trade in energy. This is of paramount importance considering that not all ECT signatories are WTO Members, with Russia being the most outstanding exception in this respect.

The ECT only refers to the GATT, however it does not actually incorporate GATT Articles.¹⁶⁴ Nothing in the ECT shall derogate from GATT obligations and related instruments when an ECT signatory is party of both Agreements, pursuant to Article 4. Likewise, trade in energy is subject to GATT disciplines even if the ECT signatory, such as Russia, is not a WTO Member.¹⁶⁵

Therefore, any interpretation of Article 7 must be consistent with the provisions and further interpretation of the WTO Agreements, in particular GATT Article V.¹⁶⁶

¹⁶² ENERGY CHARTER. "Transit Protocol". <http://www.encharter.org/index.php?id=37> (accessed on July 4th 2011).

¹⁶³ According to Article 17 of the Protocol Draft "International Energy Swap Agreement means any agreement relating to the exchange of a quantity of energy in the territory of one Contracting Party for an equivalent quantity of energy of the same type in the territory of another Contracting Party and which is entered into between:

- (a) a Contracting Party and an Entity of another Contracting Party; or
- (b) an Entity of a Contracting Party and an Entity of another Contracting Party."

¹⁶⁴ It is noteworthy that neither the ECT nor the Trade Amendment includes GATS provisions, because delegations considered this issue too complex. Nonetheless, trade in services is not completely outside the scope. The ECT investment provisions cover commercial presence and presence of natural person, which constitute respectively Mode 3 and Mode 4 of GATS. (See ENERGY CHARTER SECRETARIAT. *The Energy Charter Treaty a Reader's Guide*. *Op. cit.*, at 17).

¹⁶⁵ Article 29 of the ECT.

¹⁶⁶ LAPIASHVILI, Natia. *Freedom of Transit in International Law at the Example of the BTC pipeline legal framework*. Saarbrücken: Lambert Academic Publishing, 2010, at 19.

Moreover, any condition to transit under GATT Article V should be *a fortiori* present in ECT Article 7 as long as the latter cannot be inconsistent with the former.

The ECT looks to synchronizing both Agreements since it assumes that all signatories will eventually become WTO Members. Thus, it aims at filling the gaps until then.¹⁶⁷ Additionally, the ECT seeks to further improve regulations regarding trade in energy such as transit and investment related issues.

2. Comparison between GATT Article V and ECT Article 7

Although ECT Article 7 was based on GATT Article V, the former goes beyond the latter.¹⁶⁸ The ECT is more detailed and focused on energy transit issues. By contrasting both provisions, the most outstanding differences are the following (see also annex 5):

a) Freedom of transit

As aforementioned, both provisions enshrine the freedom of transit principle, but in different terms. While GATT states that *there shall be freedom of transit*, the ECT provides that the *parties shall take the necessary measures* to facilitate the transit of energy resources. There are two positions regarding the legal weight of both statements.

On the one hand, the ECT seems more emphatic, because parties are required to undertake positive actions; whereas GATT espouses a passive provision.¹⁶⁹ On the other hand, some scholars argue that the ECT wording has less in normativity intensity as opposed to the affirmation contained in GATT.¹⁷⁰

Analyzing the texts of both provisions, it seems that Article 7 establishes a direct and strong obligation on ECT parties when stating that they “shall take” the necessary measures which effectively appeal to actions from the parties in order to guarantee the existence of freedom of transit. Unfortunately, this provision has not been interpreted in a dispute in the framework of the ECT up to the present time.

b) Network-bound transit

Unlike the GATT, the ECT explicitly addresses issues connected with network-bound energy transit. First, the ECT provides a definition of network-bound capacities and explicitly extends its coverage over them. Although GATT Article V covers fixed infrastructure, it does not make any reference to them (see Section IV).

¹⁶⁷ KONOPLYANIK, Andrei and Thomas WÄLDE. *Op. cit.*, at 541.

¹⁶⁸ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 16.

¹⁶⁹ HERMAN, Lawrence L. *Op. cit.*

¹⁷⁰ KONOPLYANIK, Andrei and Thomas WÄLDE. *Op. cit.*, at 508.

Furthermore, the ECT parties are obliged not to arbitrarily impede the construction of new or additional infrastructures when transit cannot be carried out through any existing infrastructure.¹⁷¹ This provision constitutes a “WTO-plus” obligation over transit States as long as it is not contained in GATT Article V.

Therefore, it could be argued that GATT Article V is probably even less of a transit right than ECT Article 7. The latter undoubtedly contributes to the improvement of the energy transit regulation regarding fixed infrastructure.

c) Non-discrimination

Although the ECT Article 7 and the GATT Article V contain non-discrimination provisions, their content and scope of coverage are different.

Regarding MFN, both Agreements proscribe distinction base on origin, destination and ownership, however MFN coverage is broader under GATT Article V. Whereas GATT prevents less favourable treatment for traffic in transit for contracting parties than the treatment accorded to a third country, the ECT does not contain an analogous provision.

In addition, the ECT contains an NT provision, while the latter is absent in the GATT. As aforementioned, NT principle is of utmost importance and absolutely applicable for transit through fixed infrastructure since both domestic and transit energy goods share the same means of transport and discrimination may arise.

d) Non-interruption of energy flows

The ECT proscribes the interruption or reduction of energy flows in order to enforce a claim in a pending dispute regarding transit with another State. Even if GATT does not have a particular stipulation regarding transit of energy goods, it provides a comparable proscription in Article 23 of the Dispute Settlement Understanding (DSU).

The latter imposes an obligation on WTO Members to have exclusive recourse, and abide by, the rules and procedures of the DSU when seeking to redress a violation of obligations, including GATT Article V. Therefore, WTO Members cannot undertake any unilateral countermeasure against other WTO Member before the dispute resolution and authorization from the Dispute Settlement Body (DSB).¹⁷²

¹⁷¹ RAKHMANIN, Vladimir. “Transportation and Transit of Energy and Multilateral Trade Rules: WTO and Energy Charter”. In Joost Pauwelyn (ed.). *Global Challenges at the Intersection of Trade, Energy and the Environment*. Geneva: Graduate Institute of International and Development Studies, 2010, at 125-126.

¹⁷² Article 22 (2) of the DSU.

It is important to bear in mind that “seeking redress of a violation” has been interpreted to render “any WTO suspension of concessions or other obligations without prior DSB authorization is explicitly prohibited”.¹⁷³ Consequently, any disruption in the transit of energy goods before a panel or the Appellate Body (AB) hand down a final report is a breach of Article 23 DSU.

e) Dispute settlement mechanism

Both the ECT and the WTO include a dispute settlement mechanism, but the ECT has an *ad hoc* mechanism for transit disputes which is distinct from the WTO’s Mechanism.

On the one hand, the DSU aims for the prompt settlement of disputes between its members concerning their rights and obligations under the WTO Agreements. This mechanism may entail four major phases: consultation, panel, AB, and implementation of the report adopted by the DSB (see flowchart in Annex 9).¹⁷⁴ On the other hand, Article 7(7) of the ECT provides an *ad hoc* dispute settlement proceeding for disputes over any matter arising from transit, as explained above.

By contrasting both mechanisms, the ECT’s procedure seems to be more a conciliation that does not provide a final and binding decision as the WTO mechanism.

C. ECT Article 7 as a tool for the interpretation of GATT Article V

This sub-section examines the role that ECT Article 7 may play regarding the interpretation of GATT Article V in the context of a WTO dispute. According to Article 3(2) of the DSU, the main purpose of the dispute settlement system is to clarify the existing provisions of the WTO Agreements in accordance with customary rules of interpretation of public international law.¹⁷⁵

Based on this provision WTO panels and the AB have resorted to principles of interpretation enshrined in the Vienna Convention of Law of the Treaties (VCLT).¹⁷⁶

¹⁷³ Panel Report, United States- Import Measures on Certain Products from the European Communities, WT/DS165/R, adopted on 10 January 2001, paragraphs 6.38.

¹⁷⁴ BOSSCHE, Peter Van Den. *Op. cit.*

¹⁷⁵ The WTO Agreements are treaties with a life cycle and they are regulated by general rules on treaties that have been codified in the VCLT. Although, these general rules have not been reproduced in the WTO agreements, we have to refer to them and apply them at all times. (See ABI-SAAB, George. “The WTO dispute settlement and general international law”. In Rufus Yerxa and Bruce Wilson (eds.). *Key Issues in WTO Dispute Settlement*. Cambridge: Cambridge University Press, 2005, at 10-11.

¹⁷⁶ Appellate Body Report, European Communities-Customs Classification of Frozen Boneless Chicken Cuts, WT/DS269/AB/R and WT/DS286/AB/R, adopted on 12 September 2005, paragraph 141; Panel Report, Colombia-Indicative Prices and Restrictions on Ports of Entry, WT/DS366/R, adopted on 27 April 2009, 5.84; Panel Report, Argentina-Poultry Anti-Definitive Anti-Dumping Duties on Poultry from Brazil,

In *U.S.-Gasoline*, the AB stated that the “general rule of interpretation, contained in Article 31 of the VCLT had attained the status of customary or general international law”.¹⁷⁷

Thereby, Article 31 (3)(c) of the VCLT provides that the interpreter must take into account together with the context any *relevant* rule of international law applicable in the relations between the parties. Thus, WTO provisions can be interpreted in light of other international agreements.

The key issue is finding out which agreements may be considered as *relevant* for such interpretation. Some WTO Agreements refer to third treaties (i.e. Trade-Related Aspects of Intellectual Property Rights alludes to the Paris and Bern Conventions). Therefore, the difficulty arises when the third treaty is not explicitly mentioned in the WTO Agreements such as the ECT.

Panels have usually focused on the common membership amongst those agreements. In *Argentina-Poultry Anti-Dumping Duties*, the Panel stated that “it is not clear to us that a rule applicable between only several WTO Members would constitute a relevant rule of international law applicable in the relations between the parties”.¹⁷⁸ Furthermore, in *EC-Approval and Marketing of Biotech Products*, the Panel interpreted Article 31(3a)(c) as requiring consideration of those rules of international law that are applicable in the relations between *all WTO Members* to the treaty which is being interpreted.¹⁷⁹ Consequently, only those agreements ratified by identical WTO Members may be considered as relevant for the interpretation of WTO provisions.

It is worth mentioning that this finding has been criticized by the International Law Commission (ILC), which argues that it is practically impossible to find identical contracting parties among multilateral agreements. Likewise, the ILC states “the [Biotech] panel buys what it calls the “consistency” of its interpretation of the WTO Agreements at the cost of the consistency of the multilateral treaty system as a whole”.¹⁸⁰

WT/DS241/R, adopted on 22 April 2003; AB Report, United States-Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, adopted on 12 October 1998; Appellate Body Report, Korea-Taxes on Alcoholic Beverage, WT/DS75/AB/R and WT/DS84/AB/R, adopted on 18 January 1999, paragraph 91.

¹⁷⁷ Appellate Body Report, *United States-Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted on 29 April 1996, at 17. This principle is also resorted in Appellate Body Report, *India-Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted on 19 December 1997, paragraph 46; Panel Report, *United States-Antidumping duty on Dynamic Random Access Memory Semiconductors (DRAMs) of one megabit or above from Korea*, WT/DS99/R, adopted on 9 January 1999, paragraph 6.13.

¹⁷⁸ Panel Report, *Argentina-Poultry Anti-Dumping Duties*, WT/DS241/R, adopted on 19 May 2003, footnote 64.

¹⁷⁹ Panel Report, *EC-Approval and Marketing of Biotech Products*, WT/DS293/R, paragraph 7.70.

¹⁸⁰ International Law Commission. Fragmentation of International Law: Difficulties arising from the diversification and expansion of international law: Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, at 228, and paragraph 450.

In addition, the AB has stated that the WTO Agreements should not be read “in clinical isolation from public international law”.¹⁸¹ Hence, the DSB follows an evolutionary interpretation of the WTO Agreements, taking into account the contemporary concerns of the international community.¹⁸²

In *US-Shrimp*, the AB employed principles laid down in multilateral environmental agreements (the Convention on Biological Diversity and the Convention on the Conservation of Migratory Species of Wild Animals) to interpret GATT Article XX, although not all the disputing parties were parties to those agreements.¹⁸³ Notice that the AB has also referred to regional or bilateral agreements during its interpretative labour.¹⁸⁴

The recent AB report in *EC-Large Civil Aircraft* is noteworthy. The AB considered that, before looking at the parties of a non-WTO treaty, the relevance of this non-WTO treaty should first be determined. In this respect, the AB found that “a rule is relevant if it concerns the subject matter of the provision at issue”.¹⁸⁵

Therefore, the ECT should undoubtedly play a special role in the interpretation of GATT Article V in a transit dispute regarding, for instance, fixed infrastructure. Thereby, ECT Article 7 may be useful for the interpretation of “fixed infrastructures” as means of transport to the extent that this term is not defined in GATT Article V.

Finally, it should be borne in mind that any interpretation of WTO provision shall not in any case add to or diminish the rights and obligations of WTO Members or do not affect the rights of third WTO Members as set forth in Article 3.2 of DSU. As a consequence, a WTO panel shall not interpret that a WTO transit State is obliged to accept the construction of new or additional infrastructure under Article V, based on the interpretation of ECT Article 7.

Section IV: Outstanding debates in energy transit

In the previous sections, the *status quo* of the transit regulation in energy has been presented highlighting its main deficiencies and gaps. Neither the GATT nor the ECT provides a comprehensive regulation for the transit of energy goods. In addition,

¹⁸¹ Appellate Body Report, *United States - Standards of Reformulated and Conventional Gasoline* (20 May 1996) WT/DS2/AB/R, DSR 1996: 1, at 16.

¹⁸² BOSSCHE, Peter Van Den. *Op. cit.*, at 58.

¹⁸³ *Ibid.*

¹⁸⁴ The AB stated that the Oilseeds Agreement is a supplementary means of interpretation pursuant to Article 32 of the VCLT (See Appellate Body Report, *EC - Measures Affecting the Importation of Certain Poultry Products*, WT/DS69/AB/R, adopted on 23 July 1998, paragraph 83).

¹⁸⁵ *EC-Measures Affecting trade in large civil aircraft*, WT/DS316/AB/R, 18 May 2011, paragraph 846.

there are highly debatable matters, which pose a challenge to the achievement of a suitable legal framework. This section aims to analyze these complexities.

A. Electricity considered as a good or a service

Traditionally, energy resources such as oil clearly fall within the category of goods since they are easily stored and traded across borders. Likewise, natural gas may be stored and transported in its liquefied form.

Unlike oil and gas, electricity is not a physical substance that can be easily stored. Indeed, it is a process that occurs in power plants and is instantly transmitted through grids, which make it similar to a service.¹⁸⁶ Consequently, there is a controversial debate around electricity's classification as a good or a service.

1. Main arguments for a twofold classification of electricity

On the one hand, some States consider electricity as a good based on the following grounds:

- Since electricity is generated from other natural resources such as coal, gas, water, and uranium, it may be viewed as a manufactured good.¹⁸⁷
- Electricity can also be considered as a natural resource since some resources must be processed before their transportation and consumption i.e. natural gas needs to be transformed to become LNG. Accordingly, electricity may be equivalent to transformed natural resources.¹⁸⁸
- Some WTO Members treat electricity as a commodity, undertaking tariff commitments under this assumption.
- The Harmonized Commodity Description and Coding System (HS)¹⁸⁹ classifies electricity as commodity; however, it is an optional heading. Thus, WTO Members are not obliged by this categorization.¹⁹⁰

On the other hand, electricity has singular features that distinguish it from goods, making it closer to services, such as:

- Electricity is an incorporeal substance which can only be stored in small quantities. Indeed, it must be consumed at the same time that it is produced.¹⁹¹

¹⁸⁶ UNITED NATIONS. Department of Economic and Social Affairs. *Manual on Statistics of International Trade in Services*, ST/ESA/M.86/Rev. 1. New York: UN, 2011, at 46.

¹⁸⁷ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 55.

¹⁸⁸ *Ibid.*

¹⁸⁹ The HS was developed by the World Custom Organization.

¹⁹⁰ ZARRILLI, Simonetta. *Op. cit.*, at 38.

¹⁹¹ WORLD TRADE ORGANIZATION. *World Trade Report 2010*. *Op. cit.*, at 55.

This makes difficult to draw the line between the production of a good and the provision of a service.¹⁹²

- Its transmission depends utterly on grids. Hence, it could be argued that electricity needs to be regulated on the basis of the means of transport instead of the transported good.¹⁹³ By way of illustration, electricity supply is not subject to tariff protection but to service related fees.¹⁹⁴
- The optional nature of the electrical energy heading in the HS might reflect that some countries consider it as a service.¹⁹⁵

The outcomes of this debate will bring important legal connotations within the WTO framework. As a service, electricity shall benefit from basic investment and competition provisions under GATS (especially on monopolies and exclusive service suppliers); whereas such rules are absent in GATT. Even if the Trade-Related Investment Measures (TRIMS) Agreement applies to trade in goods, it does not protect investment *per se*.¹⁹⁶

As a good, electricity shall profit from NT and MFN general coverage offered under GATT, while GATS offers MFN protection subject to reservations taken by WTO Members.¹⁹⁷ Likewise, NT under GATS applies only to the extent that WTO Members have explicitly committed themselves to grant it, generally or specifically, in their schedule of specific commitments.¹⁹⁸

2. The EU experience

Although the EU is an internal market, the debate on trade in electricity at the multilateral level is reminiscent of a similar debate in the EU. The European Communities Treaty does not contain any reference to trade in energy, similar to the WTO Agreements. Thus, the regulation on trade in energy, including transit, was developed through litigation and legislation.¹⁹⁹

¹⁹² COSSY, Mireille. "The Liberalization of energy services...". *Op. cit.*, at 410.

¹⁹³ ROGGENKAMP, Martha M. *Implication of GATT and ECC on Networkbound Energy Trade in Europe*.

¹⁹⁴ COTTIER, Thomas *et al. Op. cit.*, at 4-11, URL, <http://www.nccr.org>

¹⁹⁵ ZARRILLI, Simonetta. *Op. cit.*, at 38.

¹⁹⁶ COSSY, Mireille. "Energy Transport and Transit in the WTO". *Op. cit.*, at 3.

¹⁹⁷ TREBILCOCK, Michael J. *Regulation of International Trade*. 2nd ed. New York: Routledge, 2005, 360.

¹⁹⁸ BOSSCHE, Peter Van Den. *The Law and Policy of the World Trade Organization*, 2nd ed. New York: Cambridge University, 2008, at 391.

¹⁹⁹ Council Directive 90/547/EEC of 29 October 1990 on the transit of electricity through transmission grids; Council Directive 90/377/EEC of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users; and Council Directive 91/296/EEC of 31 May 1991 on the transit of natural gas through pipelines.

In this respect, the European Court of Justice (ECJ) has confronted the difficult question of whether electricity is a good or a service as well as whether it falls under the EC trade or competition rules, finding that electricity is a good guided by satisfactory trade regulation. In *Commission v. Italy*, the ECJ defined a “good” as “any product which can be valued in money and which are capable, as such, of being the basis of commercial transactions”.²⁰⁰ Bearing in mind this definition, the ECJ has ruled in several cases that electricity should be treated as a good based on the classification of electricity in the Community Tariff Nomenclature (code CN 27.16).²⁰¹ In *Almelo v. Energiebedrijf IJsselmij*, the ECJ acknowledged that the rules on free circulation of goods also apply to electricity.²⁰²

In *Commission v. Italy [II]*, the Italian Government argued that electricity is more similar to the category of “services” than to that of “goods”. Electricity is a non-storable and incorporeal substance, without economic existence insofar as its utility depends on its applications. Moreover, electricity is imported and exported with the sole purpose of providing a service, thus electricity is only an aspect of this service. Nevertheless, the ECJ argued that the services related to electricity, such as transmission, are simply the means for supplying consumers with a good.²⁰³

3. Electricity in the WTO framework

As mentioned above, no WTO Agreements contain a specific reference to electricity, nor has the DSB ever ruled on this matter. Thus, the determination of electricity’s nature shall depend on the analysis of electricity itself. Trade in electricity has particular features to the extent that it is strictly linked to a particular mode of transportation. Because of its incorporeal and non-storable nature, electricity depends highly on transmission services, bringing GATT and GATS disciplines to the same field.

In order to resolve this dilemma, one must distinguish electricity from its related-services, recognizing at the same time that both GATT and GATS may be applicable to trade in electricity. First, electricity is recognized as a secondary product in the energy sector and is classified as a commodity in the HS. Hence, WTO Members have undertaken tariff commitments on this basis. Therefore, electricity may attract tariff and non-tariff barriers, addressed by GATT disciplines like, *inter alia*, Article V (Freedom of Transit), Article VI (Antidumping and Countervailing Duties),

²⁰⁰ *Commission v. Italy* [1968] Case 7/68 ECR 425.

²⁰¹ *Almelo v. Energiebedrijf IJsselmij* [1994] Case C-393/92, ECRI-5789, Paragraph 28; *Commission v. Italy* [1997] Case C-158/94 ECRI-5789 Paragraph 17; *Costa v. Enel* [1964] Case 6/64, ECR 585, *Commission v. France* [1997] Cases C-159/94 ECR I-5815; *Commission v. The Netherlands* [1997] C-157/94 ECRI-5699.

²⁰² COTTIER, Thomas *et al.* *Op. cit.*

²⁰³ *Commission v. Italy* [1997], C 158-94, ECR I-5789.

and Article XI (General Elimination of Quantitative Restrictions). At the same time, trade in electricity requires service suppliers in order to manage its transmission and distribution. These services are covered by GATS disciplines insofar as it involves commercial presence in transit States, movement of professionals and cross-border services.

It is important to be mindful of recent decisions on similar matter under the WTO framework. In *China-Publications and Audiovisual Products*, the panel decided that motion pictures were also “goods”, relying essentially on the approach to classifying motion pictures as good in the HS.²⁰⁴ Hence, Article XI (General Elimination of Quantitative Restrictions) was applicable, despite the fact that films are also covered by GATS rules on audio-visual materials. In *EC–Bananas III*, the AB found that banana import licensing procedures pertain to trade in services, even though bananas are goods.²⁰⁵ Therefore, it is broadly acknowledged that both GATT and GATS may apply to different aspects of a particular activity such as trade in electricity.

Note that the Trade Facilitation negotiation text on Article V considers electricity grids as a means of transportation.²⁰⁶ This reflects that WTO Members may perceive electricity as a good and apply to it GATT Article V.

At the regional level, NAFTA makes electricity subject to the disciplines on trade in goods²⁰⁷ as well as in CAFTA a letter of understanding between Costa Rica and the U.S. states that electricity generation shall not be considered as services for the purpose of the Agreement.²⁰⁸

B. Network-bound transit

Undoubtedly, the most significant challenge related to transit of gas, oil and electricity stems from their dependency on network-bound infrastructure, mainly electricity. Nonetheless, GATT Article V was not designed to tackle this inherent particularity. This sub-section seeks to study the most relevant aspects around transit through pipelines and grids, pointing out the weaknesses of WTO provisions on this matter.

²⁰⁴ Panel Report, *China-Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, Paragraph 7.524-7.527.

²⁰⁵ Appellate Body Report, *EC–Regime for the Importation, Sale and Distribution of Bananas*, WT/DS/27/AB/R, adopted on 9 September 1997, paragraph 222.

²⁰⁶ Negotiating Group on Trade Facilitation. *Draft consolidated negotiating text*, TN/TF/W/165/Rev.8 21 April 2011, at 22.

²⁰⁷ Electricity is regulated under Chapter Six: Energy and Basic Petrochemicals which is contained in the Part Two: Trade in Goods of the Agreement. <http://www.nafta-sec-alena.org/en/view.aspx?conID=590> (accessed on 5 July 2011).

²⁰⁸ Side Letter between Costa Rica and U.S. on 28 May 2004 to US-CAFTA+DR FTA. http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file997_3976.pdf

1. Fixed infrastructure in GATT Article V

One of the most controversial issues related to the transit of energy resource is whether GATT Article V covers transportation through network-bound infrastructure such as pipelines and grids. As aforementioned, Article V applies to all “means of transport” in broad terms, except to aircraft transit. Unlike the ECT, this provision does not make any particular allusion to fixed infrastructures. This omission allows for a twofold interpretation of its scope of application.

On the one hand, some countries, such as Russia, argue that Article V refers exclusively to “moving” means of transport. Thus, pipelines and grids should not be considered as “means of transport” due to their fixed nature.²⁰⁹ Nevertheless, nothing in the wording of Article V supports such an interpretation. In fact, this Article does not provide an exhaustive list of means of transport. Moreover, other broadly accepted means of transport depend highly on fixed capacities such as train tracks and no country would be affected by Article V’s application on train transport.²¹⁰

On the other hand, it is argued that Article V is broad enough to cover transit *via* fixed infrastructure. Article V generally refers to “means of transport”, explicitly excluding aircraft in transit. It is therefore suggested that GATT drafters did not intend to exclude other means of transport.²¹¹ Notice that it is of paramount importance to eliminate any alternative interpretation regarding the scope of Article V since it creates regulatory uncertainty and economic loss.²¹²

Consequently, Article V could be successfully invoked to prevent restrictive measures on transit through grids or pipelines, subject to the right of the transit States to levy reasonable cost-of-service charges on an MFN basis.²¹³ Likewise, WTO Members may claim to redress the “freedom of transit” principle in WTO disputes.

Bearing in mind this conclusion, it should be noted that Article V does not address some crucial aspects related to energy security due to its limited wording;²¹⁴ most pertinent is the absent of any right on building new infrastructure if the existing infrastructure is not sufficient.²¹⁵ As a matter of fact, this absent is of pragmatic

²⁰⁹ COSSY, Mireille. “Energy Transport and Transit in the WTO”. *Op. cit.*, at 1-2.

²¹⁰ MARCEAU, Gabrielle. *Op. cit.*, at 34.

²¹¹ WORLD TRADE ORGANIZATION. *World Trade Report WTO 2010*. *Op. cit.*, at 167.

²¹² *Ibid.*, at 16.

²¹³ HERMAN, Lawrence L. *Op. cit.*, at 72.

²¹⁴ SELIVANOVA, Julia. *Challenges for Multilateral Energy Trade Regulation*. *Op. cit.*, at 7.

²¹⁵ Nevertheless, Roggenkamp states that the right to build new or additional transport facilities can also be interpreted from GATT Article V.

importance for the future settlement of current disputes on energy transit i.e. the Russia and Ukraine dispute.²¹⁶

Finally, it is noteworthy to mention that, in the framework of the Doha negotiations, the scope of Article V is matter of negotiation in the Trade Facilitation Group. The draft text makes explicit reference to network-bound transportation (see Section V).

2. *Third party access*

The significant network reliance on trade in energy implies that the elimination of import barriers is not enough for the effective liberalization of the energy sector. Nonetheless, access to network-bound infrastructures and restrictive practices of companies that manage these infrastructures are not addressed to a substantial degree by existing multilateral trade rules.²¹⁷

Bearing in mind that network-bound transportation is a highly capital-intensive activity, the duplication of these networks is not always feasible. Furthermore, network owners are able to defeat any parallel construction project by adopting short-term cost-cutting competition policies.²¹⁸ As a result, network-bound transportation is usually managed by monopolies. The shortcoming is that these operators may abuse their privileged positions and obstruct transit by denying or making difficult the access to transportation networks.

Therefore, governments must implement Third Party Access (TPA) regulations whereby *rights* of access shall be granted to third parties for a reasonable fee and on practical technical terms.²¹⁹ Nonetheless, TPA regulations are highly resisted by pipelines and grids owners since they consider it unfair to grant access to competitors who did not partake in the huge investments risks related to these projects.

Regarding its operation, TPA is usually granted through quota allocations for existing commitments and new entrants as well as the definition of available capacity.²²⁰ There

²¹⁶ Notice that Russia is currently under the accession procedure to the WTO. Because of its strategic location, Ukraine serves as a major transit route for gas pipelines from Russia to west European. At the same time, Ukraine depends heavily on Russian oil and gas supplies, albeit no longer seems able to afford these energy imports needed to sustain its energy intensive economy. In August 1993, Russia cut off Ukrainian gas supplies for a few days to exert pressure regarding negotiations concerning control of the Black Sea Fleet; Ukraine responded by siphoning off gas meant for Italy and Germany using its role as a transit State.

²¹⁷ SELIVANOVA, Julia. *Challenges for Multilateral Energy Trade Regulation*. *Op. cit.*, at 1.

²¹⁸ KEYKAVOUSII, Maneli. *Legalities of Energy Transit between the Newly Independent States and the European Union*. Dissertation, Institute de Hautes Etudes Internationales, 2003, at 29.

²¹⁹ WÄLDE, Thomas W. and Andreas J. GUNST. "International Energy Trade and Access to Energy Networks". In *Energy and Environmental Services: Negotiating Objectives and Development Priorities*, UNCTAD/DITC/TNCD/2003/3. Geneva: UN, 2003, at 128.

²²⁰ *Ibid.*, at 129.

are two categories of TPA: i) *negotiated access* where the enterprises agree on the terms and conditions of access, and ii) *regulated access* where governmental authorities set up these term and conditions.²²¹

Despite its significance, TPA was not addressed neither in either the ECT nor in the GATT. An Understanding Note to the ECT clearly denied TPA stating that any contracting party is obliged to introduce mandatory TPA.²²² However, the Draft of the Transit Protocol establishes an obligation on owners and operators to enter into negotiations with other contracting parties requesting access to and use of available capacity and any denial should be duly justified.²²³

By analogy, the telecommunication experience may be useful for network access in the energy sector. In the WTO services negotiations, the U.S. and Norway proposed to devise a Reference Paper for Energy Services, modelled on the Reference Paper to the Agreement on Basic Telecommunication Services.²²⁴ Additionally, the Panel in *Mexico-Telecoms* interpreted that Mexico was obliged to ensure interconnection at reasonable costs that were economically feasible.²²⁵

Multilateral regulation may benefit from the EU experience on TPA. The EU aims to enhance the cross-border transmission by allowing allocation of interconnection capacities and compensation.²²⁶ Regarding congestion management, the maximum capacity of the transmission market networks shall be made available to market participant, complying with safety standards of secure network operation.²²⁷

In conclusion, TPA is indispensable for the consistency with the freedom of transit principle. Nonetheless, it remains a moot point as to whether there is a principle of freedom of access in international law. Meanwhile, this issue is tackled in the context of GATS additional commitments within the WTO accession processes. For instance, Ukraine, in its additional commitments, guarantees further market-access obligations to its infrastructures.²²⁸

²²¹ *Ibid.*

²²² The ECT Understanding 1 under b(i).

²²³ Article 8 of the Draft of the Energy Charter Protocol on Transit.

²²⁴ SELIVANOVA, Julia. *The WTO and Energy: WTO Rules and Agreements of Relevance to the energy Sector*, at viii.

²²⁵ Panel Report, *Mexico-Measures Affecting Telecommunications Services*, WT/DS204/R, adopted 1 June 2004, DSR 2004: IV, 1537, paragraphs 7.169-7.185.

²²⁶ EUROPEAN UNION. "Conditions for access to the network for cross-border exchanges in electricity". http://europa.eu/legislation_summaries/energy/internal_energy_market/l27041_en.htm (accessed on 9 July 2011)

²²⁷ Regulation (EC) N° 714/2009 of the European Parliament and of the Council of 13 July 2009 on Conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) N° 1228/2003.

²²⁸ MARCEAU, Gabrielle. *Op. cit.*, at 33.

3. *State trading enterprises and Private operators*

As an outcome of the recent liberalization, private companies control transport networks in the energy sector. These companies do not undertake obligations under the ECT and the WTO Agreements since the latter exclusively applies to States.

Therefore, any eventual TPA provision implemented under the WTO framework would not oblige, *prima facie*, private companies. Nevertheless, two WTO disciplines may be useful in resolving this issue.

a) State trading enterprise

Network-bound transportation has been managed by State enterprises for a long time. These entities fall within the scope of GATT Article XVII. It provides that State enterprises shall act in accordance with the general principle of non-discrimination, when their purchases and sales involve imports or exports, in accordance with commercial considerations. States enterprises shall afford the enterprises of other Members adequate opportunity to compete in such purchase or sale.

In addition, Article XVII extends its scope of application to private entities insofar as the latter are granted exclusive or special privileges.²²⁹ Thus, a company that control network-bound infrastructure seems, at first glance, to be covered considering that this activity has been recently managed by public entities on monopoly basis. Nevertheless, Article XVII is limited to “purchase and sales”²³⁰

Therefore, it could be interpreted that only when this company manages the whole energy industrial chain, Article XVII shall apply to transportation *via* fixed infrastructure. Indeed, Article XVII (1)(b) states that enterprise shall make their purchases and sales in “commercial considerations”, including price, quality, availability marketability, *transportation* and other conditions of purchase or sale.

Nonetheless, Article XVII may not be applicable when the enterprise only manages the transportation networks to the extent that this activity is independent of the purchases or sales. In this respect, the draft negotiating text on Article V includes a proposal whereby State enterprises or enterprises with exclusive or special privileges (formally or in effect) shall comply with GATT Article V regarding its regulations, formalities, fees and charges.²³¹

²²⁹ An Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994 states that “Governmental and non-governmental enterprises, including marketing board, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports and exports.”

²³⁰ JACKSON, John. *Op. cit.*, at 345.

²³¹ Negotiating Group on Trade Facilitation, Draft consolidated negotiating text, TN/TF/W/165/Rev.8, 21 April 2011, at 21.

b) Competition provisions

The GATS contains limited provisions on monopolies and exclusive service suppliers.²³² Article VIII requires WTO Members to ensure that any monopoly supplier of a service does not act in a manner inconsistent with the MFN principle and Member's specific commitments.

Because of the capital-intensive infrastructure, transport of energy goods *via* pipelines and grids tends to be considered as natural monopoly. A number of States have started to restructure this segment, giving space to private participation.²³³ Hence, Article VIII is applicable to private companies controlling the network-bound transportation of energy goods.

The problem with the implementation of Article VIII in the energy sector is that these private companies may claim lack of capacity and charge transportation fees that by far exceed the cost of services rendered.²³⁴ In addition, most WTO Members have undertaken relatively limited commitments on pipeline transportation of fuels, as mentioned above.

Therefore, additional disciplines on competition are still needed for energy services. In fact, requests for additional commitments on regulatory transparency and non-discriminatory treatment in access to and use of networks have been discussed in the negotiations on energy services.²³⁵

4. Investment related issues

Network-bound infrastructure projects require substantial specialized investments, since these structures can be used only for transportation of one specific energy good. As aforementioned, significant shares of energy reserves are in developing countries, which may not count with the capital for launching these projects.²³⁶ Thus, private-sector participation is frequently necessary to channel the needed capital and expertise to the sector. Consequently, developing countries are stimulated to create an attractive enabling environment and facilitate investments on energy transportation.²³⁷

²³² SELIVANOVA, Julia. *The WTO and Energy. Op. cit.*, at 22.

²³³ COSSY, Mireille. "The Liberalization of energy services...". *Op. cit.*, at 408-409.

²³⁴ SELIVANOVA, Julia. *The WTO and Energy. Op. cit.*, at 22.

²³⁵ MARCEAU, Gabrielle. *Op. cit.*, at 30.

²³⁶ United Nation Conference on Trade and Development, *Managing "Request-Offer" negotiations under the GATS: the case of energy services*, at 3.

²³⁷ COTTIER, Thomas *et al. Op. cit.*, at 10.

Nonetheless, investment issues are not addressed in a meaningful way by the WTO disciplines.²³⁸ The TRIMS Agreement only applies to trade in goods by prohibiting trade-related investment measures that are inconsistent with basic GATT provisions such as local content requirements. This Agreement does not protect investments *per se*, thus its scope of application and impact are limited.²³⁹

Indeed, this is one of the most serious shortcomings for an integral regulation of energy transit. In order to fill this gap, the WTO would need to develop effective investment rules which do not seem feasible in the near future.²⁴⁰ Meanwhile, countries are signing bilateral agreements to diminish investment risks.²⁴¹

Investment regulation is closely related to energy security. The latter is understood as the continuous assurance of an adequate, reliable supply of energy at a reasonable cost at any given moment in time.²⁴² Then diversification of energy supply is essential to energy security and requires additional investments. Therefore, international energy security in the long run depends on the management and minimization of risks to such investments.²⁴³

Section V: Future for energy transit

Undoubtedly, transit of energy resources requires a binding, predictable and transparent legal framework in order to guarantee energy flows; otherwise, disputes may arise with serious security and economic outcomes such as the Russia-Ukraine dispute. The transit of energy goods has been traditionally tackled at the bilateral and regional level, albeit these rules may bring uncertainty for newcomers and may be inconsistent between them.

Therefore, trade in energy, in particular energy transit, will benefit more from uniform rules set at the multilateral level such as the WTO. Other significant reasons to bring trade in energy into the WTO are the following:²⁴⁴

²³⁸ The primary concern of WTO rules is not to accord investor protection, but to reduce barriers to trade in goods and services. In fact, WTO Agreements do not define “investment”, they are concerned only with investment measures that affect trade in goods and services (see NEUFELD, Rodney. “Trade and Investment”. In Daniel Bethlehem (eds.). *The Oxford Handbooks of International Trade Law*, 619-667. Oxford: Oxford University Press, 2009, at 622.

²³⁹ SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at 23.

²⁴⁰ SELIVANOVA, Julia. *Challenges for Multilateral Energy Trade Regulation*. *Op. cit.*, at 1.

²⁴¹ CAMERON, Peter D. *International Energy Investment Law*. Oxford: Oxford University Press, 2010, at 43.

²⁴² KONOPLYANIK, Andrei and Thomas WÄLDE. *Op. cit.*, at 529-530.

²⁴³ *Ibid.*

²⁴⁴ MARCEAU, Gabrielle. *Op. cit.*, at 38.

- The system of decisions is based on consensus which grants wide legitimacy to its decisions;
- Effectiveness of the dispute settlement mechanism which includes retaliation measures in case of non-compliance;
- Extensive practices of notifications and transparency; and,
- Monitoring and surveillance systems such as the Trade Policy Review.

This section will focus on the energy transit issues currently discuss under the WTO negotiations. Afterwards, it will focus on the approach and content of a future regulation on transit of energy goods.

A. WTO negotiations

Currently, matters related to trade in energy are being discussed in different stages within the WTO. This subsection aims to illustrate the treatment given to energy matter in these different contexts, stressing energy transit developments.

1. Accession

Trade in energy is one of the most discussed issues in the accession processes.²⁴⁵ As a matter of fact, some of the major energy producers and transit States such as Libya, Iran, Iraq, Algeria and Russia are immersed in this process which is beneficial to the energy sector for the following reasons:²⁴⁶

- It is an opportunity to examine the regulatory framework governing energy transportation networks.
- This is a forum where WTO Members' concerns are expressed i.e. some WTO Members have communicated their concern regarding fees charged for the pipeline transit.
- WTO Members can impose additional obligations (not included in the WTO Agreement) on acceding Members.

It is noteworthy to mention three outstanding accession processes:

a) Ukraine

In the Working Party Report, Ukraine commits that all measures governing transit in goods, such as charges for transportation of goods in transit, would be applied in

²⁴⁵ *Ibid.*, at 32.

²⁴⁶ RICHARDS, Timothy J. and Lawrence HERMAN. *Relationship between International Trade and Energy*. http://www.wto.org/english/res_e/publications_e/wtr10_richards_herman_e.htm

conformity with GATT Article V.²⁴⁷ In its services schedule,²⁴⁸ Ukraine undertakes to ensure adherence to the principle of non-discriminatory treatment in access to and use of pipeline networks under its jurisdiction, within the technical capacities of these networks.²⁴⁹ In fact, the latter goes further than the commitments undertaken by other Members in this sub-sector, thus Ukraine is now pushing other acceding countries to accept similar commitments.²⁵⁰

b) China

In its Protocol of Accession, China undertakes to accord non-less favourable treatment to foreign companies and individuals in respect the prices and availability of goods and services supplied by national and sub-national authorities and public or State enterprises, in areas including transportation and energy.²⁵¹ In addition, China also affirmed that its regulation on transit is consistent with GATT Article V.²⁵²

c) Russia

Russia has been engaged in the accession process since 1993.²⁵³ Trade in energy has been an awkward matter in the EU-Russia bilateral agenda. Indeed, this negotiation is closely linked with the negotiation of the ECT Protocol on Transit.

In conclusion, accession processes constitute an important background to a future energy regulation, particularly in transit. Hence, language and practice developed in accession protocols may provide a useful basis for future multilateral negotiations.²⁵⁴

2. Doha Negotiations

a) Trade Facilitation negotiations

In July 2004, WTO Members formally agreed to launch negotiations on trade facilitation. The mandate is to clarify and improve better conditions for transit of

²⁴⁷ Working Party on the Accession of Ukraine. *Report of the Working Party on the Accession of Ukraine to the World Trade Organization*, WT/ACC/UKR/152, 25 January 2008, at paragraph 367.

²⁴⁸ Enforced by the *Protocol on the Accession of Ukraine*, WT/L/718, 13 February 2008, in Accession of Ukraine, decision on 5 February 2008.

²⁴⁹ Working Party on the Accession of Ukraine. *Report of the working party on the accession of Ukraine*, WT/ACC/UKR/152/Add.2, 25 January 2008, at 33.

²⁵⁰ MARCEAU, Gabrielle. *Op. cit.*, at 32-33.

²⁵¹ *Accession of the People's Republic of China*, WT/L/432, 23 November 2001, in Accession of the People's Republic of China, 10 November 2001, at 4.

²⁵² Working Party on the Accession of China. *Report of the Working Party on the Accession of China*, WT/ACC/CHN/49, 1 October 2001, at 43.

²⁵³ WORLD TRADE ORGANIZATION. "Accessions: Russian Federation". http://www.wto.org/english/thewto_e/acc_e/a1_russie_e.htm (accessed on 10 July 2011).

²⁵⁴ MARCEAU, Gabrielle. *Op. cit.*, at 33.

goods under Article V²⁵⁵ although the mandate does not mention energy transit, Members have submitted interesting proposals²⁵⁶ (included in the last draft negotiating text²⁵⁷) on this matter, such as the following:

- Scope: some Members²⁵⁸ seek to introduce explicit mention of transit through fixed infrastructure, *inter alia* grids and pipelines. Moreover, means of transport would be deemed to be in transit even if they are not in themselves in transit.
- State enterprise: Members²⁵⁹ propose that their State enterprise or any enterprise with exclusive and special privileges shall act in manner consistent with Article V with respect to their regulations, formalities and charges on or in connection with transit.
- National Treatment: Members²⁶⁰ could not grant treatment less favourable to traffic in transit than the treatment accorded to its own exports or imports regarding law, regulations, formalities, fees and charges. Nevertheless, there are some Members who are opposed to this insertion such as Israel and India.²⁶¹
- Exceptions: other proposals²⁶² clarify that Article XX (General Exceptions) and Article XXI (Security Exceptions) shall be fully applicable.

In conclusion, these proposals are significant improvements for the transit of energy goods. However, the main weaknesses lay in the absence of proposals addressing crucial issues such as congestions management and the creation of additional transportation capacity.²⁶³

²⁵⁵ Doha Work Programme, Decision Adopted by the General Council on 1 August 2004, WT/L/579 at D1-D2.

²⁵⁶ Negotiating Group on Trade Facilitation, *WTO Negotiations on Trade Facilitation of Members' Textual proposals*, TN/TF/W/43/Rev.16 (24 November 2008), TN/TF/W/43/Rev.17 (20 February 2009), TN/TF/W/43/Rev.18 (24 April 2009), TN/TF/W/43/Rev.19 (30 June 2009).

²⁵⁷ Negotiating Group on Trade Facilitation. *Draft consolidated negotiating text*, TN/TF/W/165/Rev.8, on 21 April 2011.

²⁵⁸ Former Republic of Macedonia, the Republic of Moldova, Rwanda, Switzerland and Swaziland (TN/TF/W/133/Rev.2/Corr.1)

²⁵⁹ Former Republic of Macedonia, the Republic of Moldova, Rwanda, Switzerland and Swaziland (TN/TF/W/133/Rev.2/Corr.1).

²⁶⁰ Former Republic of Macedonia, the Republic of Moldova, Rwanda, Switzerland and Swaziland (TN/TF/W/133/Rev.2/Corr.1).

²⁶¹ Negotiating Group on Trade Facilitation, *Comments and Textual Suggestion*, TN/TF/W/167, 6 January 2010, at 15.

²⁶² Turkey, Georgia and Paraguay (TN/TF/W/146/Rev.1) and Former Republic of Macedonia, the Republic of Moldova, Rwanda, Switzerland and Swaziland (TN/TF/W/133/Rev.2/Corr.1), Israel (TN/TF/W/167).

²⁶³ SELIVANOVA, Julia. *Challenges for Multilateral Energy Trade Regulation. Op. cit.*, at 3.

b) Services negotiations

In the 1990s, the privatization of public suppliers had led to the emergence of competition and the identification of core services in the energy sector.²⁶⁴ As a result, the ongoing negotiations include energy services.²⁶⁵

The proposals²⁶⁶ share the following points:²⁶⁷

- Improvements in market access will bring benefits;
- ownership of natural resources is outside the negotiations;²⁶⁸
- The necessity of public regulation in the energy sector; and
- Commitments should reflect the existing levels of market reform.

Notwithstanding, the proposals differ in the following matters:²⁶⁹

- Sector classification: There is a collective request to adopt *a sui generis* approach for identifying energy services by listing 12 sub-sectors belonging to 3 main sectors; albeit “pipeline transportation” is not included²⁷⁰ Other Members²⁷¹ favour a source-neutral classification applying to all energy sources.²⁷² Venezuela suggests a classification based on three criteria: the sources of energy, the phases of the energy process, and a distinction between “core” and “non-core” energy services.²⁷³
- TPA: The U.S. and Norway proposed the development of a reference paper, like the Reference Paper to basic telecommunications, in order to ensure transparency and non-discriminatory TPA.²⁷⁴

²⁶⁴ United Nations Conference on Trade and Development. *Trade Agreements, petroleum and energy policies*, at 39-40.

²⁶⁵ World Trade Organization. “Energy Services”, URL, http://www.wto.org/english/tratop_e/serv_e/energy_e/energy_e.htm

²⁶⁶ Canada, Chile, Cuba, the European Union, Japan, Norway, the United States and Venezuela have submitted proposal on the energy services sector.

²⁶⁷ United Nations Conference on Trade and Development. *Managing “Request-Offer” negotiations under the GATS: the case of energy services*, at 7.

²⁶⁸ Council for Trade in Services Special Session. *Report by the Chairman to the Trade Negotiations Committee*, at 17.

²⁶⁹ United Nations Conference on Trade and Development. *Managing “Request-Offer” negotiations under the GATS: the case of energy services*, at 7-8.

²⁷⁰ COSSY, Mireille. “The Liberalization of energy services...”. *Op. cit.*, at 413.

²⁷¹ The EC, Japan and the U.S (See Council For Trade in Services Special Session, *Communication from Japan, S/CSS/W/42/Suppl.3*, on 4 October 2001, at 3).

²⁷² SELIVANOVA, Julia. *The WTO and Energy*. *Op. cit.*, at vii.

²⁷³ Council for Trade in Services Special Session. *Communication from Venezuela, S/CSSW/69* (March 29th 2001). Council for Trade in Services Special Session, *Communication from Venezuela, S/CSSW/69/Add.1* (15 October 2001).

²⁷⁴ Council for Trade in Services, *Communication from United States, S/CSS/W/24* (18 December 2000) at 4.

Therefore, these proposals confirm the need of reform in the GATS and W/120 regarding energy services. Members acknowledge the benefit of identifying the core energy services.

B. Incorporation of transit regulation on energy in the WTO framework

This section focuses on the options for the inclusion of energy transit regulation into the WTO framework. There are three main options:

1. A new energy agreement

This option implies the incorporation of an agreement on trade in energy, including energy transit provisions. Sectoral agreements were previously implemented in the WTO i.e. the Agreement on Agriculture and the Textile Agreement.²⁷⁵ Then, WTO Members would need to decide whether such an agreement may be multilateral or plurilateral.²⁷⁶

This alternative seems appropriate for a complete regulation of the energy sector. This agreement may apply to goods and services, covering core and related energy services, as well as including provisions on subsidies, dual pricing amongst others.²⁷⁷

2. An amendment of the WTO Agreements

Another option would be the incorporation of specific provisions on energy transit to the WTO Agreements. This insertion must be materialized through an amendment procedure pursuant to Article X²⁷⁸ of the Marrakesh Agreement.²⁷⁹

This option may be the most immediate and practical solution for energy transit. It may not, however, cover the entire legal field necessary for the transit regulation in energy to the extent that it involves both trade in goods and trade in services.

3. An interpretation of the WTO Agreements

The third possibility is the adoption of an “interpretation decision”²⁸⁰ with the purpose of clarifying how the WTO Agreements would apply to some specific energy matter.²⁸¹

²⁷⁵ MARCEAU, Gabrielle. *Op. cit.*, at 39.

²⁷⁶ *Ibid.*

²⁷⁷ COTTIER, Thomas *et al.* *Op. cit.*, at 22.

²⁷⁸ In regards to the amendment procedure, any WTO Member or the General Council may submit to the Ministerial Conference a proposal for amendment. The latter shall reach consensus on such a proposal. If consensus is not possible, the Ministerial Conference shall decide by a two-thirds majority of the Members.

²⁷⁹ MARCEAU, Gabrielle. *Op. cit.*, at 39.

²⁸⁰ Pursuant to Paragraph 2 of Article IX (Decision-Making) of the Marrakesh Agreement, both the Ministerial Conference and the General Council have the exclusive authority to adopt interpretation of the WTO Agreements.

²⁸¹ MARCEAU, Gabrielle. *Op. cit.*, at 39.

Although this “authoritative interpretation” would be useful for clarifying some issues such as the coverage of fixed infrastructure under GATT Article V, it seems not to be enough. Transit regulation in energy requires the incorporation of some disciplines into GATT Article V such as NT principle or State enterprise provisions. The latter cannot be achieved by an interpretation of the existing Agreements.

In conclusion, the adoption of a sectoral agreement on energy will be the best alternative since the transit of energy resources concerns to trade in goods and trade in services. Therefore, it requires a comprehensive regulation. The second best would be the adoption of amendments to article V and further commitments on GATS in order to guarantee TPA.

C. Essential Provisions

This subsection points out the core provisions for a future transit regime on energy under the WTO. These provisions are the following:

1. Freedom of transit

As a cornerstone, this principle must be included in any future transit regulation on energy to guarantee its full application. The latter should be based upon GATT Article V, because it emphatically states that “*There shall be freedom of transit through the territory of each contracting party*”. Moreover, WTO Members shall take the necessary measure in order to facilitate transit, similar to ECT Article 7.

2. MFN

MFN principle is another crucial provision which must be incorporated in a future regulation in order to prevent discriminatory measures affecting like products from other Members. Nonetheless, MFN provision will need to enlarge its scope of application. Currently, MFN in Article V only applies with respect to charges, regulations and formalities in connection with transit, albeit there could be discriminatory measures which do not enter in those categories such as discriminatory practices.

3. NT

As aforementioned, it is critical to introduce the NT principle in the transit regulation. The main reason is to prevent discriminatory measures in the transit of energy goods through fixed infrastructures since both domestic and transit goods compete for the use of this infrastructure. Thus, transit States may have incentive to discriminate in favour of their domestic energy goods.

4. Transit through fixed infrastructure

Important shares of trade in energy are carried out through fixed infrastructure. As such, it is crucial to clarify that fixed infrastructures are “means of transport” covered by transit provisions of trade in goods.

It will also be necessary to establish specific rules, which can be based on the ECT and the EU provisions, such as:

- Third party access
- Construction of new or additional capacity
- Non-interruption of energy flows

5. State trading enterprise and private operators

One of the main challenges for the implementation of any transit regulation is that the energy sector is managed by State trading enterprises or increasingly by private companies. Thus, it is important to introduce a provision stating that States enterprises and private enterprises with special and exclusive privileges shall comply with transit disciplines.

6. Investment related issues

As mentioned, transit through fixed infrastructures is capital-intensive; hence, private investments are indispensable. Nevertheless, these private capitals require a friendly investment environment. Therefore, any future energy transit regulation should offer basic investment guarantees.

Conclusions

Trade in energy represents a significant share of the world trade flows, albeit energy resources are uneven geographical distributed. Thus, transit becomes a key issue in the energy sector. Export and import States need guarantees that energy goods shall transit through third States on a freedom of transit basis. Nevertheless, the latter does not form part of customary international law given that transit States always need to grant their consent through treaties.

Therefore, the transit of energy goods requires an appropriate and comprehensive international regulation. Even if the WTO Agreements and the ECT contain applicable provisions on transit, they do not cover all the complexities of the energy sector, particularly transit through fixed infrastructures.

Regarding the WTO, GATT Article V lacks the essential provisions for network-bound transit. The national treatment principle and right to build new or additional infrastructures are absent. Moreover, there is no clarity regarding the coverage of fixed infrastructure and electricity. It is also necessary to regulate the activities carried out by states enterprises or private enterprises with special privileges.

The transit of energy resources concerns both trade in goods and trade in services disciplines. Notwithstanding, GATS does not offer a broad enough legal framework for transportation services through fixed infrastructures since not all WTO Members have undertaken specific commitments in this sector. Additionally, there are no provisions regarding third party access, which is crucial for the development of the energy sector.

Even if the ECT helps to fill certain gaps, it also has some fundamental weaknesses. First, it does not state clearly that there shall be freedom of transit. Second, the scope of the MFN provision is narrow. Third, there is no regulation regarding third party access. Finally, its dispute settlement mechanism is not predictable or expeditious enough.

After this examination, it is clear that the transit regulation of energy resources needs urgent reform. The WTO seems to be the appropriate institution for dealing with this issue since it offers predictable rules, transparent mechanisms, an efficient dispute settlement mechanism and broad membership.

The best way to implement a transit regulation on energy would be the adoption of a sectoral agreement on energy since the transit of energy resources concerns trade in goods and trade in services. Therefore, it requires a comprehensive and coherent regulation. Moreover, all related fields to energy transit must be addressed, including the basic elements stated in Section V

Finally, it should be borne in mind that the elaboration of a transit regime on energy will demand a great deal of attention from governments, the private sector, experts and legal advisers. In addition, this work cannot be accomplished without the political will of major energy actors.