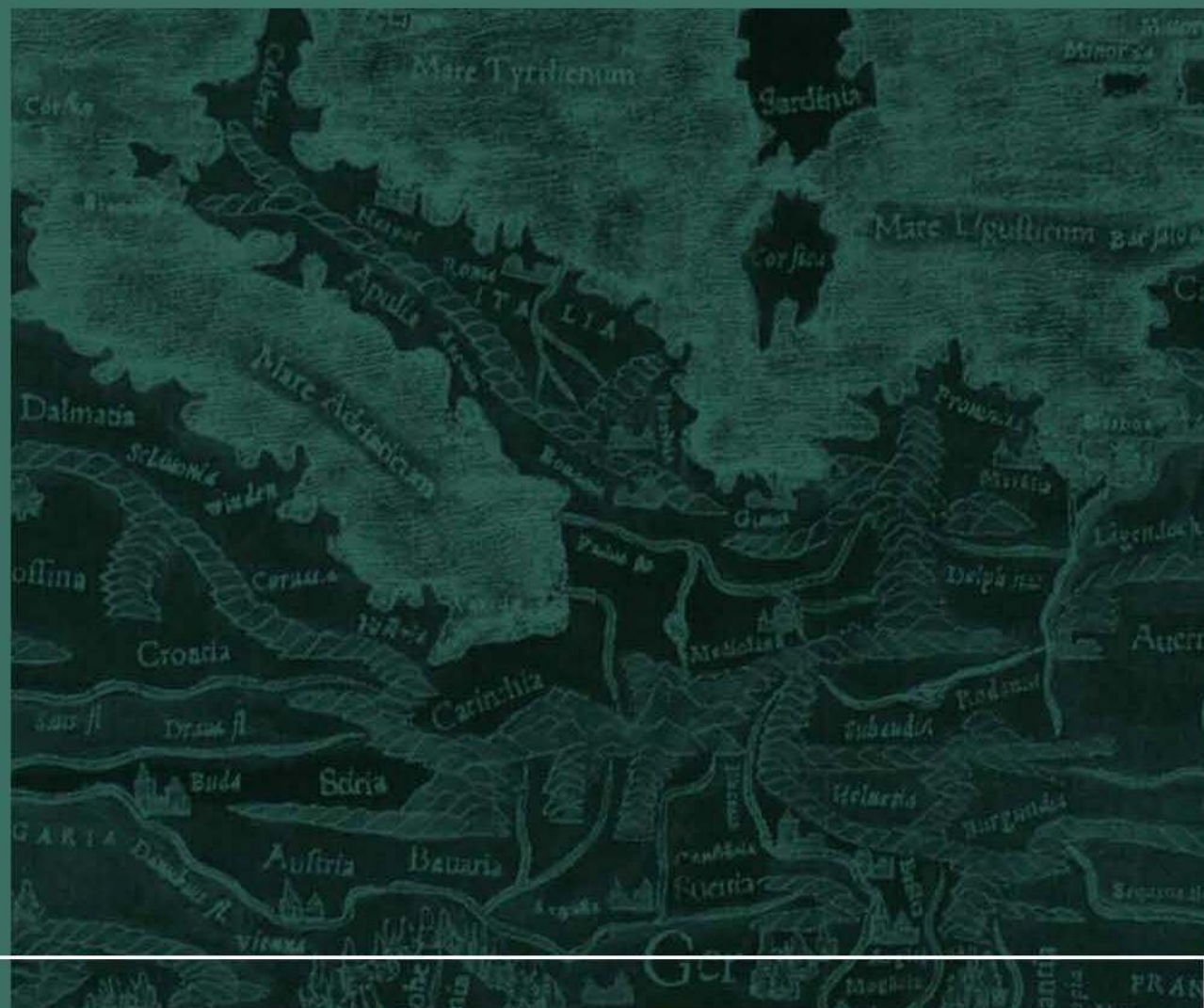


MODERN STUDIES IN EUROPEAN LAW



ENERGY SECURITY

THE EXTERNAL LEGAL RELATIONS OF THE
EUROPEAN UNION WITH MAJOR OIL
AND GAS SUPPLYING COUNTRIES

SANAM S HAGHIGHI

ENERGY SECURITY

This book offers the first comprehensive assessment of the various internal and external measures undertaken by the European Union to guarantee security of oil and gas supply. It sets out and analyses in a coherent and thorough manner those aspects of EU external policy that are relevant in establishing a framework for guaranteeing energy security for the Union. What makes the book unique is that it is the first of its kind to bridge the gap between EU energy and EU external policy.

The book discusses EU policy towards the major oil and gas producing countries of Russia, the Mediterranean and the Persian Gulf at the bilateral as well as regional and multilateral level. It brings together not only the dimensions of trade and investment but also other important aspects of external policy, namely development and foreign policy. The author argues that the EU's energy security cannot be achieved through adopting a purely internal approach to energy issues, but that it is necessary to adopt a holistic approach to external policy, covering efficient economic relations as well as development co-operation and foreign policies towards energy producing countries.

The book will be a valuable resource for students of EU law, WTO law or international energy law, as well as scholars and practitioners dealing with energy issues.

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Energy Security

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Sanam S Haghghi



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Abbreviations

APEC	Asia Pacific Economic Cooperation
APSA	ASEAN Petroleum Security Agreement
ASEAN	Association of South-East Asian Nations
bcm	billion cubic metre
BISD	Basic Instruments and Selected Documents (GATT)
BITs	Bilateral Investment Treaties
BOT	Build, Operate and Transfer
CCP	Common Commercial Policy
CDM	Clean Development Mechanism
CEE	Consortium for Energy Efficiency
CEFIC	Association of Petrochemical Producers in Europe
CEPLMP	Center for Energy, Petroleum and Mineral Law and Policy
CEPS	Center of European Policy Studies
CERA	Cambridge Energy Research Associates
CERM	Coordinated Emergency Response Measures
CFI	Court of First Instance
CFSP	Common Foreign and Security Policy
CLRTAP	Convention on Long-Range Trans-boundary Air Pollution
CPC	Caspian Pipeline Consortium
CS	Common Strategy
DG	Directorate General
DSB	Dispute Settlement Body
dwt	deadweight tonnage
EC	European Community (-ies)
ECHR	European Court of Human Rights
ECJ	European Court of Justice
ECO	European Coal Organisation
ECR	European Court Reports
ECS	Energy Charter Secretariat
ECSC	European Coal and Steel Community
ECT	Energy Charter Treaty
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EIA	Energy Information Administration
EIB	European Investment Bank

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EMP	Euro-Mediterranean Partnership
ENP	European Neighbourhood Policy
EOS	European Energy Market Observation System
EPC	European Political Cooperation
ERTA	Energy Resources and Technologies Analysis
EU	European Union
EUI	European University Institute
EURATOM	European Atomic Energy Community
FDI	Foreign Direct Investment
FIRA	Foreign Investment Review Act
FSU	Former Soviet Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
ICSID	International Centre for Settlement of Investment Disputes
IEA	International Energy Agency
IEF	International Energy Forum
IEFS	International Energy Forum Secretariat
IEP	International Energy Program
ILM	International Legal Materials
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas Transport to Europe
JODI	Joint Oil Data Initiative
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
MAI	Multilateral Agreement on Investment
mb/d	million barrels per day
mcm/y	million cubic metres per year
MEA	multilateral Environmental Agreement
Med	Mediterranean
MEES	Middle East Economic Survey
MFN	Most-Favoured Nation
Mio Tonnes	Million Tonnes
MTBE	Methyl Tertiary Butyl Ether
Mtoe	Million tonnes oil equivalent
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organisation
NT	National Treatment
OAPEC	Organization of Arab Petroleum Exporting Countries
OECD	Organisation for Economic Cooperation and Development
OEEC	Organisation for European Economic Cooperation
OIES	Oxford Institute for Energy Studies

OJ	Official Journal
OLADE	Organización Latinoamericana di Energía (Latin American Energy Organisation)
OME	Observatoire Méditerranéen de l'Énergie
OPEC	Organization of Petroleum Exporting Countries
PCA	Partnership and Cooperation Agreement
PEEREA	The Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects
PESC	Politique Étrangère et de Sécurité Commune
PJCC	Police and Judicial Cooperation in Criminal Matters
PSA	Production Sharing Agreement
QMV	Qualified Majority Voting
R&D	Research and Development
REIC	Regional Economic Integration Clause
REIL	Renewable Energy and International Law Project
REIO	Regional Economic Integration Organisation
RIIA	Royal Institute of International Affairs
R/P	Reserve to Production Ratio
RSCAS	Robert Schuman Centre for Advanced Studies
SCC	Stockholm Chamber of Commerce
SCM	Subsidies and Countervailing Measures Agreement
S&D	Special and Differential Treatment
SEA	Single European Act
SEMC	Southern and Eastern Mediterranean Countries
STE	State Trading Enterprises
TA	Trade Amendment
TACIS	Technical Assistance to the Common Wealth of Independent States
TBT	Technical Barriers to Trade
TCA	Trade and Cooperation Agreement
TEC	Treaty Establishing the European Community
TEU	Treaty on the European Union
tcf	trillion cubic feet
thb/d	thousand barrels per day
TRIMs	Trade Related Investment Measures
UAE	United Arab Emirates
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission for Europe
UNFCCC	United Nations Framework Convention on Climate Change
UNSD	United Nations Statistical Division
USD	US Dollars

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USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

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Introduction

ALMOST ONE HUNDRED years ago, one scientist observed:

No one today is ignorant of the part played by energy, not only in science, but in industry, politics, and the whole science of human welfare. From the cradle to the grave, everyone is dependent on nature for an absolutely continuous supply of energy in one or other of its numerous forms. When the supplies are ample, there is prosperity, expansion and development. When they are not, there is want.¹

The importance of guaranteeing that energy is available, and the link between this availability and economic activity, has since been acknowledged by policy-makers around the world. Although the magnitude of demand for energy was greater at one point in time than at another, competition for access to world energy resources as a vital aspect of economic growth has always been present. It is now strongly recognised that a smooth transition by the industrialised world and equitable growth in the developing world will be disturbed or frustrated by energy shortages, which will in turn affect almost every aspect of economic activity.

The energy sector carries great uncertainties because of its very nature. The time scale which must be considered in designing an energy policy and determining the need for energy supply in a given country or region is normally longer than that commonly considered for other economic policies. As this longer benchmark brings more uncertainty in prediction, policies and strategies need to consider various alternatives and assessment of these alternative strategies becomes an essential part of a given energy policy. Such assessment may be more an art than a science but this has not absolved analysts from taking, for decades, the duty of performing this assessment seriously and efficiently.

The design of an energy strategy normally takes various basic factors into account, such as energy demand, energy supply, the function of energy markets etc which are all embodied in the energy policy and economic objectives of a given country. *Energy demand* analyses the relation between economic growth

¹ See F Soddy, *Matter and Energy* (1912) cited in AA Jordan, H Bryan, and M Moudie, *Facing the International Energy Problem 1980–2000* (New York, Praeger, 1979).

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and the use of energy, and projects the increase or decrease of demand. *Supply of various types of energy*, such as oil, natural gas, coal, nuclear, and renewable sources of energy, involves studying the availability of sources; this study also involves the analysis of the geological structure of world reserves and resources, and various economic, social or political factors that influence access to these reserves and their exploration and development, as well as analysing the social, environmental and technical costs of each source of supply. The study of the *energy market* evaluates the balance between demand and supply and analyses the necessary investment in achieving this balance as well as the complex structure of costs and prices. The use of alternative sources of energy and the possible obstacles to their use, due to either their high costs or other environmental or social factors is also a part of this analysis. Assumptions of future economic growth and its link to increased demand for various types of energy, the possibility of inter-fuel substitution, social preferences and the difficulties that such assumptions may embody, become a part of energy strategies.

Hence, energy policy-makers tend to identify and analyse the trends and issues that are most likely to affect the long-term world energy environment. Speculations about growth in demand or supply, the sudden disruption of energy flow due to failures in the energy network or natural disasters, relations with energy-producing countries, the adverse effects of political events on this relation, etc necessitate sophisticated evaluations and weighing and ranking of priorities for each country or region in designing energy policies. As the challenge of supplying energy in a sustainable way is immense, it is necessary to have effective policy-making based on adequate analysis.

Furthermore, in a context of growing liberalisation of energy markets, the question arises of the appropriate extent of government intervention and the instruments that could be drawn upon by governments. This issue takes a more complex turn in Europe where it raises questions about the appropriate role of two levels of government, that of the European Community and that of its Member States, in guaranteeing security of energy supply.

Arguably, the importance of guaranteeing energy supply justifies some degree of legal regulation as well as economic and political speculations to organise the activities of the actors involved. As consumers may be unaware or negligent about the effects of their choices on the overall energy security of the community they live in, some measures must be designed to regulate their choices. Moreover, legal measures also regulate the ways in which energy is traded, invested in, or transited across borders to guarantee optimum security. On the other hand, the greater the necessity of cooperation between consumers and producers of energy is felt by both groups to guarantee security of demand and supply, in other words, the more the interdependence of both groups is highlighted, the more these regulations encompass the demands of both sides.

As consuming and producing nations reach regional or multilateral agreements, these regulations are consequently shaped to reflect upon the demands of all the players involved in one setting. The political and economic frameworks

governing these activities should ensure the equitable distribution of supplies for consumers and satisfy the demands of suppliers. Such interdependence necessitates that the worldwide multiplication of the regional or multilateral settings reflects upon all these factors.

The potential threat to internal political stability of consuming, transit or producing countries necessitates the inclusion of political aspects of such security in the framework of an energy policy. Instability in an important energy-producing country adversely affects energy security for consuming nations. Guaranteeing diverse sources of energy and transit routes through diplomatic alliances becomes another important aspect of an energy policy. In addition, efforts to boost the economic development of energy-producing countries, bringing more prosperity and more political stability, also become an important aspect to ponder in designing an energy policy. Achieving a secure supply of energy necessitates evaluating all these aspects and resolving any bottlenecks in consumer–supplier relations through negotiation, in order to reach mutually satisfactory solutions, and not policies that are exacerbated by decisions governed merely by short-term national interests.

Energy projections demonstrate that the world's growing economies and transportation needs will result in continued demand for energy, especially oil and natural gas, which calls for their reliability and affordability. Energy demand per se is not the only important factor, the degree of any country's or region's dependency on energy and the location of the natural resources to meet energy needs play an important role. Europe will continue to have substantial energy resources available to it through drawing upon imports, which will mainly be provided by the Middle East and Africa as well as Russia and the Caspian. This dependency could be diminished if alternative forms of energy, specially wind and solar energy, were to make a greater contribution to energy supply, but as they are so far driven mainly by government subsidies and mandates, their contribution to satisfying European energy needs will depend on the will of policy-makers to include them in the overall energy policy and pursue their development vigorously. Nevertheless, as the use of alternative sources of energy is faced with numerous challenges (eg the cost of wind power which, using today's technologies, is more expensive than power supplied via fossil fuels), their competition with other sources has been minimal. The more the importance of environmental protection and its link to the use of fossil fuels is highlighted, the greater the possibility of the increased use of alternative energy is. Assuming the continued use of fossil fuel for quite some time in the future, the interdependency between the supplying countries and consuming nations will continue to raise important issues for energy relations that should enter the framework of energy policy-making. It is against this background and the complex relations between all these factors that energy policies should be designed.

The concern with analysing the means of guaranteeing energy security in Europe arises from disquiet about a view that tends to become deeply rooted in the policy-making of the European Union, namely the view that energy policy is

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about the satisfaction of energy demand alone without paying much attention to its multi-dimensionality. The very strong connections between demand, supply, investment, production, distribution, access to technology, protection of environment, geopolitical issues, etc. constitute a characteristic of the energy sector that should be reflected in energy policy. On closer perusal, factors such as the level of dependence of both European consumers and producers on one another (ie mutual interdependency), vulnerability of energy systems, decision-making processes, political stability, economic development, etc. are all vital factors to be taken into account by policy-makers.

Since the inception of the European Community efforts have been undertaken to include the energy sector in the overall framework of European policy-making. The aim of achieving common policies and their actual establishment in other economic sectors, such as trade, agriculture or transport, was imprinted in the early European Community documents of decades ago (eg Treaty of Rome, Art 2). The debate on pooling energy markets emerged some years after the Second World War with the creation of the Treaty Establishing the European Atomic Energy Community (EURATOM) and the Treaty Establishing the Coal and Steel Communities (ECSC). However, apart from the general dissemination of nuclear knowledge among Member States, establishing uniform nuclear safety standards, facilitating investment in atomic activities and ensuring the supply of atomic energy, Member States were free to regulate their respective nuclear industries, and the integration of these industries into one was not regarded as the main aim. The Treaty Establishing the Coal and Steel Community, on the other hand, focused only on conventional energy in the form of coal. The treaty provided that a market in coal should be created where import and export duties, discriminatory practices among producers, purchasers and consumers, grants of subsidies and aids and restrictive practices should be prohibited (Art 4). The Community had the task of providing guidance and assistance to the parties concerned, placing financial resources at the disposal of undertakings, ensuring the establishment, maintenance, and observance of normal competitive conditions, and guaranteeing the observance of rules laid down in the treaty (Art 5). Overall, a common energy policy, encompassing all forms of energy from coal to gas, electricity and oil, did not materialise. The reluctance of Member States to accept the idea of pooling their energy markets, particularly gas and electricity, has been so strong that efforts to obtain their consent were doomed to fail for many years. Hence, the energy sector was labelled a 'strategic sector' but concrete policy advances proved difficult. The first success only occurred in 1996 with the creation of the Directive on Common Rules for the Internal Market in Electricity followed by the Directive on Common Rules for the Internal Market in Natural Gas in 1998.

This pooling together of energy markets being a new phenomenon, attention was centred on securing an efficient and well-functioning internal energy market. In regulating this market, the discussion of internal security of energy supply

came to the fore and dominated various policy initiatives. However, the discussion of *external security of supply*, namely the design of an efficient framework to guarantee security through relations with energy-producing countries, was overlooked. Demand management issues, such as energy saving, energy efficiency, stock-holding obligations, climate change issues etc were increasingly addressed at the Community level, but dependence on external sources of energy was left aside or only touched upon *en passant* for quite some time. This aspect of security remained in the hands of the Member States.

The study of this development and the internal–external link shows the absence of a clear vision and policy towards external relations at the EU level. This study argues that the increased energy demand among the 27 members of the European Union, and the inadequacy of indigenous energy within the EU, increases dependency on energy imports, mainly crude oil and natural gas. Although this dependence per se does not create problems, it should be considered as an important reason for developing an energy security framework which encompasses efficient external energy relations of the European Union with these countries. Clearly, the aim of a European energy policy is to remove obstacles to competition and act in such a way that market pressures could be smoothly, efficiently, and clearly transmitted to all relevant economic actors. Nevertheless, such an aim should be coupled with ensuring a proper link between internal and external issues of security. This study argues that a system independent from concerns for securing external sources cannot provide adequate security for the Union, and therefore a balance between various policy instruments at both levels is imperative.

The necessary elements of a legal framework at the level of the European Union to guarantee energy security have hitherto not been adequately addressed and analysed in legal scholarship, and no study has evaluated the adequacy of the instruments available to the Union to assure this security at the external level. A large volume of literature is dedicated to analysing of the development of the European internal energy market, mainly from the point of view of competition law, whereas an analysis of the evolution of European law and its link to energy security has not yet been thoroughly undertaken.

The analysis of the EU's legal environment, and the already existing efforts to manage energy security, reveals the need for a comprehensive approach to the issue of energy security where not only the mutual interdependency of consumers and suppliers of energy are advertised but also the necessity of a common foreign policy towards these countries is touched upon. This study claims that, in order to establish an energy security framework among the 27 members of the EU, three issues need to be equally addressed. The first is the establishment of an efficient framework for economic relations with energy-supplying countries in terms of investment, trade, and transit of energy. The second is the establishment of a coherent approach among Member States at the level of foreign policy towards these countries that has, as an objective, not only the stabilisation of relations between EU consumers and their suppliers but also the political

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stabilisation of these countries domestically. The third is the acknowledgment of the mutual interdependence between consumers and producers, implying that access to energy for consumers should be balanced against the demands of producing countries for economic development and economic diversification. This study argues that this triangle of economics–politics–development should be the building block of a framework to guarantee energy security in Europe. It examines these aspects and evaluates their relevance and adequacy in terms of the European Union's relations with important energy-supplying countries of North Africa, Russia and the Persian Gulf.

The first chapter defines energy security and analyses the relevant factors to be considered in designing an energy policy to guarantee security of energy supply. This chapter briefly describes these factors, namely the perspectives of demand and supply of energy, the investment, trade and transit regimes, security of energy sources, energy transit routes and energy facilities as well as the actors and instruments involved in the energy sector and their respective responsibilities.

The second chapter provides a historical overview of the ways through which the energy sector and energy security were dealt with since the inception of the European Community. This chapter is intended to highlight the difficulties that the Community has long faced in Europeanising the energy sector and the inadequacies of its relations with energy-producing countries.

The third chapter questions whether the Community has the capacity to deal with energy issues at the external level, and hence analyses the law on the division of competences between the Community and Member States in dealing with issues related to energy security. This analysis argues that the evolution of the law on division of competences paves the way for the Community to carry out activities in this field. Nonetheless, the study questions the extent to which competence should be expanded, and argues that priority has to be given to a shared competence between the Community and the Member States rather than the creeping exclusivity of the Community's competence.

The fourth chapter analyses all the internal measures at the Community level which deal with energy, and calculates their adequacy in guaranteeing security of energy supply at the external level. Important internal measures such as the regulation on the management of oil stocks, or the security of natural gas supply, are analysed in detail, followed by an analysis of the soft law measures of the Community, such as various Commission Communications or Green and White Papers, which reveal the general attitude of the Commission in approaching questions of energy security.

The fifth chapter examines the existing multilateral measures and obligations of the Community which are related to energy security at the external level. Attention is mostly paid to the legal framework of the World Trade Organization (WTO) as well as to the Energy Charter Treaty (ECT) and its importance for trade, transit and investment in energy. This chapter considers all the relevant provisions of this treaty and the relevant WTO Agreements in detail. Although this section is mainly led by the analysis of the Energy Charter Treaty, the close

relationship between this treaty and the WTO Agreements necessitate a closer look at developments in the framework of the WTO. Chapter Five argues that although the ECT is the most important multilateral instrument for the purposes of European energy security, its activities fall short of an efficient framework. Real security cannot be guaranteed for the Community unless all the important energy supplying countries become a party to that treaty. The study claims that the membership may be increased only if the Energy Charter Secretariat takes up an active role in managing the relations between consumers and producers while maintaining a balance between the demands of both sides, the lack of which has been greatly felt so far.

The sixth chapter undertakes a comparative study of bilateral relations between the Community and the important energy-supplying countries of Russia, the Mediterranean region and the Gulf, and highlights the differences in the approach of the Community with respect to these countries or regions. It argues for a balanced and equal approach to all the important energy-producing countries to satisfy the requirement of diversification of the sources of energy supply for the Community for reasons of energy security.

The seventh chapter examines the two important aspects of energy security that are largely missing in the overall energy policy-making of the European Community. The study argues that there should exist a triangle of energy security, which would not only encompass the commercial aspect of energy security, such as trade and investment, but also the economic development of energy-producing countries as well as the establishment of a common European foreign policy with respect to these countries. This chapter highlights the importance of the role of the Community in guaranteeing economic development in energy-producing countries, and argues that such economic development and diversification, which is at the centre of the demands of producing nations, contributes to a secure energy supply for consuming nations. The study argues that since the Community conducts a policy of development cooperation with developing and least developed countries, and having in mind that the majority of the energy-producing countries are developing countries, the expansion of such policy to embody these countries becomes relevant for the purposes of energy security.

This chapter also emphasises the role of a common foreign policy in assuring security of energy supply. The enquiry does not call for the full convergence of individual foreign policies but the partial convergence of some aspects which are shared among all members. It is argued that a common 'approach' among Member States towards energy-producing countries brings greater stability to relations, something that has been historically proved to be necessary for the purposes of energy security. The study argues that the instruments to create such an efficient framework are at the disposal of the Union: there is only the absence of a political will to employ them.

The last chapter concludes the study by underlining the importance of the 'triangular approach' to energy security, encompassing not only the *economic*

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aspects of this security but also the necessity of seeking *political* stability in energy-producing countries and by the adoption of a development cooperation policy that takes the demands of economic development in energy-producing countries into account. Embracing this triangular approach would enhance the credibility of the Community system in guaranteeing a secure energy supply for its Member States.

1

Security of Energy Supply in Europe: An Analysis

1.1. SECURITY OF ENERGY SUPPLY: THE FUNDAMENTALS

1.1.1. Introduction

THE DEBATE OVER what constitutes energy security is an ongoing one and has become one of the most controversial topics among energy scholars. Europe's reliance on imported energy¹ from external sources, high energy prices, the possible depletion of energy reserves, and the occurrence of regional supply shortfalls are said to have strong implications for energy security. Experts may emphasise one factor more than another or they may declare one of these factors to be irrelevant. Some argue that reliance on imported energy per se is not a security problem because there may be high dependency without any supply risk.² Similarly, the idea of the rapid depletion of energy reserves of the world is not accepted by many,³ as they believe that security development is not a question of geology but of politics and regulation. Nonetheless, one factor may influence another, or each component could directly

¹ Throughout this study the reference to 'energy' includes mainly the two conventional sources of oil and gas. Other sources of conventional energy (ie energy that comes from fossil fuels), such as coal or coal-generated electricity, as well as non-conventional energy (such as solar, wind, biomass, geothermal energies, etc) are dealt with in comparison, and their characteristics are not discussed in detail. Their relevance to the analysis of oil and gas security will be shortly referred to whenever necessary.

² G Luciani, 'Security of Supply for Natural Gas Markets: What is it and what is it not' INDES Working Papers no 2, 2004 at <<http://ceps01.link.be/files/No2%20INDES%20pdf.pdf.copy>> [hereinafter 'Natural Gas Markets']. See also J Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalization* (London, RIIA, 2002) at 4 [hereinafter *Gas Security*].

³ Some geologists and engineers argue that oil is finite and is running out. They claim that global production of conventional oil will begin to decline within 10 years (from 1998 when they published the article). See CJ Campbell and JH Laherrère, 'The End of Cheap Oil' (1998) at <<http://dieoff.com/page140.pdf>>. See also M Simmons, *Twilight in the Desert. The Coming Saudi Oil Shock and the World Economy* (New Jersey, John Wiley, 2005) who claims that Saudi Arabia's production will soon reach its peak, after which the world will face an immense and potentially catastrophic oil shortage. For a counter argument see L Maugeri, *The Age of Oil: The Mythology, History, and Future of the World's Most Controversial Resource* (New York, Praeger, 2006). See also, P Stevens, 'Consumer Governments,

or indirectly, sooner or later, challenge the energy security of Europe to a lesser or greater degree. For this reason, the implications of each factor on energy security should be touched upon here.

The necessity of drafting a policy to secure energy supply is due to the direct link between the availability of energy and the economic development of a society. The everyday functioning of a society would be brought to a halt if energy were unavailable or too costly. One example is the energy crisis of 1973 where inflation was triggered and economic recession ensued. Not surprisingly, therefore, ensuring a secure energy supply for Europe had found its way in the energy policy agenda of both the Member States and the European Community.

Various industrial sectors require energy for their day-to-day activities. Agriculture, mining, construction and manufacturing rely heavily on various sources of energy. Although this is the case in every country that undertakes such activity, the level of demand in the industrial sector varies between countries 'based on the level and mix of economic activity, technological development, and population, among other factors'.⁴

Currently, Denmark and the United Kingdom are the only countries in the European Union that have no dependency on oil imports, and the same countries plus the Netherlands have no dependency on gas imports. However, not only is demand in Europe on the rise, but European gas production, primarily in the North Sea, is expected to decline,⁵ and natural gas production will not rise much above current levels in the foreseeable future. This results in an overall growth in demand for natural gas from outside the European Union.⁶ Although the exact level of increase in demand is open to controversy, the fact that demand will rise is widely accepted.⁷ The *International Energy Outlook* of 2006 states that OECD Europe's reliance on imported natural gas grows to more than one-half of demand in 2015 and almost two-thirds in 2030.⁸ Oil is projected to remain

Energy Security of Supply and the Aftermath of the 11th of September' 9 (2001) *Online Journal of Centre of Energy, Petroleum, Mineral Law and Policy* (CEPMLP), <<http://www.dundee.ac.uk/cepmlp>>. See also <<http://www.peakoil.net>>.

⁴ See the *International Energy Outlook*, 2004 (Washington, Energy Information Administration 2004) at 12 [hereinafter *International Energy Outlook 2004*].

⁵ The extent of the decline is open to controversy. The *International Energy Outlook 2004* prepared by the Energy Information Administration, projects that the production of natural gas will decline from 10.2 tcf in 2001, to 9.8 tcf in 2025. See also Global Energy Watch, 'Energy Security Tops the Political Agenda', Cambridge Energy Research Associates (CERA), Autumn 2005.

⁶ Economic predictions in general are the basis for energy projections. As these predictions have the potential to be tainted by uncertainty, as the nature of a prediction suggests, energy projections should never be approached with too much confidence. See also P Noël and P Criqui, 'Marchés énergétiques et géopolitique pétrolière, 1990–2030', Sept. 1998 <<http://www.upmf-grenoble.fr/iepe/textes/pnpc98.pdf>>, at 1 [hereinafter 'Marchés énergétiques et géopolitique'].

⁷ Import dependency varies significantly between different Member States. A number of EU Member States are already completely dependent on imports while others will see their dependence rise close to 100%.

⁸ See the *International Energy Outlook 2006*, (Washington, Energy Information Administration 2006) at 43. The 2005 *International Energy Outlook* talked of the contribution of imports to consumption beyond 50% by 2025.

Western Europe's largest energy source, with demand increasing by 0.5 per cent per year on average from 2001 to 2025.⁹ Much of the oil currently imported into Europe comes from the Middle East, Former Soviet Union countries and North Africa, and much of the natural gas imported comes from Russia, Algeria and Norway (see tables 1.1 and 1.2).

One aspect of energy security is the capacity to switch freely from one source of energy to another. An additional reason for shifting from using one source of energy, such as oil or coal, to other sources, such as natural gas or nuclear, is due to environmental concerns. For example, in Europe natural gas is gaining over coal in electricity generation. The use of coal is projected to decline in the years to come due to the fact that coal is more polluting compared to natural gas. As a result, pressure has been put on the member countries of the European Union to reduce their subsidies for the domestic production of hard coal to the minimum necessary for energy security.¹⁰ Depending on the success of these policies, the dominant source of energy in any particular country or region varies. The development of technologies also plays an important role in this shift.

In Western Europe the largest consumers of gas are Germany, the UK, Italy, France and the Netherlands. Germany's consumption of natural gas, for example, will be the highest towards the end of the period between 2001 and 2025 specifically due to phasing out its use of nuclear power over the next 20 years. This will in turn lead to greater dependence on imported natural gas for Germany in particular and for the European Union as a whole. The largest consumers of oil in Western Europe are Germany, France, the UK, Italy and Spain.

The issue of concern for Europe is not only the increased demand for imported energy but also the competition that Europe faces from other regions of the world that are dependent on oil and gas. Export direction may gradually shift from Europe to those destinations, such as China, India and other Asian markets, where energy demand is high and on the rise.¹¹ The extent to which

⁹ Of the projected increase in oil use between 2003 and 2030, half is believed to occur in the transportation sector. See the *International Energy Outlook 2006*, *ibid*, at 43.

¹⁰ Major coal production in Europe exists in the United Kingdom, Germany, Spain, France, Poland and the Czech Republic. The European Commission approves the use of hard coal subsidies to some extent. See also the Council Reg (EC) No 1407/2002 of 23 July 2002 on State Aid to the Coal Industry [2002] OJ L/205/1. This directive perceives that maintenance of coal-producing capability supported by state aid is justified to strengthen Union's energy security, see para 7.

¹¹ On the importance of the growth in oil demand from Asia and particularly China for energy security purposes, see P Noël and P Criqui, 'Marchés énergétiques et géopolitique', above n 6, at 13. See also P Andrews-Speed, X Liao and R Dannreuther, 'The Strategic Implications of China's Energy Needs', paper presented at the conference on *The Geopolitics of Energy: The Asian Shift*, Florence, July 8–9, 2003. They depict some alarming scenarios in this respect. They state that

[the] developing countries in Asia, most notably India and China, will be the driving forces leading to a projected 50% increase in energy demand by the year 2020. The vast majority of this energy will come from the Gulf Middle East. Asia will be dependent for 80% of its oil supplies from the Gulf, as against about 35% for Europe.

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energy from a particular place may flow eastward or westward depends on many factors which will be discussed later in this section.

1.1 Crude Oil Imports: EU 15 (in mio tonnes)

Origin	2000	2002	2003	2004	2004 %
Former USSR	89.5	123.2	140.7	158.5	30.8
Norway	114.8	101.6	104.6	104.0	20.2
Saudi Arabia	65.1	53.1	61.5	66.1	12.9
Libya	45.5	38.8	45.7	49.6	9.7
Iran	35.5	25.9	34.7	35.9	7.0
Middle East/ Not Specific	13.1	19.6	11.7	9.0	1.7
Other origin	121.5	110.7	94.5	91.0	17.7
Total Imports	485.0	472.9	493.5	513.9	100.0
in million barrels	3540.5	3452.2	3602.4	3751.7	—

Source: European Union Energy and Transport in Figures (2005)

1.2 Gas Imports: EU 15 (in mio cubic metres)

Origin	2000	2002	2003	2004	2004 %
Russia	78 484	68 807	74 160	76 709	32.5
Norway	46714	61 351	66 707	67 212	28.5
Algeria	56644	53 162	52 086	49 879	21.2
Non specific origin	6 808	15 966	18 700	24 899	10.6
Nigeria	4 283	6 276	8 746	10 538	4.5
Qatar	293	2 070	1 893	3 770	1.6
Other origins	1 857	2 972	1 666	2 747	1.2
Total Imports	195 083	210 604	223 958	235 754	100.0

Source: European Union Energy and Transport in Figures (2005)

Overall, projections for the year 2025 indicate that the use of oil in Western Europe will increase by an average of 0.5 per cent and consumption of natural

They acknowledge that this theory is dependent on assuming the future scarcity of oil supplies and the inability of energy markets to provide for the needs of China and other Asian states, an assumption that could be invalid. For an elaborated study on the future of China's energy needs, see IEA's study, *China's Worldwide Quest for Energy Security* (Paris, IEA, 2000).

gas will rise by an average of 2.0 per cent within that period. In the transportation sector, the dominant source of energy will be oil and the consumption of oil in this sector will increase. On the other hand, consumption of coal and nuclear energy will be reduced and consumption of hydroelectricity and other renewable sources of energy will rise slowly by 1.3 per cent average within the period 2003–30.¹²

Clearly, the rise in consumption results in the increased importation of energy sources that are mostly used in the European Union, which in turn necessitates the designing of an efficient framework to secure energy supply. This framework has many facets that will be discussed below.

1.1.2. What Constitutes Energy Security?

It is important to determine what constitutes energy security. Firstly, it is imperative to distinguish between the two sources, oil and gas, since they have different characteristics from the perspective of energy security. Unlike oil, gas is relatively difficult to store and gas transportation infrastructure is rigid in nature (for the time being). This means that a physical link between producer and consumer is required and the number of alternative routes to the consumer is limited. For example, a cargo of oil destined for the UK can easily be switched and sent to another country in another continent: this is actually an everyday occurrence, whereas for gas this flexible switching does not happen.¹³ This is because, unlike gas, oil transportation is not costly, and therefore oil that is destined for a specific place can easily be redirected to another destination. Moreover, unlike the global oil market, the gas market is regional. A global oil market implies that a disruption of oil supply in one part of the world may affect the whole world whereas gas disruption does not necessarily have worldwide repercussions. This is again due to the fact that firstly, the costs of gas transportation are higher than oil, and delivery systems are inflexible; and secondly, gas development in one country or region is isolated (due to a lack of easy switching between routes) from the development of other regions, which suggests that disruption in one region does not necessarily influence another.¹⁴ Another difference between oil and gas is that seven cases of oil disruption have been reported since 1950, occurring for purely political rather than physical reasons,¹⁵ whereas no gas disruptions have occurred and if they did, were only minor and short-term. This last difference shows that oil has historically been used as a political weapon while gas does not have such political characteristics. (The most

¹² See the *International Energy Outlook 2006*, above n 8.

¹³ *The IEA Natural Gas Security Study* (Paris, IEA, 1995) at 24.

¹⁴ This is the case unless oil prices indirectly affect the gas price as the gas price is indexed to that of oil. See *The IEA Natural Gas Security Study*, *ibid* at 24.

¹⁵ Iranian boycott of 1951–53, Suez Crisis of 1956, Six-Day War 1967, Yom Kippur War 1973, Iranian Revolution 1979, Iran–Iraq War 1980–88, and the Gulf Crisis of 1990–91.

significant recent example of gas disruption was the blockage of gas exports from Russia to Ukraine in early January 2006. This blockage lasted only four days, and the political motives behind it are controversial and are not widely accepted).¹⁶ In addition, gas security is mostly concerned with physical shortage rather than price shocks, the latter being an oil security concern (for example, the energy crisis of 1973 was about the high price of oil and at no time was the physical availability of oil endangered).

There are debates over what constitutes energy security and these arguments have been sometimes hindered by a lack of clear understanding concerning the different components of the energy security problem and their policy implications. The multi-faceted nature of energy security, which will be elaborated below, makes it very difficult to provide a definition of energy security that is accepted by all. A commonly accepted practical definition of this concept is *adequacy of energy supply at a reasonable price*. This definition suggests that energy should be physically available and its price should be reasonable.

There is also a subtle difference between the definition of oil and gas security. Gas security could be defined as the 'guarantee that *all the gas volumes demanded* by customers will be available at a reasonable price'.¹⁷ Oil security means 'reliable and adequate supply of energy for a reasonable price'. The difference between these two definitions is that gas security necessitates the satisfaction of demand without necessarily emphasising the adequacy of gas supplies in all sectors. If one particular sector normally uses gas, but gas cannot be obtained, then it can be substituted by other fuels, such as coal or oil. The same does not apply to oil as there are sectors, such as the domain of transport in the European Union, in which oil is the dominant source of energy and no other energy can currently substitute for it. Consequently, if there is no oil reaching that sector, the sector cannot function. In this case, as the oil market is a global market, a major shock anywhere in the world will be felt throughout the world oil market. This characteristic has prompted some to suggest that even if an energy-producing country could magically and inexpensively raise its domestic output to eliminate total imports, a shock in the world oil market will nonetheless affect its domestic price and threaten the stability of its economy. Therefore, efforts to combat oil insecurity should also be made at the global level.

¹⁶ For an explanation of the crisis, see J Stern, 'The Russian–Ukrainian Gas Crisis of January 2006', OIES publication, January 2006, <<http://www.oxfordenergy.org>> [hereinafter 'The Gas Crisis of January 2006'].

¹⁷ See G Luciani, 'Natural Gas Markets', above n 2. See also the interview with Susan Ruth, the Senior Director of the Cambridge Energy Research Associates (CERA) on Energy Security, at <<http://www.cera.com/multimedia/details/1,7706,00.html>>. See also R Skinner, 'Energy Security and Producer-Consumer Dialogue: Avoiding Maginot Mentality', background paper for Government of Canada Energy Symposium on 'Energizing Supply: Oil and Gas Investment in Uncertain Times', 28 October 2005. See also CERA Global Energy Watch Report, 'Energy Security Tops the Political Agenda', Autumn 2005, and CERA Special Report by D Yergin, 'Ensuring Energy Security', March 2006, and CERA Insight by D Yergin, 'What Does Energy Security Really Mean?' July 2006.

At the European level, the concept of energy security is defined by the European Commission in a similar fashion. The Commission states:

Energy supply security must be geared to ensuring the proper functioning of the economy, the uninterrupted physical availability at a price which is affordable while respecting environmental concerns. Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence, but aims to reduce the risks linked to such dependence.¹⁸

As this definition shows, there are risks associated with dependence. These risks should be verified and the means to reduce them analysed. It is also important to determine the organs responsible for eliminating these risks in the European Union. Are these organs the Member States, the European institutions, private market players or all of the above? These issues are dealt with in the next section.

1.2. ENERGY SECURITY: PERSPECTIVES ON DEMAND, SUPPLY, AND RISKS

1.2.1. Perspectives on Demand and Supply

In order to guarantee energy supply, it should be determined precisely which events are considered as risks and how they should be responded to. Each risk necessitates a different response. It should also be specified what obligations should exist where risks arise, who should be responsible to enforce these obligations and how costs should be allocated.¹⁹ It is also necessary to verify whether obligations should be 'imposed' on market players by the governments or the institutions of the European Community or whether it should be fully left to the market to weaken the security consequences of any particular risk. The reason for such concern is especially relevant in the case of the European market and the involvement of the European Community institutions in regulating market behaviour (lesser in one sector and greater in another), by imposing rules and regulations on governments and other market players. Although the existing market is not a traditional one where monopolists decide how to secure energy supply for their customers at a specific price, it should still be determined whether energy security must be fixed not only by collaboration of governments,²⁰ firms and customers, but also by the Community institutions. There was a reluctance, which to some extent remains, to empower the Community

¹⁸ See Commission (EC), 'Towards a European Strategy for the Security of Energy Supply' (Green Paper) COM (2000) 769 Final [hereinafter Green Paper on Security].

¹⁹ See Stern, *Gas Security*, above n 2, at 6.

²⁰ Some expect that in a liberalised and competitive market governments have fewer roles to play. However, to describe the energy market as a competitive one, just like any other industry, is mistaken because the government is a major player in the energy market influencing prices, production and capital structure. See D Helm, 'Energy Policy: Security of Supply, Sustainability and Competition' (2002) 30 *Energy Policy* 173 at 174. He believes that 'the idea that governments could simply retreat

institutions to interfere with the energy security mechanisms of the Member States, mainly due to the strategic nature of energy and its immediate link to the economic development of these countries. As the next chapter demonstrates, the late appearance in the 1990s of Community laws tending to harmonise the energy laws of Member States explains the ongoing struggle between the Member States and the European Community in keeping matters of energy security outside the ambit of the Community's activities. This struggle still exists and will be elaborated in detail in the discussion on the division of competences.

Before analysing these various risks, three issues should be mentioned here. First, this study will not analyse the security issue from a purely economic point of view. There are comprehensive analyses undertaken by economists on how markets work in order to guarantee a risk-proof society. This study deals only with the European law dimension of energy security, and examines how the law could be shaped to help guarantee such security.

Secondly, risks that threaten the security of energy supply are generally classified in two broad dimensions, only one of which is analysed in this study.²¹ The first category deals with those risks that endanger short-term supply availability, and sorts out various problems, such as bad weather conditions, seasonal stresses and other operational problems, which are technical in nature. The second category looks at long-term supply objectives and strategic risks of failure in major supply sources, transit and facility. This study only looks at the second category because it is in this category that the European Union's external relations with energy suppliers—the main focus of this study—become important.

Thirdly, the policy on security of energy supply can be divided into two different categories: security measures on the demand side and those on the supply side.²² This study deals extensively with the supply side security. Demand side security, briefly described, involves measures of energy saving, energy efficiency, rules on taxation on energy products, state aid rules, rules on subsidies, etc. These measures tend to regulate demand. The belief is that demand management will play a very important role in reducing energy dependence and therefore will contribute to security of energy supply. On the other hand, the supply side security deals with measures for guaranteeing access to energy, wherever it is situated. When energy projection forecasts increased demand in the European Union and when the domestic energy supply decreases (ie the energy supply of those countries within the borders of the European Union, such as the UK, Denmark and the Netherlands), there is a need to rely on supplies from third countries outside the boundary of the EU. In relation to this dependence, the security of energy at the supply side becomes relevant.

from the scene and leave it to competitive markets is an illusion and energy is just too important to the economy and society and it suffers from market failure'.

²¹ See also Stern, *Gas Security*, above n 2, at 6.

²² See also Green Paper on Security, above n 18.

Security on the demand side is a very important component of what can be termed as 'internal security of European energy supply', and studying the management of energy demand that is undertaken at the Community level is an example of this kind of policy. Measures at the level of the Community on energy efficiency, for example, require Member States to develop and implement energy savings in the residential, tertiary and industrial sectors through various measures such as certification of buildings, billing of heating and cooling costs according to consumption, third party financing in the public sector, thermal insulation of new buildings, energy audits of energy intensive industries etc. Taxation measures are designed to guide demand towards better-controlled consumption, and the removal of subsidies on the use of some energy sources seeks to reduce the use of fossil fuel energies, permitting it only in situations where the use of that energy source is absolutely necessary.²³ The Community analyses the effect of these measures on the level of demand on an ongoing basis.

However, the demand management strategy should not be regarded as the only measure to guarantee energy security. Energy security is not only about internal security. This issue should be made clear in any study on energy security,²⁴ because internal and external security of energy supply (demand and supply from external sources) are equally important for analysing security in Europe. Overall, success on the demand side,²⁵ in terms of advancing technology for efficient use of energy, etc., does not reduce the importance of supply side security, and success cannot be achieved without taking external risks into consideration.²⁶ As a matter of fact, any discussion on internal energy security from the point of view of an energy-dependent country or region becomes incomplete if the external aspect is not referred to as one part of this security, since the internal management of energy is only relevant when efforts are equally concentrated on how this energy should flow into a specific country or region in the first place. Focusing only on internal energy security becomes justified only when dependence on outside sources is vastly reduced, which would only happen

²³ See also V Costantini and F Graceva, 'Oil Security: Short- and Long-Term Policies', INDES Working Papers, 2004 at <<http://ideas.repec.org/p/fem/femwpa/2004.115.html>>.

²⁴ For a different approach where energy security is dealt with merely from an internal perspective see C Egenhofer and T Legge, *Security of Energy Supply: A Question for Policy or the Market* (Brussels, CEPS, 2002).

²⁵ JV Mitchell believes that the link between policies to reduce demand and to increase security is ambiguous. It is unclear whether demand policy would affect the risks involved in procuring energy. He suggests that if there is a stringent policy to reduce demand, a restricted market will be created which will in turn result in the low price of energy for oil producers, and exporters' interests may lead them to a closer relationship with an unrestricted market, ie going away from the market of developed countries. Such a result would run counter to EU policy which seeks to guarantee close relations with energy-producing countries in order to guarantee security of supply and promote international trade. See JV Mitchell, *Renewing Energy Security* (London, RIIA, 2002) at 15–18.

²⁶ The whole issue of security of supply depends also on the extent to which renewable energy, clean coal technology and nuclear will dominate the market. In this case, the degree of importance of the security measures, detailed in this study will be to some extent reduced, depending on success in the use of alternative energy sources.

if and when the use of renewable sources of energy or other alternative sources becomes dominant. In other words, Europe needs to look at both aspects, even if its policy aims at reducing import.²⁷ This is especially important as energy demand and supply are strongly intertwined. The major components of 'energy security' being mentioned, this study places greater emphasis on the supply side and touches upon the demand side security only when necessary.

Generally, it is difficult to determine with certainty whether existing security arrangements or any proposed security policy is adequate. The reason for this uncertainty is because it is impossible, for example, to predict the timing, magnitude, or duration of energy crises, and it is difficult to assess the impact of any given supply loss. It is therefore not clear to what extent any measure will be effective.²⁸ This is exactly why theories on energy security are diverse. What should be done, however, is to assess whether security measures are adequate, based on the minimum reliable data one can access. For example, if it is said that supply diversification (a principle suggesting that one source of energy supply or one energy-producing country should not be relied upon, and dependence should be distributed between many energy sources and various countries or regions) is necessary to guarantee security, it is not clear whether such diversification would work properly at a time of crisis. Nevertheless, as diversification is considered to be one element of energy security, it should be analysed in detail. The aim is therefore to guarantee a minimum level of security.

In addition, in order to identify the best security measures, the risks associated with various aspects of energy security should be revealed. As mentioned earlier, there is no general consensus regarding which risks are more relevant for security reasons, but here the intention is to touch upon those that are frequently referred to in discussions among energy experts and that form the common denominator of various theories on this issue.

1.2.2. Elements of Risk

A useful categorisation of the risks associated with gas security is provided by Jonathan Stern and his classification is adopted by many. He analyses the most relevant risks that should be taken into consideration in designing a policy for such security.²⁹ Although he focuses exclusively on gas, the same categorisation is

²⁷ It is important to add here that some commentators believe that policies on climate change also affect demand and fuel choice and therefore security. However, as one writer argues, 'demand policies are unlikely to affect energy security in the short to medium term. If one reduces the use of electricity in OECD countries, it will have little or no effect on the consumption or import of oil and, therefore, on the risks of price fluctuations and interruptions of oil supply. Reducing the use of oil in transport may reduce oil imports but will have little effect on the security of electricity supply'. See Mitchell, *Renewing Energy Security*, above n 25, at 7.

²⁸ See J Bielecki, 'Energy Security: Is the Wolf at the Door?' (2002) 42 *Quarterly Review of Economics and Finance* 235 at 242.

²⁹ For a comprehensive study on gas security measures, see Stern, *Gas Security*, above n 2.

to some extent relevant for oil. This similarity will be highlighted when necessary in the following section. These aspects are: (1) reserve depletion, (2) the structure of supply contracts, (3) the investment regime, (4) the insecurity of energy sources, (5) the insecurity of energy transit routes, and (6) the insecurity of energy facilities.³⁰

1.2.2.1. *Reserve Depletion*

Available information provided by competent organisations, such as Energy Information Administration or the International Energy Agency, enables us to make a tentative judgment as to when reserves in the world will run out. The mere fact that fossil fuels will be depleted eventually is common knowledge but the speed at which this will occur is subject to controversy.

Determining when reserves will run out is the result of scientific calculations.³¹ In such calculation, both the proven reserves and the rate of production from that reserve are looked at and the number of years these reserves can be used, before they are exhausted, is determined (Reserve to Production or R/P ratio). In other words, the Reserves/Production ratio is the quantity of proven reserves divided by production in the last year, and the result will be the length of time that those remaining proven reserves would last if production were to continue at the current level. For example, if the proven reserves of Saudi Arabia are said to be 35983 million tons, and the rate of production from these reserves is said to be 409.6 million tons, the R/P ratio shows that Saudi Arabia will continue to produce at this level for another 87 years.³² This figure will change if the production rate changes or if new reserves are explored. Through this system, with which some disagree,³³ a very vague idea can be deduced of the speed at which indigenous production will decline.

As a result of the depletion of conventional energy sources, the role that non-conventional oil can play in the discussion on energy security has also been

³⁰ *Ibid.* at 6.

³¹ Some also talk of an 'oil peak' by which they mean that oil soon reaches a production peak. They argue that when production ceases is dependent on various unknown factors such as refining capacity, OPEC production capability, the amount of strategic oil stocks, security of energy facilities, energy demand etc. They also argue that if there is adequate energy in the reservoir, the cost of extraction and the price of energy also play an important role in determining the level of production. Higher prices and lower costs allow more extraction of oil, and as these two factors are never clearly established, the argument on when exactly oil production ceases continues. The greater the belief in an oil peak, the more effort should be made to use other sources of energy, such as renewable sources, to guarantee security.

³² See the extracts from the survey of energy resources of the World Energy Council on Saudi Arabia at <<http://www.worldenergy.org/wec-geis/edc/countries/SaudiArabia.asp>>.

³³ Some suggest that 'historical data, that shows reserve-to-production ratios, should not be interpreted as determinant of the number of years before reserves run out because they lead to inaccurate judgment. See Stern, *Gas Security*, above n 2, at 8. See also A Aissaoui, 'European Strategy for the Security of Energy Supply: Re-evaluating Relations between the EU and the Producers and Transit Countries of North Africa', *Middle East Economic Survey*, vol XLV, no 15 (2002)

highlighted. Non-conventional oil is the oil from oil shale, tar sands, oil in very hostile environments and heavy oil. This type of oil is difficult and expensive to extract, and depending on the future technologies that facilitate such extraction, its importance becomes relevant for energy security reasons.

The R/P ratio shows that indigenous European production will decline over the next two decades and imports will therefore rise. This deduction is more difficult in third country suppliers of energy, which lack efficient technologies to fully predict the capacity of reserves of a given country, or where there is no transparency in the data they provide. This lack of knowledge about the exact capacity of a country to produce oil and gas in the long run complicates the whole demand and supply analysis based on this ratio. These vague deductions have only been of help in clarifying the necessity of some 'minimum' security measures.

The importance of the criterion of 'reserve depletion' of oil and gas has been highlighted in discussing the need to use alternative renewable sources of energy, such as hydroelectric power, geothermal, wind, photovoltaic, and solar thermal energy, in order to lessen the degree of dependence on fossil fuel energy gradually. However, a shift from one source of energy to another is not solely the result of the depletion factor, because other factors, such as geopolitics, competition between oil and gas and other alternative sources, and technological matters, clearly interfere in such a decision. For example, it is axiomatic that the use of solar energy rather than oil or gas is highly recommendable but for the moment in some sectors where oil is the dominant source (eg transport), solar energy cannot be used, or the costs of gas-fired electricity is cheaper than generation costs of solar power plants.³⁴ As there are obstacles to substituting fossil fuels, regardless of whether they are exhaustible in the long run, these sources of energy continue to dominate various sectors. Hence, there is no strong link between lessening the dependence on oil and gas imports and the depletion factor. Nonetheless, the tendency to refer to the 'depletion' factor as a 'security' factor is common among those who advocate the use of alternative energy.

1.2.2.2. *The Structure of Supply Contracts*

It is important to ascertain next how to effectively and efficiently mobilise energy reserves and how to bring the required volumes of energy to European markets.³⁵ In this respect the type of supply contracts is considered as an important element in analysing this efficiency.

³⁴ See the IEA Study, *Projected Costs of Generating Electricity* (Paris, IEA, 2005). Photovoltaic-generated electricity (energy from the sun) is 'usually 10 times more expensive than that generated by old coal-fired plants; four times more costly than natural gas units; twice as expensive as nuclear; and three or four times more costly than wind energy'. See cover story 'Power from the Sun', (June 2004) *Chemical and Engineering News* at <<http://pubs.acs.org/cen/coverstory/8225/8225solarenergy.html>>.

³⁵ W Czernie, 'Security of Gas Supply and Long-Term Contracts', presentation at the IEA Regulatory Forum, Paris, 7–8 February 2002.

Energy operators have for many years taken advantage of their monopolies in undertaking their activities, and they were dealing with issues of security of supply. The question whether monopolies bring more security to customers has always been a subject of intense debate.³⁶ It was undeniable, however, that monopolies could balance the sources of supply with the requirements of customers, and they would create a degree of confidence, something that was thought to be lost in a liberalised market.³⁷ Monopolies did not have to worry about competition from alternative suppliers of the same form of energy. For that reason, they could enter into long-term contracts which were able to guarantee the purchaser with constant supply availability for the duration of the contract, and the producer was assured of stable finance for its production projects. This kind of sale was therefore considered as an indispensable precondition for large investments and the transport of a large volume of energy. On the other hand, everything had to be directed to ensuring that demand was always adequate to sell the energy.

The International Energy Agency has described the importance of this type of contract for natural gas, by stating

[t]here is no doubt that the type of contract concluded in the past has provided a good basis for securing gas supplies in Europe in general and in particular that it has been instrumental in providing the basis for developing new gas supply projects in a situation where the gas has been introduced into new countries or has seen rapid expansion in existing markets.³⁸

The liberalised market in Europe is already complicating long-term contracts on the part of distributors and transporters.³⁹ The Gas Directive 98/30/CE, Electricity Directive 96/92/CE, and their follow-up directives⁴⁰ ended monopolies in transport, distribution and sale, at least with regard to eligible customers, ie customers that are free to purchase gas from the supplier of their choice.⁴¹

³⁶ Eg some believe that in liberalised markets, short-term profitability is found to be the principle, and storage of stocks or any other security measure will not be automatically undertaken by energy operators if they cannot pass the costs to customers. On the other hand, they also believe that an unregulated market could lead to supply surplus and price collapse. This market is also incapable of being prepared for security events of low probability but high impact. On the other hand, the advantage is that signals are sent and supplies are efficiently allocated in the short-term and as long as costs can be passed to consumers. See Stern, *Gas Security*, above n 2, at 24.

³⁷ G Coop, 'Long-Term Energy Sale Contracts and Market Liberalization: Are They Compatible?' at <<http://www.dentonwildesapte.com>> (5 November 2002).

³⁸ See *The IEA Natural Gas Security Study*, above n 13.

³⁹ See in general, PJ Slot, 'The Impact of Liberalization on Long-Term Energy Contracts' (2000) 1 *Journal of Network Industries* 287.

⁴⁰ See Dir 2003/54/EC of the European Parliament and of the Council of 26 June 2003, concerning Common Rules for the Internal Market in Electricity and Repealing Dir 96/92/EC, [2003] OJ L/176/37. Also see Dir 2003/55/EC of the European Parliament and of the Council of 26 June 2003, concerning Common Rules for the Internal Market in Natural Gas and Repealing Dir 98/30/EC, [1998] OJ L/204/2.

⁴¹ Based on Art 23 of the Repealing Gas Directive of 2003, Member States shall ensure that the eligible customers are (a) until 1 July 2004, the eligible customers as specified in Art 18 of Dir

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Moreover, eligible customers can satisfy their requirements through operators, transporters or distributors. This possibility of switching between the three threatens transporters and distributors, as they cannot be sure that the volumes which they purchase through long-term contracts will be bought by the customer. This being the case, however, the preamble of the European Gas Directive of 2003 (paragraph 25) continues to emphasise the role of long-term contracts by providing:

Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objectives of this Directive and are compatible with the Treaty, including competition rules. It is therefore necessary to take them into account in the planning of supply and transportation capacity of gas undertakings.

Hence, European law does not prohibit long-term contracts outright. Their importance, as the best guarantee of supply security, is an established and accepted idea.⁴² Nonetheless, a pure application of these types of contracts, which often included some restrictive provisions that are found to have anti-competitive characteristics, was deemed problematic because they were found to have a de facto exclusive character, leading to a foreclosing effect in the market. These restrictions, such as 'own use requirements' or 'destination clauses' were found to lead to an artificial segmentation of a particular European market. The destination clauses restrict the freedom of the buyer to re-sell the oil or gas. For example, the buyer could be prohibited from purchasing from other producers (exclusive purchase obligations) or selling the residual amount or the whole amount of energy to another wholesaler. This issue has been attacked by the Commission and was considered as an infringement of Article 82 of the EC Treaty as it is believed that it has the effect of reinforcing the already existing dominant position of a particular company in a particular Member State.⁴³ It demanded that any such contracts existing within the European Union should be

98/30/EC (Art 18 provides that eligible customers are those inside the territory of a Member State who have the legal capacity to contract for, or to be sold, natural gas in accordance with Art 15 and 16 of that Directive, given that all customers mentioned in paragraph 2 of Art 18 (ie Gas-fired power generators and other final customers consuming more than 25 mcm/y of gas on a consumption-site basis) must be included. Member States shall publish by 31 January each year the criteria for the definition of these eligible customers; (b) from 1 July 2004, at the latest, all non-household customers; (c) from 1 July 2007, all customers. Art 21 of the repealing Electricity Directive defines eligible customers in the same way as to the one described in the repealing Gas Directive, by defining them according to Art 19(1) of Dir 96/92/EC (customers representing a specific share of the national market who have the legal capacity to contract electricity according to Arts 17 and 18 of that Directive). The same time-frame mentioned in the Gas Directive also applies to the Electricity Directive.

⁴² It should be mentioned that there are arguments for and against these types of contracts. See J Stern, *Traditionalist versus the New Economy: Competing Agendas for European Gas Markets to 2020* (London, RIIA, 2001) at 3, and J Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (London, RIIA, 1998).

⁴³ See also G Kühne, 'Energy Supply Contracts and European Antitrust Law' (2002) 1 *International Energy Law and Taxation Review* 11. See also JA Rodriguez, 'New Light on an Old Issue: the

modified.⁴⁴ The volume of energy bought was reduced in order to free some part of the buying company's purchasing capacity, and ensuring its continued existence as a customer in the market.⁴⁵ Consequently, the exclusivity of the contract was loosened. Moreover, they reduced the duration of the long-term contract in order to avoid the excessive dependence of the customer on the supplier and allowed the buyer to resell the gas.⁴⁶ Hence, the type of the contract remained the same and it was only adjusted to reflect the rules of competition law.⁴⁷

Such difficulties lingered for some time at the external level, and energy-supplying countries persisted in keeping destination clauses in long-term contracts. The rationale was that they believed that they could guarantee certain control over their end markets, and 'they could deter the initial buyers to find extra value' by reselling energy on other markets where prices were higher.⁴⁸ Clearly, the existence of such clauses was creating legal problems on the part of energy companies that had included such clauses in their contracts with energy-producing countries, based on European competition law. The added problem of such clauses at the external level was that the EC's insistence on the abolition of these clauses risked leading to a less-than-adequate energy supply. This issue, therefore, had to be balanced against the importance of long-term contracts for

European Commission's Decisions, Striking down Territorial Restrictions in Gas Services and Transportation' (May 2006) 4 *Oil, Gas and Energy Intelligence*, issue 1.

⁴⁴ See, eg, the Commission's concerns over the long-term gas supply agreement between Spanish GAS NATURAL and the electricity company of ENDESA (IP/00/297 of 27/03/2000). The interest of the Commission in this case was to ensure that the gas supply contract did not allow the dominant GAS NATURAL to prolong its de facto monopoly, which for many years impeded new entry into the Spanish gas market as it began to liberalise. The Commission closed the investigation when both companies modified the terms of their agreement in line with European competition law.

⁴⁵ M Fernandez Salas, 'Long-Term Supply Agreements in the Context of Gas Market Liberalization: Commission Closes Investigation of Gas Natural', *Competition Policy Newsletter* of 2000 on 'Liberalization and State Intervention: Application of Art 90 EC and Main Developments between first of February and thirty first of May 2000' at <<http://europa.eu.int/comm/dg04/newsle/en/index.htm>>.

⁴⁶ One type of long term contract is 'take-or-pay contracts'. The obligation of the buyer under the normal take-or-pay provision is either to take delivery of the amount of not less than a specified minimum quantity, or otherwise pay for the shortfall of that quantity from the already agreed minimum quantity over a specified period. Eg the contract obliges the buyer to take 80% of the delivery and if the buyer is not capable of finding customers for that amount and therefore decides to take only 50% of that delivery, he/she has to pay for the 30% shortfall. These contracts are beneficial to the gas producer since they are assured of a regular cash flow for a period that is normally between 15 to 25 years. The benefit for the buyer is the availability of a long-term supply. The European Commission reduced the *take-or-pay* obligations from the traditional 80–90% to 50–60% of the purchase amount. See M Brothwood, 'The EU Gas Directive and Take-or-Pay Contracts' (1998) 8 *Oil and Gas Law and Taxation Review* 318 at 318. See also J Ejegi, 'What are the Implications of Transition from Take or Pay to Liberalization: The Case of Infant Gas Markets' (June 2005) 3 *Oil, Gas and Energy Intelligence*, issue 2.

⁴⁷ See also A Neumann and C von Hirschhausen, 'Less Long-Term Gas to Europe? A Quantitative Analysis of European Long-Term Supply Contracts' (2004) 3 *Zeitschrift für Energiewirtschaft* 28.

⁴⁸ See D Finon and C Locatelli, 'Liberalization of the European Gas Markets and its Consequences for Russia', study of the 'Institut d'Économie et de Politique de l'Énergie' at <http://www.upmf-grenoble.fr/iepe/textes/CL_DF_GasRusse_02engl.pdf>.

security reasons. The solution was found in creating a positive political environment and through long negotiations with the supplying countries to convince them to modify these clauses. These negotiations were successful with Russian Gazprom, the 'Nigeria LNG' and Algeria's Sonatrach.⁴⁹ The final solution was the maintenance of long-term contracts as the best means to guarantee security of energy supply and the abandonment of the restrictive clauses. The mutual interdependence between importing and exporting countries—the need to achieve a secure flow of energy for Europe and the need to acquire adequate technology and investment for exporting countries—was raised as the main rationale underlying the dialogue, and it was accepted as the main basis to relinquish some restrictive measures taken up by the energy-producing countries in order to boost cooperation.⁵⁰ The energy-producing countries also realised that maintaining these types of contracts is more advantageous than abandoning them altogether, as they would lose a strong source of steady finance for their future projects. It is, however, interesting to mention that the Community has only questioned restrictive clauses in long-term gas contracts and the illegality of these clauses in oil contracts was never analysed.

The explanation of the structure of long-term gas contracts demonstrated the significance of such contracts in securing a minimum level of security of supply. These types of contract have become dominant in relations between European buyers and third country suppliers of energy. Other types of contracts in the field of energy are elaborated on in chapter 5.3.2 which discusses the provisions of the Energy Charter Treaty.

1.2.2.3. *The Investment Regime*

The next issue in the traditional approach to security of energy supply is the regime of investment in the exploration and production of energy, a sector which entails huge investment. Based on mutuality of interest, the importer can strive for a strong investment regime in the country where access to energy reserves is possible and creates benefits in the sale contracts for the supplying party. For example, they could facilitate the investment through the possibility of a secure and lengthy contract that warrants long-term revenue from developing energy projects in the producing country.

⁴⁹ See also Stern, *Gas Security*, above n 2, at 10. See also J Guttuso, J Scott and S Murray, 'EU to Punish Business Practices: An EU Competition Law Perspective on Destination Clauses in LNG Contracts' (June 2005) 3 *Oil, Gas and Energy Intelligence*, issue 2. Algeria reached an agreement with the EU in January 2005 which provided that 'the EU will continue to allow destination clauses, and Algeria will share the profits of any gas sales to third parties with the original buyer'. See the EIA Country Analysis Brief, Algeria, March 2005.

⁵⁰ For example, the two sides could have joint ownership in production and transmission undertakings of energy, and energy-producing countries could invest in the downstream sector, ie investment in refining and marketing of energy products.

The best investment regime from the point of view of foreign investors is one of 'open investment', where investors can invest in the exploration and production of energy in the third country where energy reserves are found without any restrictions imposed by the host state. It is clear that having direct access to energy reserves can guarantee better energy security. However, in practice host countries tend to limit free access and make it conditional upon satisfying some of their demands such as transfer of technology and know-how from the investor's side, or the free choice of the type of investment contracts, or the degree of the state's participation in such investment. Depending on the strictness or openness of various countries towards foreign investment, these demands differ. This issue will be elaborated in discussing the investment regime of the Energy Charter Treaty later in this study.

As Jonathan Stern emphasises, it is clear that the actual need for such investment in countries which possess energy reserves should first be verified. Based on his study, there are projects for which huge investment is needed in various producing countries, such as the unexplored gas reserves in the Middle East or the Caspian region, the exact amount of which would be revealed after a lengthy feasibility study. It is equally important that investors have access to the infrastructure projects of the exporting countries and establish contracts with these countries with 'reciprocity clauses' that enable exporting countries' companies to invest in importing countries' infrastructure projects as well.⁵¹ Through reciprocity and allowing energy-producing countries access to the downstream sector of the importing countries (ie investment in refineries, the transport and distribution sector, the various energy-related industries such as the petrochemical industries etc) they could also guarantee access to the energy reserves. In any case, as the starting point, it is imperative to determine the necessary investment in the energy sector of producing countries, and explore the desire of an energy-producing country to invest in the downstream sector of third countries.⁵² The next section of this chapter discusses three issues related to import dependency namely, insecurity of energy sources, of transit routes and of energy facilities.

⁵¹ See Stern, *Gas Security*, above n 2, at 11.

⁵² On the desirability of vertical integration as a strategy for oil security see G Luciani and M Salustri, 'Vertical Integration as a Strategy for Oil Security' and MA Al Moneef, 'International Downstream Integration of National Oil Companies' in P Stevens (ed), *Strategic Positioning in the Oil Industry: Trends and Options* (Abu Dhabi, The Emirates Center for Strategic Studies and Research, 1998). They argue that the engagement of national oil companies in the downstream activities (refining and marketing) is desirable because it injects cash into a refining industry in dire need of restructuring; it fosters competition in the final product market and it enhances supply security for the end consumer. It should, however, be mentioned, that not all energy-producing countries can be involved in downstream activities because of differences in resource endowments.

1.2.2.4. *Import Dependency*

Dependence on energy⁵³ imported from outside the borders of the European Union necessitates the adoption of security measures to create diversified, flexible and reliable external sources of energy.⁵⁴ In reading the following discussion, it should be kept in mind that one cannot consider the increased dependence on imports to be necessarily a threat to security of supply since it is possible to have high dependence on energy without any supply risk.⁵⁵ Furthermore, independence from imports is not at all a guarantee of security of supply. Therefore, what energy experts emphasise is that import is an element of the *security framework*, and not an element of the *security problem*.⁵⁶

1.2.2.4.1. *Insecurity of Energy Sources*

The diversity of choices between different regions and different countries that produce energy is a component of energy security, since the 'more diverse the supply source, the smaller the proportion of supply that could conceivably be interrupted'.⁵⁷ In other words, if Europe is dependent on one country as its source of energy supply, a little disruption in the energy supply from that country could greatly jeopardise the economy. Therefore, the idea is to rely on various sources in order to be able to switch from one to another at times of difficulty.

It should be briefly added here that this diversity of sources should be handled with great care. Diversification of sources of supply is a long-term security measure and it is very important to keep in mind that the lack of a balanced approach to various sources (relying on one source much more than another) might also have adverse effects on the situation of energy producing countries.

⁵³ For a historical analysis of the rationale for import control from an economic perspective, see DR Bohi and M Russell, *Limiting Oil Imports: An Economic History and Analysis* (Baltimore, The Johns Hopkins University Press, 1978).

⁵⁴ For an economic analysis of the link between supply security and import diversification see, M Hoel and S Strom, 'Supply Security and Import Diversification of Natural Gas' in R Golombek and M Hoel, *Natural Gas Markets and Contracts* (Amsterdam, Elsevier Science Publishers, 1987).

⁵⁵ The European Parliament had underlined this issue by saying that being dependent on imports is neither necessarily a bad thing nor economically inefficient provided the sources are diverse, no one supplier is dominant and we can produce sufficient goods and services to pay for them . . . We cannot alter the fact of where the oil comes from, but we can do a number of things on the demand side, in particular in the transport sector.

European Parliament, Committee on Industry, External Trade, Research and Energy, 25 July 2001, Provisional 2001/2071(COS).

⁵⁶ See G Luciani, 'Natural Gas Markets', above n 2, at 5. Some even believe that decreasing imports as a measure to create more security is a denial of exporters' expectations to have a constant flow of revenue from their energy sales and it also runs against the whole trend of modern international economic relations where the expansion of relationships between importers and exporters is encouraged. See JV Mitchell, 'Energy Supply Security: Changes in Concepts', the text of the presentation to the 'seminaire Européenne sur la Sécurité d'Approvisionnement Énergétique, Ministry of Economy, Finance and Industry, Paris, November 2000 [hereinafter 'Energy Supply Security'].

⁵⁷ See *IEA Study on Natural Gas Security*, above n 13, at 28.

Emphasising merely two sources of energy, for example Russia and Turkmenistan, could create instability in the long-term planning of other energy-producing countries, where the sale of energy is important for the domestic economy. Some commentators rightly believe that promoting a diversification of sources, for example, from the Middle East to other sources of supply, such as Russia, or vice versa, could render the Middle East or Russia both politically and economically vulnerable, and would in turn lead to small energy crises or energy shocks.⁵⁸ Most energy-rich countries are 'rentier states', ie their economy is dependent on energy revenues. Too harsh an attempt at decreasing dependence on a particular energy-rich region could thus lead to the instability of the region as a whole because of a drop in income, eventually affecting the world economy. Although diversity should continue to be an energy security objective, a smooth and balanced approach rather than a radical decrease in dependency on one country or region (if at all possible) should be pursued. This is especially the case if the energy-producing country is also dependent on one country or region for the export of its domestic energy.

Europe's actual dependence on each energy-rich country or region is not known with certainty. In order to determine whether there is sufficient diversity, the most readily available information is the contractual diversity of sources.⁵⁹ At the moment, Europe is poorly contractually diversified for gas supply. For gas imports, there are only Norwegian, Algerian and Russian gas supplies through pipeline or Liquefied Natural Gas (LNG) to satisfy the gas demand of Europe.⁶⁰ It is claimed that for security of supply reasons, reliance on Russia, for example, should be lessened through diversifying to other sources, such as countries in the Caspian or from one company in Russia, such as Gazprom, to other companies in the same country (the competition between which has recently become stronger). For oil, diversification is better guaranteed as Europe is linked to a larger number of countries for oil imports (see table 1.1 above).

The question remains as to which institution or body in Europe should guarantee diversification. Could each Member State guarantee this? Should responsibility be given to the institutions of the European Community to deal with energy suppliers and pave the way for a secure relationship between the European companies and their suppliers? This question touches upon the issue of competences of the Member States and the Community institutions, which will be discussed later in this study. It suffices here to say that Member States should be able to fully and efficiently undertake security measures that they deem fit for

⁵⁸ See particularly P Noël, 'Pétrole et sécurité internationale: de nouveaux enjeux' (1998), at <<http://www.upmf-grenoble.fr/iepe/textes/Noel98.PDF>> at 12 [hereinafter 'Pétrole et sécurité internationale'].

⁵⁹ See Stern, *Gas Security*, above n 2, at 13.

⁶⁰ Liquefied Natural Gas or LNG is a product available after cooling natural gas to a temperature of -60° Celsius. It then becomes a liquid occupying 1/600th of the volume of natural gas in a gaseous state. In this state, natural gas can be shipped at normal atmospheric pressure to markets all over the world where it is re-gasified and distributed through pipeline. See also <<http://www.lngfacts.org>>.

the purposes of their country's security of energy supply, but there should exist a standard European security framework,⁶¹ at least in the form of guidelines, for each Member State to refer to. Standards can at least ascertain the consequences of a supply emergency for all Member States of the Community alike and establish proposals. These guidelines should also highlight the importance of a cautious approach to the issue of diversity of energy sources. The sharing of responsibilities between the Member States and the European institutions for securing energy supply will be discussed in detail later in this study.

1.2.2.4.2. Insecurity of Transit Routes

The other important aspect of energy security is the diversification of transit routes. Security cannot be guaranteed by mere diversification of sources. The flow of the energy from that source into Europe under sound economic and commercial conditions should also be assured.

Transit of energy to Europe is carried out either through pipeline of oil and gas, oil cargo, or in the form of Liquefied Natural Gas (LNG) transported by tankers. The main problem is that gas and oil are transported across many countries before they reach Western Europe.⁶² From Algeria, gas travels through Morocco to reach Spain or through Tunisia to reach Italy. From Russia it passes through countries in the Baltic region or Ukraine, and from the Caspian region it goes through Azerbaijan and Georgia, or through Turkey and the Balkan region. The political instability of these countries across which energy should flow could also hinder the development of a secure energy stream. This aspect of energy security should, therefore, also be taken into consideration.

Wherever transport of gas by ship is possible (both practically and economically), gas flow through pipeline has been substituted by LNG, which is considered as a more stable means to transport gas.⁶³ It is said that through this flexible mechanism, ie substituting one mode of gas or oil delivery to another, more security can be obtained. LNG projects can be expanded in a relatively short time and sources of imports can be diverse and flexible.⁶⁴ Although this

⁶¹ Security measures are costly and it is possible that certain operators neglect these measures to reduce costs if no agreed minimum standard applies. See also Proposal for a Directive of the European Parliament and the Council concerning Measures to Safeguard Security of Natural Gas Supply, COM (2002) 488 Final.

⁶² For an interesting historical perspective on gas pipeline development in Europe during the 1970s and 1980s, see J Stern, 'Gas Pipeline Cooperation between Political Adversaries: Examples from Europe', Chatham House, January 2005.

⁶³ LNG is increasingly becoming a viable business for importers. The flexibility that the LNG transportation offers, as opposed to fixed gas pipelines, has become attractive for exporters because they can send ships carrying LNG anywhere.

⁶⁴ However, as LNG is transported by ship it embodies the inherent risk of being lost at sea due to accidents, which will in turn raise environmental concerns. See also MT Burr, 'The Geopolitical Risk of LNG' (May 2006) 4 *Oil, Gas and Energy Intelligence*, issue 1. See also PR Weems, 'Evolution of Long-Term LNG Sales Contracts: Trends and Issues' (May 2006) 4 *Oil, Gas and Energy Intelligence*,

flexibility⁶⁵ and the use of LNG rather than pipelines is very expensive,⁶⁶ or sometimes practically or economically impossible to establish, it could be considered as one major objective to be pursued and further financed in the long run if it becomes clear that security could be more efficiently guaranteed in this way. Efforts are undertaken on a constant basis to enhance the use of LNG exports from those energy-producing countries with immediate access to the open seas.⁶⁷

With respect to oil, transit takes place through pipelines or carriage at sea. The latter, however, creates some environmental concerns, such as the 2002 incident where fuel from a single-hulled tanker called 'Prestige' was spilt off the Galician coast of Spain. For that reason, there are proposals to ban the use of some types of tanker which were proven to be inefficient in guaranteeing full environmental protection.

Normally, the security of oil flow through pipelines should be guaranteed both in the territory of the supplying countries and through the transit countries. One recent example of such security is the explosion of oil pipelines and facilities in the territory of Iraq, one of the most important oil exporters in the world, which started in June 2003 in the aftermath of the US attack and lasted for quite some time. These attacks were offset by a rise in oil production in other countries, which lessened the immediate effect that these attacks could have on the oil prices, and also through fast repairing of the pipelines. If this had taken longer, some believe it could have had adverse effects on the world market as a whole.⁶⁸

Considering these problems, the more important option would be to assist supplier and transit countries in creating a more stable environment for energy flow across their territories. Energy dialogue, which would have as its starting point a programme to assist the infrastructure development of those countries, and the creation of a legal framework to structure this relationship as its second step, would create an efficient system of security on the supply side. Such dialogue should recognise the reciprocal rights and obligations of importing and exporting countries and enable them to make long-term commitments.

Some steps have already been taken in this direction at European level. First of all, the process of enlargement is itself contributing to the security of energy supply as some of the previously important transit countries of Central and Eastern Europe have become members of the European Union since May 2004

issue 1. See also T Newendorp and X Wang, 'LNG Boom: Middle East and Africa: New LNG Trade, Issues and Impacts' (May 2006) 4 *Oil, Gas and Energy Intelligence*, issue 1.

⁶⁵ For an extensive study on the evolution of flexibility requirements in OECD countries see IEA study, *Flexibility in Natural Gas Supply and Demand* (Paris, IEA, 2002).

⁶⁶ For a study on the role of LNG in Europe see 'The Role of Liquefied Natural Gas in the European Gas Market', the study by Clingendael International Energy Programme of June 2003, at <<http://www.clingendael.nl>>. See also JT Jensen, 'The LNG Revolution' (2003) 24 *Energy Journal* 1.

⁶⁷ LNG liquefaction facilities in the world are situated (as of August 2005) in Algeria, Australia, Brunei Darussalam, Egypt, Indonesia, Libya, Malaysia, Nigeria, Oman, Qatar, Trinidad, UAE and the USA.

⁶⁸ See, eg, 'Two Pipeline Blasts Halt Oil Exports at Top Iraq Port' in *New York Times* (16 June 2004).

(such as the Czech and Slovak Republics, Latvia, Lithuania and Estonia). The expansion of the basic principles of free movement of goods and services to these new countries will better guarantee an uninterrupted flow of energy through their territory. Moreover, the Euro-Mediterranean partnership, with the primary aim of attracting Mediterranean partners to a free trade area by 2010, would directly contribute to the economic development of Mediterranean countries and in turn provide a stable political environment in which security can be guaranteed.⁶⁹ In addition, the EU is encouraging countries to implement the Energy Charter Treaty⁷⁰ and the Energy Charter Transit Protocol, which creates common rules for investment, trade and transit rights. The EU initiative of October 2000 for the EU–Russia Energy partnership also aims to improve the legal and security framework for investment in energy transportation projects, linking Russia and the EU.⁷¹ In addition, the EU's technical assistance programme of 'Interstate Oil and Gas Transport to Europe' (INOGATE),⁷² provides funding for the rehabilitation of existing oil and gas pipelines, and the construction of new ones, in those countries that are members of the 'Umbrella Agreement'. This Agreement came into force in February 2001 and 'sets out an institutional and legal system designed to rationalise and facilitate the development of interstate oil and gas transportation systems and to attract the investments necessary for their construction and operation'.⁷³ More detail on this programme is provided in the discussion below on transit in the framework of the Energy Charter Treaty.

⁶⁹ See also N Ait-Laoussin, 'The Impact on the Mediterranean of European Gas Market Liberalization Process: A Producer's Perspective', Policy Papers of the Robert Schuman Centre for Advanced Studies, European University Institute, 2002/06.

⁷⁰ The relevance of the Energy Charter Treaty to the discussion of energy security will be discussed in a separate chapter. See ch 5.2 below.

⁷¹ See <http://europa.eu.int/comm/energy_transport/en/lpi_en_3.html>.

⁷² The INOGATE Programme helps meet these challenges by providing: (1) an intergovernmental mechanism possessing adequate technical assistance resources for identifying, assessing and developing both existing energy networks and new strategic pipeline routes; (2) minimizing the non-financial risks of investing in interstate projects through implementation of the INOGATE Umbrella Agreement; (3) helping to promote interstate projects for the attraction of large-scale investment from both multilateral international financing agencies and private industrial investors with the best possible terms for the INOGATE beneficiaries through the key element of reduction of risks undertaken and the corresponding minimization of the profit and guarantee margins required for these investments; and (4) focusing on commercial considerations affecting the development of interstate hydrocarbon networks and assisting in the creation of a stable institutional and legal framework upon which such networks may be structured. For more information on this programme, see <<http://www.inogate.org>>. G Luciani believes that the effectiveness of the efforts undertaken under this programme has been limited because investments for these projects are deemed to be undertaken by major energy companies and in case they do not sponsor them, the EU does little to make them happen. See Luciani, 'Natural Gas Markets', above n 2, at 15.

⁷³ The contracting parties of the Umbrella Agreement are: Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Georgia, Greece, Kazakhstan, Kyrgyzstan, Latvia, FYR of Macedonia, Moldova, Romania, Serbia and Montenegro, Slovak Republic, Tajikistan, Turkey, Turkmenistan, Ukraine, Uzbekistan. See also the INOGATE website at <<http://www.inogate.org/html/brief/brief4.htm>>.

1.2.2.4.3. Insecurity of Energy Facilities

The next subject in the category of security measures is security of energy facilities, such as production and transmission facilities. As mentioned by the International Energy Agency, ‘perhaps the biggest risk of prolonged interruption comes from the destruction of a major production or processing facility or a deep water pipeline whose replacement might take many months to build’.⁷⁴ The diversity of transit, as a security measure, would inevitably lead to the need to diversify facilities due to which the creation of new facilities at each new transit border may become necessary.

The explosion of any transmission facility, or any other accident in key import facilities, would jeopardise the security of supply especially in the peak demand season. Reliance on one plant is dangerous and building new ones is very costly. Furthermore, it is not clear whether market players would be willing to bear the cost of building these facilities in a competitive market. Hence, issues of technical risks and how quickly infrastructure can be replaced become important as markets liberalise and become more competitive.⁷⁵ We can recall the power failures in some of the largest economies of the Western European region such as in England in 2003 when London experienced an electric power outage (due to the installation of the wrong type of fuse in the backup protection equipment), or in Italy in 2003 where a power failure caused by falling trees cut off electricity in the whole country for 18 hours. It is thus necessary not only to closely supervise the energy facilities, but also to guarantee diversity in these facilities so that the failure of one does not result in catastrophic situations. This supervision can more easily take place within the boundaries of Europe but it is equally important to guarantee the protection of such facilities outside the boundaries of Europe too. Close cooperation with third countries becomes important in this respect. This issue therefore again falls within the ambit of the Union’s external relations with third countries to guarantee security of supply. The basic framework and the necessary initiatives to guarantee such security will be elaborated in detail in the following chapters of this study.

The enumerated security concerns related to import dependence, that is sources, transit and facility, show that the risks involved can also be political in nature—they concern the relations of the government with the origin of these ‘sources’ or the territory through which a transit takes place or a facility is situated. To use the words of Giacomo Luciani, ‘even if the transmission facilities do not fail, gas supplies from a given source country, or through a given transit country can only be restricted because of the sovereign decision of the relevant government’.⁷⁶ Therefore, at one end of the energy chain there is a strong

⁷⁴ See the International Energy Agency, *World Energy Outlook*, no 3, March 2002 (Paris, IEA, 2000).

⁷⁵ See Stern, *Gas Security*, above n 2, at 17.

⁷⁶ See Luciani, ‘Natural Gas Markets’, above n 2, at 6.

'government' decision which points to the necessity of reinforcing the link between security of supply and political relations between the government of the importing country and the third party. This political relationship is linked to the discussion of the European Union's foreign policy which will be extensively dealt with in the last chapter of this study. It suffices here to point out that in designing a legal framework for security of energy supply these political aspects should also be taken into account.

How can the security of energy supply be guaranteed by the government of a Member State? Should the measures adopted by that government consider the measures taken by other market players, such as consumers and energy companies, into consideration? As previously mentioned above, it is not only the energy companies who have a say in the way the energy market functions. Consumers (through demand) and governments (through the regulations they impose) also play an important role. The main issue is, therefore, to coordinate the activities of these players and to determine the role that the European Community institutions could or should play in this framework. This last issue will be further explored in the following sections of this study.

1.3. ENERGY SECURITY: ACTORS AND INSTRUMENTS

Based on the accentuated role of government, some believe that diplomacy (namely diplomatic relations between energy-consuming and producing countries) is the most effective tool to guarantee energy security.⁷⁷ Diplomatic relations between the consuming and producing countries are especially important in relation to gas, due to the inflexibility and rigidity of the gas transportation framework and the need to establish and preserve a physical link between the two countries or regions. This issue is less vital in oil security because such a physical link does not exist and there is a more flexible pattern of oil transportation around the globe. For that reason, some may give higher importance to favourable diplomatic relations between gas-producing and gas-consuming countries. However, the maintenance of political stability in oil-producing nations should remain a top priority because political instability, for reasons mentioned earlier, becomes global and affects the world economy as a whole.⁷⁸ It is thus not incorrect to talk of the necessity of diplomatic relations between energy-producing and energy-consuming nations generally.

⁷⁷ *Ibid.* Luciani believes that the role of diplomacy in securing gas supply has been the basis in the past and will continue to be so in the future.

⁷⁸ See the speech by the Venezuelan Minister of Energy and Petroleum, Rafael Ramirez, entitled 'Full Sovereignty over Oil' in the third OPEC International Seminar, 12–13 September 2006 ('OPEC in a New Energy Era: Challenges and Opportunities'). He mentions that:

[there] cannot be stability in the international oil market if there is no stability within the oil producing countries, which in turn presupposes political and social stability, justice, and a truly national and fair distribution of the oil rent.

Reliance on sources of oil supply situated in different regions, such as Russia, North Africa and the Gulf countries, the transit of this oil through pipeline and across different countries, and the storage and refining of oil in border facilities necessitates efficient cooperation between the countries involved. Diplomacy could be considered as a means to start relations with energy-producing countries or transit countries. However, diplomacy cannot in itself be a guarantee of secure energy supply. Although traditional diplomatic relations could be considered as an effective tool, one could opt for a more advanced system in which energy relations would be further 'juridified' in order to create a more reliable importer–exporter relation. This, of course, presupposes a belief in the capacity of law to effectively regulate international energy relations. After all, a change in the diplomatic relations of two parties, which would probably result in ending the relations altogether, leaves the question of the security of energy supply unanswered, as no remedy exists in these types of relations to compensate for the loss. A system based on identifiable rights and obligations could better guarantee such security. This belief has been materialised to some extent in the framework of the Energy Charter Treaty to which the European Community is a party. Chapters 4 and 5 praise the initiative of juridifying energy relations between the European Community and third countries, and address the shortcomings of this juridification.

Examining the history of energy relations, especially oil, one can see the gradual shift of the role of major oil companies from structuring the oil scene in the world independently from the power-exercise of energy-rich countries to their loss of access to oil reserves due to those countries' willingness to become direct actors in the upstream sector and claiming their sovereignty over natural resources. Before claiming the right to exercise sovereignty over natural resources—that is before 1970—major oil cartels, or the famous 'seven sisters' oligopoly,⁷⁹ directly controlled the oil market and regulated the whole industry. They had almost unlimited freedom to manage reserves (through concessions), they invested in production and they traded the produced oil. Later on, most of the energy-rich countries nationalised oil. National oil companies became stronger; the management of reserves became a sovereign decision; they introduced direct state action in the oil business, and a direct 'inter-state' dimension was introduced into oil relations.⁸⁰ The intergovernmental negotiations that ensued between importing states and 'energy-producing countries' became the most important characteristic of energy relations in the following decades.⁸¹

⁷⁹ The Seven Sisters, all Anglo-Saxon, included the four Aramco partners—Jersey (Exxon), Socony-Vacuum (Mobile), Standard of California (Chevron), and Texaco—plus Gulf, Royal, Dutch-Shell and British Petroleum.

⁸⁰ For an extensive analysis of this change of roles between oil companies and energy-rich states see, P Noël, 'Trans-national Anew, Competitive at Last: the Oil Market in the Globalization Era' (2000), at <<http://www.upmf-grenoble.fr/iepe/textes/CahieA10.PDF>> [hereinafter 'Trans-national Anew'].

⁸¹ *Ibid.* at 4.

Some energy-producing countries gradually opened up their upstream industry to foreign participation, industry became more competitive, and the major oil companies regained some power that they had previously lost. However, their status never became comparable to that which they had possessed before the direct action of the producing countries, and the 'inter-state' feature of energy relations continues to exist with some new characteristics.

The forms of state action were redefined, and the new landscape included competition between major oil companies for access to energy reserves while working along with national oil companies of the energy-producing countries. Other characteristics of the new era were the creation of spots and future markets, and competition between energy-producing countries to attract foreign companies and their technology and investment, and their eventual desire to shift from sovereignty-attentive to integration into the world economy⁸² (this phenomenon is stronger in one producing country compared to another; eg Venezuela as opposed to Iran). One can submit that this new characteristic will lead to the creation of 'company-energy-producing country' relations, and the inter-state relation will be limited to creating the *best environment* favourable to investment by these companies, making sure that both parties reap the benefits of such deal. This role, although limited, is of great importance, since the better this environment is, the better the energy supply is guaranteed. Thus, states clearly continue to play a role.⁸³

In order to create the best environment for energy cooperation, inter-state relations could start with, but should not be limited to, a diplomatic rapport. It is true that oil is a strategic good and oil security involves a conscious plan to work on the external environment in pursuit of certain well-defined and long-term objectives⁸⁴ with very strong political implications.⁸⁵ Some believe that the world energy scene is a 'geopolitical theatre' more than an environment for economic transactions,⁸⁶ and it is therefore here that the importance of diplomatic relations is evident. However, no matter how 'strategic' energy is, a legal environment

⁸² Some believe that this change of attitude has great repercussions on the functioning of the oil market. See Noël, 'Trans-national Anew', above n 80, at 8. He believes that this change results in a move towards a re-opening of these countries to the exploration and production activities of major multinationals. Production capacities therefore rise because of the efficacy of the activities of these multinationals. See also JM Martin, *Économie et Politique de L'Énergie* (Paris, Armand Collin, 1992) at 188.

⁸³ One example of the necessity of diplomatic relations between energy-producing countries and third countries is the prohibition of the activity of American oil companies in Iran after the imposition of Iran–Libya Sanctions Act of 1996. Clearly the renewal of diplomatic relations between Iran and the US will directly affect the energy security concerns of the US which could further lead to the creation of a legal framework for energy cooperation.

⁸⁴ For different meanings of strategy, see H Mintzberg, J Quinn and S Ghoshal, *The Strategy Process* (London, Prentice Hall Europe, 1998) at 3.

⁸⁵ Oil was, and still is, the most political of all commodities. See J Hartshorn 'Europe's Energy Imports' in M Kohnstamm and W Hager (eds), *A Nation Writ Large?: Foreign Policy Problems before the European Community* (London, Macmillan Press, 1973) at 104.

⁸⁶ See Noël, 'Pétrole et Sécurité Internationale', above n 58.

should be created in which the rights and obligations of both states are clarified with the greatest transparency. Diplomatic relations cannot provide such transparency, which is inevitable to ensure security of energy supply. Host states should be sure that their national reserves are exploited appropriately and with the utmost care, and the investing party should be sure that its return on investment is guaranteed and contract obligations are observed. In addition, we are here concerned with one of the most important economic sectors, the energy sector, whose role is crucial for the economic development of any given country, in whichever form. A legal environment places the activities of the major oil companies and the host states in line with the objectives of security of energy supply, ie availability of energy at a reasonable price. The role of a legal tool in such an economically important sector should not be undermined by placing too much importance on diplomatic relations, which should only be looked at as the starting point of any given inter-state relation.

Within the Community framework, the inter-state relations mentioned above can be created between the Community on the one hand and the 'producing country' on the other. The legal personality of the Community, established in Article 281 of the EC Treaty, has allowed it to establish treaty relations with other states and to be included in the 'inter-state' paradigm mentioned above. The structure of this 'inter-state' relation, therefore, becomes more complicated as soon as the relations of the Community and its constituent states enter the picture.⁸⁷

1.4. CONCLUDING REMARKS

It is not easy to define what constitutes energy security. Energy experts tend to disagree on the relevance of some components of this security. Nonetheless, the analysis above sought to explain those aspects of this security that the majority of experts consider to be fundamental.

Security of transit, diversification of energy sources, security of facilities, along with designing the best model for investment contracts between producing countries and energy companies or importing countries, are considered as the most relevant issues to emphasise when designing a framework for energy security. The analysis above showed that in creating an efficient energy cooperation framework, which would in turn contribute to energy security, the role of each market player, from the governments of the importing and exporting countries to energy companies and private investors should be taken into account. However, energy relations remain highly influenced by inter-state activities and for this reason it is justified to put more emphasis on inter-state relations to guarantee security of

⁸⁷ See I McLeod, ID Hendry and S Hyett (eds), *The External Relations of the European Communities: A Manual of Law and Practice* (Oxford, Clarendon Press, 1996) at 31 [hereinafter 'A Manual of Law and Practice'].

energy supply. This study focuses on this aspect of security only and refers to the role of companies and private parties when necessary.

Moreover, it is important to design a framework for energy cooperation between the Community and its constituent members on the one hand, and with the energy-exporting countries on the other. Designing the structure of this cooperation is not without difficulty, but before going into the details of such a complex relationship it should be mentioned that an efficient framework for energy relations in the context of European Community's external relations can best be achieved if the 'mutual interdependency' between the Community members and the third country suppliers of energy is taken as the starting point. It became clear from the above-mentioned discussion that dependence on imports of energy from third countries per se should not be considered as a threat to security of supply. On the other hand, the dependence of energy-exporting countries on their sources of demand is also highly relevant in this analysis. This interdependency should thus be considered as the crucial point of our analysis. Nonetheless, this perception is either missing, or remains at a rhetorical level, in most European documents that deal with security of energy supply, most notably the Green Papers of 2000⁸⁸ and 2006 which were designed to signal the best way to deal with energy supply problems. Regrettably, the main recurring theme in the 2000 Green Paper was only the 'internal security of supply', indicating how best to achieve an independent energy system through a strong demand management mechanism.⁸⁹ This is merely an illusion, as increasing dependence on energy that flows from outside the borders of the European Union is a fact proved by statistical data showing the increase in demand and energy import and decrease in domestic production. Strong demand management may decrease imports to some extent but cannot end them altogether. Plausibly, the Green Paper of 2006, as will be explained in detail later, sought to move away from this inward-looking approach to some extent. There are various other measures that are undertaken at the Community level to establish relations with various countries or regions that are important for European energy security. These efforts will be listed and their efficacy in constructing a real energy framework will be scrutinised.

The next part first provides a broad historical overview of the European Community's efforts to design an energy security framework since its inception up to now, and the following parts discuss in detail the advantages and the shortcoming of efforts since the beginning of the 1990's to design an efficient framework for security of energy supply.

⁸⁸ See the 2000 Green Paper on Security, above n 22.

⁸⁹ The 2000 Green Paper deals with the internal security of supply through providing theoretical solutions, rather than specific and concrete measures, see below, ch 4.5.2. See also Noël, 'Pétrole et Sécurité Internationale', above n 58, at 3. He states 'La politique énergétique européenne semble considérer la sécurité énergétique comme une préoccupation "théorique" plutôt qu'un véritable axe autour duquel s'ordonnent des actions spécifiques'.

2

External Security of Energy Supply in Europe: Historical Overview

2.1. INTRODUCTION

THIS SECTION EXAMINES the development of energy policy measures adopted within Europe since the end of the Second World War (WWII). The purpose of this study is to analyse initiatives to secure energy supply in Europe. It is shown that these measures have taken different forms over time, based on the political, social and environmental considerations of the Member States of the European Community, either in their capacity as individual countries or as parties to the European integration process.

A discussion on the issue of security of supply is inevitably linked to an analysis of the development of an energy policy for Europe. However, because the main aim of this study is to analyse the measures necessary to secure energy supply from an external perspective, ie relations with energy-producing countries, the study does not examine the development of the European internal energy market in detail, but touches upon the relevant internal measures or policies related to the discussion of external relations.

The year 1951 marks the beginning of this historical overview. However, the importance of third country suppliers of energy to guarantee security of supply already existed before that time. For instance, Churchill had already in 1911 thought of converting the British Navy's power source to oil in place of coal. This was then thought as 'a pure folly' as it meant that the Navy could no longer depend on the secure supply of Welsh coal, but would depend on distant and insecure oil supplies.¹ His reasons for such a move were the strategic benefits of oil of greater speed and more efficient use of manpower, and he committed himself to achieving that goal. However, in other European countries, coal was still considered as the main source of energy and its abundance did not necessitate an energy policy to secure the availability of other sources, either domestically or externally. This perception changed after the WWII, due to the decreased

¹ See D Yergin, *The Prize: The Epic Quest for Oil, Money and Power* (New York, Free Press, 1992) at 12.

productivity of coal mines, as the analysis below demonstrates. This meant that reliance on external sources increased and with it grew the complex web of bilateral and multilateral relations with third countries to guarantee a constant and uninterrupted energy flow to Europe.

This study first covers the aftermath of WWII until 1958. This period marks the struggle to maintain coal as the main source of energy for Europe. The second section examines the policies developed between 1959 and 1972 during which period the necessity of having a European energy policy, comprised not only of coal but also of other sources of energy, was considered vital. The third period covers the oil crisis of 1973 and the measures that were established to better remedy the situation in case the same incident were to take place in the future. This study covers these activities until the year 1986 and the adoption of the Single European Act. The fourth period analyses the time between 1986 and the creation of the single market, the fall of the Berlin Wall, the increasing role of Russia as an important energy supplier for Europe, and the discussion of the Energy Charter Treaty as an important multilateral effort to guarantee energy supply. The last period will be more extensively discussed in later chapters because of its importance to the current discussion of energy security.

2.2. THE RESTRUCTURING OF THE ENERGY SUPPLY FRAMEWORK: 1951–1958

The effects of WWII on Europe's energy supply framework were immense. Before the war, 90 per cent of Europe's energy needs were met by coal. After the war, exports from Germany, Poland and the United Kingdom were halted completely. No new investment had been made to explore new sources, and the main energy infrastructures were destroyed by bombardments.² Towards the end of the war, only one-fifth of Germany's coal was being mined as compared to maximum mining before the War.

After the war, in order to retain an adequate energy supply for Europe, an ad hoc governmental institution known as the European Coal Organisation (ECO) was established. As its main task, it undertook the fair distribution of coal among its 13 members.³ It also sought to safeguard the interests of producers and consumers, disseminate information with regard to supply and distribution of coal, and make appropriate recommendations to the member countries.⁴

In order to establish closer collaboration between the states of Europe, and to participate in a joint programme for each country's economic recovery, the

² WG Jensen, *Energy in Europe: 1945–1980* (London, GT Foulis, 1967) at 2.

³ The members of the European Coal Organisation were Belgium, Czechoslovakia, Denmark, France, Greece, Luxembourg, the Netherlands, Norway, Turkey, the UK, the US, USSR and Yugoslavia.

⁴ Later in May 1947 the task of ECO was taken over by a new regional commission of the Economic and Social Council of the United Nation—the Economic Commission for Europe, which still functions. See <http://www.unece.org>.

Organisation for European Economic Cooperation ('OEEC'; later called the Organisation for Economic Cooperation and Development or the 'OECD') was established in 1948 to administer the Marshall Plan. This organisation not only sought to deal with activities in the field of energy, but also aimed at expanding production, liberalising trade and possibly harmonising monetary policy.⁵ Three committees of oil, coal and electricity were established within that framework and they were given the task of determining the necessary changes in Europe's energy supply and the necessity of diversifying supply. The Oil Committee was in charge of examining the long-term refinery plans of the industry and expanding refineries in Western Europe.

Although some oil was imported at that time into Europe, this source of energy did not play a major role among all the European countries. Hence, oil played the role of a secondary fuel for Europe, and coal was still more prominent. In 1950, Robert Schuman, then Foreign Minister of France, made the proposal to pool French and German coal and steel as they were considered as 'commanding heights of the economy', and the creation of a common market in these fields was considered necessary. Coal and steel were said to be critically important for economic development, and pooling these resources indicated a new age of cooperation. The creation of a common market in these fields was proposed in order to 'make war between France and Germany not merely unthinkable but materially impossible'.⁶ Negotiations began on 20 June 1950 to establish a common authority for coal and steel and ended with the creation of the European Coal and Steel Community (ECSC) by a Treaty signed on 18 April 1951 between Germany, Belgium, France, Italy, Luxembourg and the Netherlands. This treaty entered into force on 24 July 1952. It required member countries to abolish import and export restrictions, financial preferences, dual pricing systems and discriminatory practices in transport, among other things. What is interesting with regard to external relations is that governments remained free to determine their policies vis-a-vis third countries (although the ECSC later moved towards a common external tariff).⁷

At the same time, the world oil market slowly changed. Previously, no cohesive world oil cartel existed. Oil contributed about 8 per cent of the total consumption of primary energy in Western Europe. However, European companies endeavoured to have a stake in the world oil industry, which was by then completely dominated by the US. Different European countries started to look

⁵ NJD Lucas, *Energy and the European Communities* (London, Europa Publications, 1977) at 3. The members of this organisation were Austria, Belgium, Denmark, France, West Germany, Great Britain, Greece, Iceland, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland, Turkey and the United States.

⁶ See the Declaration of Robert Schuman on 9 May 1950, in U Kitzinger, *The European Common Market and Community: A Selection of Contemporary Documents* (London, Routledge and Kegan Paul, 1967) at 37.

⁷ Jensen, *Energy in Europe 1945–1980*, above n 2, at 30.

for shares in different companies in the producing countries. The United Kingdom, for example, gave its support to those oil companies in areas in which their military and political presence was effective, for example, the Anglo-Persian Oil Company (now British Petroleum) in Iran. France eventually joined the oil business in this region, along with the US and UK by acquiring a 25 per cent share in the Turkish Petroleum Company (later Iraq Petroleum Company) and later created the government-controlled companies of *Compagnie Française des Pétroles* and *Compagnie Française de Raffinage* to dispose of imported oil.⁸ The participation of publicly owned oil companies of Europe in the oil business of third countries gradually became stronger. Their respective governments kept them more or less isolated from and unaffected by developments taking place with respect to the creation of a European common market.

In May 1956, in the report of a specific commission of the Coal and Steel Community, named the Hartley Report after its head, the necessity was mentioned of looking into other sources of energy, apart from coal, and treating all sources of energy in a similar fashion, including coal, gas, electricity and oil.⁹ The reason seemed to be the importance of diversification of energy sources in order to guarantee better security of supply. Gradually, oil was playing an important role in the transport sector and it was substituting coal. However, there was repeated emphasis on the principal role that coal would continue to play in other sectors of the European economy for the obvious reason that Europe still had vast resources of coal. In order not to lose this source of energy to competition with other sources, long term investments, better methods of extraction of coal and better working conditions for miners were suggested.¹⁰

However, it was inevitable that the economy of Europe, even through the efficient use of its domestic coal, was changing from an energy-exporting economy to an energy-importing economy because the cheap production of oil made the coal industry unattractive. On the other hand, the effect of this change on the general economic situation was found worthy of specific attention. One important result of this dependence on imported energy was the inevitable risks it entailed, especially because the main sources of energy for import to Europe were situated in one region, the Middle East.¹¹ Transport of oil from this region, on which most of the energy-dependent countries rely, would be problematic due to its political instability. The best means to decrease the negative effect of this situation was to encourage Member States to fully utilise their own domestic reserves, and governments were asked not to impose legislative or administrative restrictions on the exploitation of these reserves. The main task was placed in the hands of oil companies. They were asked to raise the supply by extensive

⁸ PF Cowhey, *The Problems of Plenty: Energy Policy and International Politics* (Berkeley, University of California Press, 1985) at 84.

⁹ *L'Europe face à ses besoins croissants en énergie* (Paris, OEEC, 1956) at 11.

¹⁰ *Ibid* at 61.

¹¹ *Ibid* at 26.

investment in both upstream and downstream sectors. Nonetheless, the inevitable fact was that Middle Eastern oil was cheap, which compared to the high-cost coal industry of Europe and the domestic oil industry of the United States would make the latter gradually lose its position in the world market. However, it was not until 1956 and the Suez Canal crisis that Europeans were struck by the reality of dependence.

Even before the Suez Canal crisis, Jean Monnet's Action Committee proposed that a report be prepared to present the case for nuclear energy. The idea was that developing nuclear energy would assist Europe in overcoming its energy dependence altogether. The so-called heads of delegations of the ECSC Member States' Foreign Ministries met in Messina on 1 June 1955, and agreed on a new start for economic integration. They decided that a concurrent effort be made to establish a Western European atomic energy agency (EURATOM) and to abolish trade obstacles for all commodities, or the co-called 'General Common Market'.¹² An intergovernmental committee was set up chaired by Paul-Henri Spaak, the Belgian Foreign Minister, whose work resulted in the drafting of the Treaty on the European Economic Community and the EURATOM Treaty and their signature in March 1957.

The Spaak Committee established various commissions of experts on the basis of which a final report was published in April 1956. The Report was divided into three parts: (1) the common market, (2) EURATOM and (3) sectors where urgent action was needed, the first among which was conventional energy.¹³ This last section gave priority to sources of energy other than oil. It was also emphasised that the electricity and gas sectors were peculiar sectors, in which the introduction of principles of competition was not appropriate. It explained that the manufacture, transport, and distribution of energy economically and technically differ from other manufactured goods. This issue was elaborated by stating:

The electricity supply industry and coal-based industry are made up of relatively small organisations enjoying effective monopoly within most of their area of operation. The usual concept of competition did not apply and evidently could not be introduced. Therefore, it was not thought possible to establish immediately a common market of the sort built up for coal within the ECSC.¹⁴(emphasis added)

¹² EB Haas, *The Uniting of Europe: Political, Social, and Economic Forces 1950–1957* (Stanford, Stanford University Press, 1958) at 108.

¹³ Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères (Comité Intergouvernemental créé par la Conférence de Messine) (Spaak Report), Bruxelles, 21 Avril 1956. For an online version of the Spaak Report see <<http://www.ena.lu/mce.cfm>>.

¹⁴ The Spaak Report states that

le transport et la distribution du gaz et de l'électricité se présentent dans des conditions techniques et économiques toutes différentes de la circulation de marchandises. C'est pourquoi il n'y a pas lieu d'envisager par priorité une extension du marché commun du charbon aux autres sources d'énergie. Une action limitée n'en est pas moins urgente.

See also NJD Lucas, *Energy and the European Communities*, above n 5, at 15.

The Report, however, found it necessary to determine the necessary investment required in the field of conventional energy before the imminent switch to nuclear, because ‘the emphasis on nuclear energy should not have threatened to compromise the viability of investment on conventional sources’.¹⁵ However, this undertaking did not, according to the Report, justify a new institution. Responsibility for this undertaking was to be assigned to the ECSC. Lucas believed that ‘this was not unreasonable for the function proposed at that time, because both the gas and electricity supply industries depended almost exclusively on the coal industry for their feedstock, which was dealt with within the framework of the ECSC’.¹⁶

The EURATOM Treaty came into force in January 1958. However, between March 1957 and January 1958 some interesting events took place. Firstly, the so-called ‘Report of the Three Wise Men’ laid down ‘a target for Euratom’ and emphasised the necessity of developing nuclear energy to overcome the difficulties manifested in increased dependence on unreliable oil supplies from the Middle East.¹⁷ The Report further provided that the ‘aim was to prevent oil from becoming a device for exerting international pressure’. The document anticipated that energy imports into Europe would be doubled or even tripled over the next few years. Accordingly, it recommended the building of nuclear power stations as a gradual replacement for those running on coal and oil. Europe’s international independence and prestige were at stake.¹⁸ France later indicated that it gave priority to the EURATOM project rather than a common market. However, the Suez Crisis of 1956 made European unity essential and France accepted that both initiatives be followed.

On 26 July 1956, Gamel Abd al-Nasser of Egypt froze the assets of international oil companies, defied the West, and nationalised the Suez Canal. France and the UK took retaliatory measures, blocked all Egyptian accounts in their countries, and later declared their intention to seize the canal. Eventually an Israeli–British–French trio attacked the canal on 29 October 1956. A ceasefire order by the United Nations was finally accepted by these countries on 6 November. However, in the meantime the Egyptians had blocked the canal by sinking ships and blowing up installations.

This event had grave consequences for Europe’s economy because the canal was considered vital to the European energy supply, and that year 69 million tons of oil was carried through the Suez Canal to enter Europe. However, the temporary interruption of the import of this oil was not in the beginning considered as problematic because of a belief in the abundance of European coal.

¹⁵ Lucas, above n 5, at 15.

¹⁶ *Ibid.*

¹⁷ See L Armand, F Etzel and F Giordani, *A Target for Euratom* (Report of the Three Wise Men) submitted at the request of the governments of Belgium, France, German Federal Republic, Italy, Luxembourg and the Netherlands, May 1957, pp 13–40.

¹⁸ *Ibid.*

Nevertheless, this crisis sparked some reactions within each individual member country¹⁹ as they feared the gradual, complete closure of the canal and its detrimental effects on the energy sector. It is from this time onward that the importance of the activities of a small group of powerful suppliers outside Europe was brought to the attention of European countries. This led to the adoption of measures designed to confront any sudden harmful action taken by this group in relation to oil exports. It was therefore deemed absolutely appropriate to accept the important role that nuclear energy could play in limiting Europe's dependence on imported oil.²⁰

Although it was found difficult to assess the exact repercussions of the Suez Canal crisis on European energy supply, some facts were appraised and some measures were proposed. Firstly, the detrimental effect of the scarcity of fuel oil was deemed more substantial than that of any other source of energy. Levels of production in different economic sectors fell sharply in various industries in Europe. For example, the car industry in some countries, notably the United Kingdom, suffered substantial cuts in output following falls in domestic and foreign demand influenced by restrictions on the use of petrol and apprehension of continuing shortages. Direct repercussions were also found in the glass industry of France, and in building maintenance and building materials industries in other countries. There was rapid reduction in working hours and an increase in unemployment in related professions.²¹ Moreover, road transport enterprises, in which gas/diesel oil played an important role, reduced their activities.²²

Recourse to suppliers of energy for Europe other than the Middle East, namely the US, was unlikely to improve the situation. Until 1956, the US was considered as one of the main exporters of crude oil to Europe. However, Europeans believed that unless the Texas authorities decided to increase their production of crude oil

¹⁹ A reaction from the French Government accused such activity as being a threat to overall economic relations:

[Ce] que nous admettrons jamais, c'est une violation de la morale internationale commise par un dictateur, c'est qu'il ait pris des mesures unilatérales d'une exceptionnelle gravité au mépris d'accords conclus. Le régime du Colonel Nasser fait ainsi peser une lourde menace sur les relations économique entre l'Europe et l'Asie, et particulièrement sur l'approvisionnement en pétrole de la France et de toute l'Europe . . . Le Canal doit être exploité dans l'intérêt général, dans l'intérêt du commerce mondial. (Déclaration pour le lancement de l'emprunt national 1956 et de l'emprunt pour l'Algérie, 09/1956.)

²⁰ For a recent analysis of the role of Euratom, see European Commission, *Nuclear Energy in Europe: How the Euratom Protects European Citizens* (Luxembourg, European Communities, 2005).

²¹ Report to the Executive Committee from the Economic Committee on Economic Consequences for Europe of the Suez Crisis, Organisation for European Economic Cooperation, Energy Committee, Paris, 20 February 1957, EN (57) 16, at 2.

²² *Projet de Rapport du Comité Économique au Conseil sur les Consequences économiques de la crise de Suez pour l'Europe*, Organisation Européenne de Coopération Économique, Comité Économique, Paris, le 31 Janvier 1957. EC (57) 3 (1ère révision) at 2.

above the limited amount that they had abided by, imports of crude to Europe from this source would not increase, and therefore the situation would not improve.²³

There were concerns that if these shortages continued for a long time, they would cause a complete halt of the economy. The immediate action was to substitute coal as much as possible, or use gas. However, the continuing decrease in oil production would make it impossible to have recourse to even these sources, whose production was very costly.²⁴ The fact that the consumption of crude oil increased by 90 per cent between 1950 and 1955 indicated that the prominent role of coal was under threat. The main reason for the rapid increase in the use of oil was undoubtedly due to the greater convenience of the use of liquid fuels.²⁵ By the year 1957, liquid fuels were used in road, water and air transport. The growing use of oil as feedstock for Europe's petrochemical industry also contributed to this rise. Oil products were selling at low market prices that compared favourably with coal prices, which had risen continuously since WWII.²⁶ All this provided evidence that the place of coal would be usurped by the oil industry in the near future.

This crisis also had a damaging effect on the balance of payments. The increase in the price of oil imports had aggravated the balance,²⁷ especially compared to the dollar value, the currency with which all oil contracts were made. This imbalance was worse for some countries of Europe compared to others, and the diversity of repercussions on various member countries aggravated the already existing imbalance of payments among European countries. A solution to this problem was required and sought after in the interests of increasing economic cooperation in Europe.²⁸

Although it was difficult to assess their adequacy, some measures were deemed necessary in order to overcome the energy shortage:²⁹

1. The staggering of working hours in industries in general, so as to level down peak consumption of electricity and gas, which render necessary the operation of plants working under uneconomic conditions;
2. Temporary reductions in public lighting at peak hours;
3. Provisions to prevent consumers which are short of coal or oil products from using too much gas and electricity;
4. Some government measures were adopted

²³ *Ibid* at 3:

Quant au brut, la situation des stocks n'est guère meilleure. A moins que les autorités du Texas ne modifient leur récente décision qui n'autorisait qu'un accroissement très limité de la production courante de brut, il ne faut pas compter pouvoir augmenter sensiblement, dans un proche avenir, les livraisons de produits pétroliers aux consommateurs Européens.

²⁴ *Ibid*.

²⁵ Jensen, *Energy in Europe: 1945–1980*, above n 2, at 60.

²⁶ *Ibid* at 60.

²⁷ *Projet de Rapport du Comité Économique*, above n 22, at 8.

²⁸ *Ibid* at 9.

²⁹ Overall Assessment of the Consequences of the Suez Canal Crisis for the Energy Supply of Western Europe, Organisation for European Economic Cooperation, Energy Committee, Paris, 20 February 1957, EN (57) 3, at 2.

to promote: i) The development of certain indigenous energy by facilitating investment (rendering available public funds, encouraging private investment through an appropriate tax policy, attracting foreign capital); ii) A better utilization of available sources of energy (e.g. long distance and urban heating combined with electricity production, based on coal, oil or nuclear energy); iii) A price policy enabling the energy industries to run on sound commercial principles.

Witnessing the damage inflicted after the Suez crisis, it was clear that the Hartley Report had great merit as it foresaw Europe's 'transition from a self-sufficient or energy exporting region to a region heavily dependent on imports', and it correctly described the problems that this would bring, including strategic dependence.³⁰ The European Commission repeatedly rejected the view that 'the most satisfactory way of ensuring security of supply lay in a greater degree of self-sufficiency, and argued in favour of wider diversification of sources of supply as the best means of achieving this objective'.³¹

The Suez Canal crisis slightly changed the perception within the Community away from unlimited reliance on nuclear energy. In 1958, a report by the Oil Committee of the OEEC once more drew attention to the Suez crisis in order to analyse its long-term repercussions. This report found it necessary to emphasise the importance of oil. The Committee proposed some new measures to minimise the effects of such a crisis in the future. These measures were: (1) to assure the equitable distribution of available supplies between member countries in the event of any future emergency; (2) to accumulate larger reserves of oil in Europe than had been held up to that time; (3) to diversify the origin of supplies; (4) mutual consultation and appropriate planning by government and industry to place Europe in a better position to overcome interruptions.³²

The most interesting aspect of this report is that the '*doctrine of mutual interdependence of Europe and the Middle East*' was considered as an essential element of security of energy supply for the first time.³³ This doctrine is based on the fact that the Middle East is as much dependent on oil revenues as Western Europe is on the import of oil. A balance should therefore be struck between the two, according to which a more secure energy supply for Europe can be guaranteed.³⁴ The idea in simple terms is that Europe depends economically on one particular energy-producing region and that region depends on Europe as a

³⁰ Lucas, *Energy and the European Communities*, above n 5, at 19.

³¹ Jensen, *Energy in Europe: 1945–1980*, above n 2, at 88. The Energy Committee later determined that by the year 1980 the net import of oil to Europe will reach 1100 million tons of coal-equivalent, as compared to 87 million tons in 1950. However, this consideration is not examined in depth in the Energy Committee reports and only the aim of better diversification of supplies was repeatedly mentioned as a means of overcoming the problem of dependence on one major source.

³² See *Implications and Lessons of Suez Crisis* (Paris, OEEC, 1958).

³³ *Ibid.*

³⁴ Against, see W Hager, 'The Community and the Mediterranean' in M Kohnstamm and W Hager (eds), *A Nation Writ Large? Foreign Policy Problems before the European Community* (London, Macmillan, 1973) at 196.

source of its income from sale of that energy: thus a balance exists between the demands of both sides. Others, however, did not find the theory of ‘mutual interdependency’ adequate to guarantee full security. They advocated the use of nuclear energy and thought that any attempt to guarantee oil supply would become obsolete in the long term. In some reports the importance of oil is denied in favour of the advantages of nuclear energy and the reason may be the pursuance of the aim of ‘promoting unity by leading Europe into a new age’,³⁵ the age of nuclear fuel, and not to allow any distraction as to the importance of nuclear energy.³⁶

The European Commission emphasised that reaching the objectives of EURATOM could not be viewed in isolation from the general energy context, and great importance was attached to the proper study of all the problems involved in the framing of a common energy policy, which was found vital to the smooth economic development of the Community. However, the emphasis of some Member States on atomic energy diminished the level of desirable attention paid to other sources. From the Member States’ perspective, nuclear energy was going to be top of the list of sources to guarantee energy security for Europe for years to come.³⁷ However, the reality was that the oil was cheaper and more readily available. Therefore, it was finally accepted as one major source of Europe’s energy supply. No concrete supply framework for oil dependence was established in this period. It was only in the next period, explained below, that efforts in managing the use of oil in Europe were undertaken.

2.3. THE DEVELOPMENT OF THE ENERGY SUPPLY FRAMEWORK: 1959–1972

Changes in energy markets ensued in the years between 1958 and 1960. The level of demand for coal and oil gradually increased. New oil refineries were built in different countries of Europe and technical improvement lowered some energy-related costs (eg shipping).³⁸ Oil-producing governments in turn insisted on more production and thus more revenues. During this time, Europe began to import energy from the Union of Soviet Socialist Republics (USSR). Increases in the tonnage of Soviet crude on offer contributed to the low level of oil prices in most Community markets.

³⁵ Lucas, *Energy and the European Communities*, above n 5, at 24.

³⁶ Protocol sur les Moyens d’assurer une politique coordonnée dans la domaine de l’énergie, [1957] OJ 574/57.

³⁷ See the Third General Report of the European Atomic Energy Community, April 12, 1960.

³⁸ The shipping industry started to construct larger vessels of 15,000–20,000 dwt (deadweight tonnage) with higher speeds. Therefore, shipments across the Atlantic were economically carried for as little as \$5 per ton. The transport of oil by pipeline became more and more common in the Community and elsewhere, as a means of supplying the refineries. See The General Report of the European Coal and Steel Community, 8th General Report, Luxembourg 1960.

National governments, on the other hand, did not submit themselves to applying the rules on the common market to energy. Germany was the proponent of a common market in coal but still emphasised the protection of its home coal industry and imposed a temporary duty on imports in excess of a five million ton quota.³⁹ Belgium and the Netherlands also abided by free market principles in general, but introduced protectionist measures for their energy market, including restrictions on imports from third countries. In France, the number of oil importers was restricted and investment in oil required prior authorisation. On the other hand, the policy of the Italian government was to buy the cheapest available fuel.⁴⁰

It was later agreed among member countries that the objectives of an energy policy could be achieved by protecting the production capacity of the Community through subsidies rather than import restrictions. Finally, a Protocol of Agreement on Energy Policy was adopted in April 1964.⁴¹ Oil and natural gas sectors were also dealt with by the Commission of the European Economic Community (EEC) based on the principles formulated in this Protocol. The policies were to focus on possible cooperation of companies with other consumers; analysing the possibility of sharing supplies and stockpiling petroleum products; promoting exploration in the Community; and offering subsidies for indigenous production of petroleum.⁴² The Commission also proposed freedom of establishment, a common policy for coordination of pipeline regulations and rules concerning sales of, and taxes on, energy products. The measure to safeguard security of supply in times of shortage was the 65-day stockpiling of petroleum in each Member State.

In 1968, the first guidelines towards a Community Energy Policy were established. Dependence on imports, although a strategic weakness for European countries, was seen by the Commission as an opportunity, to exert more influence on the world market by adopting a common approach.⁴³ The Commission explored the necessity to finance exploration and production of hydrocarbons in circumstances that were of particular interest to the Community and also finance a variety of investments that might be in the common interest.⁴⁴ The Commission concluded that security could be achieved by diversity and political cooperation. However, in diversifying, it was found essential to bear in mind that 'in a field affected by political tension, power balances and monopoly situations,

³⁹ Lucas, *Energy and the European Communities*, above n 5, at 32.

⁴⁰ *Ibid.*

⁴¹ See Protocol on Energy Problems concluded between the Member States and the European Communities at the 94th session of the Special Council of Ministers of the European Coal and Steel Community held in Luxembourg on April 21 1964. 13th General Report of the European Economic Community, March 1965 at 87. See also Official Gazette no 69, 29 April 1964, 'Protocol d'accord relatif aux problèmes énergétiques', OJ 30 April 1964.

⁴² See generally, Lucas, *Energy and the European Communities*, above n 5, at 35–40.

⁴³ *Ibid* at 47.

⁴⁴ *Ibid* at 48.

it is not possible to rely entirely on the sources, which are cheapest by virtue of their cost of production' (ie relying solely on the Middle East).⁴⁵ It was proposed that a permanent inventory (stock piling) of world oil resources should be kept by the Commission, which might be available in an emergency. The Commission also contacted the major international oil companies with a view to regular consultations on supplying the Community market.

These declaratory proposals of the Commission came to nothing with respect to external security. The only steps taken were purely internal and they concentrated on the need to extend the system of subsidies,⁴⁶ increase the volume of mandatory oil stocks, and the obligation to notify the Commission of imports and investments in hydrocarbons.⁴⁷ No policy on political cooperation with energy producers was pursued. Lucas believed that this poor performance can be attributed to a lack of political will among Member States and a lack of leadership from the Commission.⁴⁸ Although he believed that a conflict of interest is the prerequisite of any situation from which a common policy can evolve, this conflict did not exist because the old distinction between coal-producing countries and energy deficient countries was disappearing, due to the diminishing role of coal in the Community. In fact, 'there was growing similarity among member countries' energy patterns and they were all destined to eventually become very much net importers of energy products.'⁴⁹ However, a threat from energy-producing countries could have been considered as a new incentive for Member States to reach a common policy. Although the Suez Canal crisis could have been considered as a major reason to initiate discussions with third party producers of energy, this opportunity was not exploited by the Commission or the Member States, and therefore no concerted European action materialised at that time.

⁴⁵ The General Report of the European Coal and Steel Community, 7th Report, 1 February 1959, at 124.

⁴⁶ The system of subsidies was planned 'to remedy a serious disruption of the economic affairs of a Member State and to maintain and improve productivity and further the adjustment of the coal mining industry to the changes in the sale positions'. See the Draft Transitional Protocol among the Member States of the European Coal and Steel Community containing Special Temporary Provisions Aimed at the Attainment of the Objectives laid down in the Treaty Establishing the European Coal and Steel Community, prepared by the German government in Bonn, 11 September 1963 in the 12th General Report of the European Economic Community, March 1964, at 85.

⁴⁷ For this purpose the Commission submitted a questionnaire to the governments covering imports made during the last few years and the possibilities of their expansion. This would enable the Commission to propose to the governments the adoption of a common approach towards imports from the countries concerned. See generally, the Fourth General Report of the European Economic Community, May 1961 at 121. See also Lucas, *Energy and the European Communities*, above n 5, at 51. Reg (EEC) No 1055/72 on notifying the Commission of imports of Crude Oil and Natural Gas, [1972] OJ L/120/3.

⁴⁸ Lucas, *Energy and the European Communities*, above n 5, at 51.

⁴⁹ General Report of the European Coal and Steel Community, 12th Report, March 1964, at 74.

The Special Committee on Energy Policy prepared a draft resolution in 1964, which represented the minimum for a common energy policy on which governments might possibly agree in that period.⁵⁰ The purpose of introducing a common policy was said to be the recognition of the growing proportion of imported hydrocarbons, the prospects opened up by the development of nuclear energy and the importance of social considerations. This common policy would then aim to ensure a cheap, secure and stable supply as regards both cost and quantities available, freedom of choice for the consumer and fair competition. With regard to the hydrocarbon sector, the draft resolution declared that governments should be prepared to promote the economically rational development of the production of hydrocarbons in the Community; endeavour to agree a common policy on hydrocarbons stocks; eliminate all regulations that discriminate between their own nationals and those of the other Member States;⁵¹ endeavour to work out a fiscal system for fuel oils, and harmonise taxes.⁵² Governments were also asked to declare their willingness to introduce a common policy to ensure a widely diversified flow of supplies at low prices and as stable as possible. However, there was no clarification of how governments could guarantee such a stable flow of supply. There was no external aspect to this Draft outlining a common position concerning energy producers to determine to what extent the flow could be stable and diversified.

This Draft did not secure unanimous acceptance by the Council as it was found to be ‘wholly inadequate to bring about a common energy policy’.⁵³ They believed that the Protocol was too much confined to a declaration of intent and the only specific measure contemplated was the legalisation of subsidies. Therefore, the task was once again given to the Commission to seek a way out of that impasse and to forbid governments from introducing exclusively national measures. However, this task was found to be difficult to achieve and the focus was mainly on the creation of a common market for nuclear energy, on which most of the governments agreed. They wanted this new energy source to become the major source of European energy at the earliest possible date to ‘make its full contribution, at economic costs, to the *coverage of Community energy requirements*’ (emphasis added).⁵⁴

⁵⁰ See the Draft Resolution submitted to the Council of Ministers on 22 November 1963. 12th General Report of the European Economic Community, March 1964, at 88. See also the Draft Agreement creating with respect to the Treaty Establishing the European Coal and Steel Community, the Prerequisite Conditions for the Introduction of a Common Market for Energy, Arts 2 and 3, (3 April, 1963). 12th General Report of the European Economic Community, March 1964, at 82.

⁵¹ One example of such discrimination was that in the Netherlands, exploration of oil and natural gas from the North Sea Continental Shelf for nationals could be carried out freely and only production was subject to concessions, whereas for non-nationals both exploration and production were subject to a system of licenses and concessions.

⁵² The Draft Resolution (22 Nov 1963), above n 50, at 90.

⁵³ 12th General Report of the EEC (March 1964), above n 50, at 78.

⁵⁴ *Ibid* at 91.

The Commission believed that the energy market is a global market and decisions of each player can affect the others. It was therefore accepted that energy supply could only be effectively handled if it were seen and treated as an international affair and not merely a national one.⁵⁵ They were already aware that an energy crisis in the US (eg the 1971 crisis which resulted in the closure of schools and the restriction of airline services) could raise concerns in Europe and could affect the energy supply of the European member countries.⁵⁶ In analysing these effects, the differences of views between the Member States were manifested. They all agreed that oil security was an international security issue, and that energy supply difficulties in one country can have consequences on the supply of another, but they differed on how this matter should be approached. For example, France argued that the Community had no authority to create a common external policy, and also argued that a common internal policy for prices and imports had priority over the definition of a Community attitude in external matters related to energy. France strongly believed that there were more gains in having an independent diplomacy in the Middle East rather than a 'European' one, and also believed that 'acting within a consumer grouping would restrict its actions elsewhere'.⁵⁷ Other Member States did not insist on establishing an external policy either. Hence, no proposal of the Community to create a common external energy policy became effective.

The Member States' disagreement over creating a 'consumer grouping' did not alter even in the aftermath of the creation of the Organization of Petroleum Exporting Countries (OPEC) in 1960. OPEC was established as a permanent, intergovernmental organisation, created in September 1960 by the most important energy-producing countries at the time, namely, Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. OPEC's objective was to coordinate and unify petroleum policies among its member countries, in order to secure fair and stable prices for petroleum producers, guarantee an efficient, economic and regular supply of petroleum to consuming nations along with a fair return on capital to those investing in the industry. OPEC was seen as strong cooperation among energy exporting countries. It could have been considered by the Community Member States as a threat because they might no longer be able to easily approach individual energy-exporting countries, influence their production policies and guarantee their domestic security of energy supply. However, the creation of

⁵⁵ See the Commission Paper, *Necessary Progress in Community Energy Policy 1975–1985*, COM (72) 1201. The High Authority intended to draw up a memorandum describing the energy position of the main non-Community industrial countries like the United States, the Soviet Union, Canada and Japan. It reached the conclusion that all four countries strived to combine security of supply with minimum costs. Moreover, they all gave particular attention to the development of nuclear energy. See the 12th General Report of the EEC (March 1964), above n 50, at 75.

⁵⁶ See Lucas, *Energy and the European Communities*, above n 5, at 55.

⁵⁷ See P Noël, 'Pétrole et sécurité internationale: de nouveaux enjeux' (1998) <<http://www.upmf-grenoble.fr/iepe/textes/Noel98.PDF>>, at 12 [hereinafter 'Pétrole et sécurité internationale']. See also, Lucas, *Energy and the European Communities*, above n 5, at 57.

OPEC did not lead them to seek cooperation among themselves (the only grouping of consumers took place a decade later through the creation of the International Energy Agency (IEA), the details of which will be explained in the next section).

In 1967, the Suez Canal was again blocked by Egypt during the Arab–Israeli six-day war. Representatives of Abu Dhabi, Algeria, Bahrain, Egypt, Iraq, Kuwait, Libya, Qatar and Saudi Arabia, together with representatives of Lebanon and Syria decided to halt the export of oil to those countries whose policies were supportive of Israel or hostile to the Arab side in the conflict. After some time the shipments resumed but oil was not sold to embargoed countries, such as the US, Britain and West Germany.⁵⁸ Interestingly enough, the consequences of this embargo were not critical.⁵⁹ Some believe that in fact no real crisis materialised due to some factors: (1) the embargo on the US was mostly symbolic because the export constituted less than 5 per cent total US oil consumption; (2) stockpiled supplies existed in Western Europe; (3) swap arrangements undermined the destination embargoes; (4) Iran and Venezuela, the two main non-Arab producing countries carried on their shipments and they further increased them after the embargo; (5) due to the introduction of a new generation of tankers too large to pass through the Suez Canal, the importance of this canal for shipments from the Gulf to the West had decreased.⁶⁰ Therefore, the events of 1967 were not as important for security of supply in the importing countries as the vigorous crisis that occurred in 1972–73, the details of which will be explained in the next section.

After the events of 1967, the Commission was convinced of the soundness of the actions that they had previously recommended. These were firstly, the importance of having a ‘framework of action’ for energy policy measures, such as the creation of guidelines which would define the conditions for greater security of supply as well as the problems raised by the industrial structure in this sector; secondly, the need for suitable measures to alleviate a partial interruption of energy imports, such as stockpiling for 90 days’ consumption, the expediency of promoting unification of the market and the importance of establishing a common supply policy. The Commission also placed the ‘supply policy’ at the centre of its energy policy because of the Community’s reliance on outside sources for two-thirds of its requirements. For this reason, the Community took the first and most important step in guaranteeing security of energy supply through the adoption of Directive 68/414/EEC in 1968. This Directive obliged

⁵⁸ ‘Failure of 1967 Arab Oil Embargo: Causes and Effects of 1970 Freight Crisis’ in J Evans, *OPEC and Its Member States and the World Energy Market* (Harlow, Longman, 1986) at 75.

⁵⁹ The First General Report of the European Economic Community, February 1968 at 173. In Europe, procurement of petroleum products declined and an additional burden was placed on the Member States’ balance of payments.

⁶⁰ ‘Failure of 1967 Arab Oil Embargo’ in Evans, *OPEC and Its Member States*, above n 58, at 75.

Member States to maintain a level of stocks equivalent to 65 days of consumption. Member States with indigenous oil production had a reduced stockpiling obligation to a maximum 15 per cent of total production (the details of this Directive will be explained in chapter 4.3).⁶¹

In 1972, the alarm of increasing reliance on external supplies resonated more vigorously and the Commission sought to outline the problem in a Communication to the Council.⁶² This Communication is the first important report setting out the main considerations for improving the external relations of the Community with energy suppliers. The Commission pointed out considerable changes in the energy policy context based on some factors, one of which was the dilemma between 'cheap or secure oil', and if the choice was to fall on the latter, on how to secure it: through cooperation with the US or with the oil-producing countries? While cooperation with the US was barred by France, the Europeans saw very clearly the importance of maintaining good relations with the Arab nations.⁶³ Although no answer was yet decided upon, the Communication demonstrated that maintaining relations with energy-producing countries could become an element of energy security. This was especially the case when the mutual interdependence of Europe and energy suppliers situated in the Mediterranean and the Middle East regions was also raised again. The Commission was of the opinion that developing countries' economies should be developed and Europe could play a major part in that respect. It was said that exporting countries tried to diversify their economic activities in order not to depend exclusively upon a single export. They were also found to be interested in utilising Europe's economic capacities in the fields of commerce, economic cooperation, manpower, know-how, the capital market and tourism.⁶⁴ Moreover, Europe was considered as the main market for the most important of these countries' exportable products, and Europe also attributed primary importance to these products, and therefore, this 'complementarity of interests' was said to be a means of developing a relationship on 'equal footing':⁶⁵ a desirable goal.⁶⁶

In this respect, the Commission found the following actions necessary:

1. To create a consultative procedure with the exporting countries permitting better reciprocal information and discussion.
2. To stimulate, at the same time, the sending of

⁶¹ See the Council Dir 68/414/EEC of 29 December 1968 on Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products, [1968] OJ L/308/14. See Council Decision 68/416/EEC of 20 December 1968 on the Conclusion and Implementation of Individual Agreements Between Governments Relating to the Obligation of Member States to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [1968] OJ L/308/19.

⁶² See the Communication from the Commission to the Council forwarded on 13 October 1972 on the Necessary Progress in Community Energy Policy, [1972] 11 *Supplement to the Bulletin of the European Community*.

⁶³ See F Bicchi, 'From Security to Economy and Back: Euro-Mediterranean Relations in Perspective', at <<http://ies.berkeley.edu/research/bicchiconvergenceofciv.pdf>>.

⁶⁴ Necessary Progress in Community Energy Policy, above n 55, at 14.

⁶⁵ *Ibid* at 13.

⁶⁶ *Ibid* at 14.

groups of industrialists from the Community to the exporting countries and vice-versa, in order to determine practical ways of economic cooperation. 3. To negotiate cooperation agreements, which incorporate in particular the following points: i) an undertaking by the Community to promote the economic and social development of the exporting countries by the provision of technical and, where appropriate, financial assistance, and also by opening up markets for the industrial and agricultural products of these countries, ii) An undertaking by the exporting countries and the Community to apply rules and guarantees yet to be worked out, to their enterprises, commercial transactions and industrial investments.

Likewise, it was found necessary to monitor the activities of large international firms in the energy sector. It was pointed out that large firms had expanded their activities from the oil sector to natural gas, coal and nuclear energy and they had emerged as 'energy companies'. As this widening of the scope of their activities would gradually increase their influence on the energy market, the Commission found it necessary to monitor their activities and guarantee fair competition.⁶⁷

From what was said above, it is clear that the Commission had come up with various advantageous proposals and guidelines in order to expedite the development of an energy policy. It also acknowledged the important place of the non-member countries, exporters of energy that should be considered in designing a common energy policy, and the guarantee of security of supply as its primary objective. However, the differences among Member States' strategies to guarantee this security created barriers to reaching a common policy as desired by the Commission. The next decade and the occurrence of the disastrous oil crisis of 1973 confirmed that in order to reach a common position on energy, there was still a long and arduous way to go.

2.4. THE OIL CRISIS AND THE NEW PHASE OF ENERGY POLICY: 1973–1986

On 6 October 1973, Egypt and Syria declared their aim of recapturing the Arab territories occupied by Israel since 1967. Following this event, the Arab Oil Exporting Countries threatened to cut their production of oil by 5 per cent and to continue to reduce that amount thereafter, until Israel withdrew from the occupied Arab lands. Saudi Arabia pressured the US to change its policy towards Israel and declared that Aramco's exports (the major Saudi Arabian oil company) would be halted if no change in their policy took place. The United States, having the weak repercussions of the 1967 crisis in mind, did not take this threat seriously and thought of the use of the 'oil weapon' by Saudi Arabia as having no more effect than in 1967.⁶⁸ Saudi Arabia, on the other hand, sought to ensure that the non-Arab productive capacity would not undermine the embargo and also

⁶⁷ See generally, *ibid* at pp 8–10.

⁶⁸ Evans, *OPEC and Its Member States*, above n 58, at 84. An 'oil weapon' signifies 'any manipulation of price and/or supply of oil by exporting nations with the intention of changing the

supervised the destination embargo more closely⁶⁹ to prevent the swap arrangements, which had been used during the 1967 crisis to undermine the boycott.⁷⁰

Exporting countries, worried about the negative effects of the embargo on their revenue, increased the tax on oil, which enabled production to be cut without causing the revenue to fall below the revenue of the previous month.⁷¹ In order to minimise the detrimental effects of these gradual cutbacks, a wide variety of measures were introduced by consuming countries, such as conservation of the oil stocks, restrictions on the sale of gasoline and the use of motor vehicles, restrictions on non-essential uses of electricity, and limitations on the heating of buildings.⁷² There was at no point a shortage of petroleum in European markets, but the price kept increasing.

Oil import prices quadrupled. The posted price of Arabian light crude increased from \$3 per barrel in early October 1973 to \$11.65 per barrel in January 1974. Sudden inflation and economic recession ensued, leading to unemployment, the closing down of schools and offices and cuts in the production of major factories. This fact caused some to believe that 'a staggering disequilibrium in the global balance of payment will occur that will place strains on the monetary system far in excess of any that have been experienced since the war'.⁷³ The German Chancellor Helmut Schmidt explained the situation as an extraordinarily unstable one, which revealed the fragility of the elaborate system of economic relations among the nations of the world. However, the positive note was that, whereas the oil crisis could have touched off a chain reaction of destructive forces, it might in fact have helped to improve international cooperation.⁷⁴

The anxiety of an oil shortage led some consumers to approach oil-exporting countries directly in order to satisfy their crude oil needs, trying to buy as much as possible at whatever price (panic buying). Major oil companies also failed to take steps to reduce this consumer anxiety. Unlike some who believe that their failure to act was due to impotence, others believe the reason to be the fact that

political behaviour of the consumer nations'. See H Maull, 'Oil and Influence: the Oil Weapon Examined' in G Treverton (ed), *Energy and Security* (Farnborough, Gower Publishing, 1980) at 3.

⁶⁹ Evans, *OPEC, Its Member States*, above n 58, at 84.

⁷⁰ The arrangements allowed the Arab oil to be swapped by another country's energy to be sent to the embargoed country.

⁷¹ Evans, *OPEC, Its Member States*, above n 58, at 84.

⁷² *Ibid.*

⁷³ Statement of the Managing Director of the International Monetary Fund, Johannes Wittveen, in January 1974. See in general, M Mauksch, *Energy and Europe: EEC Energy Policy and Economy in the context of the World Energy Crisis* (Brussels, European News Agency, 1975) at 13.

⁷⁴ See H Schmidt, 'The Struggle for the World Product: Politics between Power and Morals' (1974) 52 *Foreign Affairs* 437 at 437:

He believes that each side, the oil-producing and the oil-consuming countries, must learn to understand and appreciate the other's interests, means and possibilities, since there is no other way of avoiding abortive actions and corresponding reactions. (*ibid* at 443)

See also GA Pollack, 'The Economic Consequences of the Energy Crisis' (1974) 52 *Foreign Affairs* 452.

‘they welcomed the higher prices and higher profit margins that this panic-buying induced.’⁷⁵ Whatever the reason, the oil companies would not or could not cooperate as the European Commission had predicted. Cooperation between companies and governments did not develop to mitigate the effect of the crisis, and distrust and doubt prevailed regarding the capacity and will of the companies to satisfy national and European interests.⁷⁶

The belief existed that the concept of ‘oil weapon’ was shaping the attitude of the oil-exporting countries. The use of the ‘oil weapon’ meant that exporting countries would take advantage of the dependence of the importing countries on their energy resources to achieve their political goals in combating Israel. Some nations had been reluctant to use this weapon. For example, Saudi Arabia was reluctant to have recourse to this policy due to their traditional position of ‘not mixing oil with politics’. However, the deadlock in the Arab–Israeli conflict in 1973 put an end to this policy and they showed their enthusiasm to use this new strategy. However, their emphasis was that this policy should not be translated into a revenge policy. The original intent was rather to ‘alert the world public opinion to the gravity of the Arab–Israel conflict’.⁷⁷ Other small Arab states followed the leadership of Saudi Arabia in adopting this policy (Kuwait, Qatar, Abu Dhabi and Bahrain). However, Iraq, having a long history of tense relations with the US and Britain, showed outright hostility towards the Saudi attitude and favoured a more harsh reaction and a selective embargo. They believed that all foreign oil companies belonging to ‘hostile’ countries (namely US and Britain) located in the Middle East should be nationalised and they themselves nationalised the Basra Petroleum Company (BPC), which possessed shares owned by American Exxon and Mobil. The other exporting countries of the Middle East did not follow this policy.⁷⁸

Following two meetings of the Arab countries, a distinction was created between different Western countries and more importantly between Western European ones. In these meetings, followed by other Arab summits, a basic boycott policy was launched through which various European countries were favoured or disapproved by the Arab world. The most favoured countries were

⁷⁵ For an introduction to the interpretation of the oil crisis, see R Vernon contribution in R Vernon (ed), *The Oil Crisis* (New York, WW Norton, 1976) at 6.

⁷⁶ See R Prodi and A Cló, ‘Europe’ in Vernon (ed), *The Oil Crisis*, *ibid*, at 91.

⁷⁷ See G Lenczowski, ‘The States as Actors: The Oil Producing Countries’ in Vernon (ed), *the Oil Crisis*, above n 75, at 62.

⁷⁸ It is rightly pointed out that the policy of nationalisation of oil companies located in the Middle East or other Arab exporting countries could not be followed in a uniform way. It was important to see how much the foreign company had a stake in that national company. Eg, the nationalisation of Basra Petroleum Company could not have detrimental effects upon the economy of Iraq as such because Exxon and Mobil were only ‘remote shareholders’. On the other hand, if Libya, a country in which American companies had a great stake and played a very important role in oil production, wanted to follow the policy of Iraq, grave economic consequences would have ensued, and it would have been difficult for them to find substitutes for production of their energy. See generally Lenczowski, ‘The States as Actors’, *ibid*.

held to be Spain, France and Britain, as they did not show support for the state of Israel. Belgium was placed in the list of friendly countries because it changed its approach towards the Arab world, and it was therefore eligible to receive supplies before the cutbacks began. Neutral countries such as Italy were subject to the first 5 per cent cutback only and not to the following ones. Regarding the hostile countries, such as the Netherlands and Portugal, a full embargo applied⁷⁹ since Arab countries believed that they were directly or indirectly supporting Israel.

The different approach towards Community member countries increased the already existing difficulties in reaching a common policy. France and Britain enjoyed privileged access to oil in the Middle East, and the proposal of oil sharing by the Community was resisted by Britain. In November 1973, the EEC published a declaration urging both parties in the Arab–Israeli war to withdraw and called for a peace settlement. Finally, the Foreign Ministers of the Community took a joint stand in favour of the Arab States which was later confirmed in the Copenhagen summit of December 1973. This declaration was received with satisfaction by the Arab world. They suspended their earlier decision to cut back supplies to Europe by another 5 per cent.⁸⁰ The Heads of States of the Community also agreed to develop a special relationship with the Arab world through an Arab–Euro dialogue.⁸¹ However, this remained a mere declaration and no practical steps were taken at the time because it sparked a hot debate between the Community Ministers and the US Secretary of State, Henry Kissinger, and made it difficult for the European party to move towards this dialogue without the blessing of the American ally.⁸² The Americans saw the Euro–Arab Dialogue as a threat to their plan of coordinated Western energy policy, the best example of

⁷⁹ See Lenczowski, ‘The States as Actors’ above n 77, at 66.

⁸⁰ See R Prodi and A Clò, ‘Europe’, above n 76, at 106.

⁸¹ The Council accepted the idea of having a dialogue between the Community and the Arab countries on 11 February 1974. In November 1974, the Arab League demanded the participation of the PLO (Palestinian Liberation Organisation) in the first meeting that was scheduled to take place on 26 November 1974. The Community did not reach an agreement to accept the participation of the PLO and the summit did not take place. The Community later suggested discussing the establishment of a dialogue between experts in different fields, and asked the PLO to nominate their expert as well.

⁸² See Lucas, *Energy and the European Communities*, above n 5. At the time, it was not only reaching a consensus among Members of the Community to establish a common policy towards producing countries that was difficult to achieve; the diversity of interests among Arab countries themselves added to the problems of creating an efficient dialogue. As Vanden Abeele explains:

si la Communauté Européenne ne parvient pas à définir dans le domaine de l’énergie quelle est la nature de sa communauté d’intérêts, les divergences existent également dans le camp des partenaires arabs. Il faut tout d’abord se demander quelle communauté d’intérêts peut exister entre l’Égypte et le Koweït dont les revenus nationaux par tête se situent aux deux extrémités de l’échelle et dont les problèmes de développement sont totalement différents. Même au sein du group des pays producteurs de pétrole les objectifs de développement mais surtout les besoins sont totalement différents. Il en va de même pour les régimes politiques. Comment, en effet, voir une ligne cohérente entre le socialisme militant de l’Algérie et le capitalisme sauvage de certains pays du Golfe Persique?

See M Vanden Abele, ‘Problématique de l’énergie et dialogue Euro–Arab’ in J Bourrinet, *Le Dialogue Euro–Arab* (Paris, Economica, 1979) at 224.

which was the creation of the IEA, which they considered to be a means of placing counter-pressure on the Arab states.⁸³

Nonetheless, the first declaration of the Community in the context of Euro-Arab dialogue was wholly dedicated to the Middle East peace process. It was believed that security in the Middle East would guarantee security in Europe. Only in June 1974 did the Community adopt a text in which they enumerated the fields in which cooperation should be established, and the field of energy was named as one along with agriculture, transport, science and technology, and financial cooperation. In 1975, the economic objective of this dialogue was said to be the assistance of the development of Arab countries and the reduction of 'le fossé technologique' that separated the Arab and the European countries.⁸⁴ The necessary instruments were in place for giving this assistance: great potential in the field of technology on the part of the Community and the possession of abundant primary resources on the part of the Arab states. However, the Arab League insisted that the dialogue was not a substitute either for the current efforts of finding a solution to the Middle East crisis or for discussions between the 'consumers' and 'producers' of oil. It was said that 'Europe can and should play a more active role in presenting initiatives aimed at both, supporting current efforts and preventing polarization'.⁸⁵

Although a declaration was published by all the Ministers, the real gap between the Member States did not diminish. The difficulties of the crisis were mainly the result of disturbances in the internal distribution of oil products due to the non-cooperation of Member States and the non-transparency of the activities of the oil companies. With respect to the Member States, the French and British refused to abide by any cooperation measures with other members as they were eager to maintain their favoured positions on the 'Arab Preference lists' for the future.⁸⁶ Moreover, no measure was in place to regulate the activities of the energy companies, which led some to complain that 'it is inadmissible to be kept in the dark about the sales, policies, prices and profits of the international oil companies, which were operating in their territory and which were behaving like a state within a state'.⁸⁷

This state of affairs in the aftermath of the oil crisis not only shows the difficulty in creating a comprehensive common energy policy but also highlights

⁸³ See U Steinbach, 'The European Community and the United States in the Arab World: Political Competition or Partnership' in B Khader, *Cooperation Euro-Arab* (Université Catholique de Louvain, Le Centre d'Étude et de Recherche sur le Monde Arabe Contemporain, 1982) at 316.

⁸⁴ See the first formulation of the general principles and objectives of the Euro-Arab Dialogue, reproduced in J Bourrinet, *Le Dialogue Euro-Arab* (Paris, Economica, 1979) at 296.

⁸⁵ E Volker (ed), *Euro-Arab Cooperation* (Leiden, AW Sijthoff, 1976) at 220. For example, they respected the right of the Community to conclude agreements with other states or group of states but did not accept that the agreement reached between the Community and Israel on May 1975 would necessarily further the objectives made in the declaration of November 1973 in creating an Arab-Euro Dialogue.

⁸⁶ Prodi and Clò, 'Europe', above n 76, at 106.

⁸⁷ Statement of the German Ministers of Commerce in Prodi and Clò, 'Europe', above n 76, at 104.

the link between energy security and foreign policies of various member countries. This crisis created an opportunity to pressure the Member States to also establish a common foreign policy within the Community but the time was not ripe to touch upon such sensitive issues.

Nonetheless, the crisis led to the adoption of some common measures by energy-consuming countries. A conference in Washington in February 1974 highlighted the divergence of ideas between France and the other members of the Community over the pursuit of a largely multilateral approach by the major oil-consuming countries to rectify their supply difficulties through the establishment of the Energy Coordinating Group (ECG). This Group, along with the United States, Norway, Australia, Canada and Japan, devised an oil-sharing scheme. France remained outside. The ECG later formed the International Energy Agency in the context of the OECD.⁸⁸ The two main elements of the strategy to create this agency, initially proposed by the US, were, on the one hand,

the implementation of an oil-sharing mechanism in order to protect the oil-consuming countries against a new embargo, and on the other hand, the shift from a seller's market to a buyer's market through the enforcement of oil-saving measures and the switch to other energy sources.⁸⁹

The political motive of eight Community members, France excluded,⁹⁰ to accede to the IEA lay in their realisation of OPEC's success in establishing a cartel for a commodity and the conclusion that the only safe course was to 'rally behind the US in the latter's bid to build up a countervailing power to OPEC'.⁹¹ Although they had already reached a consensus to possess an oil-saving mechanism through Directive 68/414 (referred to above), these Community Member States realised the predicament of not being powerful enough to combat any embargo in the future on their own and without the cooperation of other consuming nations outside the Community.

In 1974, a Communication from the Commission to the Council revealed again the necessity of promoting the development of nuclear energy. They referred to the detrimental effects of the oil crisis on the balance of payments and stated that a trade deficit would immediately result in an increase in the external debt of the Community.⁹² However, the problem was identified as the differences between the Member States, due to their varying gross domestic products (GDPs) and the availability of energy resources in some countries as opposed to another.

⁸⁸ See also M Willrich and M Conant, 'The International Energy Agency: An Interpretation and Assessment' (1977) 71 *American Journal of International Law* 202 at 202.

⁸⁹ See H Simonet, 'Energy and the Future of Europe' (1975) *Foreign Affairs* 450 at 454.

⁹⁰ France did not join the International Energy Agency until 1992 because of its strong belief that its country's energy security can be better guaranteed through independent action rather than a concerted action with third countries outside the Community.

⁹¹ See H Simonet, 'Energy and the Future of Europe', above n 89, at 455.

⁹² Communication presented to the Council by the Commission on 5 June, 1974, *Towards a New Energy Policy Strategy for the Community* [1974] 4 *Supplement to the Bulletin of the European Community* at 7.

The lack of energy resources in one country results in their growing dependence, which would create disequilibrium compared to the less dependent countries. The solution for such disequilibrium was once again said to be the promotion of nuclear energy.

Hence, for the first time, diversity of energy sources, ie diversification from one source of energy, such as oil, to other sources such as electricity, gas or nuclear energy, was considered as a desirable objective. It was said that natural gas would also play an important role in decreasing the dependence on oil, and a more competitive Community coal industry would give rise to the development of a greater potential market for imported coal. In addition, nuclear-generated electricity consumption was encouraged, which would in turn establish the largest market for nuclear energy. With respect to natural gas, they mentioned its inherent advantages as regards pollution and its rational use. Moreover, in the long term

natural gas was meant to offer the advantage of an additional outlet for nuclear energy in a way that the infrastructure for transporting gas could gradually be used for distributing hydrogen or synthesis gas produced by means of heat of nuclear origin.⁹³

The import of natural gas from third countries could entail a degree of dependence on outside sources of supply, but ‘they may nevertheless be more secure than oil imports, in that they further diversify the origin of supplies and their conditions of supply offer particular safeguards.’⁹⁴ It was acknowledged, however, that oil would continue to be a basic element in the supply pattern. Therefore, relations with the producing countries and continued negotiations with them to obtain information regarding future market trends were considered as an essential aspect of Community oil policy.

The Community had yet to realise the problem that creating an energy policy was much more than the mere implementation of economic and financial measures to sustain coal production or to increase nuclear energy production. Although this policy covers the whole area of energy conservation and development of energy sources other than oil, it also covers the broader issue of maintaining an alliance between the IEA members. The role of the US and their emphasis on being ‘independent’ rather than involving the producing countries in designing an energy policy, hampered the Community in acting on its own. The influence of the US and their insistence on strengthening their position within the IEA pushed the Community away from initiating a dialogue with the producing countries.⁹⁵

⁹³ *Ibid* at 8.

⁹⁴ *Ibid* at 23.

⁹⁵ No substantive measures were taken in the second half of the 1970s. At the Conference on International Economic Cooperation, a dialogue was initiated between the industrialised countries and developing countries (both the importers and exporters of energy). The final declaration of this Conference, however, did not include the Community’s proposal to have a continuous consultation on energy problems between these two sets of countries. The mechanism due to be set up for the New

The Iranian revolution of 1979 caused serious disturbances to the world oil market as prices went up once more. In this year the Community's efforts were concentrated on remedying this situation. Proposals were made by the Commission to design a concrete energy policy, and in June 1980 the Council adopted a Resolution on the Community's energy policy objectives for 1990. These policies reaffirmed the need for greater energy savings and a reduction in oil imports. At the external level, the Commission sent the Council a Communication on aspects of external measures by the Community in the energy sector.⁹⁶ Moreover, for the first time energy formed the main topic of a European Council meeting, held in Luxembourg in April 1980, which underlined the importance of international energy cooperation and the opening of a constructive dialogue with the oil-producing countries.⁹⁷

War broke out between Iran and Iraq in 1980 and the suspension of oil exports from these two important energy-producing countries prompted the Commission to propose to the Council the reinforcement of measures to prevent unjustified price increases as had occurred during the 1973 crisis. These measures were mainly directed at the utilisation of oil stocks by the Member States and refraining from abnormal purchases.⁹⁸ Later in 1981, the measures were extended to cover the reduction of natural gas imports. Nonetheless, uncertainties regarding trends in the price of oil were still worrisome. Consequently, the Commission launched a technical cooperation programme with various organisations representing producer and consumer countries, (such as the Organization of Arab Petroleum Exporting Countries (OAPEC)), and established contacts with the Gulf Cooperation Council (GCC) (details of this latter cooperation are given in chapter 6.3).⁹⁹

For the remainder of the decade, the world oil market was marked by surplus production capacity and therefore no immediate danger threatened the Community's economy. However, one major event in 1986 shifted the perspective: the

International Economic Order within the UN General Assembly's 32nd session was not applied to the energy sector. See Conference on International Economic Cooperation: Final Communiqué on Energy Raw, Materials and Trade, Development, And Finance, reproduced from the US Department of State Press Release no 257 of 3 June 1977 in (1977) 16 ILM 970.

⁹⁶ Communication presented to the Council by the Commission, (1979) 1 *Bulletin of the European Community*, points 1.2.1 to 1.2.11.

⁹⁷ (1980) 6 *Bulletin of the European Community*, point 1.1.4.

⁹⁸ See the 14th General Report of the European Economic Community, 1980 at II-12.

⁹⁹ See the 17th General Report of the European Economic Community, 1983 at II-13. The Gulf Cooperation Council was created in 1981 between 6 countries of the Gulf, namely Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the UAE. The GCC Charter states that the basic objectives of the Council are to

affect coordination, integration and inter-connection between Member States in all fields, strengthening ties between their peoples, formulating similar regulations in various fields such as economy, finance, trade, customs, tourism, legislation, administration, as well as fostering scientific and technical progress in industry, mining, agriculture, water and animal resources, establishing scientific research centres, setting up joint ventures, and encouraging cooperation of the private sector.

See <http://www.gcc-sg.org>.

accident at the Chernobyl nuclear power station. The Commission, based on Chapter III of the EURATOM Treaty, took the initiative of sending to the Council and the Parliament an outline communication on the consequences of the Chernobyl accident, which pinpointed five areas where action was needed: health protection, intrinsic and operating safety of installations, emergency procedures, international action and research.¹⁰⁰ This event showed the importance of the international responsibilities involved in the operation of a nuclear power plant and two further international conventions were adopted: one on early notification of a nuclear accident and the other on assistance in the case of a nuclear accident or radiological emergency in the framework of the International Atomic Energy Agency.¹⁰¹ The Council also adopted an important resolution concerning new Community energy policy objectives for 1995,¹⁰² in which the necessity of 'adequate and secure availability of energy on a satisfactory economic basis, as a prerequisite for the pursuit of the economic and social objectives of the Community and of the Member States was acknowledged'. For that reason, the resolution sought to contain energy consumption, to restrict the share of oil, and to ensure that the level of dependence on imported energy (in particular imported oil), was not unreasonable. An innovative aspect of the resolution was its call 'for the development of the Community's external relations in the energy sector by virtue of a coordinated approach, in particular, on the basis of regular consultations between member States and the Commission' (Art 5(h). The objective was to promote the consumption of solid fuels (such as coal) and to explore and exploit the oil and gas reserves of the Community, keeping oil imports at less than one third of energy consumption (Art 6(b)). The Council also agreed that nuclear energy should play an important part in the energy balance of the Community and appropriate measures, based on the highest standards of safety, must ensure that all aspects of planning construction and operation of nuclear installations fulfil optimal safety conditions (Art 6(e)).

Overall, the period between 1973 and 1986 marked the beginning of the establishment of an energy policy that took the externalities of energy security into account. The aftermath of the oil crisis of 1973, followed by the rise in oil prices after the Iranian revolution and the Iran–Iraq war (which saw the largest oil disruption since 1973 and resulted in the shortage of 5.6 mb/d of oil in the market for 6 months),¹⁰³ triggered an understanding among the members of the Community that some measures needed to be undertaken. At the internal level these measures mainly concentrated on the accumulation of oil stocks and the increase in the use of nuclear energy. At the external level, although measures

¹⁰⁰ (1986) 6 *Bulletin of the European Community*, point 2.1.241.

¹⁰¹ See the Convention on Early Notification of a Nuclear Accident, INFCIRC/335 and Convention on Assistance in the case of Nuclear Accident or Radiological Emergency, INFCIRC/336.

¹⁰² See the Council Resolution of 16 September 1986 concerning New Community Energy Policy Objectives for 1995 and Convergence of the Policies of the Member States, [1986] OJ C/241/1.

¹⁰³ For a review of world oil disruption see the IEA report at <<http://www.iea.org/Textbase/Papers/2004/factsheetcover.pdf>>.

were limited to initiating very basic dialogues with energy-producing countries, it showed that cooperation with them was inevitable in order to guarantee full security of supply.

2.5. THE FEEBLE ATTEMPT TO CREATE AN EFFICIENT EXTERNAL ENERGY POLICY: 1987–2006

The period between 1987 and 2006 is marked by the collapse of the Soviet Union, the signing of the Energy Charter Treaty, the adoption of the Gas and Electricity Directives, the establishment of a European energy market, and the discussion of the new Constitution for Europe, with all their direct and indirect implications for Europe's external energy security. Many measures were adopted at the Community level and many opinions were communicated between the Community institutions and the Member States. Due to the importance of these initiatives and because they reveal the current state of the Community's external energy policy, the rest of this study is dedicated to their detailed analysis. Nonetheless, a brief general overview is provided here.

In the aftermath of the adoption of the Single European Act in 1986, and up until the collapse of the USSR, there was no strong 'Community' initiative to establish external relations with energy-producing countries in order to specifically guarantee Europe's future demand for energy supply. In its 1988 working document on the 'Internal Energy Market', the Commission stated the need for the establishment of an internal energy market and analysed the obstacles to the creation of such a market in Europe. The only reference to externalities was by mentioning that 'there is an international side to energy' and the fact that Europe was dependent on the outside sources for nearly half of its energy supplies. The Commission suggested that it was in the interests of all concerned to strengthen links with the outside world and to support free trade of energy based on international trade rules as embodied in the GATT (para 26).¹⁰⁴ The rest of the document seeks to highlight the ways through which existing obstacles to the establishment of an internal energy market, such as fiscal and technical barriers, should be eliminated.

The real spark of enthusiasm came after the collapse of the USSR, which initiated a long debate on establishing international relations that were mainly focused on the energy sector with the objective of setting up a framework for the long-term guarantee of a free flow of energy into the Community. Although the need to secure the Community's energy supply had always existed, it was mainly taken care of by the Member States in their individual capacity, with the exception of the Community Directive on holding oil stocks as a safety measure in case of a crisis (see chapter 4.3.). After the collapse of the USSR, considering

¹⁰⁴ See the Commission Working Document, 'The Internal Energy Market', COM (1988) 238 Final.

the vast endowment of energy resources in that country and the geographical proximity of some of the newly independent states to Europe, efforts were initiated to take advantage of the situation and to build a new framework at the external level that concentrates exclusively on energy security, and it was then that the Energy Charter Treaty came into being. This treaty can be regarded as the first attempt of the Community to guarantee its external energy security on a multilateral level, which includes investment in, and trade and transit of, energy (see Chapter 5).

Although the necessity of establishing external relations with the energy-producing countries of the East, and later other energy-producing countries of both North Africa and the Middle East, never disappeared, efforts subsequently shifted to include the energy sector within the overall framework of the internal market, something that had not happened in previous periods. Although the concentration on creating an internal energy market could have contributed to the long-term security of energy supply, the way it was shaped focused too much on internalities rather than on also incorporating relations with energy-producing countries, because after all a major part of the energy needs of Europe were supplied from outside the borders of the internal market. Nevertheless, the initial belief was that the creation of an internal energy market would largely eradicate the problem of 'dependence'.

After the adoption of the electricity and gas directives and the difficulties faced by Member States in adjusting their domestic policies to them, attention is again being paid to the necessity of first establishing links with the geographically adjacent countries of the Community, such as Russia and the countries of the Mediterranean, which are important both for their energy reserves and the transit of energy, and secondly with the energy-rich countries of the Middle East. These efforts can be traced in the new energy dialogue with Russia, the inclusion of energy relations in the EU–Mediterranean partnership and initial attempts to build relations with the countries of the Gulf Cooperation Council. On the other hand, some traces of 'externalities' can be located in the internal legislation of the Community, although they remain dim, and some more attention is paid in soft documents, such as the Commission Communications and Green and White Papers. This new trend is due to the fact that the Community was faced with the reality that no matter how efficient the internal energy market functions, the dependence on external energy was increasing and something had to be done sooner than later, especially due to the fact that projections heralded a sharp rise in energy demand over the years to come. Especially for that reason, the European Community became more active in 2006, after the Russia–Ukraine gas crisis, and dedicated a substantial effort in the Presidency Conclusions of March and June 2006 to energy and management of external dependence. Conferences were also held by the European Commission to discuss a possible 'EU external energy policy' and how to assure a high level of supply security. For the first time the Commissioner for External relations and the Energy Commissioner highlighted in November 2006 that it is in the direct interest of the European

Community to 'maximise coordination in the external area and speak with one voice' and 'work together for the extension of the European energy market beyond the EU borders'.¹⁰⁵ While these attempts should be praised, an efficient external energy policy that encompasses all aspects of energy security does not yet exist in the Community for reasons that are extensively elaborated on in this study.

This study enumerates these measures step by step and gives an analytical account of how the Community and the Member States' responsibilities in dealing with issues of security of energy supply are divided. Secondly it examines whether these efforts have been successful in creating an efficient framework for external relations with energy-supplying countries through highlighting the missing links between various measures at the Community level. The study seeks to demonstrate that the overall endeavour suffers from various shortcomings, which, unless rectified, prevent the emergence of a genuine external energy policy.

¹⁰⁵ See the Press Release 'Energy Actors Meet to Discuss an External Energy Policy', 17 November 2006, IP/06/1578.

3

Division of Competences and Security of Energy Supply

3.1. BRIEF REMARK

BEFORE ANALYSING THE law of competences, it is important to mention one noteworthy characteristic of the energy market as far as consumer–producer relations are concerned. As previously emphasised, we should firstly highlight the distinction between oil and gas markets in our analysis. The oil market, unlike the gas market, is a flexible and global market which indicates that the origin and the destination of oil may not play an important role in formulating an oil security framework for the purposes of our discussion on competences. In the oil market, supply is not addressed to a particular region or country but to a ‘great pool’ that constitutes the ‘world’ oil market.¹ The oil can be easily re-directed to other destinations. The gas market, however, does not yet possess this characteristic. It is regional and rigid. It is therefore important to create a physical link (eg a pipeline) between producer and consumer and a privileged relationship between the two would thus guarantee a more efficient energy security system. For this reason, the following discussion on the creation of an external energy policy, by either the Community or the Member States, would be definitely relevant for energy in the form of gas. What about oil? Would the fact that the oil market is a global market lead to the conclusion that establishing a privileged relation with particular oil-producing countries is worthless and would not prevent an oil crisis? Would this characteristic lead us to have a global approach in dealing with oil security matters rather than a ‘regional’ approach, or, for the purposes of our study, a ‘Community’ approach? The answer is no.

¹ See in particular, P Noël, ‘Approvisionnement énergétique de l’Europe et politique étrangère commune: une problématique’, at 3, available at <<http://www.upmf-grenoble.fr/iepe/textes/PNeurope.PDF>> [hereinafter ‘Approvisionnement énergétique’]. See also P Noël and P Criqui, ‘Marchés énergétiques et géopolitique pétrolière, 1990–2030’, (1998) <<http://www.upmf-grenoble.fr/iepe/textes/pnpc98.pdf>> [hereinafter ‘Marchés énergétiques et géopolitique’].

Firstly, the development of world oil reserves is an important factor in securing oil supply.² Most oil-rich countries do not possess the necessary infrastructure to develop their reserves efficiently: therefore, the development of these reserves by foreign assistance becomes crucial. Another question to be answered immediately here is why, in that case, it is necessary to formulate an external energy policy for the European Community (EC) when the main task of developing a given reserve in a third country is mostly accomplished by private oil companies, such as Shell or Total? The answer is that the history of international investment in the field of energy suggests that when political relations between two countries or two regions are not at their best, foreign oil companies hesitate to invest in that country or that region. Hence the external policy of the Community in general, and in particular the policy specifically touching upon the way in which an energy-producing country is dealt with, affects the activities of a given European oil company. For that reason, the formulation of an external energy policy to secure oil supply also becomes relevant. Moreover, the development of a third country's oil reserves by private companies does not imply that other institutions or bodies cannot carry out this activity. The European Community's membership of the Energy Charter Treaty (which aims at investment in the development of energy fields), and the Community's INOGATE programme³ (which seeks to promote interstate projects to attract large-scale investment to energy-producing and transit countries), illustrate the fact that creating an environment where investment in the energy sector can be facilitated and protected is also a task of public authorities, including the EC, and not just of oil companies.

Secondly, an external policy could assist in stabilising regions in which oil is found.⁴ Those regions, such as the Middle East, North Africa or the Caspian are tainted by political instability that would indirectly affect the flow of oil to consuming countries or increase its price. Stabilisation, although a difficult task, could be achieved through the direct involvement of the Community. A stable Middle East would enable a secure environment for the activities of energy operators in the region. This would be in turn beneficial for both consuming and producing countries. For this reason too, the discussion of the relationship between the consuming and the oil-producing countries becomes significant.⁵

This issue clearly touches upon the importance of both an economic and a foreign policy approach to the discussion of energy security. For this reason, a

² See Noël, 'Approvisionnement énergétique', *ibid*, at 4.

³ For an explanation of the INOGATE Program see <<http://www.inogate.org>>.

⁴ See Noël, 'Approvisionnement énergétique', above n 1, at 4.

⁵ Some commentators add a third reason for the necessity of a Community foreign energy policy that is elaborated in the context of a military presence, which is found necessary to re-establish the normal oil supply condition where it has been halted for one reason or another. This study will not discuss this option as it necessitates a detailed discussion of the likelihood of the existence of a European military force, and also as it is believed that the first two reasons should suffice to enable the design of a policy which eradicates the need to have recourse to a military option. See Noël, 'Approvisionnement énergétique', above n 1, at 4.

separate chapter is later dedicated to foreign policy in this study. Now that it is clear that there is a role for the Community in guaranteeing energy security as a whole, including oil and gas, we turn to analysing the division of competences between the Community and its Member States regarding the security of energy supply and discuss its adequacy and shortcomings.

3. 2. INTRODUCTION

The design of an external energy policy for the European Union, ie a policy towards the energy-producing countries, is inextricable from broader economic and foreign policy challenges. As explained in the preceding chapter, the crucial role that energy plays in the economy of a given country or a region, on the one hand, and the inevitability of dealing with the overall relations between the two sets of consuming and producing countries on the other, necessitates the analysis of both these broader dimensions in designing an external energy policy. European efforts to establish a common foreign and security policy and the dependence of Europe on energy-producing countries to guarantee energy security, plead for an analysis of how best this security can be guaranteed at the EU level, and how the mutual interaction between the European Union and the Member States should be designed. It should seek to determine whether the formulation of an external energy policy should be placed outside the scope of EU activities that are concerned with economic and foreign policy, and whether the individual member countries should be allowed to design such a policy independently from each other (as they have done in the past), or whether, on the contrary, there should be a stronger role for the Community.

Some energy experts argue in favour of providing the Community with the task of formulating an energy security policy, while others emphasise the role of national governments. The former argue that in a liberalised market, where energy exchange between Member States should be guaranteed at any time (eg stock exchange and solidarity obligations at a time of crisis), when the interdependence of Member States in energy matters is increasing, and when a failure to adopt adequate measures in one Member State can have serious consequences for the operation of the internal market throughout the European Union and beyond,⁶ it seems odd if broader necessary measures, such as creating a stable relationship between importing and exporting countries, are undertaken at the Member State level alone. They argue that a degree of cooperation should be created and a Community framework of action should be adopted. On the contrary, the latter group of experts argue that national governments can better guarantee the security of energy supply independently from the Community, due

⁶ See the Memo of the Directorate General of Energy and Transport of the European Commission, *The internal energy Market: Improving the Security of Energy Supplies*, 2002. http://europa.eu.int/comm/energy/oil/internal_market/doc/memo2002_en.pdf.

to their familiarity with their own specific market.⁷ These divergent views will play a role in discussing how the division of competences in the European Community should be approached. This issue is analysed at the end of this chapter.

By examining the ways through which the competences⁸ of the Community and the Member States were divided, one can only agree that there is a direct link between the sensitivity of a specific sector and the debate on the division of competences. The closer a matter is related to the basic principles of the Community, the more likely it is that the Community will be allowed to deal with it. The best example of this link is the formulation of the common commercial policy, which was placed in the hands of the Community and the Community alone, since it was said to be directly linked to one of the most important principles of the Community, ie the establishment of a common market.⁹ It was found vital to pursue one of the Community's central objectives (free trade) by action taken externally, since otherwise the position of the Community would have been weakened in its relations with other external entities. It is thus correct to say that the more an activity comes into contact with the most basic principles of the Community, the more probable it is that competence for its formulation and regulation falls to the Community, either as an exclusive power or one shared with the Member States. The expansion of these basic principles results in the gradual extension of Community competences.

Regarding our discussion on Europe's security of energy supply, it should be determined whether the already described principles and rules adopted internally to guarantee energy security (eg the attempt to create a European energy market) necessitate the Commission's involvement at the external level and eventually the formulation of an external energy policy by the Community institutions to guarantee that security. In other words, it should be ascertained whether energy

⁷ The idea that national governments can best deal with energy security issues is rejected by some. John Mitchell believes that for European countries, the concept of energy security on a national basis is losing its meaning. He explains that the challenge for Europe is 'to focus on energy policies in a European projection rather than to play games with old labels'. See JV Mitchell, 'Energy Supply Security: Changes in Concepts', the text of the presentation to the 'Seminaire Européenne sur la Sécurité d'Approvisionnement Énergétique', Ministry of Economy, Finance and Industry, Paris, November 2000 [hereinafter 'Energy Supply Security'] at 15–18.

⁸ The terms 'competence' and 'power' are used interchangeably in this chapter of the study.

⁹ See, eg, Case 1/75, where the ECJ states that Art 113 (now 133) covers a policy, which is conceived in the context of the operation of the common market, for the defence of the common interests of the Community, within which the particular interests of the Member States must endeavour to adapt to each other.

The Court went on to say that

this conception is incompatible with the freedom to which the Member States could lay claim by invoking a concurrent power, so as to ensure that their own interests were separately satisfied in external relations, at the risk of compromising the effective defence of the common interests of the Community.

This would distort the institutional framework, call into question the mutual trust between the Community and the Member States, and prevent the Community from fulfilling its task in the defence of the common interest. See Case 1/75, *Local Cost Standard* [1975] ECR 1355, para 1364.

security is adequately guaranteed through the establishment of a European energy market or whether some active intervention by the Community at the external level is also necessary. This discussion is also directly linked to a more general discussion on the necessity to provide the Union with adequate competence to act efficiently in the international sphere and to allow the Union to speak with one voice. As one writer correctly suggests, 'the evolution of the Union as an effective international actor will depend on the balance between introspective concentration on necessary internal development and reform and a 'realistic confidence' in its external relations.'¹⁰ As far as energy security is concerned, the balance is between internal developments within the Union to guarantee energy security, such as the creation of a common energy market and regulating security stock management, and external measures to guarantee such security and to create an efficient legal and political framework to regulate relations with the energy-producing and transit countries which the Union depends upon. This study argues that a balance does not yet exist and it seems that internal developments in creating a common energy market occur without efficient external relations to accompany them. Although some may argue that success at the internal level will automatically bring success at the external level, and the creation of an efficient internal market will render externalities obsolete, this study aims to reveal the flaws in such approach. This study also goes one step further by claiming that efficient internal development ceases to exist when such a balance is absent and where the necessary security measures to guarantee external energy flow are not in place.

One surprising aspect, hinted at briefly above, is the link between the increase in the external activities of the Community and the ECJ's involvement in analysing the division of competences between the Member States and the Community. For example, due to the increase in the Community's external commercial relations in the 1970's, the ECJ has become more involved in analysing of the relations of the Community and the Member States with third countries. In contrast, by the 1980's, the Community was so much involved in internal activities that there is 'an absence of discussion on the implications for the Community's external trading relations of the internal market program.'¹¹ Although it may seem that the absence of adequate discussion of the effects of internal development on external relations was due to the mind of the Community being occupied in dealing with internal issues, some commentators point out that this same reason has sometimes acted as an excuse not to expand the benefits of the internal market to third parties. Eeckhout, in answer to this lack of linkage, suggests that the unwillingness was due to the existence of a basic policy question, which was posed to the Community as 'to what extent should the

¹⁰ M Cremona, 'External Relations and External Competence: The Emergence of an Integrated Policy' in P Craig and G de Búrca (eds), *The Evolution of EU Law* (Oxford, Oxford University Press, 1999) at 138 [hereinafter 'External Relations and External Competence'].

¹¹ See Cremona, 'External Relations and External Competence', *ibid*, at 142.

Community extend the benefits of internal market integration to non-member country suppliers of goods and services?'.¹² As he suggests, the lack of a clear linkage between internal and external activities is about limiting the expansion of the 'benefits' of the Community to those third states. However, this basic policy question does not arise in the same terms for all sectors of Community activity. The policy question does not squarely fit into the discussion of internal-external energy relations, because the question here is not whether the Community is willing to share the benefits of the internal energy market with third countries. Rather, the question is to what extent the objectives embodied in the internal sphere would not be attained if this linkage is not established? For that reason, the relevance of the Community's activity at the external level becomes especially significant. Hence, it should be determined whether developing the activities of the internal market in general and the creation of the common energy market in particular would not be hampered if sufficient attention were not paid to the matter of external energy security.

Some may argue that when the initial legislative phase for the internal energy market comes to an end, attention will be turned to the necessary external aspects of that policy. The initial phase of activities to establish a common energy market (since the creation of the gas and electricity directives) is not yet complete. However, if one argues that the internal energy market's function, ie guaranteeing the free exchange of affordable energy between Member States, is primarily dependent on either the import of energy or external factors affecting the energy price, or on both, a parallel concern for the external aspects of that policy is required, which is absent from the ambit of developments in the internal energy market. This absence can only be justified if an abundant use of other sources of energy, such as nuclear and renewable energy, renders the issue of dependence on oil and gas obsolete. As explained above, projections show that Europe's dependence on oil and gas will continue to grow in the decades to come, and the use of non-conventional sources will not substitute for conventional ones in the near future. Therefore, external concerns should also shape and define the content of an internal policy, which specifically deals with issues of energy security.

This being said, one needs to assess whether competence is or could be provided for the Community to take this aspect of energy security into account. After all, the Community can only be blamed for not putting efficient energy security measures in place if it actually possesses the power to do so. The 'story' of how energy was dealt with by the Community and the Member States, since the

¹² See P Eeckhout, *The European Internal Market and International Trade: A Legal Analysis* (Oxford, Oxford University Press, 1994) at 342 [hereinafter *European Internal Market*]. For a broad overview of the external relations of the European Community and its case law see P Eeckhout, *External Relations of the European Union: Legal and Constitutional Foundations* (Oxford, Oxford University Press, 2004). See also JV Louis, 'Les Relations extérieures de l'Union économique et monétaire' in E Cannizzaro (ed), *The European Union as an Actor in International Relations* (The Hague, Kluwer Law International, 2002) at 77.

inception of the European Community in the 1950s, was discussed generally in chapter 2. Here, those aspects that are important for our discussion on the law of competences are mentioned.

There are various determinants to decide upon the division of competences from purely legal issues to politically sensitive ones. The influence of the case law of the European Court of Justice (ECJ) on the development of the law on external competences of the Community is rightly said to be a distinctive characteristic of Community law and one of the most absorbing aspects of studying the European Community.¹³ The controversy over the issue of competences, simply stated, is rooted in a crucial balance between the extent to which Europe should ever increasingly speak with one voice, on the one hand, and due respect for the principles of subsidiarity, proportionality and the existing competences of the Member States on the other. The discussion of the competences of the Community to deal with matters related to energy security should include a study of the case law of the ECJ, and an analysis of how this balance has been reached or tipped in different situations.

The powers of the Communities are derived from the treaties. The types of possible measures that may be adopted, and the procedures through which those powers can be exercised are determined by the treaties. Article 5 of the EC Treaty expressly states that ‘the Community shall act within the limits of the powers conferred upon it by this treaty and of the objectives assigned to it therein,’ [the doctrine of attribution of powers]. The important consequence of this attribution of power to the Community is that Member States can no longer retain that power. As the Court commented in *Costa v ENEL*,

the transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a *permanent limitation* of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail.¹⁴

The principle of primacy, as outlined in this case, limits the competences of the Member States in dealing with those sectors for which the Community has been granted competences in the treaty.

Generally, the scope of competences of the Community has greatly expanded over the years. This expansion has been either due to changes in the provisions of the treaties and the addition of a specific sector to the overall competences of the Community, or has been established because it has been proved that such action is necessary to attain one of the objectives of the treaty. This evolution suggests that, in any case, a Community activity should be justified on a legal basis, which is found either expressly in the treaty provisions (explicit power) or is *implied*

¹³ E Stein, ‘External Relations of the European Community: Structure and Process’ in *Collected Courses of the Academy of European Law*, vol 1, bk 1, (Dordrecht, M Nijhoff, 1991) at 128.

¹⁴ See Case 6/64, *Costa v ENEL* [1964] ECR 585 at 593 and 594. See I McLeod, ID Hendry and S Hyett (eds), *The External Relations of the European Communities: A Manual of Law and Practice* (Oxford, Clarendon Press, 1996) at 31 [hereinafter *A Manual of Law and Practice*] at 40.

from those provisions or from secondary internal legislation based on those provisions (implicit power). Interestingly, the implicit power has been extensively used at times when the Community has been faced with new undertakings and challenges. One prominent example of the use of the implicit power is Article 308 of the EC Treaty, which provides

If action by the Community should prove *necessary* to attain, in the course of the operation of the common market, one of the objectives of the Community, and this treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.

This article can be used to extend Community legislation into new areas and to provide harmonisation measures for matters that do not have a specific legal basis (eg the energy sector). As this article is a 'residuary' power to be used 'only where no other provision of the Treaty gives the Community institutions the necessary power to adopt the measure in question',¹⁵ it has been expansively used in the field of energy.¹⁶ A statistical survey of acts adopted on the basis of Article 308 in the energy field shows the frequent use of this article to set up framework programmes, technological action programmes, research programmes, international cooperation measures¹⁷ and to conclude international agreements in the field of energy, such as the Energy Charter Treaty. The reason for such a wide use of this article, or say rather, the permission to use this article as a legal basis to adopt measures in the field of energy, was due to the fact that 'the Community already possessed an energy policy with relation to coal and nuclear (as mentioned earlier); and other sources of energy such as oil, gas and electricity were said to be covered by the general provisions of the EC Treaty, such as the internal market, competition, commercial policy, development cooperation, environmental policy, and the trans-European networks'.¹⁸ This means that the use of Article 308, as long as future treaty amendments do not limit its application, can create a Community competence in the field of energy where 'necessary'.¹⁹ Nonetheless, it

¹⁵ See Case 45/86 *Commission v Council* (Generalised Tariff Preferences Case) [1987] ECR 1493 at 1520 and Case 242/87 *Commission v Council* [1989] ECR 1425. See also S Weatherill and P Beaumont, *EU Law* (London, Penguin Books, 1999) at 157.

¹⁶ See also the Presidency Note of the 2000 Conference of the Representatives of the Governments of the Member States (IGC), CONFER 4711/00, Brussels, 22 Feb 2000.

¹⁷ See Council Decision 1999/23/EC of 14 December 1998 Adopting a Multi-Annual Programme to Promote International Cooperation in the Energy Sector (1998–2002), [1999] OJ L/7/23. See also Council Reg (EC) No 2598/97 of 18 December 1997 Extending the Programme to Promote International Cooperation in the Energy Sector 'Synergy Programme', [1997] OJ L/351/16 and Council Reg (EC) No 701/97 of 14 April 1997, [1997] OJ L/104/1.

¹⁸ See also the Presidency Note of the 2000, above n 16.

¹⁹ The Treaty Establishing a Constitution for Europe limits the application of this article. Paragraph (1) of the flexibility clause (Art 18–1) of the Constitution provides that:

if action by the Union should prove necessary, within the framework of the policies defined in part III, to attain one of the objectives set by the Constitution, and the Constitution has not provided the necessary powers, the Council of Ministers, acting unanimously, on a proposal from the

is still questionable whether the repeated use of this article might not warrant the creation of a specific legal basis in the EC Treaty. This opportunity was exploited in negotiations on the Treaty Establishing a Constitution for Europe, as explained later in this chapter.

Moreover, secondary legislation that is established in the field of energy through the implicit power based on various provisions of the treaty, such as Articles 308, 95, or 100, plays an important role in expanding the Community's competence in the field of energy. The denser the secondary legislation in the form of directives or regulations is, the more limited the competence of the Member States will gradually become. Internal legislation specifically dealing with the issue of energy security is elaborated on in chapter 4.

The other important aspect of the division of competences between the Community and the Member States is the expansion of the implied powers of the Community from internal to external matters. In the early years of the Community, when it began to perform the tasks entrusted to it by the text of the treaty, the importance of the Community's treaty-making power came to the fore, and the inevitable link between the internal and external activities of the Community became transparent. It was found that the full realisation of many EC internal policies clearly depended on the ability of the Community to negotiate and conclude international treaties with third parties.²⁰ These external abilities and powers are either expressly conferred on the Community by the treaty, or implicitly arise, according to the Court, from the treaties or from secondary legislation adopted pursuant to the treaty (implied external power).²¹ When competence is established, either through the former or latter possibility, the Court sometimes deals—although inconsistently—with the peculiar question of

European Commission, and after obtaining the consent of the European Parliament shall take the appropriate measures. This article is less flexible than Art 308 of the Nice Treaty (ex Art 235). Art 308 allows such action in 'the course of the operation of the common market' whereas the Constitution limits this action to the framework of the policies defined in Part III of the Constitution. Therefore, this 'flexibility' is applicable in so far as the action falls within the sectors already prescribed in the Constitution. See also S Weatherill, 'Competences' in B de Witte, (ed), *Ten Reflections on the Constitutional Treaty for Europe* (Florence, RCSAS, 2003) at 59 [hereinafter *Ten Reflections*]. The inclusion of a chapter on energy in the constitution should also be welcomed due to the fact that if energy was not given a separate legal basis, future Community measures, necessary in the field of energy, would not be adopted as 'easily' as before. A real constraint would thus be imposed on the Community in this field. This issue should be of great concern if the Constitution is not ratified and a new set of negotiations to reform the Constitution takes place in the future which keeps the flexibility clause, as found in the last version of the Constitution, and takes out the chapter on energy. A strong lobby from the energy sector may place this sector outside the ambit of the Constitution while the flexibility clause remains unchanged. In this case, the role of the Union in guaranteeing energy security will be extensively limited. Another feature of Art 17 is the role of the Parliament which (unlike Art 308 of the TEC that requires a consultation with the Parliament) necessitates 'the consent' of this organ. See also M Dougan, 'The Convention's Draft Constitutional Treaty: "A Tidying-Up Exercise" that Needs Some Tidying-Up of Its Own', Federal Trust Constitutional Online Essay, no 27/03, <<http://www.fedtrust.co.uk>> at 4.

²⁰ See also JHH Weiler, 'The Transformation of Europe', (1991) 100 *Yale Law Journal* 2403 at 2416.

²¹ See also R Holdgaard, 'The European Community's Implied External Competence after the Open Skies Cases' (2003) 8 *European Foreign Affairs Review* 365 at 368.

whether this competence is one that is 'shared' between the Member States and the Community, or is 'exclusive'. The consequence of fitting into one or other of these categories of competences will be dealt with in the course of examining the case law (section 3.5.). The ways through which energy activities were dealt with in the treaties should firstly be briefly explained.

3.3. FROM THE TREATY ESTABLISHING THE ECSC TO THE NICE TREATY

In negotiating a Treaty on Coal and Steel, the coal and steel resources in France and Germany were considered as the 'commanding heights of the economy'. They were found to be critically important for economic development, and the pooling of these resources indicated a new age of cooperation. The result of these negotiations, the Treaty Establishing the European Coal and Steel Community of 1951, focused on the achievement of peace through expanding production and raising standards of living. In that treaty, the institutions of the Community were 'responsible to ensure the maintenance of conditions, which would encourage undertakings to expand and improve their production potential and to promote a policy of using natural resources rationally and avoiding their unconsidered exhaustion' (Art 3). This task had to be undertaken 'within the limits of the respective powers of the Community Institutions'.²²

It should be kept in mind that this treaty dates from the 1950s, when Europe had adequate energy, especially in the form of coal and gas, and its dependence on third country producers of energy was only marginal. The latter only gradually became a concern due to the exhaustion of energy reserves and the abandonment of the use of coal in many countries because of its negative environmental effects. It could thus be said that the treaty's failure to refer to the issue of 'external security of energy supply' is to some extent justifiable. It is said 'to some extent' since one could expect the Treaty to be forward-looking: the 'exhaustion of energy reserves' had been commonly known for quite some time and energy projections heralded the increase in energy dependence in the decades to come.

In the ECSC Treaty, the power to use natural resources rationally, which can be considered as a means to guarantee energy security, was placed in the hands of the Community institutions. Moreover, Article 95 of the ECSC established that if the treaty has not provided the necessary powers in some areas, and it becomes apparent that a decision or a recommendation is necessary to attain, a decision can be taken with the unanimous assent of the Council and after consultation with the Consultative Assembly. A similar clause was later inserted into the EEC

²² See Art 3 of the ECSC Treaty. The Community institutions were the High Authority, assisted by a Consultative Committee, Common Assembly, Special Council of Ministers, and the Court of Justice. See Art 7 of the ECSC Treaty.

Treaty and has become one of the most important legal bases to adopt measures in the field of energy (see Article 308 of the TEC).²³

The Treaty on the European Economic Community and the EURATOM Treaty came into existence in 1957. The pooling of resources was again mentioned in the Treaty on the European Economic Community as a means to guarantee peace. No reference was made to the rational use of natural resources as an obligation of the Community institutions, but Article 232 of that treaty left the powers that were already granted to the Community institutions in the ECSC Treaty untouched. Article 103 of the EEC Treaty provided the possibility for the Council to act by qualified majority, upon a proposal of the Commission, to issue a directive to circumvent a difficulty that may arise in the supply of certain products. This provision can also be construed as allowing the Community institutions to be involved in adopting measures to guarantee energy security when there is shortage of energy supply. As later illustrated in the chapter on internal security measures, this provision has been the legal basis for establishing regulations on stock management.

The EURATOM Treaty, on the other hand, can be considered as one of the main obstacles to the development of an efficient security policy with respect to conventional energy sources in Europe for some time. This is because Europe was determined that the use of nuclear energy should render concern for the security of other sources obsolete, so far as dependence on third countries was concerned. The aim of the treaty was to create the conditions necessary to develop a powerful nuclear industry, which would provide extensive energy resources and would lead to the 'prosperity' of the people.²⁴ As embodied in Article 1 of that treaty, relations with other countries should have been concentrated on creating the conditions necessary for the speedy establishment and growth of nuclear industries. Interestingly, Article 52 of that treaty's chapter on 'Supplies' acknowledges the need to secure the supply of nuclear materials and establishes that this supply is 'exclusively' in the hands of an agency which can conclude supply contracts coming from inside the Community or 'outside'. This agency is an institution of the Commission and under its direct supervision. Article 64 of this treaty, on making available the source materials coming from outside the Community, provides that

The Agency, acting where appropriate within the framework of the agreements concluded between the Community and a third state or an international organisation, shall, subject to the exceptions provided for in this treaty, have the *exclusive right* to

²³ Although the ECSC Treaty ceased to exist on 23 July 2002, the content of many of its provisions, such as Art 95, was taken up by the TEC. See also the IGC 2000, Possible Extension of Qualified Majority Voting: Consideration of Some Areas Already Covered by Community Powers, Exercise of Which Has in the Past, in the Absence of Any Specific Procedure, Given Rise to Frequent Use of the Procedure Laid Own in Art 308 of the TEC, CONFER 4711/00, 22 February 2000.

²⁴ See the Preamble of the EURATOM Treaty.

enter into agreements or contracts whose principle aim is the supply of ores, source materials or special fissile materials coming from outside the Community. (emphasis added)²⁵

Hence, the mere task of securing necessary materials to guarantee nuclear supply was placed in the hands of the Community institutions.

The treaty also suggests that users of source materials are allowed to conclude contracts with third countries to supply them only if the agency is not in a position to deliver within a specific period of time or if so, only at excessively high prices. In that case, users of source materials can directly enter into contracts after communicating the proposed contract to the Commission (Art 66). Surprisingly, no such provision ever existed to provide the Community institutions with the task of supplying oil and gas from third countries. This fact clearly shows the preference attributed to nuclear energy, the dominant use of which was encouraged in Europe, and was also deemed to play an important role in guaranteeing Europe's security of supply. Nevertheless, the emphasis on this type of energy gradually changed due to the appearance of potential dangers in its production and use and the negative effects that any accident could have, especially on the environment.²⁶ Although the energy outlook changed, the supply of other sources of energy, such as oil and gas, remained in the hands of the Member States due to their constant insistence on keeping their advantageous relationship with energy-producing countries untouched. This latter point has been extensively dealt with in the first chapter.

The Single European Act of 1986, the Maastricht, Amsterdam and Nice Treaties, all failed to provide new ways through which energy supply should be guaranteed within the Community. The only change was the inclusion of a reference to energy in Article 3 EC Treaty by the Maastricht Treaty. Article 3 states the objective of promoting, throughout the Community, a harmonious, balanced and sustainable development of economic activities, and lists measures in the sphere of energy as one means of attaining this objective (Art 3(t)). However, it is problematic in that the ways through which this activity should have been undertaken were not elaborated on in other provisions of the Treaty. Declaration number 1, annexed to the Maastricht Treaty, provides that the fields enumerated in Article 3(t) will only be examined by the procedure embodied in Article N(2), (now Article 48 TEU),²⁷ that is, through treaty revision. It can therefore be

²⁵ Based on Chapter X of that treaty, Arts 101–106, the possibility exists of including the Member States in the Agreements between the Community and third countries. The Member States may also enter into contracts with third countries or international organisations independently. Although these articles do not determine the areas where the Member States can enter into international agreements, the agreements cannot be concluded for supplying the source materials for nuclear energy because that task was 'exclusively' placed in the hands of the agency. These agreements can possibly be related to cooperation with third countries in other aspects of nuclear cooperation.

²⁶ See section 2.4 of this study on the change of approach to the importance of the nuclear energy.

²⁷ See also V Michel, '2004: le défi de la répartition des compétences' (2003) 39 *Cahier de Droit Européen* 17 at 27.

submitted that those fields enumerated in Article 3(t) (ie energy, civil protection and tourism) remain ineffective until a treaty amendment determines the ways through which such activities should be put in place. Mere reference to some activities without mentioning the specific policy objectives does not provide a competence for the Community to adopt measures in those fields.

Later treaties, such as Amsterdam and Nice, included the same provision, but yet again, no detailed implementing rules were incorporated (see the current Article 3(u)). The Treaty on the European Union does not refer to energy in its text, but some measures adopted under Title V, such as joint actions or common positions include energy as one field of action. The reference to these provisions is made in the last chapter of this study on the activities under the title of Common Foreign and Security Policy (CFSP).

Other areas of the EC Treaty cover the field of energy, but they are mentioned for purposes other than the issue of security of supply. For example, the Community is asked in Title XV to contribute to the establishment of trans-European networks in the area of energy (Art 154); Title XIX on Environment permits the Council to adopt measures that would significantly affect a Member State's choice between different energy sources and the general structure of energy supply (Art 175). This Article, although limited to the sphere of environment, may have strong repercussions for the ways in which individual Member States choose the energy sources for their consumption, because it is likely to tie their hands in importing energy from third countries if that energy does not conform to the requirements imposed by the Council. Nonetheless, this article cannot be named as a provision in line with the energy security concerns referred to in this study. One aspect of energy security is controlling access to diversified energy sources, and this diversification is likely to be limited, and not expanded by a Council decision based on Article 175.

3.4. ENERGY COMPETENCES IN THE TREATY ESTABLISHING A CONSTITUTION FOR EUROPE

Recent attempts to reach agreement on a post-Nice revision of the treaties, led to the establishment of a convention to examine some important issues with respect to the future development of the EU. These attempts resulted in the adoption of a Constitution in June 2004, which was signed in October of the same year. For the first time, this document introduces a legal basis for the activities of the EU within the energy sector.²⁸ Various working groups were established within the Convention to deal with various fields of action under the treaty. Working Group V on 'complementary competencies' dealt with Article 308, which was previously used as a legal basis for activities in the energy field. Its final report provided that:

²⁸ For the text of the Constitution, see Treaty Establishing a Constitution for Europe, [2004] OJ C/310/1.

[t]o avoid the current repeated recourse to Article 308 in certain areas, e.g. . . . energy . . . , the working group agreed on the need to recommend new specific legal bases in the Treaty for such policy areas if the Union wished to pursue policies in these fields. As regards tourism, which is mentioned in TEC Article 3(u) along with energy and civil protection, there was wide agreement in the group that no separate Treaty article was desirable. *The group felt that it was an anomaly to have subject matters mentioned in TEC Article 3 without having any corresponding Treaty article setting out the policy objectives and the competence.* (emphasis added)

This working group thus identified the problem with Article 3(u) TEC, as mentioned above, and found it necessary to provide a legal basis for the Community's energy activities. The consequences of inserting such a provision will be analysed while discussing the law of division of competences as developed in the case law and explained below. However, some aspects of the new provision should be referred to briefly here.²⁹ Although the fate of the Constitution is unclear at the moment, the innovative inclusion of energy in the treaty for the first time, and its consequences for the analysis of the division of competences in the field of energy, necessitates its analysis here.

Energy appears in the third part of the Constitution in the chapter on 'the policies and functioning of the Union'. Three articles refer to energy. Two of these correspond to the current treaty articles mentioned above (ie Article III-233 on environment and Article III-246 on the trans-European networks). The third provision provides the legal basis for activities, which are directly related to the issue of energy security. Previously, article III-157, as it appeared in the July 2003 Draft Treaty Establishing a Constitution for Europe, provided the opportunity for the Union to undertake activities in the field of energy. Based on this provision, a European energy policy should ensure the efficient functioning of the energy market, ensure security of energy supply in the Union, and promote energy efficiency, energy saving, and the development of new and renewable forms of energy.³⁰ Article III-157(2) stated that these necessary measures will be enacted in European laws and framework laws (ie the new classification for legal measures available to the Union)³¹ and they shall not affect a Member State's choice between different energy sources, and the general structure of their energy supply. This latter part suggests that Member States are free to choose the energy source that they find fit for consumption by their nationals, such as oil, gas,

²⁹ For a general discussion of the Draft Treaty Establishing a Constitution for Europe, see <<http://european-convention.eu.int>>.

³⁰ See 'Draft Treaty Establishing A Constitution for Europe', CONV 850/03, 18 July 2003.

³¹ The number of acts in the Constitution are categorised as (1) legislative acts which are European laws and framework laws (replacing regulations and directives respectively with the same legal consequence upon their adoption as before, ie binding with general application and binding as to the result to be achieved on the Member States addressed); (2) non-legislative acts which are European regulations and European decisions. Regulations are binding in their entirety or binding as regards the results to be achieved, but they are implementing measures, and not legislative. Decisions are binding in their entirety on those addressed. 3) non-binding Acts which are recommendations and opinions are legal acts of the Union but have no binding force.

electricity or energy from renewable sources, or a combination of the above. This part, however, shall not apply if there is a unanimous decision by the Council of Ministers, which, based on Article 130(2)(C) of the Constitution (under the environment title), allows for the adoption of measures that could 'significantly affect a Member State's choice of energy sources and its general structure of energy supply'.³² Therefore, the broad discretion of the Member States to choose their source of energy consumption can be limited due to environmental considerations.

This Article was amended and was renumbered Article III-256 in the final version of the Treaty Establishing a Constitution for Europe as it appears in the official journal of December 2004.³³ This provision corresponds broadly to the Convention draft article discussed above, but inserts a clause which precludes the Union from taking action if these actions affect the right of the Member States to 'determine the conditions for exploiting their energy resources'. The full text of the new Article reads as follows:

1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim to: (a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union, and (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy.
2. Without prejudice to the application of other provisions of the Constitution, the objectives in paragraph 1 shall be achieved by measures enacted in European laws or framework laws. Such laws or framework laws shall be adopted after consultation of the Committee of the Regions and the Economic and Social Committee. Such European laws or framework laws shall not affect a Member State's right to determine *the conditions for exploiting its energy resources*, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article III-234(2)(c) (emphasis added).

³² Based on this provision each Member State can keep its separate structure for energy consumption. For example, France's total energy consumption, based on the 2005 figures, was 158.3 million tonnes of oil equivalent (mtoe) of which 73.1 mtoe is oil consumption and 10 mtoe consumption of energy from renewable sources. This figure shows that oil contributes to 46.1% of France's overall energy consumption compared to the 6.3% contribution of energy from renewable sources. Other energy sources, such as natural gas, electricity, solid fuels, and derived heat contribute to the remaining energy consumption. Other member countries have different energy consumption structures: Belgium's oil consumption is 45.9% compared to 1.3% of renewable sources, Italy's oil consumption is 44.7% compared to 1.3% of renewable sources, and the UK's oil consumption is 40.77% compared to 0.39% of renewable sources. See the Commission Report, *European Union Energy and Transport in Figures 2005*, at <http://europa.eu.int/comm/dgs/energy_transport/figures/pocketbook/doc/etif_2005.pdf>. Based on the new provision in the Constitution, a change in the structure of energy consumption will take place only if the Council decides unanimously that the use of renewable sources in some countries should increase, which is clearly linked to environmental considerations.

³³ See 'Treaty Establishing a Constitution for Europe', above n 30.

3. By way of derogation from paragraph 2, a European law or framework law of the Council shall establish the measures referred to therein when they are primarily of a fiscal nature. The Council shall act unanimously after consulting the European Parliament.

The insertion of this additional limit in paragraph 2 was most likely the result of pressure on the part of countries possessing energy reserves, such as the Netherlands, Denmark and Great Britain, which sought to reserve the right to regulate the methods of exploiting their reserves.

With respect to Article III-256, one of the Declarations Concerning Provisions of the Constitution provides that '[the] Conference believes that Article III-256 does not affect the right of the Member States to take the necessary measures to ensure their energy supply under the conditions provided for in Article III-131' (emphasis added).³⁴ This declaration suggests that, based on Article III-131 (which is similar to the current Art. 297), 'in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations for the purpose of maintaining peace and international security, Member States shall consult each other and take necessary steps to circumvent the situation with the objective of preserving the proper functioning of the internal market'. It was thus deemed appropriate to allow individual Member States to maintain law and order through independent measures to guarantee energy supply. If these conditions occur, the Union's measures should not limit the powers of the Member States to address internal problems or disturbances as they deem best. Nonetheless, as the case law demonstrates, the situations envisaged by Article 297 are 'clearly defined and do not lend themselves to any wide interpretation'.³⁵ These situations should be ones of actual crisis, entailing a 'grave danger to vital interests, if not its very existence, of a Member State'. Hence, it was declared 'impossible to infer from [Article 297] that there is inherent in the Treaty a general proviso covering all measures taken for reasons of public safety and security'.³⁶

Article III-256 of the Constitution places the issue of 'energy security' in its broader context. It is 'broader' because the Union is not limited and can undertake activities to secure energy flow at any time. Therefore, these activities are no longer limited to times of crisis.³⁷ The Union is no longer required, firstly, to 'define the circumstances' according to which some measures to guarantee

³⁴ See the 'Treaty Establishing a Constitution for Europe', above n 30.

³⁵ See Case 13/68, *SPA Salgoil v Italian Ministry of Foreign Trade*, [1968] ECR 453, at 463.

³⁶ See Case 222/84, *Marguerite Johnston v Chief Constable of the Royal Ulster Constabulary*, [1986] ECR 1651, para 26. See also the opinion of Advocate General La Pergola in Case 273/97, *Angela Maria Sirdar v the Army Board and Secretary of State for Defence*, [1999] I-7403, para 21.

³⁷ See the amendment proposal by GM de Vries and TJAM de Bruijn, where they argue in favor of restricting the activities of the Union to times of crisis. For the proposed amendments to the energy section, see

<<http://european-convention.eu.int/amendments.asp?content=845&lang=EN>>.

energy security are adopted, and secondly, to enumerate conditions due to which measures can be taken during the time of crisis. As shown later in discussing the proposal in September 2002 for a new directive on stocks management in the Union,³⁸ the definition of a crisis became controversial as some considered the 'lack of actual physical availability of energy' as the necessary trigger event to adopt measures to overcome the crisis, as opposed to 'an imminent risk', or a 'general perception of disruption', which embodies a broader discretion to adopt necessary measures. Based on the Constitution, the adoption of measures no longer necessitates defining the triggering event.

The lack of reference to a 'crisis' in this provision is justifiable because Article III-180 (similar to the current Article 100 TEC) already generally contemplates crisis situations by allowing the Council to adopt a European decision laying down measures 'if severe difficulties arise in the supply of certain products'. This existing power has been extensively used, as elaborated in section 4.3, to adopt measures for the management of security stocks in the Community. It would not have made much sense to provide a new legal basis for the Union's energy activities in the Constitution, which would limit its use to times of crisis, whilst the legal basis for undertaking activities where energy supply is disrupted existed elsewhere in the Treaty. The Constitution had to either limit this activity to times of crisis, ie not providing a new basis for energy activities, or establish a broader provision to manage the Union's security of energy supply beyond mere internal measures to combat a physical lack of energy supply, as found in Article III-256.

Furthermore, the categorisation of the Union's policy in the field of energy is designed to allow the Union to embark on activities at the external level because nothing in the provision limits the competence of the Union in this respect. The proposed new legal basis for energy contrasts with the provisions introduced in the Maastricht Treaty on culture (Art III-280(3)), public health (Art III-278(3)), research and technological development (Art III-249(b)), education, youth, sport and vocational training (Art III-282(2)) and development cooperation (Art III-317(2)). In each of these fields there is express reference to fostering cooperation with third countries and international organisations. For example, the provision on development cooperation lays added emphasis on the necessity of the Union and the Member States acting 'within their respective spheres of competence' while cooperating with third countries. The new legal basis for energy in the Constitution neither refers to such cooperation with third countries nor does it emphasise the necessity for the Union and the Member States to act 'within their respective spheres of competence'. However, the absence of a reference to 'cooperation with third countries' in the new provision on energy does not mean that the Union is barred from undertaking external activities if the energy security of the Union so demands. Indeed, in the absence of an express

³⁸ For a detailed analysis of the regulations on stock management within the Community, see section 4.3.

reference to external competence in a given domain, such competences can still be implied by the text, as will be shown by the analysis below of the case law on this point. Moreover, the need to include the wording ‘within the spheres of their competence’ only shows that the EC and member States’ competences are concurrent.³⁹ If one remembers the doctrine of attribution of powers and the fact that these powers, beyond those highlighted in the text of the Treaty, may also result from principles developed through the case-law of the ECJ, as demonstrated below, the reference to the Union’s activity in ‘its sphere of competence’ could also have the value of reiterating the importance of the already established doctrines of division of competences and the existence of concurrent powers for the sake of clarification.

It is also interesting to highlight here that this provision does not define what constitutes energy. Therefore, the logical result would be to include all types of energy, from nuclear to oil, coal, gas and renewable sources of energy. Doubt remains, however, with respect to the status of the EURATOM Treaty. As agreed in July 2003, and reflected in the Protocol attached to the Draft Constitutional Treaty, the provisions of the Treaty Establishing the European Atomic Energy Community continue to have legal effect with only some minor and non-substantive changes. Nowhere in this Protocol is a reference made to the provision on energy as embodied in Article III-157 (later III-256). As some commentators have rightly suggested, a sub-paragraph to the energy provision of the Constitution could have announced the expiry of the EURATOM Treaty upon the entry into force of the Constitution.⁴⁰ Otherwise, the provision should have defined what sources of energy are covered by the Constitution, and subsequently place the atomic energy outside its remit. The Constitution, as signed in October 2004, does not embody these concerns, and it remains to be seen how overlapping legal bases will be dealt with in the future.

The significance of including a distinct legal basis for the activities of the Union in the sphere of energy will be explained below (section 3.5),⁴¹ along with the analysis of the case law on the division of competences. The reason for discussing this matter at that point is due to the role that the ECJ has played in

³⁹ For another opinion on this issue see, B de Witte and G de Búrca, ‘The Delimitation of Powers between the EU and its Member States’ in A Arnall and D Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford, Oxford University Press, 2002) at 218 [hereinafter ‘The Delimitation’].

⁴⁰ See the proposed amendment by H Farnleitner at <<http://european-convention.eu.int/amendments.asp?content=845&lang=EN>>. He suggests that three new sub-provisions should be added to Art III-157 and an expiry reference made for the EURATOM Treaty. He believes that safety standards to protect the health of workers and the general public be added and emphasises that nuclear materials should not be diverted to purposes other than those for which they are intended, in particular with a view to preventing diversion of nuclear energy from peaceful uses to nuclear weapons or other nuclear explosive devices. As is clear from his suggestions, he seeks a detailed elaboration on the use of nuclear energy in order to prevent the possibility of a broad interpretation of this provision, which could go beyond purely peaceful purposes.

⁴¹ For the consequences of the inclusion of the Flexibility Clause in the Constitution, see above n 19.

identifying the conditions for the division of competences between the Community and the Member States. The only palpable result of including such a provision in the Constitution, however, is that the Union is expressly provided with powers to engage in energy activities. Reference to Article 308 for dealing with energy matters will therefore no longer be necessary if the Constitution enters into force. However, in order to verify the possibility of acquiring competences a study of the case law becomes necessary. A detailed analysis of the case law, determining the limits of this type of implied competence, will be provided below: it suffices to state here that although Article I-14 of the Constitution includes the energy sector in the list of shared competences,⁴² this shared competence might gradually limit the competences of Member States even more, both externally and internally. The more secondary legislation becomes 'dense', the greater the chance that the Member States are limited in their competence to act in that field. This dynamic element in the evolution of Community competences is a cause of concern for Member States, and may help to explain their reluctance to provide the Union with such competence for quite some time. The issue of the division of competences and its implications for security of supply is discussed in detail below.

3.5. EXTERNAL COMPETENCES: THE EVOLUTION IN THE CASE LAW OF THE ECJ

The delimitation of competences between the Community and the Member States has been subject to extensive judicial review (with the exception of Title V of the TEU⁴³ on the Union's common foreign and security policy, because of limitations imposed on the jurisdiction of the ECJ by Article 46 TEU).⁴⁴ The

⁴² What is, however, extremely absurd in placing 'energy' in the category of shared competences is the link between this provision and Art III-315 on common commercial policy where services and foreign direct investment, as well as trade, are placed within the ambit of this policy. External relations in the field of energy are concentrated on trade in energy goods, energy services and investment in the energy sector. Therefore, it is not clear and it has not been clarified which activities in the energy sector fall outside the ambit of the exclusive competence and are to be considered as shared competences. This is even more surprising considering that the only other possibility is the relation between the Member States and third country suppliers of energy, which would be limited to political relations, which is again distinct in the Constitution under the rubric of the CFSP. It would have been more reasonable to enumerate the activities in the energy sector that are shared between the Member States and the Community.

⁴³ Art 7 of the Treaty Establishing the European Community limits the powers of the Community institutions, including the ECJ, as conferred by that treaty, and Art 5 limits the exercise of the powers of the ECJ based on the provisions of the TEU.

⁴⁴ Art 46 TEU provides:

The provisions of the Treaty establishing the European Community, the Treaty establishing the European Coal and Steel Community and the Treaty establishing the European Atomic Energy Community concerning the powers of the Court of Justice of the European Communities and the exercise of those powers shall apply only to the following provisions of this treaty: (a) provisions amending the Treaty establishing the European Economic Community with a view to establishing

Court itself has announced that 'its opinion may be sought on the questions concerning the division of competences between the Community and the Member States'⁴⁵ and is therefore 'both willing and able to assert itself as the highest court in a constitutional order adjudicating on competences'.⁴⁶ As the case law below highlights, the ECJ, having the main task of elaborating this issue, has gone through a potholed road, and its deliberations have given rise to many criticisms as reflected in the scholarly writings.

While the Member States were once considered as the best authorities to guarantee their internal security of energy supply, and they were permitted to adopt measures that could potentially distort trade to meet that end, their competence was gradually weakened, especially after the adoption of various measures in the path of creating a European energy market. Hence, with respect to internal security of energy supply, the approach of the ECJ has changed accordingly. The necessity of guaranteeing an adequate supply of energy gradually became a Community concern through the ECJ's interpretation. As the case law below explains, the possibility exists that such a shift in competences could be expanded to cover externalities of security of energy supply, giving way to the creation of an implied external power of the Community to deal with such matters. In other words, it can be argued that if the ECJ had found it necessary to disallow a Member State from undertaking activities at the domestic level to rectify energy supply problems, it is not far-fetched to suppose a strong potential for an analysis of the 'necessity' in those situations, expand them, and limit the activities of the Member States at the external level. This possibility and the basis to render such competence exclusive will be analysed below after explaining the approach of the ECJ towards the issue of internal security of energy supply.

the European Community, the Treaty establishing the European Coal and Steel Community and the Treaty establishing the European Atomic Energy Community; (b) provisions of Title VI, under the conditions provided for by Article 35; (c) provisions of Title VII, under the conditions provided for by Articles 11 and 11a of the Treaty establishing the European Community and Article 40 of this treaty; (d) Article 6(2) with regard to action of the institutions, in so far as the Court has jurisdiction under the Treaties establishing the European Communities and under this treaty; (e) the purely procedural stipulations in Article 7, with the Court acting at the request of the Member State concerned within one month from the date of the determination by the Council provided for in that Article; (f) Articles 46 to 53.

⁴⁵ See Case 1/94, on the Competence of the Community to Conclude International Agreements concerning Services and the Protection of Intellectual Property, [1994] ECR I-5267, para.9, and Case 2/94, Accession of the Community to the European Convention for the Protection of Human Rights (ECHR) [1996] ECR I-1759, para 10. In the latter case, the Court expressly provides that where a question of competence has to be decided, it is in the interests of the Community institutions and of the states concerned, including non-member countries, to have that question clarified from the outset of negotiations and even before the main points of the agreement are negotiated.

⁴⁶ See A von Bogdandy and J Bast, 'The European Union's Vertical Order of Competences: the Current Law and Proposals for its Reform' (2002) 39 CML Rev 227 at 238 [hereinafter 'Vertical Order of Competences'].

In the 1983 *Campus Oil* case,⁴⁷ the Irish government defended a regulation according to which importers of petroleum products had to purchase a percentage of their requirements through a national oil refiner based on the idea that this purchase would guarantee the continued activity of the refiners and ensure the minimum supply of petroleum products at all times. The question was posed to the Court whether this activity constitutes a restriction on imports and therefore, a breach of Article 28 EC (then Art 30).⁴⁸ The Commission argued that the Community, in accordance with its responsibility in this area, had adopted the *necessary rules* to ensure supplies of petroleum products in the event of a crisis (emphasis added).⁴⁹ These ‘necessary measures’ were claimed to be measures at the level of the ‘international energy agency’, the Directive on Management of Stocks, and the Directive on Reduction of Consumption in the Event of Difficulties in Supply. However, the Court acknowledged that

Even though those precautions against a shortage of petroleum products reduce the risk of Member States being left without essential supplies, there would nonetheless still be real danger in the event of a crisis.⁵⁰

Hence, the Court was of the view that although the Community measures seek to guarantee the delivery of energy from other countries to the country that is totally dependent on imports, ‘this did not mean that the Member State concerned had *an unconditional assurance* that supplies will in any event be maintained at least at a level sufficient to meet its minimum needs’. The Court also described security of energy supply as an objective covered by the concept of ‘public security’ and therefore within the ambit of Article 30 (then Art 36), ie the exception clause for the free movement of goods. Consequently, the Court accepted that a Member State’s appropriate complementary measures at national level cannot be excluded, even where Community rules on the matter exist.⁵¹

The reason for this approach by the ECJ was that exceptional importance was given to petroleum products by stating that ‘these products are an energy source in the modern economy and are fundamental for a country’s existence.’⁵² The Court, therefore, found it necessary for the Member States to be permitted to adopt measures at national level. Nonetheless, it should be borne in mind that

⁴⁷ See Case 72/83, *Campus Oil Limited and others v Minister for Industry and Energy and others*, [1984] ECR 2727.

⁴⁸ Art 30 provides:

The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

⁴⁹ See the *Campus Oil* case, above n 47, at para 25.

⁵⁰ See the *Campus Oil* case, above n 47, at para 30.

⁵¹ See the *Campus Oil* case, above n 47, at para 31.

⁵² See the *Campus Oil* case, above n 47, at para 34.

this case was decided in the 1980s when no real attempt to create an internal energy market for oil and gas existed and the dependence of one individual Member State on energy imports justified independent national measures. As the structure of the energy market has changed due to the creation of the internal energy market in the second half of the 1990s (although it is not yet completed), the test of ‘total dependence on import’, as mentioned by the Court, no longer constitutes justification for national measures, and the growing interdependence of the Member States would justify a different approach by the Court.⁵³

The approach taken by the ECJ in the *Campus Oil* case slightly changed in later cases and it has become difficult to judge whether the Court would continue to bestow such great importance upon security of energy supply in the analysis of a ‘necessity’, permitting derogation from basic treaty obligations. Of course, the gravity of the lack of an adequate energy supply for a particular Member State has to be considered on a case-by-case basis. A generalisation of the ECJ’s approach to the issue of energy security is therefore not advisable, but there are clues in the following cases as to the possible approach of the Court in analysing the issue of ‘necessity’ and implying the competence of either the Member State or the Community to combat a supply threat.

In the 1990 case of *Commission v Hellenic Republic*, the ECJ rejected the claim of the Greek government in defending a state monopoly in the import and marketing of refined petroleum products on the grounds of public security. The Court stated that the Greek government had failed to produce any evidence that import bans, aimed at the increased use of the product of national refineries, were necessary to secure energy supply.⁵⁴ It is interesting to compare the claim of the Greek government in that case with the claim of the Irish government in the *Campus Oil* case. In *Campus Oil*, the Irish government claimed that ‘there is a need to guarantee the provision of petroleum products, in view of the fact that if a refinery is closed, all suppliers of refined products on the Irish market would have been obliged to obtain their supplies from abroad’,⁵⁵ which was found to further threaten the country’s security. Therefore, the specific case of Ireland and its total dependence on the import of petroleum products was taken into account by the Court. However, in *Commission v Hellenic Republic*, the Greek government’s claim as to the special geopolitical situation of Greece and the necessity of guaranteeing a regular supply of crude oil through maintaining public sector refineries in operation, was not found to be an adequate claim to allow derogation from Community obligations, although Greece, like Ireland, was fully dependent on the import of petrochemical products.

Although it may be true that the Greek government did not show that there is a link between the import ban and the non-operation of its refineries, the Irish

⁵³ See also PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (Oxford, Oxford University Press, 2002) at 239 [hereinafter *Competition in Energy Markets*].

⁵⁴ See Case 347/88, *Commission v Hellenic Government*, [1990] ECR I-4747.

⁵⁵ See the *Campus Oil* case, above n 47 para 5.

government's mere reference to 'total dependence on import' was found sufficient to allow independent national measures, without the need for further evidence to support this claim. This comparison not only shows the very exceptional circumstance in which the *Campus Oil* decision was rendered, but also the slight change in the attitude of the ECJ in approaching the condition of 'necessity' and allowing for Member States' derogations.⁵⁶

This attitude was reinforced with different reasoning in a later case⁵⁷ where the ECJ took the role of analysing the 'necessity' issue. The Court accepted that although the continuity of supply flow constitutes a public security objective, the arguments of the defendant country (Greece again) should go *beyond purely economic reasoning* in order to justify derogation from the Community rules. The Court later explained that the objective of public security can be achieved by 'less restrictive measures' than the ones taken by the Greek government which were in direct opposition to the rules of the Treaty on free movement of goods.⁵⁸ Although the Court does not explicitly state what constitutes a 'non-economic' objective or 'less restrictive measures' to justify one's action, the Court restricted the 'security' argument and extensively limited the application of its previous reasoning in the *Campus Oil* case.

This application becomes even more limited in the Opinion of the Advocate General in the *PreussenElektra* case,⁵⁹ in which he doubted whether recourse to the provisions on public security was still possible 'given the fact that the Directive (here the Electricity Directive) provides those types of measures necessary to ensure security of supply'.⁶⁰ Interestingly, the Court allowed the Member States to have recourse to some type of measures in the field of energy which could be considered compatible with the objectives of Article 30 EC (now Article 28). In that case, the Court linked Article 30 to the obligation imposed by Germany on public electricity supply undertakings to purchase electricity generated exclusively from renewable sources of energy, but this time not on the ground of 'public security' but on the ground of 'protection of environment'.⁶¹ It is doubtful that the Court would have accepted such a restriction as compatible with Article 30 purely based on 'security of supply' grounds, similar to the

⁵⁶ The Court emphasised this issue four years later, in the *Almelo* case, by calling for compliance with the Community rules on competition and referring the analysis of 'necessity' to the national courts. The Court suggested that the question of whether a restriction of competition is necessary in order to enable an undertaking to perform its task of general interest, ie supply of electricity, should be examined by national courts and not by the ECJ. See Case 393/92, *Municipality of Almelo and others v NV Energiebedrijf IJsselmij*, [1994] ECR I-1477, para 51(c).

⁵⁷ See the Case 398/98, *Commission v Hellenic Government* [2001] ECR I-7915.

⁵⁸ See *Commission v Hellenic Government*, *ibid.* para 31. See also the Opinion of the Advocate General, paras 47–48. In order to secure energy supply, the Greek government made the transfer of the storage obligation to refineries established in Greece conditional upon the obligation to obtain supplies of petroleum products from those refineries.

⁵⁹ See Opinion 379/98, *PreussenElektra AG and Schleswag AG*, [2001] ECR I-2099.

⁶⁰ See the Opinion of Advocate General Jacobs in *PreussenElektra* case, para 209.

⁶¹ See *PreussenElektra*, above n 59, at paras 68–81.

approach of the ECJ in previous cases mentioned above. Therefore, one can submit that the newly established rules on energy, such as the gas and electricity directives, are considered as the best guarantees of security so that recourse to purely national measures will no longer be justified, which will in turn diminish the competence of the Member States in that field. As secondary legislation in the field of energy security develops further, the Member States have less ability to invoke energy security within the ambit of Article 30.

How would the approach of the ECJ be shaped with respect to externalities of energy security? To what extent does the case law of the ECJ limit or expand the competences of the Member States in guaranteeing their security of energy supply by establishing agreements with third country suppliers of energy?

The international legal capacity of the Community, ie its capacity to be represented on the international plane and to enter into international treaties with third parties, can be transferred from the Member States to the Community. This transfer of power is either explicitly referred to in the treaty or takes place through a progressive development which originates in the *ERTA* judgment, where the important principle of ‘implied external power’ was established and was later taken up by the ECJ to ascertain conditions on the eventual creation of an exclusive competence.⁶² The settled idea with respect to competences before the *ERTA* judgment was that the Community only possesses a treaty-making power in those cases ‘expressly’ provided for in the Treaty.⁶³ The Treaty provided no basis for a Community competence to negotiate and conclude treaties in the field of road transport, the subject of that case. It was for the Court to decide whether a transfer of power to the Community had actually existed in the field of transport, as no express power in the treaty could be found. The Court stated:

In the absence of specific provisions in the Treaty relating to the negotiation and conclusion of international agreements in the sphere of transport policy . . . one must turn to *the general system of Community Law relating to agreements with non-member State*.⁶⁴ (emphasis added)

The Court sought to elaborate on this issue by stating that regard should be had to the ‘*whole scheme of the Treaty* no less than to its specific provisions’.⁶⁵ In the following paragraphs, the Court reveals the ambiguity of terms such as the ‘general system of Community law’ or ‘the whole scheme’ by stating:

Such authority may arise not only from an explicit grant by the Treaty . . . but may flow from *other provisions of the Treaty* and *from steps taken within the framework of these provisions by the Community institutions*.⁶⁶ (emphasis added)

⁶² See Case 22/70, *Commission v Council* (ERTA) [1971] ECR 263.

⁶³ See JA Winter, ‘Annotation on ERTA’ (1971) 8 CML Rev 550 at 553. See also P Pescatore, ‘Les relations extérieures des communautés européennes’, (1961) *Recueil des Cours de l’Académie de Droit International*, 103.

⁶⁴ See *ERTA* case, above n 62, at para 12.

⁶⁵ See *ERTA* case, above n 62, at para 15.

⁶⁶ See *ERTA* case, above n 62, at para 16.

The phrase 'the steps taken by Community institutions within the framework of these provisions' is interpreted as 'the laying down of *common rules* with a view to implementing a common policy envisaged by the Treaty'.⁶⁷ In the *ERTA* case, the 'common rule' is Regulation no 543/69. This Regulation vests power with the Community to enter into any agreement with *third countries* relating to the subject matter governed by that regulation, which is the harmonisation of certain social legislation relating to road transport. The existence of this common rule, which dealt with an externality, rendered possible the establishment of a Community competence to act externally in this field. This case therefore acknowledges that implied external power exists when internal rules were already adopted in that particular field, which further suggests that, firstly, a power to adopt internal rules existed, and secondly, it has been exercised.⁶⁸ The practical consequence of the application of this doctrine is that the Member States cannot, outside the framework of the Community institutions, assume obligations which might *affect* those rules or alter their scope.⁶⁹ It is submitted that although the reasoning through which a Community competence is established is of great importance, the consequence of possessing this competence is also of great significance for the Member State as the limits of Member States' activities should be determined.

The analysis of the existence of the Community's implied powers is unnecessary if a legal basis to take activities in a specific policy sector is provided for in the Treaty and the competence of the Community to deal with the external dimension of that sector is highlighted.⁷⁰ For example, the Treaty Establishing the European Community (TEC) added a few new areas of action where this competence can be established. Article 151(3) on culture explicitly provides that

⁶⁷ See *ERTA* case, above n 62, at para 17. The phrase 'the steps taken by Community institutions within the framework of these provisions' is explained to mean 'the laying down of common rules with a view to implementing a common policy envisaged by the Treaty'. What are these common rules? Opinions differ on this particular issue. McGoldrick believes that in a 'formal sense' common rules are directives, regulations, measures to be taken for the approximation of laws (Art 95), administrative provisions and measures to be taken in certain circumstances (Art 308). However, he adds that this 'formal sense' is not the one referred to in *ERTA*. The case refers to those rules whose existence will result in pre-emption. In other words, when EC internal measures exhaustively cover a particular field, Member States will be prevented from taking any action in that field. Therefore, the common rules, in the *ERTA* sense, will be those rules which completely cover a field. This pre-emption is then paralleled at the external level. See D McGoldrick, *International Relations Law of the European Union* (Harlow, Longman, 1997). Other commentators believe that common rules are those which include 'obligations of a detailed character', whether a regulation or a directive. See JA Winter, 'Annotation on *ERTA*', above n 63, at 554. This opinion, if read strictly, means that, it is not important whether the rule results in pre-emption. The rule is a 'common' rule as long as it is detailed. The Court also hints at this latter interpretation, emphasising that the content of a specific measure should be examined.

⁶⁸ This last condition was later modified in the *Kramer* judgment where it was suggested that the power to take any measure should be at the disposal of the Community no matter whether it was exercised. See the Joined Cases 3, 4, and 6/76, *Cornelis Kramer and Others* [1976] ECR 1279, paras 30–33.

⁶⁹ See the *ERTA* judgment, above n 62, at para 22.

⁷⁰ See Cremona, 'External Relations and External Competence', above n 10, at 147.

'the Community and the Member States shall foster cooperation with third countries and the competent international organisations in the sphere of culture' (similar provisions can be found in relation to education, vocational training and youth, development cooperation, public health, research and technological development).⁷¹ As no such reference is made to the field of energy in the treaty, the analysis of implied powers becomes more relevant to determining the Community's competence.

On the other hand, as the main rationale for limiting the activities of the Member States at the external level is to prevent the existing internal Community rules from being affected by the independent action of the Member States, one is obliged to compare the already existing Community rules with that of the relevant international agreement in order to determine the extent of its coverage. In other words, it should be verified whether the Member State has become active in a field for which the Community has already established internal rules. For that matter the Court speaks of a 'large coverage' of the international agreement by Community rules.⁷² Although 'largely' is not defined so as to assist one in determining the competences of the Member States and the Community, it could mean that the more the field of an international agreement is covered by Community measures, the less chance there is for the Member States to exercise their competence in those fields, and competence will be handed to the Community.⁷³ Moreover, the ECJ also allows for the possibility of adding some provisions to such an international agreement for which the Community has gained competence, which do not constitute the principal objective of the international agreement and do not impose extensive obligations, but are declaratory in nature and are not explained in concrete terms.⁷⁴ In other words, the Community can enter into international agreements with third states and add a section to those agreements without a need for a separate legal basis. In this case, the Community can claim competence for the whole agreement. For instance, if the energy sector is not a specific field of cooperation between the Community and a third state, such as Russia, the Community has the competence to add a section related to energy cooperation, if the inclusion of such a provision is justified by an express provision of the treaty or through the analysis of an implied power (eg large coverage of energy issues in secondary legislation). In this case, energy cooperation is only an 'ancillary provision' for which no separate legal basis is necessary.

The doctrine of implied powers widely expanded the Community's competence in dealing with various fields in the 1970s, but became gradually limited in the 1980s and 1990s due to the ECJ's reluctance to extend this doctrine to some areas, especially where a substantial change with constitutional significance in the

⁷¹ *Ibid.*

⁷² Case 2/91 (ILO) on the Convention No.170 of the International Labor Organisation concerning Safety in the use of Chemicals at Work [1993] ECR-I-1061 at para 25.

⁷³ See also Case 2/92 (OECD) [1995] ECR I-525 at para 34.

⁷⁴ Case 268/94, *Portugal v Council*, ECR [1996] I-06177 at para 52.

Community's legal system was entailed.⁷⁵ Nevertheless, if such drastic change was not to occur, the principle of attribution of powers continued to enable the Community to act in those areas which were implied from its provisions in future cases. The Court, for instance, suggested that whenever Community law creates internal powers for the institutions of the Community for the purpose of attaining a specific objective, the Community has authority to enter into international commitments 'necessary' for the attainment of that objective [the necessity doctrine].⁷⁶ Case 1/94 defines 'necessary' as when 'the attainment of the objectives of the Treaty is *inextricably linked* to that externality'.⁷⁷ Therefore, the power to take any measure should first be at the disposal of the Community, and should be subsequently expanded to cover external relations only where necessary. Clearly, the 'objectives' of the Community, 'necessary' expansion, or 'inextricably linked' should be defined in order to apply this judgment to individual cases. The ECJ has not adopted a uniform approach on this point and some questions remain: are the 'internal' and 'external' objectives divided for the purposes of division of competences? Can the internal objectives be fully achieved without external action? Which body decides the extent of the expansion of the Community competence to deal with externalities of energy supply? What would be the nature of this competence, shared or exclusive? These questions need to be answered in order to determine the possibility of expanding the Community's competence to encompass external relations in the field of energy.

⁷⁵ Case 2/94 on the accession of the European Communities to the European Human Rights Convention is a very good example of this perseverance and the limited application of this doctrine. The Court decided that because there was no 'general power to enact rules on fundamental rights' in the treaty, no legal basis for implied external Community action existed. The Court concluded that accession to this convention would entail a substantial change in the Community system, a change of constitutional significance, which would go beyond the ambit of Art 235 (now Art 308), through which the Community could take appropriate measures if no power was provided in the treaty. Mere respect for fundamental rights as a general principle of Community law was not adequate to create an implied external power. Although this case is referred to as an exception to the gradual expansion of Community competence in the jurisprudence of the ECJ, it fails to show where and how limitations can be imposed on the expansion of Community competence, as the channels through which the Court reached its conclusion are not determined, and the real rationales are not spelled out. See Case 2/94 (ECHR) [1996] ECR I-1763 at para 35. This case, along with the case on the legality of tobacco advertising (Case 376/98) found the use of Art 308 along with Art 95 *ultra vires*, as they allow a 'creeping expansion' of EC competences. See also B de Witte and G de Búrca, 'The Delimitation', above n 39, at 205. See also Cremona, 'External Relations and External Competence', above n 10, at 150.

⁷⁶ See Case 1/76 *Draft Agreement Establishing a European Laying up Fund for Inland Waterway Vessels*, [1977] ECR 741, para.4.

⁷⁷ See Case 1/94, above n 45, at para 86. The Court explained that one could attain freedom of establishment and freedom to provide services for nationals of the Community Member States without being obliged to extend that freedom to nationals of non-member countries. With regards to TRIPS, the Court defines the word 'inextricable' by stating that unification and harmonisation of intellectual property rights in the Community context does not necessarily have to be accompanied by agreements with non-member countries in order to be effective. See para 100.

In order to clarify the relevance of the division of competences for energy security, the already existing doctrines should be compared to the Treaty provisions and the internal measures adopted in the field of energy. An important opinion of Advocate General (AG) Tizzano in the *Open Skies* case raised some new and interesting issues for the clarification of the ambiguities in this field, which will be mainly used here as a yardstick against which the external competences of the Community and the Member States in guaranteeing security of energy supply are analysed.

In the *Open Skies* cases,⁷⁸ the ECJ had to determine whether several Member States of the European Community were in breach of Community law by having concluded bilateral agreements concerning air transport with the USA. An analysis of the division of competences was found necessary to establish whether the Community had 'exclusive' competence to initially enter into such an agreement with a third country. Firstly, with respect to the air transport, the Council has adopted regulations on Community air carriers operating inside the Community and on the fares and rates for air services which contain provisions applicable to air carriers from third countries. Therefore, some 'externalities', in the form of applying the Regulation to third country carriers, already existed in the internal measures. Secondly, these externalities provided an ample opportunity for the Court to define and elaborate on the already existing doctrines of shared competence and exclusivity. However, only AG Tizzano provided a full analysis in his Opinion and that analysis was not adopted as such by the ECJ. The Court adopted a classic approach and decided that external competence is created based on the 'effect' doctrine namely that when the international commitment falls within the area covered by the internal measure, 'effect' is established.⁷⁹ Moreover, the Court imposed a limitation on the way such link should be established by suggesting that the limited character of the provisions of the internal measures preclude inferring from them that there is an 'inextricable link' between the internal and external competence of the Community.⁸⁰ Nevertheless, the Court did not introduce new guidelines as to how exactly the implied external competence should be established.

The AG, on the other hand, first proposed an analysis of the 'necessity doctrine' by stating that 'despite the absence of any express provision, the necessity for an agreement in a given field may enable the Community to affirm its own external competences', but only the actual exercise of that competence

⁷⁸ See the *Open Sky* case, Case 467/98, *Commission v Denmark*, judgment of 5 November 2002; Case 468/98, *Commission v Sweden*, judgment of 5 November 2002; Case 469/98, *Commission v Finland*, judgment of 5 November 2002; Case 471/98, *Commission v Belgium*, judgment of 5 November 2002; Case 472/98, *Commission v Luxembourg*, judgment of 5 November 2002; Case 475/98, *Commission v Austria*, judgment of 5 November 2002; Case 476/98, *Commission v Germany*, judgment of 5 November 2002; 466/98, *Commission v Great Britain and Northern Ireland*, judgment of 5 November 2002.

⁷⁹ See the *Open Sky* Case 476/98, *ibid*, para 118.

⁸⁰ *Ibid*, para 87.

would render it exclusive.⁸¹ Moreover, what the AG highlighted for the first time was the clarification of the dilemma of ‘how and by whom the assessment should be carried out as to the necessity of an implied external power’.⁸² The AG refused to accept that Member States, the Commission, the Council or the Court could carry out this assessment on their own account. The Court, he said, cannot carry out this assessment because ‘it cannot substitute its own discretionary assessment for that which the competent legislative institutions did or did not carry out’.⁸³ No assessment can be done, he stated, unless through the establishment of competent institutions with clear procedures.⁸⁴ One can conclude that based on his proposed view, in order to determine whether an external activity is necessary on behalf of the Community to guarantee security of energy supply—eg entering into an agreement with an energy-producing country specifically designed for matters of energy security—only an institution established for analysing the peculiarities of energy security should determine this ‘necessity’, and the ECJ should respect that determination.

This proposed view is important for the purposes of Europe’s security of energy supply. There are detailed technicalities involved in assessing whether this security is endangered, for which the expertise of the ECJ does not seem sufficient to extend or limit the Community’s competence. As one commentator rightly suggests, at the time a crisis is perceived, a Member State may be willing to enter into long-term contracts with oil producers that offer better guarantees of supplies in the event of crisis.⁸⁵ In choosing that oil producer, they usually look at various issues, such as geographical and political proximity with that country, or the link between their demands and its immediate satisfaction by adopting some external measures, or the adoption of whatever else is ‘necessary’. This analysis differs between Finland, with its proximity to the important energy-producing country of Russia, and Greece, which has no immediate border with any energy producing country. The involvement of the Community in guaranteeing security of energy supply, which is based on the belief that after the creation of the internal energy market the security concerns in one country expand and cover the whole internal market, suggests that security is no longer ‘country-specific’ but is rather a Community issue. Therefore, what is ‘necessary’ should apply to all the Member States with their differing energy demands, energy infrastructure, proximity to energy producing countries, differing political relations with these countries, etc. Nevertheless, the ‘unity of security concerns’ that is shared among all Member States, if created, does not lessen the importance of examining the

⁸¹ See the AG Opinion, para 49. See also Case 1/76 *Draft Agreement Establishing a European Laying up Fund for Inland Waterway Vessels*, [1977] ECR 741.

⁸² AG Opinion, paras 48–58.

⁸³ *Ibid.* para 51.

⁸⁴ *Ibid.* para 51. Some have also argued for the creation of a special European Constitutional Council for deciding all issues of division of powers. See JHH Weiler, ‘The European Union Belongs to its Citizens: Three Immodest Proposals’ (1997) 22 *EL Rev* 150 at 155.

⁸⁵ PD Cameron, ‘Competition in Energy Markets’, above n 53.

technicalities of energy security at all times. This necessitates, for example, an analysis of the efficiency of the existing infrastructure in Greece or Finland as well as a broader global overview of the situation of energy supply. For that reason an abstract review of the case law on what is 'necessary' should not be undertaken by the ECJ.

Apart from the analysis of where and under what conditions it is 'necessary' for the Community to engage in externalities of energy security, AG Tizzano also referred to the 'effect doctrine' as established in the *ERTA* judgment. As explained above this doctrine holds that if competence is established through the implied power, the result is that Member States are precluded from acting in that field only to the extent that 'their act affects those common rules'. The issue to be resolved is to determine 'exactly what was meant by those last four words' (ie which may effect those rules).⁸⁶ The case law differs on this issue and there is disagreement as to whether 'benign' effect is also counted as 'effect'. The AG refers to the extent of the Community rules in that specific field in order to establish 'effect'. He argues that in matters covered by common rules (no matter to what extent), the Member States may not, under any circumstances, conclude international agreements, even if these are entirely consistent with the common rules, since any steps taken outside the framework of the Community institutions would be incompatible with the unity of the common market and the uniform application of Community law.⁸⁷ Moreover, he states that if the texts of the agreements reproduce the common rules *verbatim*, or incorporate them by reference, the effect is established.⁸⁸ He finds this conclusion rigid and over formalistic.⁸⁹ However, he rightly bases his statement on the rationale that the reception of the common rules into the agreements would have the effect of

⁸⁶ F Burrows, 'The Effects of the Main Cases of the Court of Justice in the Field of the External Competences on the Conduct of Member States' in CWA Timmermans & ELM Volker (eds), *Division of Powers between the European Communities and their Member States in the Field of External Relations* (Deventer, Kluwer, 1981) at 111. See also D McGoldrick, above n 67, at 75. He argues that there are examples where the international commitments at issue do not affect or alter the scope of the common rules. One example would be where Member States purported to extend the territorial application of the EC rules, or if the international obligations assumed by them would affect the common rules in a beneficial way. For example, McGoldrick's argument can be accepted in cases where a Member State enters into a bilateral agreement with a third state, and the text of their agreement is identical to that of the common rules established by the Community. In this case 'effect' is hard to establish. For an argument to the contrary, see D O'Keefe, 'Exclusive, Concurrent and Shared Competence' in A Dashwood, and C Hillion (eds), *The General Law of EC External Relations* (London, Sweet and Maxwell, 2000) [hereinafter *General Law of EC*] at 187. O'Keefe argues that the territorial scope of Community law is itself a matter for Community law, and Member States cannot alter it unilaterally. Moreover, any effect on community rule, benign or not, seems to be outlawed by the Court in Case 2/91. See also U Fabio, 'Some Remarks on the Allocation of Competences between the European Union and its Member States' (2002) 39 CML Rev 1289.

⁸⁷ See the opinion of AG Tizzano in the *Open Sky* Case, above n 78.

⁸⁸ *Ibid.* para 71.

⁸⁹ *Ibid.* He is also of the opinion that Member States could not undertake international obligations in matters governed by common rules even in order to eliminate conflicts between those rules and agreements concluded by them, before the rules were adopted. Not even the requirement to ensure the full and correct application of Community law could justify unilateral action by Member States,

distorting the nature and the legal regime of the common rules and entail a real and serious risk, which could not necessarily be reviewed by the Court. He further explains that there are ‘considerable areas in between’⁹⁰ where the international obligations are neither in conflict with the common rules nor cover the same subject matter, but may fall within the scope of the ‘effect doctrine’ in so far as they are liable to effect the common rules. This effect may occur when agreements concern those aspects which are contiguous to those governed by the common rules, or where agreements relate to aspects not regulated by those rules.⁹¹ On the other hand, in a later opinion the Court went one step further and provided that ‘it is not necessary for the areas covered by the international agreement and the Community legislation to coincide fully’. The Court suggests that ‘the assessment must be based not only on the scope of the rules in question but also on their nature and content and not only the current state of Community law in the area in question but also its future development should be taken into account insofar as that is foreseeable at the time of that analysis’.⁹²

The two doctrines of ‘necessity’ and ‘effect’ suggest that either the presence of ‘externalities’ in the internal regulation or ‘necessity’ can justify the involvement of the Community or would render the regulation ‘efficient’ for the purposes of the ‘effect’ doctrine.⁹³ This conclusion could also be interpreted in line with the ECJ’s approach to the issue of internal security of energy supply, as mentioned in the case law on internal security of energy supply above, and the fact that the creation of secondary measures regulating the internal energy market has limited the competence of the Member States to have recourse to independent security measures at domestic level because such measures were no longer found to be ‘necessary’. This conclusion supports the statement made earlier in this chapter that the greater the number of energy-related secondary measures come to exist, the more the competences of the Member States are limited.

The other consequence of the gradual expansion of the Community’s competence to deal with both internal and external matters of energy security is that such gradual expansion might lead to an ‘exclusive’ competence. The Court has

since such action might also affect the common rules, compromising the unity of the common market and the uniform application of Community law.

⁹⁰ See R Holdgaard, above n 21, at 379.

⁹¹ See also Case 1/94, above n 45, at para 79. See also J Temple Lang, ‘The Ozone Layer Convention: A New Solution to the Question of Community Participation in ‘Mixed’ International Agreements’ (1986) 23 CMLR 156 at 161. He explains the problems of mixed agreements in general, and particularly in relation to the *ERTA* judgment. He states that this decision does not clarify the issue of exclusive Community competence in external relations because it can be understood in two different ways. One is that the Community has exclusive competence irrespective of the terms of the convention and second, that the Community has exclusive competence only if the proposed convention is likely to conflict or interfere with the operation of existing Community rules.

⁹² See Opinion of the Court 1/03 of 7 February 2006 on the ‘Competence of the Community to Conclude the New Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters’.

⁹³ See the Open Sky Cases, above n 78, at para 93. See also A Dashwood, ‘The Limits of the European Union Powers’ (1996) 21 EL Rev 113 at 126 [hereinafter ‘The Limits of EU’].

provided various rulings on this issue and has been divided in allowing exclusivity due to the mere potential for Community action or the necessity for that action to be first exercised. Although one judgment of the Court rendered the competence exclusive without any prior exercise of internal powers,⁹⁴ that case has subsequently been considered as an exception.⁹⁵ Therefore, prior internal legislation will be a prerequisite for the exclusivity of implied powers.⁹⁶ The Court finds it 'undeniable' that, where harmonising powers have been exercised, the harmonisation measures thus adopted may limit, or even remove, the freedom of the Member States to negotiate with third countries. On the other hand, the internal power that has not been exercised in a specific field cannot confer exclusive competence in that field on the Community.⁹⁷ In a later opinion in 2006 the Court went as far as providing that in order to determine 'effect' and whether the Community has the competence to conclude an international agreement and whether that competence is exclusive, 'account must be taken not only of the area covered by the Community rules and by the provisions of the agreement envisaged, insofar as the latter are known, but also of the nature and content of those rules and those provisions, to ensure that the agreement is not capable of undermining the uniform and consistent application of the Community rules and the proper functioning of the system which they establish'.⁹⁸

In line with the opinion of the AG Tizzano in the *Open Skies* case, the main rationale for the exclusivity of the competence is the fact that if the Member States were allowed to reserve their concurrent power, and 'ensure their own interests' in establishing external relations to guarantee security of energy supply, adopting positions that may differ from the intended position of the Community, 'this would distort the institutional framework, call into question the mutual trust within the Community and prevent the latter from fulfilling its task in the defence of the common interest'.⁹⁹ Nevertheless, the 'effect' of the external activity of the Member States on the internal market should be proved. In order to determine when that effect would occur, the already existing internal measures and the extent to which the issue is covered by Community measures are analysed. For the purposes of our study, we are concerned with those internal measures on energy that seek to guarantee internal security of energy supply and

⁹⁴ See Case 1/76 *Draft Agreement Establishing a European Laying up Fund for Inland Waterway Vessels*, [1977] ECR 741. See also Opinion 1/03 of 7 February 2006 where the Court confirms that Opinion 1/76 continues to exist as a separate basis for exclusive competence. See M Cremona, 'External Relations of the EU and the Member States: Competence, Mixed Agreements, International responsibility, and Effects on International Law', EUI Working Papers, 2006/22. See also T Baumé, 'Competence of the Community to Conclude the New Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters: Opinion 1/03 of 7 February 2006' (2006) 7 *German Law Journal* 681.

⁹⁵ See Case 1/94, above n 45, at para 34.

⁹⁶ See Cremona, 'External Relations and External Competence', above n 10, at 154.

⁹⁷ See Case 1/94, above n 45, at paras 88/89.

⁹⁸ See Opinion 1/03 of 7 February 2006, above n 94.

⁹⁹ See *Open Skies* Opinion of the AG (referring to the Case 1/75), para 64.

the functioning of the internal energy market. If the internal measures expressly refer to externalities of energy security, the Community will possess the competence to deal with those matters. In the absence of any express provision, which is the case with the majority of the internal measures on energy as explained below, exclusive competence is also established where the internal measures have achieved complete harmonisation.¹⁰⁰ In that case, the independent activity of Member States is perceived to effect those rules and States are therefore no longer able to retain freedom to negotiate with non-member countries.¹⁰¹

We must consider here the effect of such a limitation or expansion of Community and Member State competences on security of energy supply. For instance, the creeping exclusivity, (ie exclusive competence as a result of the exercise of an implied power based on the analysis of the case law) places the issue of energy security in the hands of the Community alone. In that case, it should be determined whether this security is in 'good hands'. In other words, can energy security be better guaranteed through exclusivity or should it be shared between the Community and the Member States?¹⁰² history of the development of an energy policy within the European Community reveals that there is a strong reluctance on the part of the Member States to rely on the Community to enter into negotiations with third country producers of energy. Such reluctance is not only due to bad experience or the ineptitude of the Community to deal with this matter, but is also due to the eagerness of the Member States not to lose their advantageous relationship established in previous decades with individual energy-producing countries. Due to the fact that the existing internal measures in the field of energy play an important role in analysing the potential to expand the Community's competence, the relevant directives and regulations that could have direct or indirect broader security implications are identified and analysed in the next section.

Before analysing these measures, one other important aspect of the division of competences should be mentioned. The possibility of the Community establishing relations with third countries which supply energy cannot be analysed only within the context of the purely economic and commercial aspects of energy security, or the first pillar. The issues discussed in the sphere of the Common Foreign and Security Policy (CFSP) should also play a role in this evaluation, due

¹⁰⁰ The Court finds it 'undeniable' that, where harmonising powers have been exercised, the harmonisation measures thus adopted may limit, or even remove, the freedom of the Member States to negotiate with non-member countries. On the other hand, the internal power that has not been exercised in a specific field cannot confer exclusive competence in that field on the Community. See Case 1/94, above n 45, at paras 88/89. For a comprehensive study of the case law on the division of competences, see A Dashwood, and C Hillion (eds), 'General Law of EC', above n 86. See also D McGoldrick, *International Relations Law of the European Union* (Essex, Longman, 1997) and McLeod *et al*, *A Manual of Law and Practice*, above n 14.

¹⁰¹ See also Case 2/91 (ILO), above n 72, and Case 1/94, above n 45.

¹⁰² What is interesting is the approach of the working groups of a Constitution for Europe, which placed all matters related to energy in the category of shared competences. See Art 13 of the Draft Constitution of July 2003 or Art I-14 of the adopted text in August 2004; CIG 87/04.

to the existence of various instruments at the Union's disposal in that framework which could be adopted to form such relations. It is the focus of this study to demonstrate the importance of approaching Europe's security of energy supply not only from an economic perspective, but also from a political perspective as energy relations have never been established on a purely economic basis. Although this characteristic can be found in many other fields of external relations, its importance is greater in the energy sector where most issues of energy security were politically driven (eg Suez Canal crisis). For this reason the ways in which CFSP measures can be adopted and added to the economic measures should be analysed. Although a detailed analysis of this issue is provided in section 7.2., a brief remark on the division of competences as found in this sphere of policy is provided here.

3.6. DIVISION OF COMPETENCES AND THE CFSP

The ways in which the competences of the 'Union' and the Member States are divided in the framework of the Common Foreign and Security Policy is not clear. Although, as the previous discussion revealed, this lack of clarity also exists within the sphere of economic policy (the first pillar): the particular lack of precision in the sphere of CFSP can be attributed to the special features of this policy framework. Firstly, the Union is given the competence to enter into international agreements. Article 24 of the Treaty on European Union stipulates that the Council, acting unanimously, can open negotiations to conclude an agreement with one or more states or international organisations. There are arguments as to whether these agreements are concluded on behalf of the Member States or the Union¹⁰³ and whether, because of this Article, the Union is provided with an international legal personality.¹⁰⁴ Nevertheless, it is clear that the competences of the Council on the basis of Article 24 are limited to measures within the framework of the CFSP and Police and Judicial Cooperation in Criminal Matters (PJCC). As one writer rightly suggests, Article 24 refers to 'the implementation of this Title and to matters falling under Title VI'. This means that agreements based on Article 24 must aim at reaching the CFSP and PJCC

¹⁰³ See Cremona, 'External Relations and External Competence', above n 10, at 137.

¹⁰⁴ On the international legal personality of the Union, see D Vignes, 'L'Absence de personnalité juridique de l'Union Européenne: Amsterdam persiste et signe' in G Hafner *et al* (eds), *Liber Amicorum Professor Seidl-Hohenveldern :In Honour of his 80th Birthday* (The Hague, Kluwer Law International, 1998) at 757. Compare to RA Wessel, 'Revisiting the International Legal Status of the EU' (2000) 5 *European Foreign Affairs Review* 507 at 533. See also N Neuwahl, 'A Partner with a Troubled Personality: EU Treaty-Making in Matters of CFSP and JHA after Amsterdam' (1998) 3 *European Foreign Affairs Review* 177. Compare also Art I-7 of the Constitution where explicit reference is made to the legal personality of the Union. Some believe that the inclusion of this provision was a logical consequence of the decision to merge the existing treaties into one. See M Cremona, 'The Draft Constitutional Treaty: External Relations and External Action' (2003) 40 *CML Rev* 1347 at 1350 [hereinafter 'The Draft Constitutional Treaty']

objectives alone, such as strengthening the security of the Union in all ways (Art 11).¹⁰⁵ Therefore, their activities cannot extend to cover matters embodied in the TEC. Moreover, Declaration no 4 of the Amsterdam IGC provides that the provisions of Article 24 and any agreement resulting from them shall not imply any transfer of competence from the Member States to the Union. This means that Article 24 should not be construed to strip the Member States of their treaty-making competences.

Nonetheless, even if there was a clear demarcation of competences between the Union and the Member States in the provisions of the TEU, some doubts would persist in dividing these competences in practice, not only between the Union and the Member States but also between the Union and the Community. This is even more the case considering that the acts of the European Council are not 'justiciable'. The European Council has never been subject to judicial review by the ECJ, due to the fact that it was not considered by the Court as an institution of the Community (Arts 230 and 234). As two writers suggest, this results in the European Council being able to 'set standards in its conclusions directly for the national legislative processes independently from the Union's order of vertical competences' without further supervision of the ECJ.¹⁰⁶

On the other hand, as section 7.2 of this study shows, the measures adopted in the sphere of common foreign and security policy reveal that the distinction between Community policy areas and areas of intergovernmental cooperation is blurred, allowing the intergovernmental features to encroach upon Community competences (eg the adoption of common strategies).¹⁰⁷ Although some decisions by the ECJ did not allow a measure to be brought outside the ambit of an exclusive competence by its political dimension, such as the Common Commercial Policy,¹⁰⁸ it is inevitable that expansion of measures in the framework of the CFSP will eventually increase the friction between the competences of the Union and the Community.

¹⁰⁵ See RA Wessel, 'Revisiting the International Legal Status of the EU', *ibid*, at 533.

¹⁰⁶ See von Bogdandy and Bast, 'Vertical Order of Competences', above n 46, at 259.

¹⁰⁷ See also R Baratte, 'Overlaps between European Community Competence and European Union Foreign Policy Activity' in E Cannizzaro, *The European Union as an Actor in International Relations*, above n 12, at 51. See also B Weidel, 'Regulation or Common Position? The Impact of the Pillar Construction on the European Union's External Policy' in S Griller and B Weidel (eds), *External Economic Relations and Foreign Policy in the European Union* (Vienna, Springer, 2002) at 23. On the lack of 'primacy' and direct effect of CFSP measures see, B de Witte, 'The Pillar Structure and the Nature of the European Union: Greek Temple or French Gothic Cathedral?' [hereinafter 'The Pillar Structure'] in T Heukels, N Blokker and M Brus (eds), *The European Union after Amsterdam, A Legal Analysis* (The Hague, Kluwer Law International, 1998) at 53 [hereinafter *European Union after Amsterdam*]. See also E Denza, *The Intergovernmental Pillars of the European Union* (Oxford, Oxford University Press, 2002), Chapter 1.

¹⁰⁸ See, eg, Case 70/94, *Werner*, [1995] ECR I-3189 or Case 124/95, *Centro-Com*, [1997] ECR I-81 at para 30, where the ECJ explicitly provides that 'even where measures have been adopted in the exercise of national competence in matters of foreign and security policy, they must respect the Community rules adopted under the common commercial policy'.

It is interesting to reveal briefly here that this fact has not been taken into account in the recent negotiations on a Treaty Establishing a Constitution for the European Union. It was proposed to create a distinct category of competence for the CFSP, detached from the overall categorisation of competences of the Union as a whole in other areas.¹⁰⁹ The only justification provided for this distinct approach to the CFSP is that the 'separate paragraphs given to the CFSP and to the coordination of Member States' economic policies reflect the specific nature of the Union's competences in those areas.¹¹⁰ This different approach to the issue of the CFSP suggests that the characteristic of a concurrent competence—ie the Union and the Member States have the power to legislate and adopt legally binding acts while Member States are able to exercise their competence, only if and to the extent that, the Union has not yet exercised it—would not be applicable to CFSP measures. On the other hand, Article I-13(2) of the Constitution provides that the Union shall have exclusive competence 'for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or insofar as its conclusion may affect common rules or alter their scope'. Putting the regrettable attempt to summarise the case law in one provision aside¹¹¹ this suggests that exclusive competence can also arise within the CFSP through the conclusion of international agreements, as the reference is to the Union which is comprised of the CFSP. Would this exclusive competence function similarly to the way the exclusive competence of the Community functions? In other words, would the conclusion of international agreements by the Union in the field of CFSP lead to pre-emption? The Constitution does not clarify this issue as it links pre-emption to 'shared competences' which does not include the CFSP in its ambit.¹¹² Hence, this ambiguity suggests that nothing in the Constitution simplifies the complexity of the division of competences and its extension to the field of the CFSP.

As one writer submits, the inclusion of the CFSP in the overall competences of the Community is necessary in order to guarantee 'greater transparency and higher level of clarity' while preserving the intergovernmental character of the CFSP which would not necessarily be damaged.¹¹³ However, the final version of the Constitution did not take these issues into account and created a distinct framework of competences for CFSP measures (Art I-16). Although Member States are to refrain from actions contrary to the Union's interests or which are

¹⁰⁹ For the background to the negotiations on this issue see I Pernice and D Thym, 'A New Institutional Balance for European Foreign Policy' (2002) 7 *European Foreign Affairs Review* 369.

¹¹⁰ See the Note of the Convention Presidium on Draft of Art 1 to 16, Feb 2003, CONV 528/03 at 16.

¹¹¹ See also B de Witte, 'The Constitutional Law of External Relations' in I Pernice and MP Maduro (eds), *A Constitution for the European Union: First Comments on the 2003: Draft of the European Convention* (Baden-Baden, Nomos, 2004) [hereinafter 'The Constitutional Law'].

¹¹² See also Cremona, 'The Draft Constitutional Treaty', above n 104, at 1351.

¹¹³ See S Griller, 'External Relations' in de Witte *Ten Reflections*, above n 19, at 140.

likely to impair its effectiveness (Art I-16(2)), it remains to be seen how this provision would limit the activity of the Member States in practice, taking into account that the ECJ still has no jurisdiction in this field.¹¹⁴

The measures embodied in the framework of the CFSP will be analysed in chapter 7.2. It suffices to say here that the division of competences in the CFSP framework reveals interesting points with respect to the security of energy supply. There are CFSP measures in place that could be interpreted as measures contributing to a secure energy supply for Europe. Given that these measures are legally binding, they must be included in a survey of Europe's external energy policy. This relationship is fully explored in chapter 7.

As mentioned before, in order to reveal the relevance of the discussion of the division of competences to Europe's energy supply security, it is necessary to look at all of the existing and possible measures that can be undertaken by both the Community and the Member States in the energy sector. The advantages or disadvantages of expanding the Community's competence in this specific field will be analysed at the end of next chapter. The objective of that chapter is to analyse these internal measures in order to verify their efficiency in guaranteeing Europe's security of energy supply as a whole, and also to relate that efficiency to the issue of competences. As explained in the first chapter, it is absolutely ineffective to design an energy policy focusing solely on internal security measures while Europe's dependence on external energy sources is set to increase in the years to come. It is thus necessary to first analyse those internal measures which, as the next chapter provides, are divided into hard measures (legally binding) and soft measures (in the form of Communications or Green and White papers), where the importance of Europe's external security of energy supply has been repeatedly raised. As these measures have soft law characteristics it is necessary to briefly analyse their role in the legal framework of the Community. Following this discussion, the role that the Community and the Member States should or could play in guaranteeing energy security will be examined. This study concludes that the aim should be efficient cooperation between the two rather than an antagonistic approach that focuses solely on which party (the Community or the Member States) prevails and excludes the other in guaranteeing Europe's security of energy supply.

¹¹⁴ Art III-376 of the Treaty Establishing a Constitution for Europe.

4

Internal Outlook: EU Measures in the Field of Energy

4.1. INTRODUCTION

THIS CHAPTER EXAMINES the most important secondary legislation in the Community's internal market that is relevant to the analysis of the internal security of energy supply. These internal measures have direct or indirect implications for energy supply security from both an internal and external perspective. As explained in the previous chapter, in the absence of an express provision in the EC Treaty, the external competences of the Community could be expanded through the increase in the numbers and the areas covered by secondary legislation. The potential for this expansion can be verified through the close analysis undertaken in this chapter of the content of this legislation. Thus, the external aspects of Community measures dealing with the internal energy market are discussed herein, while chapters 5 and 6 discuss external relations in the form of bilateral, regional or multilateral relations, which have implications for security of energy supply. On the other hand, it should also be determined whether the mere establishment of purely internal measures would guarantee adequate security of energy supply or whether specific external measures should accompany them. Moreover, there are various important soft law measures, mainly in the form of White or Green Papers, which specifically deal with the issue of Europe's security of energy supply. These soft law instruments have strong external implications, whose importance should be scrutinised from a legal point of view. The final part of this chapter compares the analysis of the law of division of competences and secondary legislation in the field of energy, and reveals the merits of providing either the Community or the Member States with the powers to carry out measures to guarantee an optimum security of energy supply.

The high degree of governmental ownership and control of the energy sector had, for a long time, constrained its liberalisation and opening up in Europe. Moves towards liberalisation in all the major sectors of the European economy began to take shape immediately after the inception of the European Community, and we are now witnessing their maturity. The energy sector's isolation from

that movement signalled the reluctance on the part of governments to subject themselves to European regulations that sought to create an internal energy market. The strategic nature of the energy sector and its importance for the overall economy has been considered as one of the underlying rationales for such a conservative approach. This has been especially problematic in the electricity and gas sectors, because the physical characteristic of other sources, such as coal and oil, had already 'led to international trade and free market practices, with a declining government role, except in fiscal matters.'¹ Due to the existence of such reluctance, 'energy' appeared more as an exception to the principles of the internal market than part and parcel of it (see, eg, chapter 2, and the discussion of *Campus Oil* and related cases in the previous chapter).

The necessity of introducing competition in the energy sector, along with the fast development of integration in other sectors (especially since the creation of the Single European Act in 1986), finally led to the creation of laws that specifically addressed the integration mechanisms in the energy sector. The reasons for this move were named as efficiency gains, price reduction, higher standards of service and increased competitiveness, which were said to be advantageous for the Community as a whole. The move towards integration finally led to the creation of the Directives on Electricity and Gas. These directives, the most important undertakings in shaping the structure of the internal energy market, aim at opening up the electricity and gas markets through the gradual introduction of competition, increasing efficiency in the energy sector and improving the competitiveness of the European economy as a whole. In general, they are concerned with the degree of market opening as well as the imposition of minimum obligations regarding access to energy networks, consumer protection, and the unbundling of the transmission and distribution functions of energy companies. They are also deemed to contribute strongly to internal security of energy supply. The following paragraphs briefly touch upon the contribution of these directives to such security and reveal whether they embody externalities, or in other words, whether external security of energy supply could also be guaranteed through their application.

The first Electricity Directive² was adopted in 1996 and entered into force in 1997. This directive was the first and most important measure aimed at achieving a common European market in energy. Although the idea was to harmonise Member States' activities in the field of electricity and to impose competition rules on this sector, it was believed that such coordinated action would bring more security to the Community because of increased efficiency in production, transmission and distribution of electricity.

¹ See PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (Oxford, Oxford University Press, 2002) at 239 [hereinafter *Competition in Energy Markets*] at 19.

² See Dir 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning Common Rules for the Internal Market in Electricity [1996] OJ L/27/20.

Although the broad aim of the directive was that electricity undertakings must be able to operate with a view to achieving a competitive market in electricity, it was significant that the structural differences in the Member States and the different systems for regulating the sector were repeatedly acknowledged. The provisions were therefore confined to general principles, whose detailed implementation was left to the Member States. Article 3(2) of the directive recognised that Member States may impose public service obligations on their undertakings, which may relate to security, including security of supply, regularity, quality and prices of supplies and environmental protection.³ On the other hand, no reference was made in this directive to contracts and dealings with third states in supplying electricity for the Community as a whole. Therefore, no single obligation was imposed on the Member States in their dealings with third countries.

In 2003, the new Electricity Directive came into existence and replaced the previous directive.⁴ The new directive created various new measures necessary for the full establishment of an internal market in electricity and sought to rectify the shortcomings of the previous law. The analysis here does not go into the detail of these new measures, as they possess no external aspect in general. The only link to externalities was the role given to the Commission to provide a 'general assessment of the progress achieved with regard to bilateral relations with third countries which produce and export or transport electricity, including access to the networks of these countries'. Article 25 of this directive also imposes an obligation on Member States to inform the Commission every three months of imports of electricity from third countries. Clearly, this monitoring mechanism is linked to the objectives of security of supply. Although the necessary measures to be adopted by the Community are not mentioned in case this assessment reveals the shortcomings of bilateral relations, or reveals restrictions on having access to the network of third countries, or inadequate import of electricity, the Commission would most likely publish guidelines or undertake extra measures within its competence to rectify this inefficiency. In any case, no precise Community guidelines to secure the flow of electricity into the Community from third countries were established.

The Gas Directive was adopted on 22 June 1998 and the Member States were given two years to transpose it into national regimes.⁵ Transmission, storage, distribution and supply of natural gas were regulated in this directive. The main aim of the directive was to achieve a competitive market in natural gas. Similar to

³ See Arts 17, 18 and 19 of Dir 96/92/EC, *ibid.* See also MM Roggenkamp, A Ronne, C Redgwell and I Del Guayo (eds), *Energy Law in Europe: National, EU and International Law and Institutions* (New York, Oxford University Press, 2001) at 303 [hereinafter *Energy Law in Europe*].

⁴ See Dir 2003/54/EC of the European Parliament and of the Council of 26 June 2003, concerning Common Rules for the Internal Market in Electricity and Repealing Dir 96/92/EC [2003] OJ L/176/37.

⁵ See Dir 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning Common Rules for the Internal Market in Natural Gas [1998] OJ L/204/1. See also P Cameron, 'The Internal Market in Energy: Harnessing the New Regulatory Regime' (2005) 30 EL Rev 631.

the Electricity Directive, public service obligations could be imposed that gave leeway to Member States in applying the provisions of the directive flexibly for security purposes, only if they are transparent, non-discriminatory and verifiable. Based on the same reasoning given in the analysis of the Electricity Directive and the division of competences, no reference was made to a Community external competence to deal with the issue of security of supply through relations with third countries. Member States could undertake necessary activities to secure their own energy supply. Although the directive stated that the external supply of natural gas was of particular importance for the purchase of natural gas in Member States that were highly dependent on gas imports, no concrete measures to facilitate access to this supply at the external level were mentioned. It is arguable that the underlying rationale for not highlighting necessary measures at the external level was the belief that the creation of a competitive common market facilitates access to such supply for those disadvantaged members of the Community.

This directive was later replaced in 2003. The most important externality in this later directive is found in paragraph (5), where it is acknowledged that ‘in view of the anticipated increase in dependency as regard natural gas consumption, consideration should be given to initiatives and measures to encourage reciprocal arrangements for access to third-country networks and market integration.’⁶ This provision can be said to be directly linked to our discussion of security of supply and the necessity of considering the dependence of the Community on external sources in internal measures. The directive does not design a framework for such a reciprocal relationship with third countries. Like the Electricity Directive, it only imposes an obligation on the Commission to produce a general assessment of progress in bilateral relations with third producers or transit countries. Nevertheless, the mere reference to ‘encouragement of reciprocal arrangements’ is already a useful reminder.

The other set of rules that can be directly linked to the discussion of energy security is the initiatives, especially since the end of the 1990s, in the field of energy efficiency and the use of renewable energy resources. The number of directives, regulations, decisions and proposals in these fields is impressive and specifically unique in a regional setting, and indicates a very strong political will to harmonise laws and create a fully energy-efficient Community. This in turn has repercussions for energy security, as briefly referred to below.

The initial stages marked the imposition of obligations to provide labelling and standard product information of the consumption of energy on household appliances.⁷ Although no reference was made to the overall security of supply

⁶ Dir 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning Common Rules for the Internal Market in Natural Gas and Repealing Dir 98/30/EC [2003] OJ L/176/57.

⁷ Council Dir 92/75/EEC of 22 September 1992 on the Indication by Labelling and Standard Product Information of the Consumption of Energy and Other Resources by Household Appliances

objective of this initiative, the introduction of such regulations would indirectly affect the use of energy through rational consumption. The objective of energy efficiency was also linked to those of protecting the environment, such as the introduction of the SAVE programme, which necessitated limiting carbon emissions by improving energy efficiency.⁸ Although the protection of environment was considered as the major rationale for introducing a series of measures on energy efficiency, the text of the laws acknowledges their relevance for security of energy supply as well. For example, paragraph 15 of the second SAVE Programme Directive expressly refers to the ‘positive impact that improved energy efficiency has on security of energy supply.’⁹ This reference to energy security is logical as the greater the number of energy-efficient measures are put in place, and the more energy is used rationally, the less energy is consumed.¹⁰ This being said, the necessity of using energy efficiency measures is said to go hand in hand with other objectives, such as welfare, as it is believed that ‘through the use of these measures, those billions that are not spent on energy, translates as net saving and contributes to the increase in jobs and better living conditions for EU citizens.’¹¹

[1992] OJ L/297/16. See also Reg (EC) No 2422/2001 of the European Parliament and of the Council of 6 November 2001 on a Community Energy Efficiency Labelling Programme for Office Equipment [2001] OJ L/332/1. See Council Decision of 14 May 2001 concerning the Conclusion on Behalf of the European Community of the Agreement Between the Government of the United States of America and the European Community on the Coordination of Energy-Efficient Labelling Programmes for Office Equipment [2001] OJ L/172/1. See also Dir 2000/55/EC of the European Parliament and of the Council of 18 September 2000 on Energy Efficiency Requirements for Ballasts for Fluorescent Lighting [2000] OJ L/279/33, and Council Dir 92/42/EEC of 21 May 1992 on Efficiency Requirements for New Hot-Water Boilers Fired with Liquid or Gaseous Fuels [1992] OJ L/167/17.

⁸ Council Decision 91/565/EEC of 29 October 1991 concerning the Promotion of Energy Efficiency in the Community (SAVE Programme) [1991] OJ L/307/34. See also Council Dir 93/76/EEC of 13 September 1993 to Limit Carbon Dioxide Emissions by Improving Energy Efficiency (SAVE) [1993] OJ L/237/28.

⁹ See Council Decision 96/737/EC 16 December 1996 concerning a Multi-Annual Programme for the Promotion of Energy Efficiency in the Community (SAVE II) [1996] OJ L/335/50.

¹⁰ See also Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, Action Plan to Improve Energy Efficiency in the European Community, COM (2000) 247 Final. Also Decision no 1230/2003/EC of the European Parliament and of the Council of 26 June 2003 adopting a multi-annual programme for action in the field of energy: ‘Intelligent Energy—Europe’ (2003–2006) [2003] OJ L/176/29. See also the recent Proposal for a European Parliament and of the Council Establishing Competitiveness and Innovation Framework Programme (2007–2013), COM (2005) 121 Final. See also the Dir 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the energy performance of buildings [2003] OJ L/1/65.

¹¹ See Green Paper on Energy Efficiency: Doing More with Less, COM (2005) 265 Final. With respect to energy security, the Green Paper mentions that: ‘By 2030, on the basis of present trends, the EU will be 90 per cent dependent on imports for its requirements of oil and 80 per cent dependent regarding gas. It is impossible to predict the price of oil and gas in 2020, particularly if demand from the developing world continues to increase as rapidly as today. As indicated on the 2nd May 2005 in the context of the IEA Ministerial meeting, energy efficiency is one of the key methods to deal with this challenge. Making a real effort to at first cap EU energy demand at present levels and subsequently reduce it, would represent an important contribution in developing a coherent and balanced policy to promote the security of energy supplies for the European Union.’

The second group of measures are those related to the use of renewable sources of energy, such as biomass, solar, hydro, geothermal, and wind energy. Due to the high importance the EU attaches to tackling the problems of climate change, the use of renewable sources became a key priority in EU energy policy-making.¹² Since 1997, the Union has been working towards the target of a 12 per cent share of renewable energy in gross inland consumption by 2010.¹³ Although the Commission acknowledges the many advantages of using fossil fuels, such as their cheap extraction, their convenient use, their wide availability, the existence of their delivery infrastructure and well-organised industries, they also admit that they emit pollutants and greenhouse gases causing climate change and they increase security risks. For the latter concern of security, the Commission suggests that the objective is not to reduce import dependency but to increase diversification of sources and technologies, which would contribute to better security of energy supply.¹⁴

However, the use of renewable energy among the EU Member States has remained marginal, except in the two old-fashioned sources of electricity from hydropower, and traditional uses of wood for heating.¹⁵ Although the use of bio-fuels has been repeatedly raised as the best substitute for oil, especially in the transport sector, its use has also been marginal. The first problem leading to such a low use of renewable sources has been identified as the financing of this type of energy and the fact that Community has only limited means to support its development.¹⁶ This problem, along with a lack of adequate technologies to totally render the use of such sources meaningful in comparison to fossil fuels, and the lack of public support due to the still dominant eagerness to use fossil

¹² See Council Decision 98/352/EC of 18 May 1998 concerning a Multi-Annual Programme for the Promotion of Renewable Energy Sources in the Community (Altener II) [1998] OJ L/159/53. See also Decision no 646/2000/EC of the European Parliament and of the Council of 28 February 2000 adopting a multi-annual programme for the promotion of renewable energy sources in the Community (Altener) (1998 to 2002) [2000] OJ L/79/1.

¹³ See Green Paper on 'Energy for the Future: Renewable Sources of Energy', COM (96) 576 Final. See also Communication from the Commission, Energy for the Future: Renewable Sources of Energy, White Paper for a Community Strategy and Action Plan, COM (97) 599 Final.

¹⁴ See Communication from the Commission to the Council and the European Parliament, The Share of Renewable Energy in the EU Commission Report in accordance with Article 3 of Directive 2001/77/EC, Evaluation of the Effect of Legislative Instruments and Other Community Policies on the Development of the Contribution of Renewable Energy Sources in the EU and Proposals for Concrete Actions, COM (2004) 366 Final.

¹⁵ See Communication on the Evaluation of the Legislative Instruments, *ibid*, at 34.

¹⁶ There are, however, initiatives to encourage the use of such sources. For example, see the directive that imposes the obligation on the Member States to take appropriate steps to encourage greater consumption of electricity produced from renewable energy sources in conformity with national indicative targets, Dir 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the Promotion of Electricity Produced from Renewable Energy Sources in the Internal Electricity Market [2001] OJ L/283/33. The use of renewable sources for the production of electricity has been 13.8% in 2003 for the EU 15 (the target is 22% in 2010), compared to 13.7% in 2002, 15.4% in 2001, and 14.2% in 1999, which shows a decline in the use of these sources. See European Commission, *European Union Energy and Transport in Figures* (Luxembourg, European Communities, 2001–) [hereinafter *Energy in Figures*] of 2005, 2004, 2003 and 2001 respectively.

fuels, have contributed to the sluggish growth of renewable sources in Europe.¹⁷ It is clear, therefore, that until technologies improve, attitudes towards the use of renewable sources will not change. Political will does not currently exist to finance the use of renewable sources, thus these sources will have difficulty in taking off and becoming competitive with fossil fuels. Until that time, they will pose no threat to the use of conventional sources, and concern over the issue of security of energy supply will continue to persist.¹⁸

Another important issue in relation to the internal market is the membership of Norway, the major gas producer for the European Union, in the Agreement on the European Economic Area (EEA). Previous to the EEA Agreement, in 1961, the 7 countries that were not members of the European Community (Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK) established the European Free trade Agreement (EFTA) with later membership of Iceland.¹⁹ Gradually some members left EFTA to become members of the EC, and the remaining EFTA states focused on concluding free trade agreements with the EC. In 1991, the European Economic Area Agreement (EEA) was signed and entered into force in 1994. This agreement now unites the 25 EU members and the three current EEA/ EFTA states, namely Iceland, Liechtenstein and Norway (Bulgaria and Romania are yet to sign the Agreement as of February 2007). The design of the EEA allows its outside members to participate in the internal market while not assuming the full responsibility of EU membership. Therefore, they have no voice in decision-making but they can be consulted in the formulation of EC legislation. A Joint Committee integrates new EC legislation in areas covered by the EEA, which include the four fundamental pillars of the internal market, namely freedom of goods, services, capital and persons, as well as rules on competition, and other common rules and the horizontal policies, such as social policy, consumer protection, environment, statistics and company law.²⁰ If EEA/ EFTA countries are admitted to cooperate with the EC in some activities, they

¹⁷ These problems, as the 1997 White Paper on a Community Strategy for the Use of Renewable Sources demonstrates, are linked to the fact that

energy costs for conventional fuel cycles do not currently reflect the objective full cost, including the external costs to society of environmental damage caused by their use. A further obstacle is that renewable energy technologies, as is the case for many other innovative technologies, suffer from initial lack of confidence on the part of investors, governments and users, caused by lack of familiarity with their technical and economic potential and a general resistance to change and new ideas.

See the Communication from the Commission, (1997) COM 599 Final.

¹⁸ The contribution of renewable sources of energy to the overall energy use of the EU 15 is as follows: in 2003, renewable sources contributed 3.89% to total energy consumption (4.25% in EU 25) compared to 3.97% in 2002, 4.29% in 2001 and 4.27% in 1999. This figure shows that the use of renewable sources in the total energy consumption has not changed drastically in the past few years. See the European Union, *Energy and Transport in Figures of 2005, 2004, 2003 and 2001* respectively.

¹⁹ EFTA is comprised of three institutions, the EFTA Secretariat, the EFTA Surveillance Authority and the EFTA Court.

²⁰ For a comprehensive analysis of the EEA Agreement see S Norberg, K Hokborg, M Johansson, D Eliasson and L Deichen, *EEA Law: A Commentary on the EEA Agreement* (Stockholm, Fritzes, 1993).

also contribute to the budgets of the programmes without a voting right. The EEA is not a custom union and does not apply to basic agricultural products, harmonisation of taxes, or common policies and each contracting party also keeps its full freedom vis-a-vis third countries.

The legal effects of EC law, and the way in which they should be implemented in the EEA/EFTA countries, can be found in the Annexes attached to the EEA Agreement (ie the 'reference technique' which implies the applicability of those laws in the annexes of the EEA instead of recopying the legal acts).²¹ Annexes are divided into two parts: the 'Acts' which are regulations, directives, and decisions; and 'Acts of which the Contracting Parties shall take note' such as recommendations, communications, notices, etc. Annex IV of the EEA Agreement refers to 'energy'.

The majority of Community legislation concerned with measures to protect the environment in the field of energy, along with measures on energy efficiency, are adopted by the EEA/EFTA countries. For the purposes of the abundance of energy resources in Norway, the most important undertaking is the adoption of both the Electricity and Gas Directives by Norway (and also by other EFTA/EEA countries). As a result, the important internal market provisions will be similarly applied to Norway, with only minor modifications. This is particularly important for the purposes of Europe's security of energy supply because the existence of abundant reserves in Norway, and their inclusion in the internal energy market, would create a secure flow of these two resources into the Community. Fair and open access, avoidance of any abuse of a dominant position, capacity that should be made available, environmental protection, etc. are all objectives that are shared between the Community and Norway, due to the existence of the EEA Agreement and the inclusion of these two important Directives in that framework. Moreover, the adoption of the Directive on transit of electricity through transmission grids and the Directive on the transit of natural gas through grids,²² which oblige entities responsible for the national grids to open their entity to other operators within the EEA, are also of particular importance to Europe's security of energy supply. Hence, as far as these two energy sources are concerned, the matter of reliance on Norway becomes an internal matter. It is linked to the efficiency of the internal energy market, and is no longer an external issue which should be discussed within the framework of the EU's external relations with energy-supplying countries. However, this claim is limited to the Gas and Electricity

²¹ EC laws are not directly applicable in the EEA/EFTA countries. With respect to the direct effect of these laws, some EFTA states 'seem to be of the opinion that Art 6 EEA (on the effect of the EC) jurisprudence in the EEA countries) does not entail the taking over in the EEA of the EC) jurisprudence concerning the legal effects of the Treaty provisions and the EC acts integrated in the EEA (ie direct effect and primacy) but only the jurisprudence interpreting the substance of the provisions. This can, however, be questioned'. See T Blanchet, R Piipponen and M Westman-Clement, *The Agreement on the European Economic Area (EEA): A Guide to the Free Movement of Goods and Competition Rules* (Oxford, Clarendon Press, 1994) at 21.

²² See [1991] OJ L/147/37 and [1990] OJ L/313/3.

Directives, and not to the other important Directive on the mandatory stock-holding obligation in the Community which is not applied to Norway.²³ The analysis of the stock-holding obligation below will clarify the relevance of this Directive for Europe's security of energy supply. It suffices to say here that its incorporation by the EEA would have added to the overall security framework of the EU, because the stocks of another country, namely Norway, would have become available to the EU in the event of a shortage of supply.²⁴

Based on the overall framework of the European internal energy market, as it was shortly reviewed here, the attempt is to create an efficient and competitive market where energy will be freely exchanged. Clearly, the creation of such a market, if it acts efficiently, contributes to the security of energy supply in each individual country, something that could not have been easily achieved without the existence of an internal energy market. This being said, the external aspects of some specific internal measures in the field of energy, which are deemed important for our study on energy security, should also be looked at. This study will be provided below, followed by an overall analysis of the adequacy of these measures to guarantee an efficient framework for security in Europe and its link to the question of the division of competences between the Community and its Member States.

4.2. COMMUNITY MEASURES AFFECTING TRADE IN ENERGY GOODS AND SERVICES

In this section, Community measures related to trade in energy goods and services that are relevant for our discussion on energy security are named and analysed. The aim is to provide an overview of the adequacy of the Community legislation to guarantee the security of Europe's energy supply. References are also made to the links between these measures and the analysis of the law of

²³ One writer suggests that the directive was not adopted for three probable reasons:

1) EFTA countries have already made the same commitments as the EC concerning stockpiling within the framework of the International Energy Agency (IEA), 2) this legislation does not have any great importance for the normal movement of goods, 3) although the joint decision-making system in the EC is stricter relative to that of the IEA, the EEA does not give EFTA countries any formal say in internal EC decision making.

See Cameron, *Competition in Energy Markets*, above n 1, at 73.

²⁴ Norway acts as a member of the International Energy Agency under a special agreement. Norway has been historically active in the activities of the IEA but despite its interests it was found difficult for this country to participate in the Emergency Sharing System of the IEA and take new commitments. As there would be differences in commitments of Norway and other IEA members, and exceptions for Norway 'could not be written into the agreement or be permitted by way of reservation to it', Norway's concerns were accommodated in another agreement based on which Norway would agree, on the basis of its own decision, to take appropriate oil demand restraint measures and to 'activate any standby oil production capacity there might be on the Norwegian continental shelf'. Norway has responded, for example, to the 1991 oil crisis, by contributing to the emergency response measure through oil conservation and stock draw. See generally, R Scott, *The IEA the First 20 Years: Origins and Structure* (Paris, IEA, 1994) at 104.

competences as undertaken in the previous chapter. It is necessary to mention here that the international trade rules of the World Trade Organization (WTO) are also incorporated in the Community legal system, as well as the international trade rules of the Energy Charter Treaty. These rules are copied from the GATT/WTO rules, with some minor modifications. These international trade rules are considered as part of the overall Community legal framework, and they are therefore important in analysing the existing framework on trade in the Community and their implications for the Community's security of energy supply. However, the following section only analyses those rules that are *designed by the Community* as relevant to trade in goods and services: the subsequent section analyses the international rules of the WTO and the Energy Charter Treaty, which are equally part of Community law but were not adopted unilaterally by the Community.

4.2.1. Trade in Energy Goods

The EC Treaty's approach to commercial policy can be found in Article 133, which grants discretion to conduct the form and content of this policy to the Community legislative institutions. No definition of the Common Commercial Policy (CCP) is given in the treaty. Little guidance is given as to what the objectives of this policy should be,²⁵ and the treaty does not list the instruments with which the Community can implement this policy.²⁶ However, this concept has been developed and interpreted in the case law of the ECJ and in legal scholarship.²⁷

The discussion of 'what Common Commercial Policy consists of' is an ongoing one. Nevertheless, no matter what the boundaries of this policy are, Article 133 states that the principles shaping this policy should be uniform. Some particular fields of importance are also enumerated, such as uniform principles in: tariff rates, the conclusion of tariff and trade agreements, methods of liberalisation, export policy, and measures to protect trade. This list is not exhaustive: therefore, any activity, which could be considered as 'commercial', can be governed by this article. The controversial paragraph 5, which extends the

²⁵ M Cremona, 'EC External Commercial Policy after Amsterdam, Authority and Interpretation within Interconnected Legal Orders' in JHH Weiler (ed), *The EU, the WTO and the NAFTA* (Oxford, Oxford University Press, 2000) at 6 [hereinafter 'EC External Commercial Policy']. See also M Cremona, 'External Economic Relations and the Amsterdam Treaty' in D O'Keefe and P M Twomey (eds), *Legal Issues of the Amsterdam Treaty* (Oxford, Hart Publishing, 1999) at 225 [hereinafter 'External Economic Relations'].

²⁶ JHJ Bourgeois, 'External Relations Powers of the European Community' (1999) 22 *Fordham International Law Journal* S 149 at S 151.

²⁷ See Case 1/94, *on the Competence of the Community to Conclude International Agreements concerning Services and the Protection of Intellectual Property* [1994] ECR I-5267. See also M Maresceau, 'The Concept "Common Commercial Policy" and the Difficult Road to Maastricht' in M Maresceau (ed), *The European Community's Commercial Policy after 1992: The Legal Dimension* (Dordrecht, Martinus Nijhoff, 1993) at 6 [hereinafter 'The Concept of CCP'].

ambit of this policy to cover services and intellectual property, also suggests that some activities, which have relations with trade and could adversely affect trade, should also be covered.²⁸

The pluses and minuses of this article are extensively dealt with in scholarly writing.²⁹ focus here is limited to the situation of trade in energy products, and the extent to which the Common Commercial Policy deals with this trade. One aspect of the external dimension of the EU's energy policy mainly concerns the export and import of energy products from, and to, third countries. To implement the Common Commercial Policy embodied in Article 133 of TEC, the Council has adopted regulations establishing the export and import of goods in general. These regulations will be analysed below with respect to their application to energy products.

4.2.1.1. Import

In the early years of the common market, Member States were allowed to restrict intra-Community trade in products originating in third countries for which there was not yet a uniform Community import regime. Therefore, Member States were still able to protect their national markets for a number of various products, the most prominent examples being the import of motor vehicles, textiles, clothing and bananas.³⁰ Some Council regulations gradually came into force that sought to establish uniform principles for the trade of particular products.

These regulations dealt with import from third countries,³¹ import from non-market economy countries,³² and import of textiles from third countries with which the Community had concluded bilateral agreements and protocols or other arrangements³³ and with those that the Community had not concluded specific arrangements.³⁴ The first two regulations prescribe that imports should take place freely and without being subject to any quantitative restrictions. However, safeguard measures could still be applied if products imported were in such a greatly increased quantity and/or on such terms or conditions as to cause,

²⁸ See the amendment to Art 133 as found in the Nice Treaty explained below in the section on trade in energy services.

²⁹ See M Cremona, 'A Policy of Bits and Pieces: the Common Commercial Policy after Nice' (2001) 4 *Cambridge Yearbook of European Legal Studies* 62; P Koutrakos, 'I Need to Hear you Say it: Revisiting the Scope of the EC Common Commercial Policy' (2003) 22 *Yearbook of European Law* 407 [hereinafter 'A Policy of Bits and Pieces']. See also C Herrmann, 'Common Commercial Policy after Nice: Sisyphus would have done a Better Job' (2002) 39 *CML Rev* 7.

³⁰ See P Eeckhout, *The European Internal Market and International Trade: A Legal Analysis* (Oxford, Oxford University Press, 1994) at 147.

³¹ [1994] OJ L/349/53.

³² [1994] OJ L67/89.

³³ [1993] OJ L/275/1, as amended.

³⁴ [1994] OJ L/67/1, as amended.

or threaten to cause, serious injury to Community producers.³⁵ Some believe that it is hard to see what kind of safeguard measures a Member State would adopt with respect to energy products, bearing in mind the large dependence of European countries on imports of energy.³⁶ In any case, no product import can be limited, except those explicitly mentioned by the Council as being subject to different regulations (mainly textiles), and energy products were of no exception.³⁷ This outcome can be linked to energy security matters, because the dependence of Europe on energy justifies the removal of all import barriers for those products. One writer explains that it is hard to imagine that the flood of imports of energy into the Community would threaten or cause serious injury to Community energy suppliers.³⁸ The energy of the latter supplier is not in direct competition with external supplies as the demand for energy in the Community calls for both sources, and production at Community level is limited due to the inadequacy of internal energy reserves to meet demand. It should be clarified here, however, that this claim is correct as long as the primary form of energy, in the form of natural gas or crude oil is concerned, because the influx of some products, for example refined petroleum products, could cause injury to the petrochemical industry of Europe if the imported products are sold cheaper in the European market. This issue will be further elaborated in the discussion on dual pricing in section 5.4.9.3 below.

Nonetheless, two possibilities remain whereby the import of oil could be prohibited. One is the imposition of economic sanctions. Economic sanctions are adopted to meet some political objectives and therefore potentially involve both the CCP and the Common Foreign and Security Policy (CFSP). For that exact reason, the adoption of economic sanctions raised various legal problems (for example, the issue of the division of competences between institutions, or the fact that such sanctions should have been only in furtherance of the objectives of the CCP, and not merely political goals, in order for Article 133 to apply). The Maastricht Treaty ended this problem: Article 301 of the EC Treaty, which is the basis of sanctions regulations, now combines the first and second pillar actions without an overlap of competences.³⁹

³⁵ See, above n 31, at Art 16.

³⁶ M Ayrat, *Droit communautaire de l'énergie* (Paris, Joly Éditions, 1997) at 52 [hereinafter *Droit de l'énergie*].

³⁷ It should be added here that a previous Council Regulation obliged the Member States to notify the Commission of imports of crude oil and natural gas. This regulation was later repealed. See 1996] OJ L/80/2. Another Regulation also obliges Member States to register imports of petroleum and its products. See [1981] OJ L/373/9.

³⁸ See Ayrat, *Droit de l'énergie*, above n 36.

³⁹ Art 301 provides:

Where it is provided, in a common position or in a joint action adopted according to the provisions of the Treaty on European Union relating to the common foreign and security policy, for an action by the Community to interrupt or to reduce, in part or completely, economic relations with one or more third countries, the Council shall take the necessary urgent measures. The Council shall act by a qualified majority on a proposal from the Commission.

As an example of sanctions directed at energy-exporting countries, one may mention that in August 1990 (pre-Maastricht), the Council adopted a regulation (as a result of a UN Security Council Resolution in the aftermath of the Gulf War) to prevent Community trade with Iraq and Kuwait. This prohibition included imports and exports of all commodities or products, with the exception of medical products and foodstuffs.⁴⁰ Sanctions were lifted with respect to Kuwait in March 1991.⁴¹ Following Security Council Resolution 986 (1995) on authorisation to permit the import of petroleum and petroleum products originating in Iraq (as a temporary measure to provide for the humanitarian needs of the Iraqi people), the Council adopted another regulation. This later regulation was based on then Articles 73g (on movement of capital and payments) and 228a (now Arts 60 and 301 respectively), upon the adoption of a common position by the Council,⁴² to allow such conditional imports.⁴³ Article 2

On the absence of an overlap, see RA Wessel, 'The Inside Looking Out: Consistency and Delimitation in EU External Relations' (2000) 37 CML Rev 1135 at 1158. For an overview of economic sanctions in the EU, see A Lukaschek, 'Economic Sanctions and the European Union's Legal Framework' in S Griller and B Weidel (eds), *External Economic Relations and Foreign Policy in the European Union* (Vienna, Springer, 2002) at 323. See also Y Buchet de Neuilly, 'European External Relations Fields: The Multi-Pillar Issue of Economic Sanctions against Serbia' in M Knodt and S Princen (eds), *Understanding the European Union's External Relations* (London, Routledge, 2003) at 92. See also I McLeod, ID Hendry and S Hyett (eds), *The External Relations of the European Communities: A Manual of Law and Practice* (Oxford, Clarendon Press, 1996) at 352.

⁴⁰ See Council Reg (EEC) No 2340/90 of 8 August 1990 Preventing Trade by the Community As Regards Iraq and Kuwait [1990] OJ L/213/1. Another regulation extended the sanction to cover non-financial services, except postal, telecommunication and medical services. See Council Reg (EEC) No 3155/90 of 29 October 1990 Extending and Amending Reg (EEC) No 2340/90 preventing trade by the Community with regards Iraq and Kuwait [1990] OJ L/304/1. For the preceding proposals, see Proposal for a Council Regulation (EEC) Prohibiting the Introduction into the Territory of the Community of Crude Oil and Refined Petroleum Products or their Derivatives Originating in or Last Exported from Iraq, COM (1990) 376 Final. See also Proposal for a Council Regulation (EEC) Prohibiting the Introduction into the Territory of the Community of Crude Oil and Refined Petroleum Products or their Derivatives Originating in or Last Exported from Kuwait, COM (1990) 375 Final.

⁴¹ See Council Reg (EEC) No 542/91 of 4 March 1991 Amending Regs (EEC) No 2340/90 and (EEC) No 3155/90 Preventing Trade by the Community with Regards Iraq and Kuwait [1991] OJ L/60/5.

⁴² See 96/741/CFSP: Common Position of 17 December 1996 defined by the Council on the basis of Art J 2 of the Treaty on European Union concerning the Derogations from the Embargo with Regard to Iraq [1996] OJ L/337/5.

⁴³ See Council Reg (EC) No 2465/96 of 17 December 1996 concerning the Interruption of Economic and Financial Relations Between the European Community and Iraq [1996] OJ L/337/1. For amendments, see Council Reg (EC) No 1346/2002 of 25 July 2002 [2002] OJ L/197/1, and Council Reg No 1210/2003 of 7 July 2003 [2003] OJ L/169/6 and the Council Reg (EC) No 1799/2003 of 13 October 2003 [2003] OJ L/264/12, and Council Reg (EC) No 1412/2004 of 3 August 2004 [2004] OJ L/257/1. See also the Commission regulations on the same issue: Commission Reg (EC) No 208/2003 of 3 February 2003 [2003] OJ L/28/26 followed by No 2204/2003 of 17 December 2003, No 1566/2004 of 31 August 2004, No 1087/2005 of 8 July 2005 and No 1286/2005 of 3 August 2005. For the related CFSP measures after the changes in the Amsterdam Treaty with respect to the adoption of sanctions, see Common Position 96/741/CFSP: Common Position of 17 December 1996 Defined by the Council on the Basis of Art J.2 of the Treaty on European Union concerning the Derogations from the Embargo with Regard to Iraq [1996] OJ L/337/5, and Repealing Common Positions.

of this Regulation provides that the introduction into the territory of the Community of petroleum and petroleum products originating in Iraq shall not be prohibited, whose export has been approved in accordance with Security Council Resolution 986 (Oil for Food Program), and under the conditions for payment determined by the Committee established under the Security Council Resolution 661.

The second scenario is related to the environment. An issue that recently has become controversial is whether the Community would in the future target non-environmentally-friendly energy production processes (so-called dirty energy) in some third countries, justifying restrictions on the import of energy products made through such a process. The reason is said to be that lower environmental standards have an effect through the emission of noxious gases, basically through low standard burning of coal and fuel oil. This means that the EU imposes some extraterritorial standards or even sanctions on third countries, in order to ban imports of such products entirely, if they do not comply with those standards, thus contributing to the improvement of their energy production process. Although it may be hard to believe that the import of energy products, which Europe is increasingly dependent upon, would be restricted based on this claim, a few issues remain to be elaborated on here.

Firstly, the two first Council regulations on trade mentioned above create different scenarios. The first regulation deals mainly with market economy countries, in other words, the WTO members. The possible reaction of these countries is clear as they fall within the WTO's jurisdiction, where extensive case law exists. If the Community, in its dealings with members of the WTO, limits the import of energy products because of hazardous production processes, some requirements should first be met. For example, import restrictions could be justified by a heavy burden of proof such as 'solid scientific evidence of risk, conformity with accepted international guidelines or environmental agreements effective between both states, or evidence of serious efforts to reach a solution by agreement'.⁴⁴ Secondly, in the case of non-market economy countries, countries who are not WTO members, one should look at the environmental provisions of any already existing agreements between the Community and that exporting country. Again, it seems unlikely that the Community would choose to have recourse to an outright ban of imports, rather than other possible measures, considering the vital need for energy within Europe. Moreover, as one writer suggests, under the impact of an import restriction, the product produced in those countries is sold instead to the lower tariff-paying neighbouring countries, which would not reduce the EU's environmental risks. In other words, an import restriction is unlikely to lead to closure of the production process but to a greater

⁴⁴ See T Wälde, 'The International Dimension of EU Energy Law and Policy' in M Szuniewicz and F Fitzmaurice (eds), *Exploitation of Natural Resources in the 21st Century* (The Hague, Kluwer Law International, 2004) at 9.

deterioration of the production process.⁴⁵ One could also suggest that, in such a case, the Community could create some efficient investment rules, which would allow European companies to invest in those exporting countries and play a role in improving the production process. That said, it is interesting to highlight that some Member States have adopted such import bans on electricity, and their actions have not yet been questioned by the Commission. For example, laws in Austria and Luxembourg contain a provision that

allows the government to reject contracts for electricity from countries outside the European Union if it determined that the power would come from facilities whose technology does not correspond to 'state of the art', that pose a 'direct or indirect danger' to persons, or that fail to demonstrate a state-of-the-art waste management plan or concept.⁴⁶

Although such import restrictions could be considered as infringements of the Community's exclusive competence under Article 133 to deal with trade issues, interestingly, they have not yet been tackled by the Commission.

4.2.1.2. Export

The aim of the Common Commercial Policy is said to be to control quantities of imports and maximise the quantity of exports.⁴⁷ At first glance, maximising exports of energy on which Europe itself is heavily dependent does not seem a plausible policy aim. However, this issue has been raised within the framework of development cooperation. A good example, among many, can be found in the context of the Euro-Med Partnership, which seeks to enhance the relationship

⁴⁵ *Ibid.* at 47.

⁴⁶ Section 13 of Austria's 1998 Electricity Act provides that Electricity Supply Contracts Involving the Purchase of Electric Energy from Third Countries (1) Electricity supply contracts involving the purchase of electric energy, with a view to covering domestic demand, from third countries 1. producing part of their electricity requirement in plants which do not comply with the state of the art or in plants the operation of which directly or indirectly jeopardises the life or health of persons, animals or plants in the Federal territory, or 2. Failing to furnish proof of the proper disposal of waste resulting from the generation of electric energy and to draw up a plan for the disposal of waste resulting from future generation shall not be permissible. (2) *Elektrizitäts-Control GmbH* shall issue an ordinance determining the third countries to which the conditions specified in paragraph 1 apply.

The Law of 24 July 2000 on the Organisation of Electricity Market of Luxembourg, in Art 17:7 provides:

Within two months after the notification to the minister of a planned supply contract to be concluded with a supplier or a plant established in a third country that is not a member of the EU or the EEA, the minister can object to the conclusion of this contract if he comes to the conclusion that: the supply will be done from installations that do not comply with the state of the art or whose operation constitutes a direct or indirect danger for persons or goods, or the supply is done from installations of an enterprise that does not prove to dispose of waste from generation according to the state of the art, or that does not have a concept for future waste disposal.

See J Bielecki and MG Desta, *Electricity Trade in Europe: Review of Economic and Regulatory Challenges* (The Hague, Kluwer Law International, 2004) at 200.

⁴⁷ On the aim of this policy, see F Snyder, *International Trade and Customs Law of the European Union* (London, Butterworths, 2000) at 162.

between the European Union and countries of the Mediterranean region. Twelve countries are involved in this partnership, of which only two are net exporters of energy to Europe, ie Algeria and Egypt. Syria and Tunisia are in balance. However, Cyprus, Israel, Jordan, Lebanon, Malta, Morocco, Palestine Territories and Turkey are net importers. The export of energy from Europe to these countries, where rapid expanding populations means that their need for energy is becoming a serious policy concern, is on the agenda (see ch 6.2 below).

Leaving aside the necessity of exporting to other Community partners in need, some other rules relating to the export of energy must be mentioned here. The main regulation of the Council on exports was Regulation 2603/69.⁴⁸ This regulation established the basic principles of free exportation from the EEC to third countries. The most important category of goods excepted from the principle of freedom of export (until 31 December 1992) was that of petroleum oils and oil obtained from bituminous minerals and crude, light, medium and heavy oils and petroleum gases, other gaseous hydrocarbons and some other natural gas liquids. This regulation was subsequently amended and substituted by Regulation 1934/82 and Regulation 3918/91 based on which principle of freedom of export would apply without any exception beyond 31 December 1992.⁴⁹ This latter regulation was mainly imposing exceptions on the export of these products until the time when the Council adopts appropriate measures based on international commitments to regulate such export and it was mainly referring to the emergency response measures (emergency sharing system) agreed upon by the International Energy Agency (IEA). This system is extensively discussed in the next part of this study. It suffices to say here that when a fall in supply of at least 7 per cent occurs in one or more of the Member States, minimum stock obligations are triggered, and in times of crisis, demand restraint, allocation and rationing powers are adopted. The aim was to provide for a collective response to short-term shortages among members of the IEA. The restriction on exports in this situation was applicable based on this EC regulation.⁵⁰

Secondly, Regulation 3918/91 amended Regulation 2603/69 and provided that only two categories of products were to be excluded from the common export regime: petroleum products were no longer included.⁵¹ Since December 1992, petroleum products are within the ambit of the Community's policy of non-restricted exports. This conclusion suggests that the ECJ's important judgment in

⁴⁸ Reg (EEC) No 2603/69 of the Council of 20 December 1969 Establishing Common Rules for Exports [1969] OJ L/324/25.

⁴⁹ Council Reg (EEC) No 1934/82 of 12 July 1982 Amending Reg (EEC) No 2603/69 Establishing Common Rules for Export [1982] OJ L/211/1 and Council Reg (EEC) No 3918/91 of 19 December 1991 Amending Reg (EEC) No 2603/69 Establishing Common Rules for Exports [1991] OJ L/372/31.

⁵⁰ *Ibid.*

⁵¹ Furthermore, those two categories of products (Product of Annex I, and products restricted by the Member States pursuant to a decision taken in European Political Co-Operation) were claimed as exceptions to this regime only until 31 December 1992.

Bulk Oil in 1984,⁵² dealing with the restriction of exports to a third country by a Member State, can no longer serve as a justification for banning the export of energy. In that case, the UK authorised the exportation of UK oil only to Member States of the Community, Member States of the International Energy Agency and countries with which an ‘existing pattern of trade’ existed prior to 1979.⁵³ This policy was intended to prohibit direct and indirect exports of crude oil to other non-member countries (destination clause). In that case, the Court allowed the policy, since, based on Regulation 2603/69, the UK was not prohibited from imposing new quantitative restrictions or measures having equivalent effect on its exports of oil to non-member countries. After the amendment to this regulation, however, a Member State can no longer restrict exports of oil products to a third country through a destination clause, as these products no longer come within the exceptions to this regulation, and to the CCP in general. Hence, the CCP does not allow an individual Member State to take such a step.⁵⁴

Before analysing the relevant rules on trade in energy services, two important exceptions to the rules on export should be mentioned here. One is Article 30 of the EC Treaty which is specifically about intra-Community trade. Based on Article 30 (ex Art 36), or under the ‘rule of reason’ approach, restrictions on energy are justified on grounds of public security. Restrictions aimed at guaranteeing the continuity or regularity of supply, or protecting the environment, may be justified under this rule if no distinction is made between domestic and imported (or exported) goods. In order to determine the necessity of applying this rule, the Member State should show that the particular measure is objectively necessary to achieve the results being sought and that there are no less restrictive means for achieving this objective (proportionality test).⁵⁵ This article—as previously discussed in the context of the *Campus Oil* and the *Almelo* cases⁵⁶—has been extensively used. As explained above, this derogation can no longer be acceptable in a straightforward fashion without further justification by the Member State. As reflected in the case law, this conclusion is due to the belief that the existing Community measures can best guarantee the security of Member

⁵² Case 174/84, *Bulk Oil (Zug) AG v Sun International Limited and Sun Oil Trading Company* [1986] ECR 559.

⁵³ *Ibid.* para 3.

⁵⁴ This is especially clear considering a decision of the Council, which repealed a 1977 Council decision allowing restrictions on export in times of difficulty. The Council stated that these restrictive measures were previously allowed in the event of excessive price disparities between the Member States, and where pricing policies would aggravate the shortage of supply in other Member States applying a price ceiling policy. The Council provided that these measures are no longer in place and that applying these restrictive measures on exports is now contrary to the provisions of the Treaty [namely Art 133]. See Council Decision 97/374/EC of 5 June 1997 Repealing Decision 77/186/EEC on the Exporting of Crude Oil and Petroleum Products from One Member State to Another in the Event of Supply Difficulties [1997] OJ L158/42.

⁵⁵ Roggenkamp *et al*, *Energy Law in Europe*, above n 3, at 225.

⁵⁶ For an analysis of these cases, see Case 72/83, *Campus Oil Limited and others v Minister for Industry and Energy and others* [1984] ECR 2727 and Case 393/92, *Municipality of Almelo and others v NV Energiebedrijf IJsselmij* [1994] ECR I-1477.

States' energy supply. The same principle of restriction on export due to public security can also be found in Regulation 2603/69 with respect to export of products to third countries. The general norm was established that a national measure which prevents or restricts the export of certain products to third countries cannot be treated as falling outside the scope of the common commercial policy on the ground that it has foreign or security objectives unless it is proved that 'the risk of a serious disturbance to foreign relations or to peaceful coexistence of nations may affect the security of a Member State'.⁵⁷

The other exception, similar to the situation of imports of energy, is the ban on exports of petroleum and petroleum products due to an economic sanction. Based on Article 228a and upon the adoption of a common position, this prohibition was imposed on the export of petroleum and petroleum products⁵⁸ to the Federal Republic of Yugoslavia in 1999. The sale, supply, or export, directly or indirectly, of these products (whether or not they originated in the Community) to any person or body in that country, or to any person or body for the purpose of any business carried on in, or operated from, the territory of that country was prohibited, unless for the use of diplomatic or consular missions of the Member States as well as for the use of an international military peace-keeping presence or on a case-by-case basis.⁵⁹ This regulation was later repealed in 2000 in support of the new government in Yugoslavia.⁶⁰

The above-mentioned analysis shows that petroleum products are no longer a general exception to the applicability of the CCP, and any restriction on the trade of these products can only be adopted by the Community as part of its exclusive competence, unless they fall within the general exceptions embodied in the EC Treaty, which would be analysed on a case-by-case basis.

4.2.2. Trade in Energy Services

The European Court of Justice's interpretation of Article 133 (ex Art 113) of the EC Treaty conferred an exclusive competence on the Community to engage in

⁵⁷ See Case 70/94, *Werner* [1995] ECR I-3189, para 27. See also Case 83/94 *Criminal Proceedings against Leifer and others* [1995] ECR I-3231.

⁵⁸ See Common Position 1999/273/CESP of 23 April 1999 Defined by the Council on the Basis of Art J.2 of the Treaty on European Union concerning a Ban on the Supply and Sale of Petroleum and Petroleum Products to the Federal Republic of Yugoslavia (FRY) [1999] OJ L/108/1.

⁵⁹ See Council Reg (EC) No 900/1999 of 29 April 1999 Prohibiting the Sale and Supply of Petroleum and Certain Petroleum Products to the Federal Republic of Yugoslavia (FRY) [1999] OJ L/114/7. See the amending regulations in October 1999, No 2111/1999 of 4 October 1999 [1999] OJ L/258/12 and Council Reg (EC) No 2421/1999 of 15 November 1999 [1999] OJ L/294/7.

⁶⁰ See Council Reg (EC) No 2228/2000 of 9 October 2000 Repealing Reg (EC) No 2111/1999 Prohibiting the Sale and Supply of Petroleum and Certain Petroleum Products to Certain Parts of the Federal Republic of Yugoslavia (FRY) [2000] OJ L/261/4. For the necessary CFSP measure for adopting sanctions, see Common Position of 23 April 1999 Defined by the Council on the Basis of Art J.2 of the Treaty on European Union concerning a Ban on the Supply and Sale of Petroleum and Petroleum Products to the Federal Republic of Yugoslavia (FRY) [1999] OJ L/108/1.

activities related to the Common Commercial Policy. The Court invoked two major reasons to justify such a view with regard to goods. The first one was economic, the simple fact being that if the Member States adopt different policies there would be trade deflection and distortion of competition. The second reason is more political, namely the need to unify actions at the international level, particularly within the General Agreement on Tariffs and Trades (GATT) framework.⁶¹ The question was constantly asked, however, to what extent such reasons would justify the extension of the CCP to other fields, such as services.

Until *Opinion 1/94*, it was unclear whether services were considered as part of this policy, as the mere wording of this Article does not verify its implication for services.⁶² It could be argued that because international trade in services is closely linked to that of trade in goods, treating them differently, and based on different policies, would result in a distortion of trade. In *Opinion 1/78*, the Court acknowledged this argument, and explained that the aim of the Treaty is not the mere liberalisation of trade, but the development of a commercial policy aiming at regulating the world market for certain products. Not taking those fields into account limits this policy and renders it nugatory in the course of time.⁶³

The Court, however, departed from this reasoning in *Opinion 1/94*. The Court pointed out that trade in services cannot be immediately, and as a matter of principle, excluded from the scope of Article 113 (now Art 133), but made a distinction between different types of services. Among various types of services such as the cross-frontier supply of services, consumption abroad, commercial presence and presence of natural persons, only the first one, ie cross-frontier supply of services, was considered as part of the CCP. The existence of different chapters in the Treaty dealing with these two sets of issues was invoked as an additional reason.⁶⁴

This approach has been extensively criticised. One commentator raises his concern by saying:

It is particularly regrettable and illogical that at a time when the multilateral trade system was accomplishing its most important advance since 1947, by merging into a coherent whole, the rules relating to services and the rules relating to goods, demonstrating thus the close link between both fields and making clear the fact that one

⁶¹ See K Leivo, *The Need for an Exclusive External Competence of the European Community with Regard to International Trade in Services* (Brussels, European University Press, 1996) at 13.

⁶² See M Hilf, 'Unwritten EC Authority in Foreign Trade Law' (1997) 2 *European Foreign Affairs Review* 437. He believes that the lack of clarity as to the extent of the foreign trade authority could pose the most important current constitutional problem of the Union.

⁶³ See Case 1/78, *International Agreement on National Rubber* [1979] ECR 2871.

⁶⁴ See Cremona, 'EC External Commercial Policy', above n 25, at 11. She believes that this is not very convincing in textual terms because the Treaty has separate chapters on the free movement of goods as well as persons and a chapter on services. Moreover, trade in goods and trade in services are subject to different modes of supply. However, she states that the Court is recognising a political reality, namely the sensitivity of the Member States with respect to rights of entry for third country nationals.

should not conceive at present international trade law without taking into account of the rules applicable to services, the Court made the Community take a step in exactly the opposite direction.⁶⁵

Following Opinion 1/94, political discussions continued as to whether, and how, to rearrange the division of competences regarding trade in services. The controversy eventually resulted in the addition of paragraph 5 to Article 133 of the Amsterdam Treaty, which did not directly extend the CCP to cover services and intellectual property but allowed the Council to subsequently do so through a unanimous decision.⁶⁶ The Nice Treaty, on the other hand, amended this provision and rewrote paragraph 5. The provision of services in the form of services provided abroad, commercial presence, and the presence of natural persons, are now covered by the regime of Article 133. The new Article 133 provides that Council unanimity is no longer required,⁶⁷ unless an agreement covers specific fields in which the Community has not yet exercised its power or when unanimity is required for the adoption of internal rules.⁶⁸

Although efforts to include trade in services within the ambit of the CCP were successful, the problem remains of what actually constitutes 'services'. Although there is no general definition of services, attempts have been made to compare this type of activity to that of trade in goods in order to highlight the differences. For instance, it is argued that goods are tangible, whereas services are usually regarded as intangible, perishable, invisible and non-storable.⁶⁹ Some regard these attributes as having the consequence that services require their consumption at the same time and in the same place as their production.⁷⁰ Furthermore, the difficulty again arises when a service is embodied in a good, etc.

From a legal perspective,⁷¹ where different regulations exist for two sets of issues, a clear distinction and definition is necessary. For example, in depicting

⁶⁵ G Friden, 'Cour de Justice des Communautés européennes' (1994) 4 *Annals du Droit Luxembourgeois* 339 at 350, Cited in P Pescatore, 'Opinion 1/94 on "Conclusion" of the WTO Agreement: Is There an Escape from A Programmed Disaster?' (1999) 36 *CML Rev* 387 at 387.

⁶⁶ It was at that time, however, debatable whether the issue of exclusivity would be extended to para 5 of Art 133, as it is claimed that if the Council denies exclusivity in the context of exercising the option granted by Art 133(5), 'it would be redefining the nature of the CCP as hitherto generally accepted'. See Cremona, 'EC External Commercial Policy', above n 25, at 22.

⁶⁷ Art 133 is transformed into Art III-315 of the Constitution where not only services and intellectual property are embodied in the CCP but foreign investment is also considered as part of this overall policy. However, the Constitution necessitates unanimity in the negotiation and conclusion of agreements (a) in the field of trade in cultural and audiovisual services, where these agreements risk prejudicing the Union's cultural and linguistic diversity; (b) in the field of trade in social, education and health services, where these agreements risk seriously disturbing the national organisation of such services and prejudicing the responsibility of Member States to deliver them.

⁶⁸ See HG Krenzler and C Pitschas, 'Progress or Stagnation? The Common Commercial Policy After Nice' (2001) 6 *European Foreign Affairs Review* 291.

⁶⁹ R McCulloch, 'Services and the Uruguay Round' (1990) 13 *World Economy* 329 at 334.

⁷⁰ See K Leivo, *The Need for an Exclusive External Competence*, above n 61, at 15. Some believe that these attributes of intangibility and non-permanence are irrelevant.

⁷¹ From an economic point of view, it is argued that the distinction is artificial because it is more a question of 'tendency': these two kinds of trades can be distinguished by 'the relative proportion of

which agreement dealing with trade in services requires unanimity voting, it is necessary to determine whether that agreement actually falls under the category of services. In the EC Treaty (unchanged by the Nice Treaty), there is a vague definition of services within the Community in Article 50 (ex Art 60).⁷² This article provides that where there is 'remuneration', the work is a service, in so far as it cannot be governed by provisions relating to freedom of movement for goods, capital and persons. This vague definition is not surprising, as the same was encountered in the ambit of the WTO. In the General Agreement on Trade in Services of the WTO (GATS), the concept of service was purposely undefined, and the lack of a generally accepted economic definition was cited as the reason.⁷³ On the other hand, the ECJ provides some inadequate hints as to the limits of this activity. For example, Opinion 1/94 decided that 'cross-frontier' services, whether or not embodied in goods, should be treated as 'not unlike trade in goods' as there is no movement of persons.⁷⁴ In general, the effort to define 'services' has been concentrated on linking them to their similarities to 'trade in goods' in order to determine the laws applicable to them, rather than defining what services actually mean.

Services in the energy sector can be placed into two broad categories: traditional and emerging services. The traditional services are related to oil and gas

the price of the traded substance, which can be attributed to value added by services industries and by manufacturing industries'. This means that the difference can be depicted by looking at the proportion of the price, leading some to believe that there is no need to establish a new international institution to deal with the liberalisation of trade in services. See Leivo, above n 61, at 15.

⁷² Art 50 provides that:

Services shall be considered to be 'services' within the meaning of this Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons. 'Services' shall in particular include: (a) activities of an industrial character; (b) activities of a commercial character; (c) activities of craftsmen; (d) activities of the professions. Without prejudice to the provisions of the chapter relating to the right of establishment, the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals.

The Constitution keeps the same definition as found in Art III-145.

⁷³ T Stewart (ed), *The GATT Uruguay Round: A Negotiating History*, vol II, *Commentary* (Deventer, Kluwer Law and Taxation Publishers, 1993) at 2409.

⁷⁴ See Case 1/94, above n 27, at para X. This paragraph reads as follows:

As regards cross-frontier supplies not involving any movement of persons, the service is rendered by a supplier established in one country to a consumer residing in another. The supplier does not move to the consumer's country; nor, conversely, does the consumer move to the supplier's country. That situation is, therefore, not unlike trade in goods, which is covered by the common commercial policy within the meaning of the Treaty. There is thus no particular reason why such a supply should not fall within the concept of the common commercial policy.

In *Almelo*, it was also held that electricity should be considered as a commodity without explaining the underlying rationale of such a statement. See the *Almelo* case, above n 56, at para 28. See also Case 158/94, *Commission v Italian Republic* [1997] ECR I-5789. In this case, it is explained that 'electricity is a good for the purposes of Art 30, as is confirmed in particular by the Community tariff nomenclature (Code NC 27.16)', para 3.

exploration, drilling services, derrick erection,⁷⁵ re-gasification services, refinery services and wells and pipeline building.⁷⁶ The emerging services are those arising from the break-up of integrated energy systems and the introduction of competition and privatisation to this sector. They are, for example, the operations related to the power pools, the provision of continuous information on energy prices, energy trading, and brokering, energy management, reductions in greenhouse gas emission, and trading of emission rights.⁷⁷ There are also specialised services in the petroleum sector, namely construction services to build pipelines and refineries, services to clean oil from impurities and to liquefy natural gas.

In the natural gas sector, apart from exploration and production, services of transmission and distribution through pipeline or LNG (Liquefied Natural Gas) also exist. Transmission, in the case of natural gas, involves transporting gas from the place of purchase to areas of demand (ie distribution companies, large volume consumers and power generators). Distribution of natural gas is when the gas is transmitted to areas of demand and is later moved to local low- or medium-pressure pipelines to final consumers. Coal, as another source of energy, is treated as goods as most aspects of its trade relate to trade in goods. Only coal mining includes services worthy of our attention here. Electricity services, on the other hand, are divided into four different modes: generation, transmission, distribution and supply. Generation is the change from primary energy, such as oil and gas, to electrical energy. Transmission involves transferring this energy from generators (through electricity grids) to the distribution level. Distribution transfers this energy to final consumers. Supply is the selling of electricity to end-users.

As explained in the beginning of this chapter, no provision in the EC Treaty expressly deals with the issue of energy in general, and energy services in particular. However, some provisions can be extended to apply to the energy sector. For example, the rules on competition would regulate the activities of all the exploration, production, transmission, distribution and supply services mentioned above in the energy sector. The provisions on merger control and state aids can also be applied to services in the energy sector.⁷⁸

⁷⁵ A derrick is a structure placed over an oil well that is used to raise and lower piping, drills, and other equipment.

⁷⁶ S Zarilli, 'Energy Services in International Trade: Development Implications' (2001) 8 *Dundee University On-Line Journal*, Art 15.

⁷⁷ *Ibid.*

⁷⁸ It is interesting to point out here that some commentators take the view that there seems to be substantial evidence of the continued non-application of the prohibitions embodied in the Treaty to the energy sector. The actual application of these provisions has faced barriers due to their non-enforcement, or by virtue of the application of the exceptions to such prohibitions. See Roggenkamp *et al*, *Energy Law in Europe*, above n 3, at 279. For example, in the Decision on the German *Jahrhundertvertrag*, the Commission allowed some specific arrangements through which the German electricity-generating utilities and industrial producers of electricity agreed to purchase a specific amount of German coal up to 1995. This agreement included subsidies and the restriction of imports from third countries. See Decision of 22 December 1992 Relating to a Proceeding under Art 85 of the Treaty, and Art 65 of the ECSC Treaty [1993] OJ L/50/14. The approval of such an agreement

Apart from these treaty provisions, secondary legislation also exists that is related to energy services. For instance, the 1990 Community rules on procurement procedures of services of entities operating in the water, energy, transport and telecommunications sectors⁷⁹ regulated the acquisition of products, works or services through award of contracts for public consumption in these areas.⁸⁰ This Procurement Directive explains that the previously existing restrictions on the free movement of goods and the freedom to provide services, in respect of supply contracts awarded in these fields, are prohibited. The problem was that entities of the utilities sector, such as energy entities, did not purchase on the basis of Community-wide competition and they were given special or exclusive rights by national authorities to provide a service, or exploit a given geographical area, for a particular purpose.⁸¹ Therefore, some common rules were adopted to regulate this situation. The importance of these common rules for energy services is that the procurement rules are not confined to conventional utilities, such as producing energy and/or supplying it through a network, but also extend to companies engaged in the exploitation of natural resources and all the services consequent upon these engagements.⁸²

These sectors were previously excluded from those principles that necessitate the opening up of their public procurement markets due to the fact that, as the directive explains, some of the entities providing such services were in some cases governed by public law and in other cases by private law. The Procurement Directive thus found it necessary that, in order to ensure a 'real opening-up' of the market and a fair balance in the application of procurement rules in these sectors, these entities should no longer be identified through their legal status but through their activities. That said, the directive exempts some transactions from the application of its rules, including contracts awarded for the pursuit of such activities in a non-Member State. Article 22 of the 2004 Directive provides:

This Directive shall not apply to contracts governed by different procedural rules and awarded: 1. Pursuant to an international agreement concluded in conformity with the Treaty between a Member State and one or more third countries and covering supplies

can be understood in the very specific context of the situation of the German coal industry. An arrangement in the International Energy Agency (IEA) between oil companies to undertake an emergency scheme in case of oil crisis, which would normally be in violation of Art 81(1), was also accepted due to the irreversible detriment of not applying such arrangements in the event of an oil crisis.

⁷⁹ See Council Dir 90/531/EEC of 17 September 1990 on the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Telecommunications Sectors [1990] OJ L/297/1.

⁸⁰ See Council Dir 93/38/EEC of 14 June 1993 Coordinating the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Telecommunications Sectors [1993] OJ L/199/84. See also Dir 2004/17/EC of the European Parliament and of the Council of 31 March 2004 Coordinating the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Postal Services Sectors [2004] OJ L/134/1. See also Roggenkamp *et al*, *Energy Law in Europe*, above n 3, at 288.

⁸¹ See the introductory note of the 1990 Directive on Procurement. See also Roggenkamp *et al*, *Energy Law in Europe*, above n 3, at 290.

⁸² *Ibid*.

or works intended for the joint implementation or exploitation of a project by the signatory States; 2. To undertakings in a Member State or a third country in pursuance of an international agreement relating to the stationing of troops; 3. Pursuant to the particular procedure of an international organisation.

However, these exceptions apply in so far as they do not involve the physical use of a network or a geographical area within the Community.⁸³ Therefore, Member States are free to pursue these activities in a third country as long as a Community network is not used. Moreover, although the wording of the directive tends to distinguish between the internal and external regulations of public procurement, Member States are expected to refrain from external activities that undermine the provisions of this directive.⁸⁴ Nonetheless, competence to pursue these activities in third countries, all conditions met, rests with the Member States, until new provisions are added to extend the directive's application to the activities of companies in third countries. In addition, the more the criteria for tender incorporate concerns for security of supply, the greater is the contribution of the overall procurement of the energy service by the government to such security in the Member State.

The difficulty lies not only in distinguishing trade in goods from services, but also in dividing the laws and regulations of the Community in this sector into different categories of trade and services, due to the fact that various rules of the Community on energy combine these two activities in single undertakings. In any case, if an activity could be clearly identified as an energy service, paragraph 5 of Article 133 EC applies. For the purposes of procurement of energy services, the Member States are free to enter into agreements with third countries if the conditions mentioned above are satisfied. This rule applies as long as the activity is also compatible with the principles of the WTO Agreement on government procurement, to which the European Community is a party.

⁸³ See the 1990, 1993 and 2004 Procurement Directives.

⁸⁴ The activities of the Member States should be in conformity with the rules of the plurilateral agreement on 'government procurement' within the WTO. Para 14 of the 2004 Directive stipulates that:

The contracting entities covered by that Agreement which comply with this Directive and which apply the latter to economic operators of third countries, which are signatories to the Agreement, should therefore be in conformity with the Agreement.

Art 6 of the same Directive also provides that:

This Art shall be without prejudice to the commitments of the Community in relation to third countries ensuing from international agreements on public procurement, particularly within the framework of the WTO.

4.2.3. Transit in Energy

The Electricity Transit Directive⁸⁵ and the Council Directive on the Transit of Natural Gas through Grids⁸⁶ came into existence in 1990 and 1991 respectively. The objective was to improve free access to electricity and gas in transit through coordination of the building and operation of the interconnections. Both directives claim that greater electricity and gas transfers between grids can minimise the cost of investment and fuels involved in services related to this transit, and ensure optimum use of the means of production and infrastructure. The Gas Directive also provides that increased transfers between grids would encourage cooperation between natural gas transmission companies to find ways of improving natural gas transmission equipment, which would contribute to the overall security of gas and electricity supply. The external dimension of these two directives resides in the claim made in their preambles that there is a great advantage in seeking cooperation with third countries that are involved in the interconnected European network, because a lack of efficiency in those countries could ultimately have negative consequences for the flow of electricity and gas within the internal borders of the Community.

Both directives define transit, among other things, as the time when 'the transport involves the crossing of one intra-Community frontier at least'.⁸⁷ Hence, this transit may also cross frontiers of third states, as long as it crosses one intra-community frontier, and therefore, it acquires an external dimension. Due to this externality, and as the previously discussed case law on the division of competences between the Member States and the Community revealed, one may argue that Member States should be prevented from concluding agreements with third countries that would 'affect' these internal common rules on transit. This effect, however, cannot be automatically exclusive in ERTA terms unless, gradually and over time, complete harmonisation in this field is established and 'creeping exclusivity' translates into limiting the activities of the Member States in securing electricity and natural gas supply through grid transmission altogether. In the next chapter some elements of transit within the Community are revealed while comparing the rules on transit established by the Community and the Energy Charter Treaty.

⁸⁵ See Council Dir 90/547/EEC of 29 October 1990 on the Transit of Electricity through Transmission Grids [1990] OJ L/313/30.

⁸⁶ See Council Dir 91/296/EEC of 31 May 1991 on the Transit of Natural Gas through Grids [1991] OJ L/147/37.

⁸⁷ See Art 2(1)(C) of the 1990 Directive on Electricity Transit, and Art 1(1)(C) of the Gas Transit Directive.

4.3. THE OBLIGATION TO HOLD STOCKS OF CRUDE OIL AND/OR PETROLEUM PRODUCTS

4.3.1. Prefatory Remarks

From the perspective of internal security of supply, one of the most important undertakings to guarantee energy supply within the Community is the obligation imposed on each Member State to keep a minimum amount of oil stock available for times of crisis. In other words, the Community found it necessary to oblige Member States to keep 'some energy aside'. This mechanism is widely viewed as a useful way for improving the Community's energy security because it provides a valuable guarantee against short to medium term oil supply disruptions.

Generally there are five types of emergency response measures in place to combat supply disruption, namely demand restraint (reduce demand of total oil consumption), fuel switching (switch out of oil into alternative fuel), emergency stocks and coordinate stock-draw, surge in oil production or using spare capacity, and emergency sharing system.

The most feasible and efficient measures are considered as stock-draw and demand restraint policies because there is already a high oil stock capacity within the Organisation for Economic Cooperation and Development (OECD) countries, great dependence on oil is still persisting, there is reduced spare capacity in OECD members with inland oil reserves, and there is overall reduced fuel switching capacity.⁸⁸ In practice these two measures have been found the most useful. For example, after the oil crisis of 1991 all four emergency measures were adopted but the biggest component of the response was stock-draw followed by demand restraint.⁸⁹

Emergency stocks can be held in several ways. The stocks can be either kept by governments, or by companies, or by stock-holding agencies. Government stocks are financed by the central government budget and are held exclusively for emergency purposes. Company stocks are either compulsory, and part of emergency oil stocks, or they are commercial (or operational). Agency stocks are

⁸⁸ See V Costantini and F Gracceva, 'Oil Security: Short- and Long-Term Policies', INDES Working Papers, 2004 at <<http://ideas.repec.org/p/fem/femwpa/2004.115.html>> [hereinafter 'Oil Security: Short- and Long-Term Policies']. See also the APEC Study on *Emergency Oil Stocks and Energy Security in the APEC Region*, (Tokyo, Asia Pacific Energy Research Centre, 2000) at 19.

⁸⁹ *Ibid.* Nevertheless, there is an ongoing debate whether oil stocks should be withdrawn at times of emergency when prices are too high or when there is only physical lack of supply in the market. The general belief is that stock draw would likely lower prices in the short term but its long-term consequences are not very clear. On the other hand, some argue that there is no direct link between stock draw and oil prices and the only advantage of keeping oil stocks is to make them available when the market suffers from the lack of adequate oil supply to meet demand. Some argue that the 'IEA does not believe strategic oil stocks can be effectively used to address price fluctuations and this would distort market mechanisms and signals, and invites unnecessary confrontation with producers'. See KD Jacoby, 'Coordination of Oil Stocks and Interventions in the Oil Markets', at <<http://www.i20.org/publications>>.

maintained merely for emergency purposes and are held either by public or private bodies and industry may delegate its obligation partly or entirely to the agency.⁹⁰ Countries choose to maintain stocks either through all or through some of these channels.⁹¹ Generally, there is advantage in providing the government with the responsibility of holding stocks as these stocks are stored separate from private commercial stocks over which the government may not have control.⁹² Hence, in the case of emergency, due to the transparent procedure for the release of stocks controlled by the government, their impact on the oil market is greater. In general, the issue of private and public ownership of stocks centres on the fact that those emergency stocks should be held separate from operational stocks (ie stocks that are constantly used in the course of the functioning of the company or the stock-holding body but the company places the lacking amount back) so that unhampered access is guaranteed.

The type of the stock kept also differs in various countries. Some hold crude oil, some hold products and some hold both. The decision on the type of oil stocks depends on a number of factors including the types of product needed in a given country, the availability of refinery capacities to refine the existing crude oil, the cost of storage, maintenance of quality, speed of delivery to the consumer, etc.⁹³ Generally, however, it is believed that keeping crude oil is more advantageous because 'crude oil is cheaper to store and its quality is technically easier to maintain and crude oil stocks also provide more flexibility because they can be processed into products that meet the specific demand patterns during a supply disruption'.⁹⁴

Stocks can also be held jointly by several countries or individually. The stocks can also be kept in the territory of another country based on a bilateral agreement. In this case, transfer of oil or petroleum products from the country where they are held to the country on behalf of which these stocks are held should be guaranteed through a bilateral agreement.

The rights and obligations of Member States in holding stocks at both international and Community level will be analysed below. However, in reading this section, one question should be kept in mind: whether an additional security

⁹⁰ Government stocks and agency stocks are generally referred to as public stocks whereas company stocks are referred to as private stocks.

⁹¹ See also the presentation by E Harks, 'IEA, Security of Oil Supply, Oil Crisis Mitigation Stocks' Amsterdam 6–7 May, 2003.

⁹² In some countries, the cost of maintaining a strategic reserve is entirely born by tax payers, such as the USA, while in other countries the burden is on private oil companies that are required to maintain excess inventories.

⁹³ See Costantini and Gracceva, 'Oil Security: Short- and Long-Term Policies', above n 88. With respect to products it is said that if refining capacity is low in relation to domestic demand, then the country faces problems. In addition, one major problem associated with product stocks is that the quality of products deteriorates over time. See the APEC Study, above n 88, at 20. See also the presentation of K Kuolt in the IEA/China Seminar on Oil Stocks and Emergency Response, 'Overview of IEA Oil Emergency Procedures and Measures in IEA Member Countries', Beijing, China, 9–10 December 2002.

⁹⁴ Costantini and Gracceva, 'Oil Security: Short- and Long-Term Policies', above n 88, at 3.

measure should still be adopted by the Community if an efficient stock-holding obligation is already in place? These issues are analysed below.

4.3.2 The Obligation to Hold Stocks: The International Energy Agency

In the aftermath of the 1973 oil crisis, consuming countries decided to commit themselves to maintain, at normal times, a level of stocks equivalent to 90 days of net imports of oil and/or oil products, to be used in the event of a supply crisis, 'to make good all or part of a supply shortfall'.⁹⁵

The 1974 Agreement on an International Energy Program (IEP) established a coordinated reaction mechanism, based on the solidarity of the Member States: 1) to reduce consumption (with predefined reduction percentages depending on the level of disruption), or 2) to draw down on stocks or 3) to ensure equitable distribution of available stocks among themselves. Based on the IEP Program, the emergency measures explained above may be activated if there is a disruption equal to at least 7 per cent of the normal level of supplies (trigger situation).⁹⁶

The first option is adopted, ie reduction of consumption, when the group of Member States can sustain or can reasonably be expected to sustain a reduction in the daily rate of its oil supplies at least equal to 7 per cent of the average daily rate of its final consumption (the trigger situation). In this situation the final consumption should be reduced by 7 per cent, and if the reduction by 12 per cent is expected, final consumption should be reduced by 10 per cent of the final consumption during the base period.

With the second option, governments are allowed to use the emergency reserves that they have held in excess of their obligation. Through a centralised and predefined procedure, the stocks of each country are drawn and divided between Member States. This mechanism immediately calculates the obligations and rights of each Member State of the IEA based on specific calculation methods.

With the third option, for the allocation of available supply, each country's share of the oil supplies available during an emergency is compared against scheduled supplies as previously reported. The available supply is subsequently allocated based on a predefined calculation mechanism.

After the oil crisis of 1979–81 (Iranian revolution and Iran–Iraq war), the weaknesses of this mechanism were raised by the US and later examined by the Agency. It was mentioned that the 7 per cent benchmark is not necessarily a valid one, because disruptions lower than 7 per cent could also have great economic

⁹⁵ The Member States of the IEA are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Republic of Korea, Spain, Sweden, Switzerland, Turkey, UK and the USA.

⁹⁶ See also R Willenborg, C Tonjes and W Perlot, *Europe's Oil Defences: An Analysis of Europe's Oil Supply and its Emergency Oil Stockholding Systems* (The Hague, Clingendael Institute, 2004).

consequences. Moreover, the oil allocation mechanism that necessitated radical intervention in the market was found to be a very difficult mechanism to put in place, especially with regard to the evolution of the market since the last energy crisis of 1973. On the other hand, some countries, such as the Community members, believed that stock-drawing should only be envisaged if accompanied by the reduction of consumption.

For these reasons, the mechanism of 'Coordinated Emergency Response Measures' (CERM) was put in place by the IEA in 1984. This mechanism could be triggered without oil-sharing between members, and could apply whether or not the oil supply disruption would be large enough to activate other emergency measures.⁹⁷ Based on this mechanism, the disruption does not necessarily have to reach the level of 7 per cent. Moreover, each member has to make an equivalent effort to restore balance to the market, and it is up to the country to decide what form that effort should take. This effort could be undertaken in the form of reducing consumption, running down stocks, boosting domestic production, fuel switching, or a combination of these.⁹⁸ Some countries such as the US, the UK and Japan employ full stock-drawing at the time of crisis, rather than demand restraint or fuel switching, whereas all European countries (except the UK) include the reduction of consumption in their response measures.

4.3.3. The EC and the IEA: Competences Revisited

The Community is not a member of the IEA but 17 countries of the EU are members of the IEA.⁹⁹ The activity of the Community complements that of the IEA and the obligations within the IEA should be taken into consideration when new rules on stock-holding are established.

From the point of view of the law of competences of the Community, as it was mentioned before, there is the principle that the Community has only those powers which have been conferred upon it in both the internal and the international action. Hence the Community can become active in the international scene only as far as such exercise is in accordance with the objectives set by the EC Treaty. Although no provision in the treaty expressly confers power upon the Community to enter into stock-holding agreements with third countries to

⁹⁷ For a description of the decision-making process that triggers this measure, see the study on the 'Coordinated Emergency Measures (CERM) of the International Energy Agency' at <<http://www.iea.org>>. For example, the United States has fully opted for the measure of 'stock-drawing' rather than demand restraint or fuel switching, whereas Australia opted for no stock draw but for demand restraint and increased indigenous production. On the other hand, Belgium dedicated 27 thb/d in its emergency response programme of which 9 thb/d are stock draw and 18 thb/d are demand restraint.

⁹⁸ At the time of the Gulf War, a Contingency Plan was decided upon in 1991, which made the oil available to the market at 2.5. mb/d as a CERM/type response.

⁹⁹ These countries are Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the UK.

guarantee energy security, the competence of the Community can be deduced through other provisions of the EC Treaty and the jurisprudence of the ECJ. Based on the case law of the ECJ, and as explained in detail in chapter 3.4 above, when Community law has created Community powers within its internal system for the purpose of attaining a specific objective, the Community has authority to enter into international commitments necessary for the attainment of that objective even in the absence of an express provision to that effect (necessity doctrine).¹⁰⁰

In brief, it could be argued that as the conclusion of the IEP Agreement is necessary for security of energy supply purposes, for the attainment of which the Community has already established internal measures, competence for the Community can be established. As explained before, the emergency measures prescribed in the IEA are measures to reduce the domestic demand, measures to resort to emergency oil stocks, and measures to ensure equitable distribution among the Member States of available stocks. The first two measures are already subject to Community regulations.¹⁰¹ The legal basis of these regulations is Article 100 (ex Art 103) of the EC Treaty, which allows the Council to act unanimously, based on a proposal from the Commission, to decide upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products.¹⁰²

Moreover, regarding the third measure embodied in the IEA framework (ie equitable sharing of available stocks), as a shortfall in the supply of crude oil and/or petroleum products creates an increase in trade in those products between Member States, and the activity will be of a commercial character, it falls within the ambit of the common commercial policy, where competence is

¹⁰⁰ See Case 22/70, *Commission v Council* (ERTA) [1971] ECR 263, paras 18–19. Progressively, with the introduction of the common rules, the Community alone could be in a position to assume and carry out, with effect for the whole of the field of application of the Community legal order, the commitments agreed with regard to third parties (creeping exclusivity).

¹⁰¹ See Council Framework Dir 73/238/EEC on Measures to Mitigate the Effects of Difficulties in the Supply of Crude Oil and Petroleum Products [1973] OJ L/228/1, and Council Decision 77/706/EEC of 7 November 1977 the Setting of a Community Target for a Reduction in the Consumption of Primary Sources of Energy in the Event of Difficulties in the Supply of Crude Oil and Petroleum Products [1977] OJ L/292/9. All these regulations were established based on Art 100 (ex Art 103 EEC) which allows the Community to take measures during economic difficulty. Art 100 provides:

Without prejudice to any other procedures provided for in this Treaty, the Council may, acting unanimously on a proposal from the Commission, decide upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products.

¹⁰² The new proposal of 2002 which called for a Council Directive Repealing Council Directives 68/414/EEC and 98/93/EC Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products, and the Council Directive 73/238/EEC On Measures to Mitigate the Effects of Difficulties in the Supply of Crude Oil and Petroleum Products, explained in detail below, has a different legal basis, namely Art 95 EC on the general internal market of the EC. This proposal, however, was never adopted.

exclusive to the Community. The combination of these internal measures, therefore, could pave the way for establishing the necessary competence for the Community.

From the point of view of the IEA, the Community's accession is already consented to in Article 72 of the IEP Agreement.¹⁰³ Although the European Commission participates in the activities of the IEA, and can cooperate with the IEA on the basis of the OECD Convention,¹⁰⁴ it has only the right 'to have access to IEA meetings, to receive regularly agendas and other documents distributed to IEA bodies, and to speak and make proposals, but not with the right to vote in those bodies'.¹⁰⁵ Commission cannot influence the decisions of the IEA based on the wish of its constituent member countries and does not contribute financially to the budget of the Agency.

Generally, one could argue that as not all new EU members after enlargement are yet members of the IEA (only Czech Republic and Hungary are members, and Slovak Republic is in the process of becoming a member), the Community's membership should await the membership of all EU 27.¹⁰⁶ This being a legitimate justification, the issue of non-membership of the Community in the IEA dates back to long before enlargement, some elements of which are revealed below.

Historically it was said that Article 72 was included in the IEP Agreement to 'reduce the risk of conflict and to keep to a minimum any potential EC opposition to the IEA, particularly if one or more EC members were not to participate in the Agency'. Moreover, some also raise the question whether upon the accession of the Community, Member States remain members of the IEA but retreat from direct participation, or would they formally withdraw, or would they be active together with the Community in the IEA? These questions have been raised in the context of the accession of the Community to almost all international organisations. In general, as long as there is no prohibition in the statute of

¹⁰³ See the International Energy Programme at <<http://www.iea.org/Textbase/about/iep.pdf>>, Art 72 provides that:

1. This Agreement shall be open for accession by the European Communities. 2. This Agreement shall not in any way impede the further implementation of the treaties establishing the European Communities.

¹⁰⁴ See the Supplementary Protocol Number 1 of the OECD Convention and the letter of 20 Nov 1974 from Governing Board Chairman Davignon to the Commission President Ortoli, stating that the Commission of the European Communities shall take part in the work of the OECD. The letter also provides that 'this invitation, of course, in no way commits the Community with regard to the decision that it may take on the basis of Art 3 of the Decision establishing the Agency'. This article states that 'This Decision will be open for accession by the European Communities upon their accession to the Agreement in accordance with its terms'. See R Scott, *The IEA First Twenty Years: Origins and Structure 1974–1994* (Paris, IEA, 1994).

¹⁰⁵ See Scott, *The IEA First Twenty Years*, *ibid*, at 152.

¹⁰⁶ In order to become a member of the IEA, states should first become a member of the OECD. From the 27 countries of the EU, four countries (Czech Republic, Hungary, Poland and Slovak Republic) are members of the OECD. The rest of the EU countries along with the European Community need to first join the OECD.

that organisation's treaty to admit an intergovernmental organisation such as the EC,¹⁰⁷ and as long as the competence can be established for the EC to join that organisation, such membership should not be legally unfeasible. Member States of the EC withdraw their membership only when the EC has obtained an exclusive competence to deal with the activities of that international organisation which means that Member States are pre-empted from acting in those fields.

The second issue is that the future membership of the Community in the IEA cannot be automatically established because the IEP Agreement talks of the activities of 'participating countries' of the IEA and participating countries are defined as 'states' (Art.1) and the Agreement does not refer to the potential participation of intergovernmental institutions. Therefore, it seems that the first step would be to either amend the IEP Agreement, which, based on Article 73, can take place only through unanimity,¹⁰⁸ and talk of 'participants' rather than 'states' in the new version, or reach a separate agreement between the EC and the IEA which recognises the EC as a member. Although the latter option is easier as it avoids the difficulty of obtaining a unanimous vote, it can still be argued that Article 72 should be given a legal weight as a provision that was consented to by all members of the IEA at the time and, therefore, should stand as an adequate legal basis for the accession of the Community without the necessity of amending the Agreement. However, it seems that there is as yet no political will among the IEA member states to allow the Commission to raise the question of membership.¹⁰⁹ Hence, the issue can be labelled as political rather than legal. Nevertheless, there are sound reasons within the ambit of the European Community law to call for such membership. Although the Member States of the Community may be reluctant to give up their own national external policy and they are not keen to reduce their own role within international organisations, they are nevertheless obliged to take all appropriate measures to ensure fulfilment of the obligations arising out of the EC Treaty or resulting from action taken by the institutions (Art 10 TEC) (eg actions to guarantee security of oil supply). On the other hand, considering that the Community can argue for its competence in this field, the Community membership will enhance transparency of obligations at

¹⁰⁷ Eg, the membership of the European Community in the International Labour Organization is not possible because such membership is only open to states even though the Community enjoys external competence in the area of social policy. See also Case 2/91 *Convention No 170 of the International Labour Organisations Concerning Safety in the Use of Chemicals at Work* [1993] ECR I-1061.

¹⁰⁸ See, eg, the membership of the Community in the United Nations Food and Agriculture Organisation whereby the latter modified its statutes in order to allow the EC to become a member. See the Opinion of the Advocate General Jacobs, Case 25/94, *Commission v Council* [1996] ECR I-1469, at I-1472-83. See also J Heliskoski, 'Internal Struggle for International Presence: the Exercise of Voting Rights within the FAO' in A Dashwood and C Hillion (eds), *The General Law of EC External Relations* (London, Sweet and Maxwell, 2000) [hereinafter *General Law of EC*].

¹⁰⁹ There is also the problem of voting rights upon the accession of the Community. The Governing Board of the IEA needs to determine whether the EC's vote should count as an additional vote or the EC should cast the vote of its Member States either in their names or in its own name.

the international scene and the autonomy of the EC legal order is better ensured if the Community as well as the Member States also becomes subjects to the same international obligations.¹¹⁰ This all should pave the way for future membership of the Community in the IEA.

Putting the complexities of the membership of the Community in the IEA aside, already at the end of the 60s and due to the political upheaval in the Middle East and the disruption of oil supply in Europe, the Community was already faced with the question whether it was necessary to develop a system of stock piling in order to guarantee security of oil supply. This system was adopted in 1968. The elements of this system will be explained below, and its interaction with the rules of the IEA will be revealed.

4.3.4. The Obligation to Hold Stocks: the European Community

The European Council, after the 1967 Six Days War that led to the second blockage of the Suez Canal,¹¹¹ adopted the Directive 68/414/EEC. The reasoning for such a move was said to be that:

Imported crude oil and petroleum products are of increasing importance in providing the Community with supplies of energy, and any difficulty, even temporary, having the effect of reducing supplies of such products imported from third countries could cause serious disturbances in the economic activity of the Community. Therefore, the Community must be in a position to offset or at least to diminish any harmful effects in such a case. A crisis in obtaining supplies could occur unexpectedly and it is therefore essential to establish forthwith the necessary means to make good a possible shortage. To this end, it is necessary to increase the security of supply for crude oil and petroleum products in Member States by establishing and maintaining minimum stocks of the most important petroleum products.¹¹²

This directive obliged Member States to maintain a level of stocks equivalent to 65 days of consumption. Member States with indigenous oil production had a reduced stockpiling obligation to a maximum of 15 per cent. This directive calculated the stockpiling obligation based on the level of consumption of each Member State. Stocks could be drawn on when 'difficulties arise' and after consultation between the Member States (Art 7). What the difficulties were

¹¹⁰ See in general, I Govaere, J Capiau and A Vermeersch, 'In-Between Seats: the Participation of the European Union in International Organisations' (2004) 9 *European Foreign Affairs Review* 155. See also J Sack, 'The European Community's Membership of International Organisations' (1995) 32 *CML Rev* 1227.

¹¹¹ For the details of this incident, see ch 2.3 above.

¹¹² See Council Dir 68/414/EEC of 29 December 1968 on Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [1968] OJ L/308/14. See Council Decision 68/416/EEC of 20 December 1968 on the Conclusion and Implementation of Individual Agreements Between Governments Relating to the Obligation of Member States to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [1968] OJ L/308/19.

comprised of was not elaborated on, but it could be interpreted as the physical shortage of oil in the Community compared to demand. This obligation was increased in 1972 to 90 days.¹¹³

The important difference between the IEA and the Community measure was firstly, the storage obligation and the basis of its calculation being the inland consumption of oil,¹¹⁴ as opposed to the IEA's rule on total net imports of the preceding year for each participating country. An example clarifies the difference. The UK had no obligation to hold stocks as an 'oil producer' based on the IEA rules. However, under the Community measure, this country was obliged to hold stocks but with the 15 per cent reduction (later 25 per cent) of the 90 day obligation due to its domestic production.

The other difference between the IEA and the Community system is that the IEA, in calculating the level of stocks, converts stock of finished products into crude oil equivalents by multiplying them by one of the two predetermined coefficients whereas the Community converts the stocks of crude oil and feed-stocks into finished products equivalents (Art 5 of Dir 68/414/EEC). The other difference between the two systems is that the IEA applies a 10 per cent reduction for unavailable stocks while European Union does not apply any deduction for these types of stocks.

In addition, the Community Directive allowed the possibility of keeping stocks within the territory of a Member State for the account of undertakings of another Member State, which owns the stocks, provided that a specific storage agreement had been concluded between the two governments and these stocks remained at the free disposal of the Member State on whose behalf the stocks were held (Art 6).

In 1973, the Council adopted a new Directive 73/238, which provided for the creation of a group of delegates from the Member States (Oil Supply Group) that would carry out the necessary consultations in order to ensure coordination among Member States of the measures to be taken.¹¹⁵ It also obliged the Member States to be ready at a time of crisis to react rapidly and to adopt the necessary emergency measures. The only exception to this consultation was what was provided in 1977, where the Commission, based on the request of the Member States or on its own initiative, could set a target to reduce consumption of petroleum products by up to 10 per cent of normal consumption, for a maximum period of two months.¹¹⁶ The reduction of consumption was designed to

¹¹³ The Council Dir 72/425/EEC of 19 December 1972 Amending the Council Directive of 20 December 1968 Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [1972] OJ L/291/154.

¹¹⁴ This obligation should be maintained for each category of motor spirit and aviation fuel, gas oil, diesel oil and kerosene and jet-fuel of the Kerosene type and heavy fuel oil.

¹¹⁵ Council Dir 73/238/EEC, above n 101.

¹¹⁶ Council Decision 77/706 of 7 November 1977 on the Setting of a Community Target for a Reduction in the Consumption of Primary Sources of Energy in the Event of Difficulties in the Supply of Crude Oil and Petroleum Products [1977] OJ L/292/9. Later in 1979, a Commission

include those countries of the EEC that were not then members of the IEA (ie France). This directive also aimed at establishing a system of sharing the quantities of petroleum products that were saved as a result of the differentiated reduction of consumption. All these measures were intended to ensure that the users of energy within the Community bore a fair share of the difficulties arising from the crisis.¹¹⁷ In the same year, as an exception to the free movement of trade in goods, the EEC authorised the Member States to restrict exports of oil and petroleum products between themselves in case of supply difficulties.¹¹⁸

In 1998, Council Directive 98/93/EC¹¹⁹ amended the first directive on stock obligation (Directive 68/414/EEC) to take into account the development of the European internal market. This directive considered it necessary that the organisational arrangements for oil stocks should not prejudice the smooth running of the internal market. Furthermore, this obligation should not affect the full application of the EC Treaty, in particular its provisions concerning the internal market and competition.¹²⁰ It increased the exception to indigenous production to 25 per cent and provided the possibility to have recourse to a stock-holding body or entity, which will be responsible for holding all or part of the stocks.

Member States that pass on all or part of their obligations to their industry should devise appropriate arrangements for identifying, accounting for and verifying these stocks, including penalty and inspection. This obligation is not without difficulty. Some countries of the Community have a stock-holding body and hold stocks for 90 days. However, some do not have such a mechanism and it is the industry (mainly companies) that keeps all the stocks that the country is obliged to hold. Operational stocks of the industry, ie stocks that the industry uses for its own operation, will not be identifiable from those that are available at a time of crisis. Therefore, there is no transparency in predicting the status of that country, and other countries for that matter, during crisis.

decision allowed a Member State to draw on stocks of crude oil and/or petroleum products held in excess of its obligation, instead of restricting consumption. See Commission Decision 79/639 of 15 June 1979 Laying Down Detailed Rules for the Implementation of Council Decision 77/706/EEC [1979] OJ L/183/1.

¹¹⁷ See the preamble of Dir 77/706, *ibid*.

¹¹⁸ Council Decision 77/186/EEC of 14 February 1977 on the Exporting of Crude Oil and Petroleum Products from One Member State to Another in the Event of Supply Difficulties [1977] OJ L/61/23. This Decision was later amended by Council Decision 79/879/EEC of 22 October 1979 [1979] OJ L/270/58, and authorised a Member State to suspend the issue of export licenses and to cut short the validity of existing licenses or to revoke them to the extent necessary to prevent the abnormal increase in trade in petroleum products between Member States due to the shortfall in supply of crude oil and/or petroleum products.

¹¹⁹ Council Dir 98/93/EC of 14 December 1998, Amending Dir 68/414/EEC Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [1998] OJ L/358/100. See also the codified directive, Council Dir

2006/67/EC of 24 July 2006 Imposing an Obligation on Member States to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products [2006] OJ L/217/8.

¹²⁰ Council Dir 98/93/EC of 14 December 1998, *ibid*.

As the Community law on stocks demonstrates no comparable IEA CERM mechanism exists in the Community. At the IEA the Governing Board activates triggering measures which could be preceded by coordinated emergency response measures (CERM). If these measures are insufficient, trigger mechanism comes into action where all available crude oil and petroleum products from both imports and domestic production are brought into a common oil-sharing system for all the Member States to share the same percentage in reduction in its market supplies. If the supply failure exceeds 7 per cent or 12 per cent (Articles 13 and 14 of the IEP), although not mandatory, stock draw can take place, and other emergency measures may still be applied. At the Community level the Commission is not authorised to take requisite measures at the time of a crisis. It arranges consultation with the Member States and they are to adopt any emergency measures they see fit. In the 2002 proposal explained below, the adoption of measures for ensuring a coordinated response from the Member States in the event of crisis was suggested which was not adopted.

One other difference between the Community and the IEA systems is that the Community law in the introductory note of the Directive 98/93/EC refers to the 'difficulty' as not only reduction of supplies of crude oil and petroleum products but also significant increase in the 'price' thereof on international markets. Therefore, both a physical lack of petroleum products and the price were included in the definition of a 'difficulty' whereas in the IEA reference is merely to a reduction in oil supplies.

Directive 98/93/EC is still in place. Although a proposal was put forward by the Commission in September 2002¹²¹ to change some basic elements of this directive, it met with resistance by the Member States and the European Parliament. In this new proposal, the stock-holding obligations were increased to 120

¹²¹ See the Security Package, Communication from the Commission to the European Parliament and the Council, *The Internal Market in Energy: Coordinated Measures on the Security of Energy Supply*. This included the (1) Proposal for a Council Directive Repealing Council Directives 68/414/EEC and 98/93/EC Imposing an Obligation on Member States of the EEC to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products, and Council Directive 73/238/EEC on Measures to Mitigate the Effects of Difficulties in the Supply of Crude Oil and Petroleum Products; and (2) the Proposal for a Council Decision repealing Council Decision 68/416/EEC on the Conclusion and Implementation of Individual Agreements Between Governments Relating to the Obligation of Member States to Maintain Minimum Stocks of Crude Oil and/or Petroleum Products and Council Decision 77/706/EEC on the Setting of a Community Target for a Reduction in the Consumption of Primary Sources of Energy in the Event of Difficulties in the Supply of Crude Oil and Petroleum Products, and (3) Proposal for a Directive of the European Parliament and the Council concerning the Alignment of Measures with regard to Security of Supply for Petroleum Products, and (4) Proposal for a Directive of the European Parliament and the Council concerning Measures to Safeguard Security of Natural Gas Supply, COM (2002) 488 Final. The external aspect of all these proposals is mentioned in various parts of this study except the proposal for a directive on the alignment of measures with regard to security of supply for petroleum products. This proposal only acknowledges the risk of an economic crisis due to the lack of an efficient security framework and suggests two reforms (1) an obligation on the Member States to set up a national stockholding agency, (2) reform of the provisions governing the holding of security stocks in another Member State (para 12).

days. The Commission also proposed a similar obligation in the gas sector, arguing that the lack of a Community framework aimed at guaranteeing a minimum level of gas stocks would decrease the security of supply.¹²²

The first difference between this proposal and the existing 1998 Directive on the Stock-holding Obligations of the Member States is that 'an obligation' was imposed on the Member States to create a stock-holding body, something which was previously optional. The second difference is that, based on the 1998 Directive, Member States are free to decide whether they find it appropriate to keep their stocks in another Member State, whereas the new proposal seeks to abolish the need for such an agreement and make the keeping of stock in another Member State automatic without the need to conclude an agreement. This latter point was the subject of intense discussion since, on the one hand, the Commission argued that the existence of an internal market suggests that the need for an agreement between Member States should no longer exist. They aimed to ensure that nothing hampers competition between the importers of petroleum products and national refiners or distributors. On the other hand, Member States argue that the non-existence of an agreement translates into a lack of control of the operators of those stocks, ie a lack of transparency, and the eventual lack of access to those stocks at the time of a crisis. Nothing in the proposal guaranteed such necessary transparency.

The third difference is that the criteria for drawing stocks, ie the necessary conditions under which stock should be used, was changed to include not only the reduction of supplies and increase in price, but also the 'expectation of the risk of physical disruption' (a rather psychological criterion). This was added because the Member States believed that even a remote expectation of disruption in the future creates panic and has the same effect as a real physical disruption.

The fourth difference is that in the 1998 Directive, the authority responsible for deciding on the release of stocks is the 'oil security group' and no real decisional procedure existed to involve the Commission. It was proposed that the Commission should undertake this responsibility by consultation with the regulatory committee (comitology). The issue of providing the Commission with sufficient power to authorise measures in an emergency has a long history. Already in a 1992 proposal for a Council directive, there was an emphasis on providing the Commission with such a task. The Commission would be assisted by a committee composed of representatives of the Member States, who would establish the criteria for the existence of a crisis (taking into account the analysis of the IEA), determine the objectives to be attained by Member States, and agree on the measures to be implemented by the Member States.¹²³ It was believed that

¹²² See also the Briefing paper of the Clingendael Institute, T Westerwoudt, 'No 1: EU Policy on Improving the Security of Oil and Gas Supplies', May 2003, at <<http://www.clingendael.nl>>.

¹²³ See Proposal for a Council Directive Providing for Appropriate Measures to be taken in the event of Difficulties in the Supply of Crude Oil and Petroleum Products to the Community, COM (92) 145 Final, 27 April 1992. For background information, see also Communication from the

the work of the IEA and that of the Community should be complementary, and that is only possible if the Commission is provided with the necessary powers to act at a time of crisis. Therefore, under that proposal, the Member States would finalise a Community position vis-a-vis the IEA. This position would be adopted by a qualified majority of the Council, and presented by the Commission, which would be assisted by a management committee. This change of procedure was not accepted in 1992 and it is unlikely to be accepted now. Member States remain reluctant to provide the Commission with powers that could lead to the restriction of their own authority to manage energy security. Energy security is still a responsibility that is deemed to be more appropriately assumed by the Member States, even in the minimal form of influencing the upcoming proposal from the Commission in a way which delimits the latter's powers.

As shown above, an effort was made through the directives to secure energy supply through a stock-holding mechanism. The rationale underlying the decision to have another set of rules for stock-holding in the Community, along with the existing rules of the IEA, was said to be the inadequacy of the IEA framework to guarantee security. The first reason mentioned for this inadequacy was the IEA's voting procedure, which rendered the attainment of a decision to draw on stocks difficult since this requires unanimity. It is said that agreement must be reached 'between 26 participating countries whose geographical origins and at times very different interests do not make it easy to reach a consensus'. The risk of measures being blocked was therefore obvious.¹²⁴ Secondly, it is said that the IEA mechanism links the management of the oil stocks of the European Union to that of numerous external partners, such as the US, Japan and Australia, whose priorities are not necessarily the same as the EU's.¹²⁵ It is unclear what the different priorities are among various countries / members of the IEA, which could impede the achievement of unanimity at a time of crisis. An oil crisis is eventually a global crisis, and the failure of one Member State to make stocks available to another would also affect other members. Thus, the 'priority' would be to take concerted action.

The new proposal also mentions that the gradual establishment of a European internal energy market is a unique achievement and that no other country in the IEA has succeeded in developing such an integrated structure. For this reason, it was found advisable to adopt a different system of energy security through a stock-holding mechanism. The message contained in these lines suggests strong

Commission to the Council on the Oil Supply Situation, Incorporating Two Proposals for Council Directives on the Steps to be taken in the Event of Supply Difficulties and on the Maintenance of Stocks of Oil, COM (90) 514 Final.

¹²⁴ See Communication from the Commission to the European Parliament and the Council: The Internal Market in Energy: Coordinated Measures on the Security of Energy Supply, COM (2002) 488 Final.

¹²⁵ See Communication on Security, *ibid*, at 10.

opposition to reliance on the IEA to guarantee the security of the Community's energy supply. However, coordinating Community measures with those of the IEA is not altogether rejected.

Although the structure of the internal energy market is definitely unique, the oil market is a global market. Effects in one country due to a lack of adequate energy supply, no matter where it is 'geographically situated' can have grave consequences on other consuming countries.¹²⁶ Thus, it seems unlikely that non-EU members of the IEA would veto a decision to ensure timely draw on stocks at a time when the reduction of oil supplies has occurred or can reasonably be expected to occur. Some examples of the IEA's crisis management demonstrate that this organisation has acted efficiently when such disruptions occur.¹²⁷ For example, in 1991 and during the Gulf War, the IEA activated its Contingency Plan to make 2.5 mb/d of oil available to the market. Arrangements were also made in December 1999 and January 2000 to maintain an emergency response team and corresponding arrangements were made in the IEA member countries. The crisis assessment mechanism of the IEA has also been activated in 2003 and in a situation where 'global oil markets were tight, there were low inventories, high uncertainty with strikes in Venezuela and disturbances in Nigeria.' The IEA assessed the situation and shared its findings with member countries.¹²⁸ More recently, after the disruptive effects of Hurricane Katrina on the supply of energy from the Gulf of Mexico in September 2005, the IEA issued a press release urging all 26 members of the IEA to act collectively and make available to the market the

¹²⁶ See P Noël and P Criqui, 'Marchés énergétiques et géopolitique pétrolière, 1990–2030', (1998) <<http://www.upmf-grenoble.fr/iepe/textes/pnpc98.pdf>> [hereinafter 'Marchés énergétiques et géopolitique'] at 18. These scholars say that

les conditions sur un marché local (tension, surplus...) tendent à se traduire par des mouvements de prix ressentis mondialement. Par exemple, un hiver rigoureux sur la côte est des Etats-Unis fera monter fortement les cours du fuel sur le marché local; l'effet se diffuse ensuite au marché du brut local, puis de la aux cours mondiaux.

The reason for this effect is the transport costs of oil, which are less than \$1 per barrel and are more or less independent of distance, which means that no matter what destination the oil was originally being sent to, it can be rapidly diverted to another destination; Noël and Criqui also believe that this characteristic of the oil market means that having privileged relations with certain energy-producing countries is not beneficial. The link between security of energy supply at a national level and privileged relations with an energy-producing country is relative. It is more important that there should be a balance between supply and demand, and a rupture in this equation cannot be compensated at national or European level due to the existence of privileged relations with one or two energy-producing countries, *ibid.* at 19. However, one could also argue that the better the relations with energy-producing countries, the lesser the risk of a shortage of supply in the market or reduced export by the energy-producing countries because a privileged relationship could at least strengthen the development of the energy reserves of a given country. Therefore, the importance of these relations are not undermined but should be dealt with from a global rather than a national perspective. See also, P Noël, 'Approvisionnement énergétique de l'Europe et politique étrangère commune: une problématique' at <<http://www.upmf-grenoble.fr/iepe/textes/PNeurope.PDF>> [hereinafter 'Approvisionnement énergétique']. It should be added that the gas market has different characteristics and what has been said above does not apply to the gas market.

¹²⁷ The US withdrew stocks outside the framework of the IEA during the Gulf War in 1991.

¹²⁸ See the IEA website at <<http://www.iea.org/Textbase/Papers/2004/factsheetcover.pdf>>.

equivalent of 2 mb/d of oil for an initial period of 30 days.¹²⁹ This initiative of the IEA resulted in stock-drawing by the IEA members at a rate of 2 mb/d comprised of crude oil, products, motor gasoline, middle distillates and fuel oil.¹³⁰

Nonetheless, it is correct to say that the peculiarities of the European internal energy market require extra measures beyond those provided by the IEA. For example, the duty of cooperation between the Member States of the Union and their effort to comply with internal market rules on competition and the free movement of goods (including petroleum goods) necessitate non-discriminatory access to those stocks, and the establishment of stocks outside national territory for those countries that cannot hold them in their own territory. These measures can all be carried out more efficiently at Community level, as the IEA does not impose such obligations on its participating states. However, the IEA mechanism does not prevent the Community from adopting extra measures necessary to satisfy the demands of an integrated market.

A more plausible reason for creating a Community mechanism to secure energy supply could rest in the differences between the Community and the IEA in taking measures in case of Member States' non-compliance with their stock-holding obligations. Member States are compelled to abide by the obligations contained in a directive, and their infringement would trigger the infringement procedure and a process before the European Court of Justice. For example, Greece has frequently infringed its obligations to hold stocks according to the provisions of the Stock Directive, and the Commission formally informed Greece that in case of further non-compliance, an infringement procedure would be initiated.¹³¹ Greece finally complied. Most EC Member States were usually considered as non-compliant, since they do not possess a stock-holding body. Their stocks are therefore kept by the industry, the supervision of which is not an easy task. For this reason, the Commission provides them with a specific period during which they should establish this body or create an efficient monitoring mechanism to supervise the obligation of the industry to keep the necessary stocks. In the case of infringement of both, a formal infringement procedure will ensue.

At the IEA level, however, when an obligation imposed by the International Energy Program is infringed, no similar measure exists.¹³² At this level, current

¹²⁹ See the IEA Press Release, IEA/Press (05) 14, Paris, 2 Sept 2005.

¹³⁰ Countries committed a total initial response of 2.1 mb/d. This consisted of 94% stock-draw, 3% demand restraint and 3% increase indigenous production. North America offered the biggest contribution of total response (52%), followed by Europe (30%) and the Pacific Region (18%), based on agreed shares of consumption. Countries have committed to drawing stocks at the rate of nearly 2 m/bd. See the IEA Press Release, 'Contribution of IEA Member Countries to the Hurricane Katrina Oil Supply Disruption', PR (05) 15, 7 Sept 2005.

¹³¹ For updated information on infringement proceedings against Member States, see the website of the European Community at <http://europa.eu.int/comm/secretariat_general/sgb/droit_com/index_fr.htm>.

¹³² On 23 July 1980 a decision adopted the IEA Dispute Settlement Centre Charter (IEA/GB (80) 56, Item 8, and Annex) and its charter. Based on Art II of the Charter

measures to address non-compliance include, among other things, the establishment of a policy of choosing the Committee chairs and vice-chairs among complying countries only, or denying, limiting or suspending the voting rights of non-compliant countries, or limiting benefits from oil allocation in a crisis. These measures resemble a 'penalisation' procedure more than the prevention of such infringement. However, the last measure, ie 'limiting benefits from oil allocation', is definitely not plausible. Although oil allocation has not taken place since the inception of the IEA and therefore, its effectiveness cannot be measured, it is not at all clear whether limiting the benefits of such a measure would be advisable in managing a crisis. It does not seem right to penalise a country after a crisis has occurred by preventing allocation to that country, since the negative economic consequences of such a move will eventually affect other countries. The handling of an oil supply emergency rests on the capability of the IEA members to act together. The insufficiency of the act of one member would place the credibility of the whole system at risk, and the 'non-allocation' sanction would do nothing to improve this situation. The whole mechanism should aim to prevent a crisis rather than adopting a 'sanction mechanism'.¹³³ Comparing the two remedial systems, it seems that the Community provides a more plausible mechanism to force a Member State to comply with its stock-holding obligations through its infringement procedure mechanism, and therefore, possesses a more reliable system to guarantee security of supply.

Finally, not all the new members of the Community have joined the IEA. This is an additional justification for the existence of a separate framework of stock-holding obligations in the Community for the time being.

Although it is recognised that Community regulations have their merits in guaranteeing security of supply, a clear coordination of the activities of the Community with those of the IEA should be guaranteed, to avoid the risk of potential conflict between decisions of the IEA and the Community. This latter point is not explicitly mentioned in the text of the 1998 Directive. As referred to earlier, the Community has sought to coordinate the activities of the Member

The jurisdiction of Arbitration Tribunals convened pursuant to the Charter extends to any dispute between a seller and a buyer of oil, or between the parties to an exchange of oil, arising out of an oil supply transaction during implementation of the emergency allocation of oil and under the International Energy Program and as between the parties to a particular supply transaction but not to decisions or rights or obligations of IEA Countries under the International Energy Program, including allocation rights and allocation obligations of IEA Countries.

Based on this charter the only dispute settlement mechanism perceived in the IEA is when under emergency allocation there are disputes between sellers and buyers of oil or 'between parties to an exchange of oil which the parties thereto may consider appropriate for settlement by arbitration under the auspices of the International Energy Agency'. As mentioned above, there is no settlement mechanism for disputes among members of the IEA. See R Scott, *The IEA the First 20 Years 1974-1994: Principle Documents*, vol 3 (Paris, IEA, 1995) at 56.

¹³³ It is interesting to see that a sanction mechanism is introduced in the 1998 Directive, but this sanction applies at the level of control and prior to the crisis. Art 17 provides that it is appropriate to strengthen the administrative supervision of stocks and establish efficient mechanisms for the control and verification of stocks, and that a regime of sanctions is necessary to impose such a control.

States through the 'Oil Supply Group'. In the event of crisis, the Oil Supply Group, comprised of the representatives of the Member States, decides on reasonable steps to be taken. However, no link exists between their decisions and those at the IEA. Although the Commission is currently present in the IEA, and the two organisations actively cooperate, it is difficult to determine the best means of cooperation of these two bodies in a crisis as no supply disruption has triggered the simultaneous activation of the two mechanisms. Nevertheless, some suggestions could be of help.¹³⁴ For example, the Oil Supply Group could make its position known to the IEA at the time of crisis. It is vital that each Member State's position does not differ in the Group and in the IEA. If the IEA fails to react rapidly to the situation, the Community can apply its own mechanism, and if the Oil Supply Group fails to provide the IEA with a timely position, the IEA could decide according to its own decision-making procedure.

Now we will turn to the link between the stock-holding obligation and relations with energy-exporting countries.

4.3.5. The Stock-Holding Mechanism and Relations with Energy-Producing Countries

The 2002 Communication from the Commission to the European Parliament and the Council on the Internal Market in Energy, Co-ordinated Measures on the Security of Energy Supply, although not approved by the European Parliament and the Council, reveals some interesting issues as to how the issue of energy security is perceived within the Community. First of all, the Communication's explanatory memorandum explicitly reveals that although the Union is acquiring the most integrated internal energy market in the world, this success is not accompanied by the *necessary coordination of measures guaranteeing security of external supplies*.¹³⁵ It was therefore found necessary to define a Community framework for the implementation of measures to ensure this security. These measures were deemed to set out the roles and responsibilities of the various players in the oil and gas market. Moreover, it suggested that the objectives of the proposed action, because of the scale of its effects, cannot be sufficiently achieved by the Member States and can therefore be better achieved by the Community (Article 5 of the EC Treaty).

One way provided to reach this objective is the institution of a permanent dialogue with producer countries, with a view to improving price formation

¹³⁴ The 2007 Communication entitled 'An Energy Policy for Europe' confirms that the oil stocks mechanism of EU works well and should be maintained but continues by providing that 'the manner in which the EU manages its contribution to this mechanism could however be improved' and 'there should be better coordination if the IEA calls for stocks to be released'. See the Communication from the Commission to the European Council and the European Parliament, An Energy Policy for Europe, COM (2007) 1 Final, at 11.

¹³⁵ See the Communication on Internal Energy Market, COM (2002) 488 Final, above n 121, at 4.

mechanisms, conclusion of agreements and *the use of reserve stocks in the mutual interest*.¹³⁶ The IEP Agreement of the IEA also refers to such cooperation with energy producing countries in Chapter VIII. Although the rationale for such cooperation are not spelled out, Article 47 refers to the importance of such cooperation, through accelerated industrialisation and socio-economic development in the principal producing areas, which would have implications for international trade and investment, which clearly have implications for security of energy supply as well. In the context of the Stock proposal, it is further provided that measures to coordinate action on the security of oil and gas supplies are conceivable only in co-operation, rather than confrontation, with the producer countries. What is the form of this cooperation? Are stock-holding obligations and the policies of the energy-producing countries compatible?

The Directive suggests that stocks could be used in a coordinated manner with the producer countries, and the European Community must develop, institutionalise and give substance to the energy dialogue between producer and consumer countries. The reason for such a statement is that keeping oil stocks was meant to create a safeguard for times when the producing countries influence the price through their production quota. Stock-drawing does not take place based solely on the ways that producing countries influence the price: therefore, this influence is not the only situation in which the emergency measures are triggered. On closer perusal, it is evident that disruptions in oil supply in the past fifty years were not necessarily concerned with changes in the production and pricing mechanisms undertaken by the energy-producing countries. For example, the rise in prices in May 2004 (close to \$40 per barrel and the highest since 1991) were attributed to a rise in demand, violence in the Middle East (Iraq and Saudi Arabia), and insufficient US refinery capacity to meet demand.¹³⁷ Some other past crises were also not directly linked to the activities of energy-producing countries. Therefore, history supports the conclusion that not all disruptions can be attributed to the influence of these countries. The crises differ in cause and duration and they differ in terms of price effect.¹³⁸ Energy-producing countries have repeatedly stated, especially in the framework of the Organization of Petroleum Exporting Countries (OPEC), that they are ready to rectify any supply loss through increased production if necessary. The mentality of the 'oil weapon'

¹³⁶ *Ibid* at 12.

¹³⁷ The main message of OPEC's 138th extraordinary meeting of Energy Ministers in June 2005 was exactly linked to the issue of the shortage of investment in global refinery capacity, which had contributed to high oil prices. They suggested that all parties involved, from producers to consumers, need to concentrate on attracting more investment in the refinery sector in order to satisfy the demand of the market for refinery products. See the press release of the June Ministerial Conference at <<http://www.opec.org>>.

¹³⁸ The APEC study on oil stocks shows that the key issue is the availability of capacity to offset the lost supply and the willingness of the owner of such capability to use it. See the APEC Study, above n 88, at 14. However, it has become clear that even when there is adequate supply in the market, and where there is the willingness on the part of energy-exporting countries to produce more, the price can still go up.

or revenge of the producing countries against the politics of some consuming nations, as happened in 1973, no longer applies. The environment is clearly in favour of cooperation rather than enmity.

Emphasis on the fact that the new proposal for stocks tends to encourage cooperation with energy-producing countries rather than confrontation is repeated throughout the explanatory memorandum, but is not reflected in the text of the proposed directive. That said, no concrete measures were recommended to achieve this goal and it is therefore unclear how this coordination can take place in practice.

Nonetheless, if some optimism could be shed on the intention of the drafters of the proposal to refer to substantive measures rather than mere rhetoric, one can recommend some measures to ensure that responsibility to keep stocks within the Community could be designed in cooperation with energy-producing countries. However, it should be mentioned that these measures seem to correspond more to overall energy cooperation for security purposes rather than being directly linked to stock-holding obligations of the Community.

Cooperation between energy-consuming and energy-producing nations at a time of crisis is not without precedent. For instance, the Association of South East Asian Nations (ASEAN) has designed a Petroleum Security Agreement (APSA) in 1986, in which the ASEAN members agreed to establish the ASEAN Emergency Petroleum Sharing Scheme for crude oil and/or petroleum products, in times of both shortage and over-supply.¹³⁹ Where there is a critical shortage of supply, the oil-exporting countries of the ASEAN (eg Indonesia or Malaysia) are committed to supplying a necessary quantity of crude oil and/or petroleum products. If there is oversupply, the importing countries are required to purchase exports from member economies in distress in order to increase their level of exports to at least 80 per cent of normal exports.

There is no agreement between the consuming nations of the Community and energy-producing countries outside the Community to guarantee exports of necessary energy supply to those nations at a time of crisis. However, before the Iraq war of 2003, Saudi Arabia announced its willingness to provide those countries with available spare capacity if the war results in an energy crisis, thereby proving that such cooperation is attainable.¹⁴⁰ The Saudi Oil Minister pledged to the IEA to keep oil markets supplied in the event of war in Iraq. It could be argued that if such a promise materialises, there would be no need to seek a separate agreement between the Community and the energy-producing countries to guarantee the use of this capacity. If the Community tends to

¹³⁹ The ASEAN Petroleum Security Agreement, commonly known as APSA in ASEAN, was signed by the ASEAN foreign ministers on 24 June 1986 in Manila on the same occasion as the signing of the Agreement on Energy Cooperation. The APSA was signed by all then six ASEAN member economies, namely Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand, and was subsequently ratified by Vietnam, Laos, Myanmar and Cambodia when these economies joined as new members of ASEAN in later years. See the APEC Study, above n 88, at 28.

¹⁴⁰ See also the discussion in ch 7.2 below.

separate itself once more from the IEA by reaching a separate agreement with those countries, it has the competence to do so but such a promise could substitute for such an agreement.

There is no agreement among experts on which energy-producing countries have spare capacity, but they all concur that Saudi Arabia is definitely one country whose spare capacity consuming nations can rely upon.¹⁴¹ It is argued that Saudi Arabia can keep spare capacity due to the fact that it has developed wellhead capacity of 10 mb/d and large surface infrastructure to handle this kind of volume.¹⁴² Although the analysis lingers between strong optimism and pessimism about the fact that Saudi Arabia can hold or add to its spare capacity,¹⁴³ it is submitted that Saudi Arabia has the potential to increase production to 11–12 mb/d and maintain this production for a decade. The spare capacity, however, could decline if the oil demand grows faster than expected and other energy-producing countries are not able to meet production growth expectations. Whatever the situation, the promise on the part of Saudi Arabia to consider this assistance could help the energy-consuming countries in dealing with an energy crisis.

Some additional points should be raised here. Firstly, Saudi Arabia's willingness is not manifested in a binding agreement of understanding that it would actually use its spare capacity before consumer countries would open their reserves.¹⁴⁴ Secondly, even if this spare capacity is estimated at about 2 mb/d, the Community is not the only destination for such spare capacity. Other importers of Saudi Arabian oil would also join the demand for this capacity. Therefore, only if the quantity of excess capacity is adequate to satisfy the needs of all the IEA countries—which depends on the degree of the crisis's effect—is this alternative of value. Thirdly, this cooperation is not directly linked to the stock-holding obligations of the EU Member States because it can be used in parallel to stock-drawing in the Community. The statement of Saudi Arabia to release the spare capacity is not conditional upon the use of spare capacity prior to the release of stocks, and it does not seem appropriate to demand such a condition, because

¹⁴¹ The Energy Information Administration declared that OPEC, excluding Iraq, has just 2.17 mb/d to 2.67 mb/d of spare production capacity, where Saudi Arabia spare capacity is estimated at 1.7 mb/d to 2.2 mb/d. In addition, it provided that, apart from Saudi Arabia, only UAE—at 380,000 b/d—and Qatar—at 90,000 b/d—hold spare capacity. See <<http://www.petroleumworld.com/storyT1341.htm>>. See also the CERA Watch Report, 'Supply Shock: The Aggregate Disruption of 2006', Spring 2006.

¹⁴² See 'Saudi Arabia's Spare Capacity Guarantees World Petroleum' at the Middle East North Africa Financial Network website, at <<http://www.menafn.com>> (06 March 2004).

¹⁴³ The amount of spare capacity that Saudi Arabia possesses is subject to controversy. In 2004 when Saudis argued that they have between 1–1.5 mb/d spare capacity, that capacity was mostly comprised of heavy sour that could not be used in the market, therefore its importance was questioned at the time. The rapid availability of such spare capacity as well as price dynamics also contributed to this doubt. However, the recent development shows that Saudis are investing in refining that capacity to provide the market with good quality (light crude) spare capacity.

¹⁴⁴ See 'Saudi Arabia will not Pump above 9.2 mb/d in case of War' at Alexander's Gas and Oil Connections Website at <<http://www.gasandoil.com/goc/news/ntm31468.htm>> (04 April 2003).

eventually it is the consuming nations who have to decide on their fate in an energy crisis. If they perceive it as ominous to await the decision of Saudi Arabia, they should be able to use their stocks, which they have borne some considerable costs to maintain. If the energy-producing countries are willing to assist these countries to overcome the difficulties of the energy crisis, they should provide their spare capacity at a time when the release of Community stocks is insufficient to meet demand. However, if the consuming nations find it more appropriate to first use the spare capacity before resorting to their stocks, they should do so if such spare capacity is provided to them.¹⁴⁵

Another option is to keep the stocks in the territory of the energy-producing countries neighbouring the Union. Although the 1998 Directive only discusses the possibility of holding stocks within the Community, the new proposal of 2002 takes the 'geographical benefits of enlargement' into account and proposes to keep the stocks not only within the Community but in candidate countries, or equally in producer or even transit countries.¹⁴⁶ This issue, however, does not correspond to other provisions of the proposal suggesting that there is no longer a need to enter into bilateral agreements to keep stocks, since that proposition was linked to the necessity of the full functioning of the internal market only (unless some special provisions are sought with candidate countries). Therefore, one could argue for an additional provision allowing the possibility of entering into bilateral agreements with third states, either producing or transit countries, to keep these stocks. Although this option could be linked to some type of cooperation with energy-producing countries, its benefits are far from clear.

Based on the 1998 Directive, more detailed rules are needed to guarantee the availability and accessibility of stocks kept in one Member State for the account of another Member State in the event of oil supply difficulties. The former shall not oppose the transfer of these stocks to the latter and shall send a report to the Commission concerning the stocks maintained within its own territory for the benefit of another, as well as the stocks held in other Member States for its own benefit. In both cases the storage locations, companies holding the stocks, quantities and product category stored should be indicated.¹⁴⁷ If the stocks were deemed to be kept in the territory of the energy-producing countries, or were possessed by these countries but kept within the territory of the Community, the responsibility to undertake all the necessary measures at the time of crisis could be transferred to the energy-producing countries that keep the stocks on the account of a Community Member State. In this case, it is much more difficult to

¹⁴⁵ The idea against forcing the Member States to first use the oil that comes from third countries was shaped in a discussion with Prof. Giacomo Luciani in the context of the EUROGULF Project, ie a project co-financed by the European Commission on energy cooperation between the European Union and the Countries of the Gulf Cooperation Council which was initiated in May 2003 and was finalised in April 2005. For a list of the papers submitted for that project, see <http://europa.eu.int/comm/energy_transport/doc/2005_04_eurogulf_kuwait.pdf>.

¹⁴⁶ See the Proposal for Stocks, above n 121, at 18.

¹⁴⁷ See Dir 98 on Stocks, above n 119, at point 7.

safeguard the control and availability of these stocks. The possible lack of transparency in this system of stock-holding could create additional difficulties for the already arduous obligation of stock-holding within the Community and only between the Member States.

Thus, the relationship between the stock-holding obligation of the Member States and cooperation with energy-producing countries is not straightforward. This does not mean, however, that the Community should not enter into bilateral agreements with transit or producer countries to keep spare capacity on behalf of the Community for times when the quantity of stocks available in a crisis is not adequate to satisfy demand. However, holding stocks in producing countries rather than in another Member State of the Community does not seem justifiable, due to the extreme complications that will ensue. A lack of transparency and a lack of timely availability of stocks are more accentuated in dealing with third countries rather than Community members. In any case, if there is a willingness on the part of energy-producing countries to assist Member States of the Community that are in difficulty, they would do that no matter whether stocks are to be released prior to, or after, the use of the spare capacity of the energy-producing countries.

The 1998 Directive on stock is still in force, and it seems that Member States are not willing to change their obligations in a new set of instruments. The existence of this piece of legislation is definitely important in creating an internal market for energy where access to energy required at a time of crisis should be guaranteed. For the external aspect of this type of security, it is more plausible to determine ways through which the necessary stock can first be obtained for Member States through enhanced relations with energy-producing and transit countries. An overall energy cooperation framework embodying a reciprocal relation with these countries, where their demands are also satisfied, would be more efficient. This issue is discussed in the next chapter. With respect to competences, as the case law mentioned above revealed, an implied competence of the Community can be deduced based on the repeated use of Article 95 EC in establishing measures to secure energy supply. However, as no direct reference is made to the externalities of this security in the internal measures, exclusive competence is yet to be established. In the following discussion, the last important internal measure which relates to security of energy supply is discussed and its externalities, if any, are revealed.

4.4. THE DIRECTIVE ON THE SECURITY OF NATURAL GAS SUPPLY

The Proposal for a Directive of the European Parliament and the Council concerning Measures to Safeguard Security of Natural Gas Supply¹⁴⁸ was put forward by the Commission in 2002 along with another three proposals focusing

¹⁴⁸ COM (2002) 488 Final.

on various aspects of security of energy supply in a 'security package' as it was later called. Apart from the above-mentioned proposal on security of gas supply, the legislation package was comprised of (1) a proposal for a directive concerning the alignment of measures with regard to security of supply for petroleum products, (2) a proposal for a directive repealing the 1998 Directive relating to the obligation of Member States to maintain minimum stocks of crude oil and petroleum products (elaborated on in the previous section) and measures to mitigate the effects of difficulties in the supply of crude oil and petroleum products, and 3) a proposal for a Council decision on implementation of individual agreements between governments relating to the obligation of Member States to maintain minimum stocks of crude oil and/or petroleum products.¹⁴⁹ Only the proposal for a directive on gas, discussed here in this section, was adopted two years later and the two other proposals were abandoned.¹⁵⁰

The Directive on Natural Gas Security was adopted, based on Article 100 EC, (ie where the Council may decide upon measures appropriate to the economic situation, in particular if severe difficulties occur in the supply of certain products) in order to introduce new measures to guarantee the functioning of the internal market for gas. Measures to guarantee gas supply were said to be required in order to deal with extraordinary supply situations.¹⁵¹ The Commission argued that as the demand for gas and electricity within the EU is set to increase by more than 40 per cent before 2020, most of which is dedicated to power generation, the increasing dependence on gas raises a number of issues, namely, security of gas supply and the issue of dependence. Although Norway, as Europe's most important gas producer, was already considered as an integrated part of the internal gas market, the decline in its production as well as the increased demand for imported gas from other sources made securing the continuity of supply from these sources a top priority.

One reason for establishing a crisis management mechanism was considered to be the very substantial cost of a failing security of supply, the example of which was given as the cost that the state of California had to endure after black-outs in January 2001, which amounted to 42 billion USD.¹⁵² Secondly, it was said to be inevitable that the creation of an internal energy market renders Member States increasingly interdependent regarding security of supply.¹⁵³ Therefore, a failure to adopt security measures in one Member State was said to have grave economic consequences in another, making a minimum level of harmonisation between security measures necessary.¹⁵⁴ Thirdly, before the creation of an internal market, direct state involvement in guaranteeing security of gas supply was less necessary

¹⁴⁹ For the details of this 'security package', above n 121.

¹⁵⁰ See Council Dir 2004/67/EC of 26 April 2004 concerning Measures to Safeguard Security of Natural Gas Supply [2004] OJ L/127/92.

¹⁵¹ See the Proposal on Natural Gas Security, above n 121, at 262.

¹⁵² See the Proposal on Natural Gas Security, above n 121, at 263.

¹⁵³ See the Proposal on Natural Gas Security, above n 121.

¹⁵⁴ *Ibid.*

‘as the national gas companies responsible for security of supply in many cases were partly or fully publicly owned’.¹⁵⁵ However, after the creation of the newly liberalised gas market, no single player ‘would necessarily maintain the overall responsibility at national level’ and it is not evident that ‘strategic priority will be given by gas suppliers to security of supply’, but would probably be given—although the Commission does not highlight this issue—in order to increase companies’ revenues. Therefore, it was said that Member States should be obliged to ensure that all market players take minimum security measures. It was then alleged that security measures should be defined and agreed in advance of a crisis.

These necessary measures were enumerated as the necessity to keep a minimum amount of gas stocks in storage, the use of long-term gas contracts, creation of security of supply policies at Member State level, an effective mechanism to deal with extraordinary supply situations and technical expertise supporting the implementation of the measures. The introductory note to the directive took the concerns of the Commission into account, and suggested that a minimum common approach to security of supply should be adopted between the Member States. Paragraph 1 of Article 3 of the 2004 Directive on Security of Natural Gas Supply defines the policies to secure gas supply as follows:

In establishing their general policies with respect to ensuring adequate levels of security of gas supply, Member States shall *define the roles and responsibilities of the different gas market players* in achieving these policies, and *specify adequate minimum security of supply standards* that must be complied with by the players on the gas market of the Member State in question. The standards shall be implemented in a nondiscriminatory and transparent way and shall be published. (emphasis added)

The directive does not impose an obligation on the Member States to keep gas stocks, as is the case with crude oil or petroleum products, but suggests that ‘Member States may set or require the industry to set indicative minimum targets for a possible future contribution of storage’. The additional value of this provision is not clear as to when it is necessary for Member States to oblige their market players to become active, and a reference to the possible action of the Member State seems justifiable only as a reminder of Member State’s rights.

The directive sets out the criteria that the Member States need to take into account in securing the energy supply of their specific customers. Article 4 provides the ‘security of supply standards’ as follows:

1. Member States shall ensure that supplies for household customers inside their territory are protected to an appropriate extent at least in the event of: (a) a partial disruption of national gas supplies during a period to be determined by Member States taking into account national circumstances; (b) extremely cold temperatures during a nationally determined peak period; (c) periods of exceptionally high gas demand during the coldest weather periods statistically occurring every 20 years.

¹⁵⁵ *Ibid.*

Although the annex to this directive provides a list of instruments to enhance security of gas supply, such as enabling diversion of gas supplies in pipelines to affected areas, system flexibility, import flexibility, long-term contracts etc., it is unclear how Member States can take necessary measures to cooperate with each other. Although the directive prescribes that, if an adequate level of interconnection is available, Member States could cooperate with each other through the establishment of bilateral agreements to use the storage facilities situated in another Member State, the lack of establishment of such agreements (due to their non-obligatory nature) does not guarantee cooperation in the event of a crisis. This is particularly problematic considering the fact that the directive's main aim is to prevent the crisis in the first place, and only to later diminish its effects if it occurs. This means that in order to abide by the directive and, for instance, withdraw capacity of the gas storage, or divert the capacity of pipelines to affected areas, an efficient framework of coordination should already be in place. Trying to come up with ways to assist the affected areas, when the crisis has already taken place, may not be efficient.

Hence, it is necessary to elaborate how exactly coordination between the Member States should be achieved. This problem could be to some extent diminished through the obligation imposed on the Commission in Article 6 to monitor

- a) the degree of new long-term gas supply import contracts from third countries; b) the existence of adequate liquidity of gas supplies; c) the level of working gas and of the withdrawal capacity of gas storage; d) the level of interconnection of the national gas systems of Member States; e) the foreseeable gas supply situation in function of demand, supply autonomy and available supply sources at Community level concerning specific geographic areas in the Community.

The monitoring system being an efficient undertaking, the directive mentions that the Commission may submit proposals, if it concludes that gas supply is not adequate in the Community. The efficiency of a system based on Commission proposals requiring approval by the Member States is doubtful. An obligation should be directly imposed on the Member States to guarantee a minimum level of gas security at all times in order for this type of security measure to be worthwhile.

Moreover, in relation to the monitoring system, the most controversial aspect of the Commission proposal, which was not taken up in the final version of the directive, was the establishment of a European Observation System (EOS) to assist in evaluating the effectiveness of the functioning of the internal natural gas market. The Commission was intended to be responsible for monitoring the supply of hydrocarbons and strategic stocks, as well as creating a reliable, objective and comparable databank in order to fulfil its tasks. Through this system, the Commission could interfere in Member States' energy policies by asking them to ensure that there exists an appropriate minimum share of new gas supply from non-EU countries, based on long-term contracts, and that adequate and transparent gas supplies are developed. It also provided that the Commission should issue recommendations to Member States to take measures to assist other

members that were affected by supply disruption. The European Parliament deleted these proposals. The monitoring task of the Commission is limited in the directive to what was mentioned above, which is only undertaken based on the reports that the Member States submit to the Commission. After receiving these reports, the Commission has to balance the necessity of gas supply based on projections to the degree of contracts with third countries, or the existence of gas supplies in the market, or the level of gas interconnection, or the available sources of supply in specific geographical areas (see Art 6). Under the directive, the role of the Commission amounts to consultation, issuing proposals or convening the Gas Group in case of disruption, rather than adopting independent technical tasks of monitoring (on this issue see also the 2006 Green Paper below). Clearly, the rejection of the proposal in this respect is related to the fact that direct interference of the Commission in national energy policies concerning security of gas supply was not deemed appropriate by the Member States.

The 2004 Directive on Natural Gas Security takes it for granted that ‘the Community has a strong common interest with gas supplying and transit countries in ensuring continued investment in gas supply infrastructures’.¹⁵⁶ Although it is clear that establishing investment in supplying or transit countries is an important aspect of security measures, the need for such investment in those countries cannot be mentioned in general terms. It is more important to firstly identify those countries whose gas supply is important for the Community, and secondly to determine the level of foreign investment needed in their gas infrastructure. For example, Russia, as one of the most important gas suppliers to Europe, may need foreign investment in normal circumstances, but after the rise in oil prices in 2004, the country itself had adequate revenue to invest in the necessary infrastructure, and the role of foreign investment was substantially reduced. In this case of ‘independent investment’ Russia’s priorities may not be similar to those of the consuming nations. Although securing the flow of energy through Europe can be guaranteed by investment in both supplying and transit countries, it should first be determined where this investment should be sent to and under what circumstances. The directive fails to highlight this important aspect.

The 2004 Directive rightly mentions the important role that the long-term gas contracts play in securing the flow of gas to Europe, which also guarantees stable revenue to supplying countries. However, the directive mentions that the long-term contracts will continue to be adequate at Community level, because companies will go on including such contracts in their overall supply portfolio.¹⁵⁷ It is not clear why a description of the status of the long-term contracts in the year 2004 was mentioned in this legislation, as this level is always subject to change considering the terms of the contracts or the geopolitical issues that

¹⁵⁶ See the Preamble of the Council Dir 2004/67/EC on Natural Gas Security, above n 150, para 10.

¹⁵⁷ See the Preamble of the Directive on Natural Gas Security, above n 150, at para 11.

would hamper the constant existence of long-term contracts. Nevertheless, the only relevant issue raised in the directive is that the Commission is asked to monitor the 'degree of new long-term gas supply import contracts from third countries',¹⁵⁸

The Directive on Natural Gas Security, firstly, fails to enumerate solutions to problems that already existed in relation to those types of contracts with major gas-supplying countries, particularly the issue of destination clauses, where major gas-supplying countries prohibited the resale of gas bought by European companies to other countries or companies. This created a controversial debate concerning these provisions' relation to EC competition law (this issue is discussed in chapter 1 at 1.2.2.2). The directive should have highlighted the ways through which companies are supposed to deal with supplying countries to establish such contracts. Secondly, the benchmark for evaluating the 'degree' of new contracts, and when these contracts are considered 'adequate' for overall European security of gas supply, is not specified. The idea behind the creation of this directive was to coordinate the activities of various market players. It is not clear how this coordination is guaranteed through monitoring these types of contracts, since mere monitoring, without something more, does not guarantee coordination.

The provisions mentioned above are the only references made by this directive to externalities of security of supply. The remainder of the directive deals with internal measures. The directive is plausible from an internal perspective as it refers to the necessity of creating a set of measures in the gas sector to secure supply, something that was previously absent. It defines the minimum responsibilities of all market players, which is necessary for the good functioning of the internal market. The directive mentions that the Community needs to 'mobilise significant additional volumes of gas over the coming decades much of which will have to come from distant sources and be transported over long distances.' However, nothing is established in the directive to highlight the best ways to mobilise these sources. Internal coordination should definitely be accompanied by coordination at the external level. At a minimum, some general guidelines (considering the competence of the Community) that highlight the necessary measures to secure supply at the external level could be useful in order for the directive to create added value for security purposes at that level.

It is submitted that efforts are needed to guarantee this gas security at the external level as well. Concrete actions to guarantee necessary investment in third countries, recommendations for establishing efficient interconnection between third country suppliers of energy and Europe, and means of securing access to third countries' gas resources should be taken to complement this directive. We will turn to the necessity of each aspect in the remainder of this study.

¹⁵⁸ See Directive on Natural Gas Security, above n 150, Art 6(a).

Before analysing the importance of internal ‘hard’ measures in guaranteeing security of energy supply, those internal ‘soft’ measures that are relevant for our discussion should also be mentioned. After presenting these measures, the efficiency of the established framework at the Community level to secure energy supply will be analysed and the expanding role of the Community to undertake this responsibility will be discussed.

4.5 EXTERNAL ASPECT OF IMPORTANT INTERNAL SOFT MEASURES

There are numerous measures adopted by the Community dealing with the security of Europe’s energy supply that do not create outright legal obligations for Member States or the institutions, but instead have a soft characteristic. These measures refer to the importance of securing energy supply in Europe and provide hints and guidelines regarding the best ways to guarantee this security. The idea here is to highlight five such measures which the author considers as most important and relevant for security of energy supply at the external level, namely the 1995 White Paper on an Energy Policy for the European Union, the 2000 Green Paper ‘Towards a European Strategy Policy for Security of Energy Supply’, the 2002 Communication from the Commission on the ‘coordinated measures on the security of energy supply’, the 2003 Communication on the ‘development of energy policy for the enlarged European Union, its neighbours and partner countries’, and the 2006 Green Paper on ‘A European Strategy for Sustainable, Competitive, and Secure Energy’. There are other documents that hint at the importance of the security of energy supply with minor references to the externalities of this security. One example is the 2003 Communication from the Commission on ‘infrastructure and security of energy supply’, which called for the enhancement of the security of energy supply through strengthening the internal energy market of the enlarged European Union, supporting the modernisation of energy systems in partner countries, and the realisation of major new energy infrastructure projects.¹⁵⁹ A further example is the Opinion of the Economic and Social Committee on Research Needs for a Safe and Sustainable Energy Supply, which considered a common energy research with candidate and neighbouring countries as a strategic element of any long-term and successful energy policy.¹⁶⁰ Nevertheless, the five measures mentioned above go beyond mere reference to security aspects and underline the increasing dependence of the Union on energy imports from third countries. Although references to externalities in these documents do not elaborate efficiently and clearly the necessary steps to be taken by the institutions or the Member States with respect

¹⁵⁹ Communication from the Commission to the European Parliament and the Council, Energy Infrastructure and Security of Supply, COM (2003) 743 Final.

¹⁶⁰ See the Opinion of the Economic and Social Committee on Research Needs for a Safe and Sustainable Energy Supply [2002] OJ C/241/13.

to energy-exporting countries, the reactions they generated (especially following the circulation of the Green Paper) is worth examining here. These instruments initiated a debate on energy security, which is far from over, but undeniably shed light on some important issues of concern for various institutions of the Community and the Member States. After examining these instruments, their legal relevance and their possible effects within the Community are looked at. Although these instruments do not create legally binding obligations, as they do not fall within the category of Community 'legislation', the indirect effect that they may have in encouraging the Member States and the Community to cooperate in establishing a framework for security of energy supply is important which is examined here.

4.5.1 The 1995 White Paper on an Energy Policy for the European Union and External Security of Energy Supply

Efforts made shortly before the creation of the Electricity and Gas Directives sketched the basic requirements of an efficient framework of external energy security. For example, the 1995 White Paper on An Energy Policy for the European Union¹⁶¹ took some steps in the right direction, ie signalling the importance of external relations in securing energy supply and providing some concrete proposals. However, the White Paper remained simply a White Paper¹⁶² and the important principles that it sought to highlight went into oblivion.¹⁶³

The White Paper highlighted that:

[t]he Commission feels that it is essential for the effectiveness of the policies conducted at national level that the responsibilities deriving from energy policy should form part of common aims that have been defined at Community level. The Commission is thus prepared to use all of the provisions of the Treaties to that end in order to establish, first of all, a framework for the discussion of energy policy that involves all of the public and

¹⁶¹ White Paper on an Energy Policy for the European Union, COM (95) 682. The White Paper was followed by the Green Paper, 'For a European Union Energy Policy', COM (94) 659 Final.

¹⁶² Commission White Papers are documents that contain proposals for Community action in a specific area. When a White Paper has been favourably received by the Council, it can become the action programme for the Union in the area of concern. See the glossary of the European Union at <http://europa.eu.int/scadplus/glossary/index_en.htm>.

¹⁶³ The Green Paper that was established prior to this White Paper had created a debate between the Community institutions, Member States, and national parliaments that had made the White Paper state that:

the Community energy dimension is important and that there is a need for Community policy guidelines. There is recognition that the Community already possesses a large range of competences on energy matters based on the Treaties and that a Community dimension to energy policy, while respecting subsidiarity, can bring added value in some areas, particularly in the areas of Research and Technological Development (RTD), international relations and environmental protection. All participants welcomed the opportunity of continued dialogue on the many important energy issues raised by the Green Paper.

See the 1995 White Paper, above n 161, at 6.

private operators concerned, secondly, a framework for consultation on energy policy guidelines and on activities in this area and, finally, a framework for cooperation with the Member States in order to achieve jointly-defined aims.

Moreover, this Paper attributed great importance to international energy relations and the necessity of energy cooperation with third countries by providing:

The external dimension is considered in general to be the most important vehicle for action, first of all because the Community's supplies mainly come from outside producers and, above all, because the growth of consumption in non-member countries will be the main cause for concern during the years ahead. Community funds, and the bilateral and multilateral agreements, must be activated in order to provide a coherent approach to energy matters with our major partners. These fora for dialogue are already in place and must be used in order to implement that approach. It must, indeed, be borne in mind that the energy sector, in view of its strategic function, must aim at making investments secure, facilitating technology transfers and broadening consultation and cooperation.¹⁶⁴

The White Paper further states that

conditions of access of energy products into the EC market on the basis of its trade competences, the access of energy companies to third countries' markets, and the organisation of dialogue, assistance, cooperation and emergency aid are *the international responsibilities of the Community*.¹⁶⁵ (emphasis added)

A strong link is therefore established between promoting international cooperation and strengthening the Community's role in managing energy security. One area of cooperation, for example, was the Government Procurement Agreement which, subject to reciprocity, allows foreign companies to have the same access to the Community's territory for exploration and exploitation of hydrocarbons. Allowing foreign companies to be involved in downstream activities was considered as a good tool for cooperation, as it would in turn allow European companies access to these sectors in the supplying countries. One way of dealing with this was found to be the application of rules in the Energy Charter Treaty whereby consumers and producers were deemed to have effective access to resources and to each other's markets respectively.¹⁶⁶ On the other hand, one important aspect of energy security did not go unnoticed in this paper: it mentioned that attention should be given to the expectations of exporting countries in receiving technology from consuming countries to update their energy-producing projects. This paper gave importance to this transfer of technology to third country markets and emphasised the development of a protocol on cooperation in Research and Technology Development (R&D) and technology transfer.¹⁶⁷

¹⁶⁴ See the 1995 White Paper on Energy Policy, above n 161, at 3.

¹⁶⁵ See the 1995 White Paper, above n 161, at 26.

¹⁶⁶ For more details on the Energy Charter Treaty, see ch 5.2 below.

¹⁶⁷ See the 1995 White Paper, above n 161 at 27.

The dialogue between consuming and producing nations referred to in this paper was meant to take place not only between politicians (being therefore pure diplomacy), but also between economic operators in the Community and those of the energy-supplying countries. There again, a stable long-term economic interdependence was found to be an aim to be pursued.¹⁶⁸ The most important reference in the White Paper (something that ended as a signal, and was never referred to again in later studies on the security of energy supply) was the emphasis on the role of energy investment for *economic development, social framework and political stability of beneficiary countries*.¹⁶⁹ The link between energy security in the Community and the creation of a politically stable energy supplying country¹⁷⁰ was rightly referred to in this document as an important pillar of an energy security policy.

Development of a coherent and consistent approach to energy matters with third countries was welcomed in the Council Resolution on this White Paper.¹⁷¹ However, more emphasis was placed on the necessity of decreasing dependence on external sources in general, and the promotion of new and renewable energies and energy efficiency in particular, as the best means to create a secure energy supply system. This aim is currently proving to be illusory due to the fact that Europe's dependence on energy is increasing and mere demand management and other internal measures to secure energy have proved insufficient to guarantee full security of energy supply. The Council Resolution no longer referred to the building blocks of external relations, namely the importance of technology transfer, economic development and political stability in the energy-producing countries. The Resolution of the European Parliament also laid emphasis on lowering import dependency, and produced a detailed analysis of the measures necessary to promote renewable energies.¹⁷² At the external level, the Resolution urged the conclusion of the Energy Charter Treaty by the countries of the Mediterranean Region and the development of bilateral contacts between those countries and the EU. It also advocated closer relations in the form of agreements with the most important oil-producing countries, and hoped that the Commission would speed up negotiations with the countries of the Gulf Cooperation

¹⁶⁸ This objective could be pursued through facilitating joint ventures, allowing for cross-fertilisation in the exploitation, production and refining sectors, and developing other energy resources as well as oil-related downstream activities.

¹⁶⁹ Measures in this context were the promotion of joint economic interests, such as strengthening energy transport networks, energy efficiency, renewable energies and transfer of clean and efficient technology to those countries. See the White Paper, above n 161, at 28.

¹⁷⁰ See generally, Noël and Criqui, 'Marchés énergétiques et géopolitique', above n 126, at 21. They believe that energy security is very strongly linked to the political stability of the regions that are important in providing energy. Therefore, one could advertise for ways through which this stability can be guaranteed, one of which could be the economic development of the energy-producing countries.

¹⁷¹ See Council Resolution of 8 July 1996 on the White Paper on Energy Policy for the European Union [1996] OJ C/224/1, at para 3.

¹⁷² See Resolution of the Parliament on the Commission White Paper on an Energy Policy for the European Union, COM (95) 682-C4-0018/96.

Council on the conclusion of a free trade agreement (this agreement has not yet come into existence). Nevertheless, no reference was made to the interdependency of the consuming and producing nations, and the real security issues, as reflected in the text of the White Paper, were not highlighted by the Parliament. Finally, the proposals of the White Paper on undertaking concrete action to manage the external dependence of the Community, which were mainly designed to guarantee a balanced approach between the consuming and producing nations, were not adopted.

4.5.2 The 2000 Green Paper: Towards a European Strategy for the Security of Energy Supply

The Green Paper¹⁷³ on Europe's security of energy supply entitled 'Towards a European Strategy for Security of Energy Supply'¹⁷⁴ was considered at the time as the most important document reflecting the major concerns of Europe with respect to this security. In the year 2000, after the rise in the price of crude oil since the March of the previous year, efforts were focused at the EU level to create a framework where various security issues are discussed and efficient solutions are put in place.

The Green Paper acknowledges that the Community's energy production is not sufficient for the Union's energy requirements. It is projected that the Community has eight years of known reserves at current consumption rates from the North Sea. However, the cost of extracting one barrel of oil in Europe ranged between \$7–11 compared to \$1–3 in the Middle East. Therefore, external dependence was deemed to constantly increase.¹⁷⁵ It was said that if no measure was taken, the Union's energy dependence will rise to 70 per cent in the next 20–30 years (compared to 50 per cent in the year 2000). The consequences of such dependence are said to be costly, since 6 per cent of total imports to the EU were already dedicated to energy imports in the year 1999, which amounted to 240 billion euros, a significant amount. The Green Paper sets the goals of guaranteeing 'uninterrupted physical availability of energy products on the market, at a price which is affordable for all consumers while respecting environmental concerns and looking towards sustainable development'. The enlargement of the EU to 27 has also raised concerns, due to the different energy structure and needs of the new member countries. This paper also rightly acknowledges that there has not been a real debate on the choice of energy sources and even less on energy policy regarding security of energy supply. It also stated that 'the European Union

¹⁷³ Green Papers are documents intended to stimulate debate and launch a process of consultation at European level on a particular topic. These consultations may then lead to the publication of a White Paper, translating the conclusions of the debate into practical proposals for Community action.

¹⁷⁴ See the 2000 Green Paper, 'Towards a European Strategy for the Security of Energy Supply', COM (2000) 769 Final.

¹⁷⁵ The following remarks are taken from the introduction to the Green Paper.

has very limited scope to influence the energy supply side' and therefore, efforts should be concentrated on the demand side, mainly by promoting energy saving in buildings and the transport sector. The Green Paper can be considered as a missed opportunity for exactly this latter point: a presumption of the general impossibility of influencing the supply side has led the strategy to focus merely on internal matters.

Firstly, the Green Paper sketches the main pillars of a strategy to secure energy supply by focusing on (a) a demand policy, (b) real change in consumer behaviour through taxation measures, (c) the development of new and renewable energies, and (d) the analysis of the contribution of atomic energy. As far as the import of oil and gas is concerned, the focus was supposed to be on building up strategic stocks and foreseeing new import routes.

On the external side, 'the most acute case of Community dependence was considered to be oil, where 76 per cent of demand is met from external sources'¹⁷⁶ the majority of which comes from the Middle East region. Europe's dependence on gas was said to be 'moderate', as dependence is 40 per cent and reserves are situated in regions where both production and transport costs are at economically viable levels, such as Russia and the Caspian. However, as the use of natural gas instead of oil is more in line with environmental policies, dependence on natural gas will also rise.

As Chapter 1 of this study provided, geographic diversification of energy sources, meaning the undesirability of dependence on one major energy-providing area, for example Russia, is said to be one of the most important factor of a policy on energy security. However, the Green Paper provides that 'adopting a policy of geopolitical diversification has not been able to free the Union from effective dependence on the Middle East and Russia, and a number of Member States, in particular the new ones, are entirely dependent on a single gas pipeline that links them to a single supplier country (e.g. Poland to Russia)'. Diversification of energy sources for Europe means 'spreading' dependence from Russia to the Middle East or to Algeria or any other energy-producing country. In other words, diversification in the case of Europe means dependence on all countries and not one. Therefore, it is wrong to state that 'a policy of diversification' frees the Union from dependence on the Middle East *and* Russia. It should have mentioned that diversification guarantees the security of Europe's energy supply by not depending on one major source, such as Russia, and enlarging the horizon of dependence to cover the other energy-producing countries.

Moreover, as dependence on diversified transit routes is another major component of energy security, satisfactory diversified relations with transit countries were encouraged. A very broad overview of this diversification is provided in the Green Paper, by stating that the transit facilities of the Caspian basin should be

¹⁷⁶ See the 2000 Green Paper on Energy Security, above n 174 at 22.

developed, in addition to the already existing ones for transporting Russian supplies. A detailed analysis of alternative transit routes was not provided in the Paper.

The maintenance of strategic stocks has been mentioned as one important aspect of energy security, as referred to above in the discussion on the stocks directives. However, the Green Paper acknowledges that the Community's own mechanisms to release oil in the market are limited, as there is no centralised decision-making process to release this oil. On the other hand, it was confirmed that the stock mechanisms are 'in no way intended to deal with circumstances such as the rise in the price of oil'. It is thus confirmed that these measures play an important but a rather limited role.

Given the external factors associated with energy dependence, such as volumes, prices, investment levels and geopolitical factors, the Green Paper finds the maintenance of diversity of energy sources (eg from oil to gas or other sources) and supplies to be an important element of a policy on energy security. Furthermore, it is recognised that the Union can in no way 'arrest the growing dependence'. However, it concludes that diversity of energy sources, meaning here diversity from oil and gas to nuclear or renewable energies, has been difficult to achieve. The potential health and environmental risks of nuclear fission have made this type of energy a non-option in public opinion. Changing this opinion has been an onerous task, made even more difficult due to the announcement of a 'moratorium' on the use of nuclear power by many Member States (eg Belgium, Germany, the Netherlands, Spain and Sweden). The use of coal also faces barriers due to its heavy and solid character and the need for large storage areas. The Green Paper mentions that the pollution generated by coal in every stage of its production and utilisation cycle renders its use undesirable (although its transportation does not create environmental hazards as the transport of oil and gas does). For all these reasons, coal has been mostly considered as a back-up fuel rather than a major source of energy. What, therefore, remains to be considered in Europe's diversified view of energy sources are oil, natural gas and renewable energies.

The Green Paper mentions that, due to its calorific value and ease of use, oil has remained Europe's preferred energy source. Dependence is set to increase on this form of energy. Due to the rising demand for oil in the next 20 years, it was found necessary to focus on both OPEC countries, where production costs are very low, and on the non-OPEC production areas of Russia and the Caspian where, although production costs were said to be around \$5, investment was also found necessary. However, a rather misplaced statement in this policy is interesting. The Green Paper stipulates that because technological developments allow the use of new production techniques in difficult areas (where it was previously impossible to extract energy), along with the use of non-conventional oil, and the development of new fuel substitutes and technologies in the transport sector, a principal threat is posed to OPEC countries. There is no further explanation of how this threat is going to materialise, but one can assume that the authors of the

Green Paper had in mind a substantial decrease in dependence on OPEC oil due to these developments. But is this assumption correct? What are the projections for the easy extraction of energy in difficult areas? Even if that is proved to be without difficulty, are energies found in those areas competing with the abundant energy reserves in OPEC countries? Moreover, does the usage of new technologies actually compete with the cheap price that can be paid to extract oil from OPEC countries? There is also an odd reference to non-conventional oil.¹⁷⁷ Even if any systematic evaluation of the locations and distribution of these types of sources are made, the very high costs of their recovery do not enable them to really compete yet with other sources of energy.¹⁷⁸ Hence, it is not at all clear why reference is made to this issue as a threat to OPEC countries.

In addition, the Green Paper refers to the importance of the price of oil and oil shocks as a significant element to be considered in designing an energy policy. It provides that a short-term rise in oil prices is no longer a security problem because:

[e]nergy diversification and the almost general exclusion of oil products from the production of electricity and structural changes in Europe's economy, have lessened the impact of erratic fluctuations in the price of oil.

However, this statement being true, the substantive use of oil in the transport sector would make any 'prolonged' oil crisis and consequent high oil prices critical. In order to rectify this problem, the Green Paper suggests the replacement of oil with other alternative sources of energy and to 'curb consumption in the road transport sector where oil consumption is high'.

With respect to natural gas, its new role in the European economy and its extensive use in all sectors of energy consumption had contributed to a rapid increase in demand. Dependence on the principal gas-exporting countries, such as Norway, Russia and Algeria was inevitable but the continuity of supplies from these countries, without any major disruption, was found to be a testimony to an 'exemplary stability'. Moreover, the European Union was considered to be geographically well-placed and close to these important suppliers. Supply-side competition between not only these suppliers, but also others, such as Iran and Qatar (where natural gas in liquefied form (LNG) has entered the market) would

¹⁷⁷ Non-conventional oils are tar sands, heavy oil and oil shale, which are found mostly in Western Canada, Venezuela, the US, Brazil, Zaire, Madagascar and India. Due to their glue-like consistency, they are too difficult to extract from the ground by conventional production techniques (they are 10,000 times more viscous than crude oil). Eg, it is said that from the 2.5 trillion barrels of tar sand in Alberta, Canada, 2.2. trillion barrels are unrecoverable with current mining methods. See the Encarta Reference Library, 2003.

¹⁷⁸ There are also the environmental effects of producing non-conventional oil to consider, ie separating the hydrocarbon consistencies of the tar sands from sand and clay. 'Large volumes of sand and clay waste are created as the bitumen is separated from the tar sands in the processing plant. This type of waste, known as fine tailings, presents a significant disposal problem' (*ibid*). Moreover, large quantities of water are required to separate the sand from the bitumen. The resulting wastewater, which is oily and has a high acidity, is very polluting.

also contribute to greater security. This is especially the case as not only diversification is guaranteed but also competition would ensure access to natural gas on more advantageous terms. The Green Paper thus finds the development of a long-term energy partnership with key suppliers essential.

The most important focus of an energy policy identified by the Green Paper is the role of new and renewable energies. It is said that the use of renewable sources, such as biomass, wind, solar, geothermal and hydro energy, could significantly reinforce sustainable security of supply. However, in the final energy consumption of EU-27 the contribution of renewable sources is only 6 per cent.¹⁷⁹ Increased use of these types of sources necessitates substantial investment, especially in the electricity sector where the target was set of 24 per cent of green electricity in 2010 as compared with 12 per cent in 2000.¹⁸⁰ In any case, the major problem with this type of energy is financial, as significant initial investment is needed for the efficient use of these sources. The Green Paper hopes for a 'voluntarist policy', which 'ranges from drastic fiscal measures in favour of renewable sources or the obligation on the part of electricity producers and distributors to purchase a minimum percentage of electricity produced from renewable sources to aid to research or to financing mechanisms',¹⁸¹ 'voluntarist policy' is not yet taken seriously by the majority of Member States and the political will to do so has yet to materialise.

The methods by which the Green Paper dealt with externalities of an energy policy to guarantee security of supply, or in other words, ensuring external supplies, are interesting. Although the Green Paper remarks that the EU's power to act and margins for manoeuvre are very limited, it puts forward some ideas of great importance. One is the establishment of an ongoing dialogue with producer countries, which would lead to greater transparency on the market and ensure stable prices. A quick reference is also made to the expectations of several producer countries regarding political developments in the Middle East. This dialogue is said to be extended to all matters of common interest, in particular protection of the environment and technology transfer. Second is the strengthening of supply networks. The construction of new oil and gas pipelines and technical assistance to energy and transit countries in improving energy infrastructure, along with the role that the Energy Charter Treaty's rule on transit can play, are mentioned as important components of this external energy policy. With respect to a dialogue, it was agreed that it should be extended to encompass economic development and investment issues. In addition, some correctly argued that a more adequate legal framework is necessary and should be established to regulate such a relationship. Some provided that this framework should include

¹⁷⁹ See *Energy in Figures 2005* at 2.2.2. Significant use of this type of energy in EU 15 is found in Finland (18.2% of final energy consumption), Sweden (15.3%), Portugal (13.6%), and Austria (9.8%).

¹⁸⁰ See the 2000 Green Paper on Energy Security, above n 174, at 43.

¹⁸¹ *Ibid* at 50.

‘provisions for supply and investment promotion agreements to be followed up by identification of joint cooperation projects’,¹⁸²

One type of a dialogue between the European Union and the producer countries was already initiated in 1991, where ministers of oil-producing and gas-producing countries and consuming countries informally discussed matters concerning production, consumption, investment and trade in hydrocarbons. This cooperation and ‘dialogue’ later continued at the level of the International Energy Forum in 1999. At the 7th International Energy Forum (IEF) in Riyadh in 2000, Saudi Arabia announced the establishment of a permanent secretariat for this Forum in Riyadh (IEFS). The Secretariat became an international and independent non-profit entity which maintains the informal dialogues and seeks to ‘facilitate the channels of communication’ between these consuming and producing nations.¹⁸³ Within the framework of this dialogue, the two sets of countries meet every two years to discuss their concerns. One important undertaking at the level of the IEF, and a major contribution to consumer–producer dialogue, is the creation of the ‘Joint Oil Data Initiative’ (JODI) which contributes to data reliability and transparency in the oil sector which is done through the improvement of networks and statistical systems in various countries. This system also increases contacts between oil companies, countries and organisations to enhance such transparency.¹⁸⁴ Although such an initiative is welcomed, its informal and non-legally binding recommendations lack the force to be considered as a major step towards guaranteeing security of energy supply at a global level in general, and in the European Union in particular. Without doubt, such a framework for dialogue highlights the important concerns of both

¹⁸² See Communication from the Commission to the Council and the European Parliament, Final Report on the Green Paper ‘Towards a European Strategy for the Security of Energy Supply’, COM (2002) 321 Final at 19.

¹⁸³ The objectives of the IEFS are enumerated as (1) strengthening dialogue and co-operation between oil-producing and gas-producing and consuming countries, and international organisations in fields of common interest; (2) ensuring the continuity of the dialogue between the biennial forums and follow-up on international energy development; (3) fostering and promoting the relationship between the energy industry and the governments of oil-producing and gas-producing and consuming countries through the active involvement of the industry in the activities of the IEF; (4) broadening the dialogue to include international and regional energy issues. Although the dialogue is international in character, there are interregional as well as specific issues (oil, gas, renewable sources, technology, environment etc.) that emanate from the dialogue and need to be addressed and elaborated; (5) facilitating contacts between the parties involved in oil and gas matters at all times; (6) improving oil and gas data collection and dissemination among countries, international organisations and the industry, since the availability, comprehensiveness and coverage of data is a cornerstone to the relations between the parties involved in world energy relations; (7) providing the necessary contacts among the relevant organisations involved in oil market forecasting by exchanging experiences on relevant inputs and parameters in the forecasting methodologies. See <<http://www.energyforum.gov.sa>>.

¹⁸⁴ The seven international organisations involved in JODI are the energy research centre of the Asia Pacific Economic Cooperation (APEC), Eurostat, IEA, IEFS, Latin American Energy Organisation (OLADE), OPEC and UN Statistical Division (UNSD). They have agreed to open the JODI World Database on the occasion of the inauguration of the IEFS premises on 19 November 2005. See <<http://www.jodidata.org>>.

producing and consuming countries, but their implementation is not guaranteed. Nevertheless, its existence can be considered as an important step towards energy cooperation at the political level.

The Green Paper poses several questions as a framework for debate, which gave rise to many responses and reactions from Member States and the Council, European Parliament, the Economic and Social Committee and the Committee of the Regions. The common denominator of all these opinions was that demand management should be at the forefront of a debate on security of energy supply. A few measures were adopted by the Community within the framework of demand management, such as the Directive on Electricity Production from Renewable Sources¹⁸⁵ and the Directive on Energy Saving in Buildings.¹⁸⁶ Moreover, it was suggested that the internal energy market will contribute to security of energy supply through healthy competition and that 'a power blackout like the one in California would not be possible in the internal market'.¹⁸⁷ However, this latter statement is still debatable. The internal market has not fully contributed to security of energy supply, as the September 2003 blackout in Italy demonstrated. The blackout left many parts of Italy without electricity for several hours. The malfunctioning of two major supply sites outside Italy was identified as the main problem although a long-standing electricity exchange scheme was in place to help deal with peaks in demand.¹⁸⁸ Normally it is said that the 'European network system should operate in such a way that any single incident should not jeopardise the security of the interconnected operation' and therefore, mutual assistance between national sub-systems should have existed which was not put in place. The final report of the investigation of this blackout suggested that more reliability and a securer exchange of electricity should be created to prevent such incidents in the future and new market rules should be identified and adopted.¹⁸⁹ This incident signals the danger of presuming that the internal energy market fully guarantees security of energy supply. Hence, it should be remembered that there is still a need to update or create new interconnection infrastructure and to improve the use of existing networks.

¹⁸⁵ See Dir 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the Promotion of Electricity Produced from Renewable Energy Sources in the Internal Electricity Market [2001] OJ L/283/33.

¹⁸⁶ See Dir 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the Energy Performance of Buildings, above n 10.

¹⁸⁷ See Communication from the Commission to the Council and the European Parliament, Final Report on the Green Paper 'Towards a European Strategy for the Security of Energy Supply', COM (2002) 321 Final, at 8.

¹⁸⁸ The sequence of events leading to this blackout was initiated by a tree flashover in Switzerland that led to an overload in various electricity lines. Although imports of electricity through some lines were reduced, an overheating of the conductors in some other areas worsened the situation and led to the blackout. See Final Report of the Investigation Committee on the 28 September 2003 Blackout in Italy, The System Security in the Light of System Failures in 2003, at <<http://www.ucte.org>>.

¹⁸⁹ See the Final Report at 13. See also F Vanderberghe, 'Lessons and Conclusions from the September 2003 Blackout in Italy', at <<http://www.iea.org/dbtw-wpd/textbase/work/2004/transmission/vandenbergh.pdf>>.

With respect to the lack of a proper framework for managing external dependence, the Economic and Social Committee criticises the Green Paper as being very EU-centric, whereas the issue should have been approached from a global perspective, especially in relation to oil supply security where a global approach is more appropriate than a regional one (see chapter 1). The Committee rightly suggests that fossil fuels are limited and competition for energy resources will intensify; therefore, an advantageous relationship with the sources of supply should be established. The Committee suggested that the Commission should have been far more concerned about the EU's external dependence rather than demand management, and efficient EU common measures should have been assessed to prevent the vulnerability of the Member States due to their growing external dependence.

The European Parliament also adopted a Resolution on the Green Paper, where interestingly (and for the first time), the security of energy supply was defined in broad terms by emphasising that 'import dependency is, in itself, not a decisive criterion for security of supply and has to be complemented by other criteria like lack of resources, risk of price insecurity, risk of domestic or foreign political crises, infrastructure failure or loss of public acceptance'.¹⁹⁰ This resolution also states that the best way to reduce Europe's external energy dependency is 'through reducing the demand of end energy and improving energy efficiency' and considers the most appropriate strategy to ensure energy supply in diversifying energy sources and origins of supply'. Although the resolution recognises the importance of good political relations with the EU's major energy supply partner countries, it does not refer to a balanced approach in this relationship. It explicitly highlights that 'this cooperation should be reinforced in order to be able to create commercial conditions which are *favourable for European enterprises* and for the supply of gas and petrol' (emphasis added). Along the same lines, the resolution emphasises initiating relations not only with Russia but with the Caucasian republics, Iran and other countries producing fossil fuels, and calls for 'the speedy ratification of the Energy Charter Treaty' by these countries.

The Parliament also takes the view that, despite the absence of a separate energy chapter in the Treaty, the EU has plenty of opportunities to conduct an energy policy of its own. It considers that such a policy should consist of various elements, one of which is 'developing geopolitical frameworks for concluding energy contracts'. This element means that the EU seeks to establish relations with producing countries in order to establish trade or investment contracts on favorable terms. No reference is made as to how this framework should be designed. In any case, before one is allowed to take such references to a geopolitical framework as an indication of the importance of externalities of energy security, the Parliament mentions that 'maintaining security of energy

¹⁹⁰ See European Parliament Resolution on the Commission Green Paper Towards a European Strategy for the Security of Energy Supply, COM (2000) 769 – C5-0145/2001-2001/2071(COS) [hereinafter 'Resolution on Green Paper']

supply is primarily a matter for the energy policy of the Member States, though this does not rule out agreements concluded with other countries for improving security of energy supply'. This is a sign of the continued willingness of Member States to keep their competence to deal with energy matters. The Resolution on the Green Paper also considers that national responsibility for ensuring security of energy supply means that Member States must have freedom of action in the means they use to ensure security of supply, whilst fully respecting EU competition and State aid rules.¹⁹¹ Eventually, these remarks on internal and external security do reveal the attitude of the Parliament with respect to externalities of security of energy supply, as it seems that the resolution is split between those who emphasised keeping matters of external security outside the ambit of the Community's activities and competence and those who found it necessary that the Community should deal with such a matter. It is clear, therefore, that there is disagreement on granting the external competence to the Community. Although a call for the freedom of the Member States to act in the field of energy supply does not necessarily preclude the establishment of relations by the Community with energy-producing nations, there is no reference to cooperation between the Member States and the Community to secure energy supply at European level.

To conclude, the majority of opinions on the Green Paper agreed that Europe should aim at strongly reducing energy consumption and should consider demand management as the most important step in guaranteeing a secure future for Europe.¹⁹² Although the importance of the externalities of this security did not go unnoticed, its relevance was not considered vital by many. Hence, it is not too farfetched to conclude that the belief was that efficient demand management renders concerns for external dependence obsolete. Overall, it can be deduced that 'mutual interdependence', as a concept based on which energy security should be drafted, was not considered as a starting point to design a security framework. Looking at the abundance of directives and regulations in the field of energy efficiency, as mentioned before, after the establishment of the Green Paper also shows that the efforts of the Community to manage demand have been more successful than the design of an external policy.

A 2005 report on the progress of the 2000 Green Paper¹⁹³ outlined that efforts still needed to be undertaken to reach the objectives enumerated in that Green Paper. Energy efficiency, diversification of energy sources, the use of clean coal and renewable energy sources were highlighted as areas where additional measures and guidelines needed to be adopted. It was also highlighted that dialogues within major energy producing countries should be pursued in order to ensure

¹⁹¹ See the Resolution on Green Paper, *ibid*, at para 34.

¹⁹² See also *Report on the Green Paper on Energy: Four Years of European Initiatives*, (Luxembourg, European Communities, 2005).

¹⁹³ The report is entitled *Report on the Green Paper on Energy: Four Years of European Initiative* (Brussels, European Communities, 2005).

stable prices. These concerns led to the creation of another Green Paper on energy security in 2006 the details of which are elaborated later in this chapter.

4.5.3 The 2002 Communication on the Internal Market in Energy and Coordinated Measures on the Security of Energy Supply

The Communication from the Commission on the Coordinated Measures on the Security of Energy Supply¹⁹⁴ sought to detail the new concerns of the Community in relation to this security. It focused mainly on the internal market and reflected upon the new changes that the entry into force of the Gas and Electricity Directives brought about in terms of a gradual opening of the market, as well as the importance of creating the necessary infrastructure network to enhance security of supply. On the external side, the communication acknowledged that security of energy supply is linked to political stability in the producer countries. It stated that:

It has been seen on a number of occasions that the events in the Middle East or certain political crises which have destabilised the political power in place in producer countries could put the energy market under severe pressure. This pressure leads if not to the actual physical disruption of supplies, then at least to sharp fluctuations in oil prices which inevitably affect economic growth in the consumer countries.

This is an important acknowledgment since political stability was never mentioned as an important aspect of security. Moreover, previous efforts to guarantee such security were not focused on the fact that no matter how efficiently the internal energy market functions, dependence on imported energy necessitates consideration of the stability of the exporter countries as well. The communication does not elaborate on any other external aspect of this security.

The role that the political stability of producer countries plays is linked to increases in the price of the exported energy. The less stable a country is politically, the greater the danger of an increase in the price of oil due to the uncertainties created as to the continuous flow of energy from that country. On the other hand, as mentioned in chapter 1, increases in the price of energy are directly linked to reduced economic growth. As the communication provides, an increase of \$10 in the price of a barrel of crude oil is likely to reduce economic growth by around 0.5 per cent in the industrialised countries, and 0.75 per cent for developing countries. The reduction will be higher if there is sudden and unexpected increase in prices. It is also interesting to note that, since 1973, significant reductions in the economic growth of the United States and Europe have all been preceded by sudden sharp increases in the price of crude oil. The

¹⁹⁴ See Communication from the Commission to the European Parliament and the Council on the Coordinated Measures on the Security of Energy Supply, COM (2002) 488 Final.

Communication rightly observes that this reduced economic growth has direct consequences on employment and social cohesion and it acknowledges that

in this situation, it would be impossible to attempt to construct an internal market between the economic operators whose objective is to increase the efficiency of the European economy if such a market is not based on principles which guarantee social cohesion.

For that matter, it not only calls for the creation of an efficient framework at the external level, it questions whether the flow of energy can be secure if it is left entirely to the industry, which is itself dependent on its external suppliers.

Although natural gas today appears as the diversification product which is essential for a healthy balance in energy consumption, capable of reducing CO₂ emissions, its rapid growth on certain markets such as electricity could give rise to fears of the emergence of a new structural weakness in the European Union in terms of external dependence. The first proposal of the Communication is, therefore, a 'coordinated response by all Member States, acting in a spirit of solidarity, which will guarantee an adequate level as regards safety, security and the prevention of serious crises and accidents'. Apart from suggesting necessary internal measures such as harmonisation of national storage systems, coordinated use of security stocks, harmonisation of intervention criteria, clarification of responsibilities between the Member States and various market players, and emphasis on the necessity of keeping long-term supply contracts which provide an element of stability for energy purchases, it also calls for the establishment of an energy dialogue between producer and consumer countries. Although this necessity is raised in the Communication, it suffers from the same caveat as the Green Paper in not elaborating on what this dialogue should consist of. It also fails to address the mutual interdependency between the consumer and producing countries and therefore, does not raise the necessity of reflecting on the possible demands of other parties to the dialogue. It is still questionable how political stability can be guaranteed in producing countries if the dialogue only reflects the needs of the consuming nations. Hence, the communication suffers once more from the one-sidedness of the affair.

4.5.4 The 2003 Communication on the Development of Energy Policy for the Enlarged European Union, its Neighbours and Partner Countries

The Communication on the Development of Energy Policy for the Enlarged European Union, its Neighbours and Partner Countries¹⁹⁵ takes the externalities of security of energy supply into account by acknowledging that stability and

¹⁹⁵ Communication from the Commission to the European Parliament and the Council on the Development of Energy Policy for the Enlarged European Union, its Neighbours and Partner Countries, COM (2003) 262 Final [hereinafter 'Communication on Neighbours'].

sustainable development in the European continent should be projected to the ring of countries that surround the Union. This new and unprecedented emphasis on energy security can be explained by the fact that some of the neighbouring countries of the Union supply a major part of its oil and natural gas requirements, especially Algeria and Russia.

The communication stipulates one goal to be the expansion of the principles of the internal energy market to neighbouring countries, through the creation of 'substantively similar levels of market access and adoption of equivalent standards.' Another goal is said to be the establishment of a dialogue with Russia where 'common interests' are reflected upon, 'including the introduction of co-operation on energy saving, rationalisation of production and transport infrastructures, European investment possibilities, and relations between producer and consumer countries.' Clearly, the Communication on Development of Energy Policy acknowledges the two-sidedness of energy relations and takes into account Russia's need for investment as a means of enhancing economic development. The same approach is followed in relation to the Caspian Region, where securing safe export routes for Caspian oil and gas is said to be not only important for the EU's security of energy supply but also crucial for the economic, social and political development of the Caspian region. The first link between the security of export routes and developments in these fields are not elaborated on, but one can assume that a smooth flow of energy exports from these countries guarantees steady revenue and employment growth, which should also be linked to the ways this revenue is managed and distributed in those countries. There cannot be a direct link between safety of export routes and these developments if other conditions, such as the eradication of corruption and the fair distribution of wealth in these countries, are not met. However, there is no doubt that investment in this field is of high importance to the Caspian as well as the Mediterranean region, where there is dire need for foreign investment in the energy sector. For this reason, the emphasis of the communication on the necessity of financing various projects should be welcomed.¹⁹⁶

The communication attaches strong importance to the necessity of exporting the principles and standards of the common energy market to neighboring countries. This document rightly highlights that Russia and the Mediterranean countries are eager to integrate their energy markets with that of Europe, as highlighted in the Russia-EU energy dialogue and the discussions in the EUROMED Energy programmes (the details of which are provided in chapter 6.2.). Nevertheless, the communication acknowledges that integration with the Mediterranean market should be first approached gradually through the integration of the immediate countries of Algeria, Morocco and Tunisia. If successful, it can be extended to other countries of the Eastern Mediterranean. On the other hand, the increased participation of the countries of the Caspian in the European

¹⁹⁶ See especially point 7.5 and 8 of the 'Communication on Neighbours' at 28 and 29.

Union's internal gas market is not readily expected. Although the communication talks of the necessity of taking the issues of common interests into account between the countries of the Caspian and Europe, it fails to question whether these countries are ready to receive the 'advantages' of the internal energy market without analysing how these 'advantages' can be implemented in these countries. Even if Russia fully integrated into the energy system of the European Union, it is doubtful whether the integration of these countries through Russia and with the European Union is at all possible. This is especially the case considering the need to integrate energy infrastructure as part of the integration of the whole energy market between the two regions, where Russia has shown some hostilities in allowing access to its already existing infrastructure to Turkmenistan and Kazakhstan on some occasions. It remains to be seen to what extent Russia will be eager to cooperate with these countries at that level.

Overall, this communication promises concrete actions at the external level, although limited to the neighboring countries, something that was lacking in previous attempts of the Commission to design an action framework to guarantee security of energy supply. Taking into account the Union's increasing dependence on the neighboring countries, the call for an active approach to develop an efficient and real energy partnership cannot but contribute to the overall understanding of the major concerns of the Union with respect to security of energy supply. If the Union persists in approaching this issue from the perspective of 'mutual interdependency' rather than one-sidedness, whereby common concerns are reflected upon, the sketch of a framework for external relations in the field of energy can be said to exist.

4.5.5. The 2006 Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy

In spite of some progress made within the internal energy market since the year 2000, the Commission declared that there is a need to explore further avenues to guarantee energy security which would emphasise three main objectives, namely security of supply, competitiveness and environmental sustainability. Such new emphasis was the result of the realisation of the continued growth in dependence on imported energy, new realities and constraints with respect to climate change measures, the new obstacles in achieving a truly competitive internal energy market, the new place that nuclear could possibly occupy in the overall EU energy mix, and the anxieties created in the aftermath of the Russia–Ukraine conflict in the beginning of January 2006 and its potential impact on the security of supply in Europe.¹⁹⁷

The 2006 Green Paper highlights six priority areas for the Community to focus upon in order to obtain a secure energy environment: (1) completing the internal

¹⁹⁷ For references to this conflict see ch 6.1 below.

European gas and electricity markets, (2) solidarity between Member States, (3) stepping towards a more sustainable, efficient and diverse energy mix, (4) creating an integrated approach to tackling climate change, (5) establishing a strategic European energy technology plan, (6) establishing a coherent external energy policy.

The 2006 Green Paper¹⁹⁸ is similar in many aspects to the 2000 Green Paper: sustainability, competitiveness and security of energy supply are the most important objectives to be pursued. For example, the Paper refers to the general concerns over energy security as those related to: (1) concentration of reserves in few countries; (2) increase in import dependency; (3) increase in the global demand for energy; (4) rise in the price of oil and gas; (5) climate change; and (6) the slow development of a competitive European internal energy market. Concerns being the same, there is a new emphasis that a response to these concerns needs to become truly 'European' and no longer in the form of national measures by the 27 Member Countries of the European Union. In other words, the basis of the new strategy is the creation of a truly 'common' European policy with a 'common' voice.

In this relation the Green Paper suggests new measures to guarantee the efficient completion of the internal energy market through the creation of, for example, a Single European Energy Regulator,¹⁹⁹ a European grid, or a priority interconnection plan. Moreover, the Paper calls for enhancing security of supply in the internal market through the establishment of the 'European Energy Supply Observatory'. The idea of this system is to monitor the demand and supply patterns and identify shortfalls in infrastructure and supply.²⁰⁰ details of such system are not elaborated upon and although such innovation can clearly contribute to security of supply if it is undertaken efficiently, the question remains as to how such monitoring can take place outside the borders of the

¹⁹⁸ The Green Paper on A European Strategy for Sustainable, Competitive and Secure Energy, COM (2006) 105 Final [hereinafter 'the 2006 Green Paper']. See also the Commission Staff working document, Annex to the Green Paper, 'What is at Stake', Background document, SEC (2006) 317/2.

¹⁹⁹ The Council of European Energy Regulators Response to the Energy Green Paper, REF C06-SEM-18-03, 11 July 2006 at <<http://www.ceer-eu.org>>, at 21.

²⁰⁰ There is also an 'Amsterdam Forum on Sustainable Energy' which is organised by SenterNovem under the authority of the European Commission, Directorate-General for Energy and Transport and the Dutch Ministry of Economic Affairs. As the website of the forum explains the objectives are: to develop the European Union's energy policy in a way that contributes to the objectives of sustainability, increased competitiveness and security of supply; to provide opinions on any Commission's initiative in the field of renewable energy sources (RES) and energy efficiency ((EE), including transport) policies. The basis for the work of the Forum would be the different directives and Commission documents on these topics; to serve as an observatory and monitoring assistance centre for those policies; to help facilitate the interaction and integration of RES/EE in concrete applications in supply and demand; to help define corrective measures to solve the problems/concerns associated to the RES access to the grid; to assist the Commission in organising and analysing debates and other not above mentioned actions in the framework of RES/EE policies; The Forum will provide opinions and reports at the request of the Commission. See <<http://www.senternovem.nl/AmsterdamForum>>.

European Union and whether special arrangements should be made with producing countries to cooperate for better functioning of this system.

Another important reference is to cooperation with the IEA. The 2000 Green Paper highlighted the difficulties that could be created while negotiating with the IEA to combat an energy crisis. However, the rapid coordination of the members of the IEA in the aftermath of Hurricane Katrina in September 2005 led the Commission to emphasise that the 'stock management system of the EU should be compatible with that of the IEA' and called for 'transparency and the publication, on a regular and transparent basis, the state of the Community oil stocks. Moreover, similar to the efforts in 2002 in establishing a system of maintaining gas stocks, which was failed, as explained above, the Commission once again proposed the establishment of a new legislative proposal concerning gas stocks.

Another innovation of the 2006 Green Paper is the creation of a 'Strategic EU Energy Review' with periodic updating from Member States. This review could have the potential to 'provide an informed public debate on European energy policy'.²⁰¹ The Green Paper stipulated that 'such review would be presented to the Council and the Parliament on a regular basis, covering the issues identified in the Green Paper which would constitute a stocktaking and action plan for the Spring European Council, monitoring progress and identifying new challenges and responses on all aspects of energy'.²⁰² Referring to the incorporation of European energy matters in the annual work programme of the European Council demonstrates that the EU institutions have come to realise the increasing importance of energy security for Europe and called for the intensification of dealing with these issues at both the EU and Member States level. It is for this reason that already the March 2006 Presidency Conclusions dedicated a large part to energy security issues.²⁰³

Another relatively new emphasis is also placed upon the use of coal and nuclear. Unlike the 2000 Green Paper that did not call for the necessity of initiating a debate on nuclear and highlighted the difficulty in obtaining the approval of the public, the 2006 Green Paper calls for an objective and transparent debate, which draws attention to the renewed interest in this source of energy as an element of energy security of Europe. Although the Green Paper also calls for a minimum level of the overall EU energy mix to originate from 'secure' and low-carbon energy sources, the heads of governments clearly rejected the imposition of such level by the Community in their energy mix in the Council meeting of March 2006 and called for the 'respect of Member States' sovereignty over primary energy sources and choice of energy mix.²⁰⁴

²⁰¹ *Ibid.* at 19.

²⁰² See the 2006 Green Paper, above n 198, at 5.

²⁰³ See the Presidency Conclusions of 23–24 March 2006, 7775/1/06, REV 1.

²⁰⁴ *Ibid.* at 16.

The other real novelty of the Green Paper is the emphasis on the creation of an external energy policy for the EU.²⁰⁵ It was found important to identify aims of this policy as well as necessary actions to achieve those aims. The best reference for identifying the 'common vision' among Member States with respect to externalities was considered as the 'strategic EU Energy review'. The number of goals and instruments were identified as (i) A clear policy on securing and diversifying energy supplies, (ii) Energy partnerships with producers, transit countries and other international actors (dialogues with energy producers and developing a pan-European energy community),²⁰⁶ (iii) Reacting effectively to external crisis situations, (iv) Integrating energy into other policies with an external dimension, (v) Energy to promote development.

Although the 1995 White Paper, as mentioned above, referred to the importance of creating such an external policy, there is novelty in identifying the elements of this policy. Various elements of such policy are touched upon in different sections of this study, such as the importance of establishing relations with transit and producers countries, creating a pan-European energy community and expansion of the internal energy market to neighboring countries, etc. Nevertheless, few issues remain ambiguous. For instance, the Green Paper talks rightly of diversification of various types of energy as one element of energy security and calls for upgrading and construction of new infrastructure such as new oil and gas pipelines and energy. The same diversification is not referred to as such with respect to various supplying countries and the 'spreading' of dependence among them. Emphasis, again, is placed on the importance of Russia and the fact that 'a true partnership would offer security and predictability for both sides, paving the way for the necessary long-term investments in new capacity'. The same should be applied to other important oil and gas producers on which European is dependent in order to satisfy the other requirement for guaranteeing security of energy supply, namely diversification of sources of energy supply. 'Fair and reciprocal access to markets and infrastructure including in particular third party access to pipelines' which is considered as one aim in the Green Paper to be pursued with respect to Russia should equally apply and be considered as important in relation to other sources of energy.²⁰⁷

In addition, the Green Paper calls for the adoption of a 'formal, targeted instrument to deal with emergency external supply events'. In other words, the aim is to establish an instrument to deal with external energy supplies which could be in the form of 'a monitoring mechanism to provide early warning and to enhance response capabilities in the event of an external energy crisis'.²⁰⁸ How

²⁰⁵ See also 'An External Policy to Serve Europe's Energy Interests', paper from Commission/SG/HR for the European Council, S160/06 (15/06/2006).

²⁰⁶ During the meeting of 17 November 2006 of the Energy Community, Ministers agreed to adopt concrete measures for the development of the energy market and also gave observer status to Turkey, Ukraine, Moldova and Norway. See the Press Release, IP/06/1580 at <http://europa.eu>.

²⁰⁷ See the 2006 Green Paper, above n 198, at 15.

²⁰⁸ See the 2006 Green Paper, above n 198, at 16.

would such an instrument be created? Monitoring external supplies needs a great degree of transparency at that level as well as efficient cooperation with external suppliers in order to identify potential physical lack of energy. Although such instrument could theoretically contribute to security of energy supply, its real function in practice cannot be determined without adopting additional measures, such as specific arrangements with supplying countries. It remains to be seen how such arrangements will be established in the future activities of the Commission.

Similar to the 2000 Green Paper, the new Green Paper lacks the necessary vision in approaching the issue of energy security from both the consuming and producing countries' perspective. All the innovations in the 2006 Green Paper mentioned above lack the 'external' aspect, although a new focus is found necessary on externalities in general. In other words, although the Green Paper seeks to highlight the importance of establishing an external energy policy, it fails to look at the significance of externalities in various measures that it introduces. Not indicating the need for cooperating with oil and gas producing countries to both establish an efficient European energy supply observatory, and monitor external supplies to prevent a crisis, shows the one-sidedness of the approach of the Commission towards the issue of energy security once again. In addition, the mutual interdependency of consuming and producing countries is not referred to in any section of the Paper. Energy producing countries, especially in the framework of OPEC, and more interestingly, in the framework of EU-OPEC dialogue, have declared that although they are concerned about the security of supply for consuming nations, they are equally concerned about security of demand due to the simple fact that their economy depends highly on oil revenues.²⁰⁹ Despite referring to such concern in the dialogue itself, the Green Paper fails to reflect upon its importance in order to establish an efficient framework for energy security. Moreover, oil producing countries have repeatedly mentioned that the threat of a crisis due to the rise in the price of oil has a lot to do with the 'serious tightness in the global refinery system' and they have called

²⁰⁹ In the press release of the Third Ministerial Meeting of the EU-OPEC Energy Dialogue of June 2006, it is mentioned that the representatives of both sides recognise that security of supply and security of demand were two faces of the same coin. They also mention that

[both] the EU and OPEC face similar and growing challenges stemming from the need for security of supply and demand, large investments both upstream and downstream, and stable and predictable markets with reasonable oil price levels that are not damaging to either exporting or importing countries.

In addition, the press release of the First Ministerial Meeting of the EU-OPEC dialogue issued on June 2005 provides that although OPEC's response in raising output and speeding up the implementation of capacity expansion plans are acknowledged, the participants nevertheless recognised that uncertainties, particularly associated with the level of future oil demand, will remain substantial. This carries additional risks for the level of investments that are necessary along the entire supply chain'. For the text of the press releases see the website of OPEC, <<http://www.opec.org>>.

for more efforts to create an environment that promotes downstream investments in major consuming countries and regions.²¹⁰ This last aspect, as an important element of security of supply is also missing in the framework established by the Commission.

Although acknowledging the importance of establishing an external energy policy by a Community institution is plausible as a first step, and the extensive reference to such policy in both March and June 2006 Presidency Conclusions heralds a new era for the Community to approach the topic of energy security, the Green Paper fails to identify the real and concrete steps that need to be taken at the external level and does not succeed in highlighting the most important elements of such policy in light of mutual interdependency between consuming and producing nations, namely the creation of a balanced approach where the needs of both groups as well as the current concerns in the market are taken into account. Even though the Commission and Secretary-General/High Representative mentions that developing a coherent and focused external EU energy policy should draw on the full range of EU internal and external policies, it considers the two building blocks of energy security as 'functioning markets' and 'diversification' without adding the necessity of including the concerns and demands of energy producing countries in this security framework.²¹¹ It is only in the October 2006 Communication on 'External Energy Relations: From Principles to Action' that it is mentioned that 'EU and Russia should see mutual long term benefits from a new energy partnership, which would seek a balance between expectations and interests of both sides'. The communication also mentions, for the first time, the concern of an energy producing country, here Russia, by providing that

Russia wants a stronger presence in the EU internal energy market, ensured long-term gas supply contracts, the integration of electricity grids and free trade for electricity and nuclear materials, as well as the acquisition and control of downstream EU energy assets and EU investments and technology for the development of the Russian energy resources.²¹²

This reference being an extremely important step in the efforts of the Commission to design an efficient external energy policy, it lacks the general view that the important element of energy security, namely diversification of energy sources, calls for the inclusion of all major energy producing countries in this policy and not only Russia. Nevertheless, it remains to be seen how the future activities at

²¹⁰ See the press release of the Second Ministerial Meeting of EU–OPEC Energy Dialogue, 2 December 2005 at <<http://www.opec.org>>.

²¹¹ See 'An External Policy to Serve Europe's Energy Interests', Paper from Commission/SG/HR for the European Council, 30 May 2006, ENER176, 9971/06.

²¹² See the Communication from the Commission to the European Council, External Energy Relations: from Principles to Action, COM (2006) 590 Final.

the level of the Community will incorporate these necessary elements and how the Member States show eagerness in supporting the Community in designing a new energy framework for Europe.²¹³

After explaining the development of soft law measures in relation to security of energy supply, we should now turn to the importance of these instruments from a legal point of view. What is the significance of having these types of documents in the Community, and what role do they play in creating a framework for security of energy supply in Europe? Due to the fact that some of the most important messages for security of energy supply (both internally and to a lesser extent externally) are embodied in these documents, their status in the legal framework of the Union should be revealed here.

4.5.6. The Relevance of Soft Law: A Brief Analysis

Green Papers are normally those documents that are 'intended to stimulate debate and launch a process of consultation at European level on a particular topic'. These consultations lead to the publication of a White Paper where concrete proposals are mentioned and 'if this Paper is favourably received by the Council, it can become the action programme for the Union in the area concerned'.²¹⁴ The Council adopted a Resolution on the White Paper on the European Energy Policy, but the Green Paper on security of energy supply never reached the stage of 'recognition' by the Council. As both were simply preparatory works, they cannot be considered as creating any rights or obligations for the institutions or the Member States.²¹⁵ However, the existence of two Parliament Resolutions and one Council Resolution, along with the opinions of various Community institutions and Communications of the Commission, necessitate a brief analysis of their legal relevance here.

²¹³ The 2007 Communication of the European Commission entitled 'An Energy Policy for Europe' dedicates one section to 'EU International Energy Policy Priorities'. These priorities are 1) driving forward international agreements; 2) building up energy relations with the EU's neighbours; 3) reducing the threat of possible disruption beyond EU border; 4) enhancing relations with Russia; 5) deepening dialogues and relations with key energy producers and transit countries, whether through OPEC and the GCC or fully implementing the Memoranda of Understanding with Azerbaijan and Kazakhstan and moving on to establish new ties with other important Central Asian producers like Turkmenistan and Uzbekistan' (the 5th priority shows the new focus on diversification away from Russia to other major oil and gas producing countries, a move that is welcome for the purposes of EU's security of energy supply); 6) developing a new Africa-Europe Energy partnership; 7) enhancing relations with other major energy consumers; 8) promoting non proliferation, nuclear safety and security. See 'Energy Policy for Europe', above note 134 at 24.

²¹⁴ See the Glossary of the European Documents at <<http://europa.eu.int>>.

²¹⁵ It seems that the legal character of these documents is debatable as well: the European Parliament has alleged that the Commission uses these documents as 'alternatives' to real legislation. See L Senden and S Prechal, 'Differentiation in and through Community Soft Law' in B de Witte, D Hanf and E Voss (eds), *The Many Faces of Differentiation in EU law* (Oxford, Intersentia, 2001) at 189 [hereinafter *Many Faces*].

Article 249 of the EC Treaty lists the legal instruments of the Community as regulations, directives, decisions, recommendations and opinions.²¹⁶ This list is not considered exhaustive, and the practice of the Community demonstrates the development of other forms of Community action. Resolutions and communications are not enumerated in this Article and therefore, the analysis of their possible legal effects and their soft law characteristic have become a topic of discussion. They lack features such as obligation, uniformity, 'justiciability', sanctions and/or an enforcement element,²¹⁷ but at the same time they are deemed to have certain indirect legal effects. The problem then arises whether, in the absence of concrete legally binding measures in the realm of security of energy supply, the content of these documents on externalities of energy security can be used to provoke both the institutions and the Member States to act in this field and to establish, for example, a dialogue with energy-producing countries, or to create an efficient framework for the economic development of these countries, which could eventually contribute to energy security.

The construction of this concept in European law has been undertaken only in the scholarly literature, and no provision in the EC Treaty or case law is found that elaborates on their relevance. These academic writings discuss the effects of these types of documents on legal doctrine or analyse the pros and cons of the proliferation of these instruments. The analysis here does not seek to elaborate on this literature and the soft law thesis. The focus here is just a brief remark on the most relevant ideas of this doctrine for the purposes of our study.

The main argument surrounding these types of instruments is whether they can be considered as part of a new regulatory framework to meet various goals and be accepted as an alternative to harder forms of EU law-making. There are debates on the contribution of these types of instruments to enhancing the effectiveness, legitimacy and transparency of Community action. The transformation of consensus among the Member States and the institutions to form regulatory policies as new models of governance at the European level, which are also stripped of a top-down 'command and control' approach, is said to be helpful to serve different ends where no legally binding rule has proved possible

²¹⁶ Art 249 provides that:

A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. A decision shall be binding in its entirety upon those to whom it is addressed. Recommendations and opinions shall have no binding force.

²¹⁷ See DM Trubek, P Cottrell, M Nance, 'Soft Law, Hard Law and European Integration: Towards a Theory of Hybridity', at <<http://www.ssrn.com>>. See in general, F Snyder, 'The Effectiveness of EC Law' in T Daintith (ed), *Implementing EC Law in the United Kingdom: Structures for Indirect Rule* (New York, J Wiley, 1995); KC Wellens and GM Borchart, 'Soft Law in EC Law' (1989) 14 *European Law Review* 267; J Klabbers, 'The Undesirability of Soft Law' (1998) 36 *Nordic Journal of International Law* 381; H Hillgenberg, 'A Fresh Look at Soft Law' (1999) 10 *European Journal of International Law* 499.

to agree upon.²¹⁸ This approach is especially clear in the White Paper on European Governance, where the debate is centred on the idea of whether the traditional modes of legislation are adequate, or new forms of 'governance', such as benchmarking, peer-pressure, networks and the open method of coordination, should be put in place.²¹⁹ The rationale is said by the Commission to be that 'legislation is often only part of a broader solution combining formal rules with other non-binding tools such as recommendations, guidelines, or even self-regulation within a commonly agreed framework',²²⁰ and, therefore, calls for other methods for the 'management' of the Community. While admitting the acceptability of other instruments, the Commission includes the 'traditional' soft law instruments as part of the legislative framework of the Community. But how are these soft law instruments actually affecting the Community action?

It seems that although the use of these instruments was not itself new, their role as an alternative to legislation is.²²¹ Although Community practice signals a confirmation of their use rather than their renunciation,²²² the increase in their use cannot be equated to them having legal effects. It is especially in this respect that opinions differ. Some believe that the effectiveness of Community action is difficult to realise because the rights and obligations that these instruments may entail are far from clear.²²³ Where there is no clarity, realisation of a legal effect becomes difficult or impossible. This is especially the case in relation to the instruments that were explained above regarding security of energy supply. The Resolution on the Green Paper, for example, speaks broadly of measures that the Commission or the Member States should undertake. For example, it calls on the Commission and the Member States 'to integrate the objective of economic and social cohesion into energy policy and, at the same time, to use energy policy to help strengthen such cohesion',²²⁴ The link between an energy policy and economic and social cohesion is not spelled out, nor are the respective obligations of the Commission or the Member States clear. Either the resolution calls on the Commission and the Member States to adopt a binding programme with clear timetables for CO₂ reduction²²⁵ or it calls on the Commission and the

²¹⁸ See, eg, the role of soft law in the EU's state aid regime in M Cini, 'The Soft Law Approach: Commission Rule-Making in the EU's State Aid Regime' (2001) 8 *Journal of European Public Policy* 192 at 193 [hereinafter 'The Soft Law Approach'].

²¹⁹ See the White Paper on European Governance, COM (2001) 428.

²²⁰ *Ibid* at 20. The Paper continues by providing that this issue 'highlights the need for close coherence between the use of different policy instruments and for more thought to be given to their selection'.

²²¹ See specifically L Senden, *Soft Law in EC Law* (Oxford, Hart Publishing, 2004) at 21.

²²² *Ibid*.

²²³ See Senden, above n 221, at 26.

²²⁴ See Resolution of the Parliament on the Green Paper for a European Union Energy Policy, COM (94) 659-C4-0026/95, para 6.

²²⁵ See the Resolution, *ibid*, at para 22.

Member States to support nuclear disarmament.²²⁶ The Resolution of the Council on the White Paper does not create legal obligations either, as it talks of ‘inviting’ the Commission to establish a process of cooperation between the Community and Member States in order to ensure that Community and national energy policies are compatible with these objectives and for them to ‘speak with one voice’.²²⁷ The focus is more on ‘general concerns’ rather than requiring a particular entity to undertake necessary activities. Therefore, it is hard to deduce any ‘legal’ effect.

The fact that these instruments do not have ‘legal effects’ does not lead one to conclude that they are stripped of any ‘effect’ entirely. Some commentators speak of the role of these instruments in giving guidance as to the interpretation and application of Community law.²²⁸ This point is accepted with relation to the development of the proposals on energy security. For instance, the Resolution of the Parliament on the Green Paper, or more so the Communication of the Commission, can guide one to interpret the legal instruments that were adopted following their publication: such as the Directive on Energy Performance of Buildings, the underlying rationale of which lies in managing demand; or the Council Directive concerning Measures to Safeguard Security of Natural Gas Supply as analysed above, which refers to the Green Paper as its origin.²²⁹ They could also be used as interpretative guides for the previous directives on electricity and gas.²³⁰

The second point raised is that these instruments are substitutes for legislation where no need or no consensus existed for legislation. Their role is said to be the establishment of closer cooperation among Member States in a non-binding way, as they prescribe certain behaviour for their addressees. This point is also relevant for the documents on energy security, where reaching a consensus has proved difficult to achieve, although closer cooperation has so far materialised in their dealings with internal aspects of the energy market rather than external ones.

It is clear that the White and Green Papers, and the resulting resolutions and opinions, have gradually crystallised into legally binding instruments.²³¹ Hence it is not erroneous to describe them as a “practical solution, allowing difficulties associated with introducing more formal policy instruments to be circumvented’

²²⁶ See the Resolution, above n 224, at para 25.

²²⁷ See the Resolution, above n 224, at 4.

²²⁸ See Senden and Prechal, ‘Differentiation in and Through Community Soft Law’, above n 215, at 188.

²²⁹ See Dir 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the Energy Performance of Buildings, above n 10.

²³⁰ See Council Dir 2004/67/EC on Security of Natural Gas Supply, above n 150.

²³¹ See Dir 2004/8/EC of the European Parliament and of the Council of 11 February 2004 on the Promotion of Cogeneration Based on a Useful Heat Demand in the Internal Energy Market and Amending Dir 92/42/Eec [2004] OJ L/52/50 and Dir 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the Energy Performance of Buildings, above n 10.

at a given moment in time²³². This is especially relevant for politically sensitive areas such as energy security, and it is interesting to note that this crystallisation has only taken place in relation to internal security of energy supply, ie demand management. With respect to security of energy supply, these types of documents cannot be considered as a 'stepping-stone' to hard law but an alternative to it, pending their embodiment in hard law instruments²³³ and they are definitely a key contribution to the formation of the Community's energy strategy and the associated package of measures, especially after the Green Paper. Depending on the political will of the Member States or the institutions, these soft law instruments create an effect worthy of consideration, regardless of the fact that the political will to turn them into hard law has yet to materialise. For now, some soft law measures have resulted in hard law instruments but those that establish examples of some actions at the external level have not yet been adopted.

The following discussion is intended to encompass all measures at the Community level to guarantee security of supply, both hard and soft measures, and conclude whether they are efficient while analysing their link to the discussion of the external competence of the Community in this field.

4.6. CONCLUSION: THE DIVISION OF COMPETENCES AND SECURITY OF ENERGY SUPPLY

At the Community level, the search for a legal basis in the Treaty for energy activities has not been an insurmountable hurdle in the past ten years. A number of articles have been used as the basis for the measures mentioned above: Articles 95, 100 and 133, and where no legal basis was available, Article 308 was used as a 'gap filling' provision. However, the analysis of the energy-related measures at the Community level reveals that the Community has been primarily concerned with creating an efficient internal energy market in the expectation that such a market would eventually lead to a secure framework for energy supply. Measures in the form of the electricity or gas directives or the obligation to keep minimum levels of stocks, which is the most directly relevant undertaking with respect to security of energy supply at the Community level, do not refer explicitly to externalities of energy security or the importance of assuring a steady flow of energy from outside the Community. Security of energy supply at the external level remained largely within the competence of the Member States, without any provision or case law to actually declare this explicitly or delimit the competences of the Community and the Member States in this field.

²³² See R Dehousse and JHH Weiler, *EPC and the Single Act: From Soft Law to Hard Law?*, EUI Working Paper (Florence, EUI, 1990) at 26.

²³³ M Cini, 'The Soft Law Approach', above n 218, at 196.

Although there is nothing wrong in believing in the long-term efficiency of the internal energy market, this belief should stand to the test. Only if the Community measures fully guarantee the energy security of each individual Member State, by taking all the legal, political and technical aspects of both internal and external security into account, can one consider there to be an efficient framework at the Community level to guarantee security of energy supply. The Community measures do not encompass all these elements, and the main message of these measures is the creation of an internal energy market where healthy competition is targeted. Nonetheless, as the ECJ case law on the external implied powers of the EC demonstrates, there is a possibility that the existence of these limited energy-related measures at the internal Community level allows the Community to expand its competence to all aspects of energy security, including external ones. Regulating European activities in the transit of energy outside the borders of the Community could be 'inextricably linked' to internal Community measures (namely the directives on transit of electricity and gas through grids), and therefore, the Community would justify its involvement in this field. The occupation of a field of legislative activity by the Community would gradually exclude the Member States from also acting at the external level. Hence, concentration on internal development and reform of the energy sector could be expanded to the external level.

What are the implications of such a development of the law on division of competences on Europe's security of energy supply? Clearly, the vitality of Europe's energy security suggests that competence be conferred upon a body that can guarantee an efficient security framework. Some argue that experience shows that the Community and the Member States are 'better off with each other than without'²³⁴ in many sectors. What about the energy sector?

The above-mentioned analysis of the internal measures of the Community to guarantee security of energy supply criticised the lack of references to externalities of energy security in these measures. It was found unacceptable that the Community has constantly been one-sided and has only taken the objectives of the internal market into account, without focusing on the vital doctrine of 'mutual inter-dependency' between the consuming and producing nations. This lack of reference was not found justifiable due to the growing dependence of the Union on outside sources. The study also criticised the disparate hierarchy of objectives in various hard law and soft law measures, and mentioned that some of the most important proposals in the soft law measures, which could hint at the creation of an efficient external policy, were never taken up by the Community. The study also mentioned that whenever the externalities were named, they were left as mere statements without further elaboration.

²³⁴ This expression is used by S Weatherill, 'Competences' in B de Witte, (ed), *Ten Reflections on the Constitutional Treaty for Europe* (Florence, RCSAS, 2003) at 59 [hereinafter *Ten Reflections*] at 45.

Nevertheless, one has to admit a paradox here. References to externalities in the internal measures could pave the way for the establishment of a Community competence to act in all areas of energy security at the external level. As mentioned before, the more 'dense' the secondary legislation becomes and the more references are made to the link between internal and external security of supply, the greater the chance of expansion of Community's competence and the gradual disappearance of Member States' competence. Is that desirable for the purposes of Europe's security of energy supply?

One could argue that the ideal situation is the situation where activities in the energy field are mutually reinforcing. Speaking of delimitation of competences in this field is not welcome, because it means that the involvement of the Community in some fields of action is rejected, even where it is found to be necessary in the course of time. No rigid demarcation of competences is proposed with respect to measures to be adopted in the field of energy, which are linked to Europe's security of energy supply, and restraining that competence and lessening its out-of-control flexibility in some areas of action is desirable. One can presume some preferences for Community action over national action in the field of energy that should remain at the 'general' level. These are those measures that seek to create a better environment for the activities of Member States' public or private actors outside the borders of the Community, but not to substitute the activity of these actors, no matter whether this proposal brings more legal uncertainty to the already gloomy field of division of competences (especially for those who seek a catalogue of competences). Energy security involves legal, political and technical aspects, which are subject to change, and depending on the situation or the forecasts heralding a need for a better framework for energy security, these tasks should shift.

In other words, creating a partnership between the Community and the Member States, and seeking cooperation rather than confrontation, to exercise powers in the field of energy would better guarantee security of energy supply. Although the European Commission may not necessarily be willing to adopt such an approach, as their proposals in the field of energy indicate their willingness to expand their competences, the Member States could reject those proposals or argue the added value of such an approach—for example at the technical pre-legislative consultation—and in this way gradually hint at the limits of the Commission's action in this field.

The European Commission does not have energy experts to analyse the very basic necessary measures to guarantee security of energy supply. The Commission seeks the advice of experts of the Member States, for example, through consultation with the 'Oil Supply Group', which is a group of delegates from the

Member States (energy experts) convened only when difficulties arise with regard to the supply of energy in the Community or Member States.²³⁵

The Commission's stock proposal of 2002 faced objections by the Member States because the claim of 'necessary reform' (such as the extension of stock keeping from 90 days to 120 days) could not be adequately justified by the Commission and would not bring an added value to the already existing situation. Adding 30 days more to the stock-piling obligations would create various other difficulties (such as financing) that the Commission had not predicted or had not considered as important. In addition, the rationale for such an increase was not provided, which finally led to the abandonment of the proposal, and some 'waste of time' for all the parties involved.

Moreover, energy security requires high analytical skills for the analysis of world demand and supply as well as expertise in comparing various data in this field. Although the Community possesses its own statistics technique, a specific observatory system for energy market has not yet become fully operational.²³⁶ The Community needs to employ the data provided by the IEA or the US Energy Information Administration (EIA). Moreover, Member States interpret these data based on their own energy needs, and they could communicate them with the Community to establish policies. The Commission has also financed studies within the framework of its Synergy programme, to study the details of the necessary relations between the Community and energy-producing countries, such as the EUROGULF project,²³⁷ which sought to highlight the difficulties in establishing a framework of cooperation between Europe and the Gulf countries, but no follow-up on those projects has been proposed by the Commission.

Furthermore, in order to identify a region with good potentiality for energy exploration, extensive geological studies become necessary for which the Community has no proficiency. The rationality of linking various transport routes, such as pipelines, and creating new ones, is also outside the fields of expertise of the Community and these aspects are all directly linked to the issue of energy security. These activities can be supported or financed by Member States or actors that are under its direct legal obligations. The Community should only seek to provide the best atmosphere for them to act with the utmost efficiency, and ultimately finance those projects that have been extensively studied by

²³⁵ See the 2000 Green Paper on Energy Security, above n 174, and Council Directive on Measures to Mitigate the Effects of Difficulties in the Supply of Crude Oil and Petroleum Products, above n 101, Art 3.

²³⁶ The Energy Commissioner had proposed the establishment of an 'Oil and Gas Market Observatory Unit' to improve statistics and transparency. This observatory will be linked to the data of other organisations that have expertise in this field such as OPEC, but it remains to be seen whether this cooperation becomes fully efficient in terms of 'data sharing'. See 'Five Point Plan to React to the Surge in Oil Prices', Press Release, MEMO/05/302, 6 Sept 2005. See also the proposal for establishing the 'European Energy Supply Observatory' in the 2006 Green Paper, which is sought to monitor the demand and supply patterns and identify shortfalls in infrastructure and supply. See section 4.5.5 above.

²³⁷ For the details of the EUROGULF Project see ch 6.3 below.

experts in those fields. For example, the INOGATE programme seeks to verify the best possible means of transporting oil and gas from other countries to Europe. One good example was the common interest between Europe and Asia in establishing a Euro-Asian Oil transport corridor, which was marked by negotiations in extending the pipeline from Odessa and Brody in Ukraine to Plock in Poland. The governments involved signed a statement on extending the line to Plock and formed an expert working group. However, the real task was given to the Polish and Ukrainian pipeline operating companies to construct the extension. Finally, the European Commission awarded the contract for finalisation to a consortium of European companies, which are funded by the EU.²³⁸ Therefore, the task of the Commission was limited to 'providing the playground'. Clearly, in this example, cooperation exists between the Commission and the pipeline companies to make the construction of this pipeline possible. It is, however, important to mention that companies need to be eager to cooperate with the Commission and invest on these projects, because 'in case they do not sponsor them, the EU does little to make them happen'.²³⁹ If, in this case, the Member States are not provided with the necessary competence to individually undertake such security measures in the form of constructing a cross-border pipeline, such a security mechanism would not materialise at any level. The end result of such a situation is clearly not advantageous for security of supply purposes, unless the Community can fully guarantee that it enables these measures to be undertaken and facilitates the implementation of projects. The Community needs to provide the Member States with the necessary confidence to 'trust' the Community, and as long as such a guarantee does not exist, competences to engage in security of energy supply at the external level should be shared with a strong sense of 'cooperation'.

As some find it wrong to 'treat the vice to be a long-term power grab by the EU, and the virtue an entrenchment of state power',²⁴⁰ mutual reinforcement of EU and Member State activities should be maintained at all times. If the balance is tipped in favour of the EU or the Member States, the implications are anything but supply security. The creation of the internal market necessitates constant supervision of the activities of the Member States by the Community and the creation of the 'best environment for cooperation of main actors', whereas handling all aspects of energy security through the Community is not at the moment possible, unless a thorough reorganisation of the Community takes place to include technical expertise in this field. However, this has not been the

²³⁸ See 'The European Commission Starts Project on the Extension of the Odessa-Brody Oil Pipeline to Poland' at <<http://www.delukr.cec.eu.int/site/page35926.html>>. See also the INOGATE website for various similar projects, <<http://www.inogate.org>>.

²³⁹ See G Luciani, 'Security of Supply for Natural Gas Markets: What is it and what is it not' INDES Working Papers no 2, 2004, at <<http://ceps01.link.be/files/No2%20INDES%20pdf.pdf.copy>> [hereinafter 'Natural Gas Markets'] at 15.

²⁴⁰ Weatherill, 'Competences' in *Ten Reflections*, above n 234.

task of the Community. The rigidity of delimiting competences through a catalogue of competences undermines the everyday development of the cooperation between both sides, and at the same time, there is a demand for a prudent exploration of the best ways to guarantee optimum security and to prevent the uncontrolled expansion of Community competence in this field. If this issue becomes an established idea, one may hope that the density of the externalities in the secondary legislation of the Community becomes less threatening for the purposes of security of energy supply.

In order to 'create the best environment', the Community can strengthen relations with energy-producing countries, or assist either those countries or the European actors operating in those countries financially, which enables them to invest in exploration and production activities. These various possibilities are explored in the next chapter and their adequacy is determined.

External Outlook: Energy Charter Treaty and the GATT/WTO

5.1. INTRODUCTION

THE PREVIOUS PARTS of this study sought to highlight the absence of a link between purely internal legal measures at Community level to guarantee Europe's security of energy supply and the necessary external measures. It was argued that, due to the high dependence of Europe on external sources of energy, it is imperative to create a legal framework through which the European Union's relations with important energy-producing and transit countries are designed. The study distinguished between internal and external security of energy supply, and argued that the Community appears to reduce security threats through purely domestic or internal measures rather than also focusing on externalities of energy security: externalities of security of supply were only referred to, without really identifying the ways through which it should best function. The study argued that, without such externalities, the internal issues are undermined and it is thus necessary to approach the topic from both sides. The scattered references to externalities in the internal measures show that there is an awareness of their importance, especially in recent activities of the Commission, although the adoption of concrete measures has been neither possible nor desired, or has simply been ignored.

References to externalities of energy security in the internal measures being weak and unsatisfactory, there are measures adopted at the external level that seek to create the necessary legal framework for guaranteeing security of energy supply. One could argue that these measures, elaborated in detail below, could be considered as reasonable first steps, but the study intends to analyse their content in detail, and determine their loopholes for security purposes. The study concludes that there is a need for extensive revision, not only of their content, but also the approach of the institutions responsible for undertaking these measures.

The following sections of this chapter seek to highlight one important measure at Community level, which is designed to guarantee Europe's external security of energy supply, the Energy Charter Treaty. The Energy Charter Treaty (ECT) is the most important external undertaking by the Community to guarantee energy

security. The study enumerates the important provisions of this treaty, which range from investment to trade and transit, and analyses whether they can be considered as a full guarantee of security. This study concludes that, although the content of the ECT can be considered as the best example of a legal framework through which Europe's energy security can be guaranteed, in practice this security is undermined by the realities of the energy world, which suggest a different or sometimes additional attempt. This study recommends that, as the first step, membership of the ECT should be expanded to cover the most important energy-producing countries. In addition, the Energy Charter Secretariat's role should be expanded to become a distinct organisation, reflecting the interests of both consuming and producing countries. The study concludes that without such reforms, the ECT's role as the most important tool for guaranteeing Europe's security of energy supply is diminished. Accordingly, reliance on other measures becomes necessary for Europe.

The close link between the ECT and the various energy-related agreements of the World Trade Organization (WTO) was problematic in this analysis. As explained below, many trade provisions of the General Agreement on Trade and Tariffs (GATT) are copied in the ECT, and the WTO has been considered as the relevant body for trade in energy goods and services. As the Community and its Member States are members of the WTO, and WTO law has been fully incorporated into European law, a distinct analysis of the role that this law plays in the overall security of Europe becomes clearly inevitable. Nevertheless, due to their similarity with only minor modifications, and in order to avoid repetition, the focus has been placed on the ECT. The overall system of the WTO and its relevance has been closely analysed as well, and any differences between them have been revealed. Therefore, although the title of this chapter suggests the relevance of the ECT, it actually encompasses both the ECT and the WTO legal frameworks. Moreover, the analysis of the details of the ECT provided the opportunity to examine all the significant global issues that are of relevance for energy security in Europe.

5.2. THE ENERGY CHARTER TREATY: A GENERAL OVERVIEW

5.2.1. Introduction

The idea of an international treaty on energy trade, transit and cross-border investment was proposed at the European Council in Dublin on 25 June 1990. In reaction to the collapse of the USSR, and the vast endowment of energy resources in the Former Soviet Union countries (FSUs), an East–West energy corridor was proposed in order to secure Europe's need for energy supplies and to provide those countries with capital, technology and the eventual transformation of their centrally planned economy. This treaty was intended to serve as a political and

legal foundation for cooperation between these two sets of countries, and to enhance political stability throughout Europe by promoting Eastern Europe's economic development.

The European Energy Charter, which in 1994 was called the 'Energy Charter Treaty', was initially drawn up as a declaration of intent after the initial proposal of the then Dutch Prime Minister Ruud Lubbers, who launched the idea of a pan-European energy community. The initial idea was welcomed, and expanded to a multilateral effort comprising all OECD countries. This led to the signature of the Charter on 16–17 December 1991 by 50 governments and the European Community. The signatories of this Charter 'undertook to pursue the objectives and principles of the Charter and implement and broaden their cooperation as soon as possible, by negotiating in good faith the Basic Agreement and Protocols.' Creating an energy cooperation scheme was found important because 'broader energy cooperation among signatories was essential for economic progress and, more generally, for social development and a better quality of life'.¹ Moreover, with regard to the link between the existence of this treaty and security of supply, reference was made to the fact that 'signatories are *willing to do more* to attain the objectives of security of supply and efficient management and use of resources' (emphasis added).²

The European Community considered the implementation of the European Energy Charter Treaty of 'fundamental importance to Europe's future and its security of energy supply'. The ECT is a mixed agreement between the Community and the Member States, due to the fact that various provisions of the treaty necessitate the membership of both. For example, the trade provisions of the treaty necessitated the inclusion of the Community as a contracting party as the Community has exclusive competence over issues related to the common commercial policy (Article 133 of the EC Treaty). In addition, it was recognised that the treaty could potentially affect internal legislative acts adopted on the basis of Article 308, and therefore, reference to this Article was also found necessary, and the involvement of the Community was required.³

With respect to foreign investment, the competences of the Member States and the Community are also shared. Although there is no explicit treaty provision for exclusivity (considering that the Common Commercial Policy (CCP) does not yet cover activities in the field of investment),⁴ Chapter 4 of the EC Treaty regarding movement of capital and payment established a competence for the

¹ See the Concluding Documents of the Hague Conference on the European Energy Charter, annexed to *The Energy Charter Treaty and Related Documents* (Brussels, Energy Charter Secretariat, 2004) at 129.

² See the 'Concluding Documents of the Hague Conference', see *ibid* at 130.

³ These legal bases were eventually referred to in the final text of the Energy Charter Treaty. See Council Decision 94/998/EC of 15 December 1994 on the Provisional Application of the Energy Charter Treaty by the European Community, [1994] OJ L/380/1.

⁴ See Art III-315 of the Treaty Establishing a Constitution for Europe where foreign direct investment is added to the ambit of the CCP.

Community. Articles 56 and 57 provide that all restrictions on payment between Member States and between Member States and third countries should be prohibited, and the Council is given the competence to adopt measures on the movement of capital to or from third countries. These provisions provide a competence for dealing with external matters related to investment that has yet to become exclusive.⁵ This competence has been extensively used by the Community in external relations, such as Article 53 of the Partnership and Cooperation Agreement with Russia, or Article 12 of the EC–China Cooperation Agreement, and also in establishing the ECT and its related investment provisions.

Primarily through the ECT, the European Community saw the chance to secure access to Eastern markets for its energy industries, something that was not easily available up to that time.⁶ After the collapse of the Soviet Union, the Community was willing to take advantage of opportunities for investment in the FSU countries. Investment opportunities were vast but market access was limited, and the unfavourable legal and fiscal climate in these countries, along with the danger of transit disruptions, were strong barriers to Western investment.⁷ For this reason, they found it vital to subject these countries to new rules on investment, trade and transit, which could also ensure a secure long-term energy flow from these countries to Europe. Moreover, the emphasis on the FSU countries, as opposed to other energy-producing countries, such as Algeria, was due to then ‘intensifying conflicts between the government of Algeria and Islamic fundamentalists’, which could not be controlled by the Community. The Gulf was also the centre of instability during the Iran–Iraq war in the 1980s, and in the aftermath of the Gulf War of 1990. It was thus necessary to diversify dependence on energy resources from these countries. Some also believed that the West genuinely wished to support democratic reform and restructuring efforts in the FSU countries.⁸ In the words of the negotiators of the ECT, the rationale for the creation of this treaty was that:

⁵ See also Case 2/92 (OECD) [1995] ECR I-525. In s V, para 6, the Court provides that: it should be noted, first of all, that although the Community has adopted measures capable of serving as a basis for an exclusive external competence in accordance with the aforesaid case-law and falling in particular within the scope of Articles 57(2), 75, 84 and 100a of the EC Treaty, it is undisputed that those measures do not cover all the fields of activity to which ‘a specific decision’ relates.

Hence, the Community can participate in an international agreement, but such competence does not cover all the matters to which that decision relates, with the result that joint competence is shared with the Member States. This theory is still applicable. See also W Shan, ‘Towards a Common European Community Policy on Investment Issues’ (2001) 2 *Journal of World Investment* 603. See also J Ceysens, ‘Towards a Common Foreign Investment Policy? Foreign Investment in the European Constitution’ (2005) 32 *Legal Issues of Economic Integration* 259.

⁶ See Part I for a historical overview of external relations of the Member States and the Community with the energy-producing countries.

⁷ See J Doré, ‘The Negotiating History of the Energy Charter Treaty’ in T Wälde and K Christie (eds), *Energy Charter Treaty: Selected Topics* (Dordrecht, Kluwer Law International, 1996) at 139 [hereinafter ‘The Negotiating History’].

⁸ See Doré, ‘The Negotiating History’, *ibid*, at 139.

[i]n exchange for *guarantees* of investment protection and promotion given by all the signatories, the EU Member States would *ensure* closer cooperation with the FSU and CEE states in the field of energy investment and as regards access to EU energy markets. In this way *both sides* would benefit. The post-socialist states would gain access to investment capital and technology from EU sources, enabling them to expand their energy resources industries both domestically and for export, while the EU Member States would secure access to energy resources from their Eastern neighbours, thereby reducing their dependence on Middle Eastern sources.⁹ (emphasis added)

Interestingly, the European Energy Charter Treaty was considered as ‘a purely European exercise’ which was not welcomed by many.¹⁰ As this exercise was considered by the non-European OECD countries, such as the US, as a monopolised access to the reserves of the FSU countries—which could be considered as a threat to the energy security of these non-European countries—insistence on the expansion of the Charter became imperative. Many countries accepted the inclusion of the US in negotiations, due to ‘the importance of both the US energy industry and their trading partnership’: many others, such as France and Belgium, contended that this treaty remains purely ‘European.’¹¹ However, the inclusion of many other non-OECD countries in the club of the US to insist on the expansion of the treaty, such as Canada, Japan and Australia, resulted in their eventual participation in the Conference held in July 1991. Their participation in negotiations on the Charter continued for another three years, and led to the formation of the legally binding ‘Energy Charter Treaty’, which was signed in Lisbon on 17 December 1994.¹²

The ECT sought to add protocols on nuclear issues, energy efficiency and hydrocarbons, but a compromise on these issues was difficult to achieve. The protocol on nuclear and hydrocarbons became too contentious and was put aside.¹³ Only the text of the Energy Charter Treaty, along with the Protocol on Energy Efficiency, was agreed upon. After ratification by thirty states, the ECT and its Protocol entered into force in April 1998.¹⁴ Interestingly, however, the US

⁹ See P Muchlinski, ‘The Energy Charter Treaty: Towards a New International Order for Trade and Investment or a Case of History Repeating Itself?’ in T Wälde (ed), *Energy Charter Treaty: an East–West Gateway for Investment and Trade* (London, Kluwer Law International, 1996) at 205 [hereinafter T Wälde, *East–West Gateway*].

¹⁰ See Doré, ‘The Negotiating History’, above n 7, at 140.

¹¹ *Ibid.*

¹² For the text of the ‘Energy Charter Treaty’, see 35 *International Legal Materials* 509 (1995). For an overview of the history of the treaty’s negotiations, see Doré, ‘The Negotiating History’, above n 7, at 137. See also J Doré and R de Bauw, *The Energy Charter Treaty: Origins, Aims and Prospects* (London, RIIA, 1995), and P Cameron, ‘Creating a Legal Framework for Investment in the Common Wealth of Independent States’ Energy Sector: Lessons from the Energy Charter Experiment’ (1994) 1 *Tulsa Journal of Comparative and International Law* 233.

¹³ For the rationale behind non-acceptance of these Protocols, see Doré, ‘The Negotiating History’, above n 7, at 141–42.

¹⁴ Fifty-one states along with the European Community are signatories to the Energy Charter Treaty (47 of them have already ratified the treaty). Australia, the Russian Federation, the US, Belarus and Iceland have not yet ratified the treaty, and 19 countries are observers as of 1 April 2007:

failed to ratify the treaty as they objected that it suffered from substantial defects. Some believe that these objections were flawed and that non-ratification was only because the final decision to sign the treaty was taken by an entirely different component of the US federal government, which did not agree with the text of the treaty at all.¹⁵

The conclusion of the ECT and the Energy Charter Protocol on Energy Efficiency by the European Communities and its Member States was deemed 'to help attain the objectives of the European Communities'. These objectives were explicitly revealed as allowing the members of the Common Wealth of Independent States and the Countries of Central and Eastern Europe to develop their energy potential while helping to improve security of supply.¹⁶ Therefore, the ECT was considered a step in guaranteeing Europe's energy supply. It should be clarified here whether this objective is at all attainable through energy cooperation with these sets of countries as prescribed in the treaty, and whether the provisions of the treaty could be considered as the best common denominator of the necessary rules to achieve this goal.

5.2.2. The Objectives of the Energy Charter Treaty

The ECT covers broad provisions on energy trade, transit, investment and dispute settlement. The Energy Charter Conference, which is the governing and the decision-making body of the treaty, may authorise negotiation of Energy Charter Protocols or Declarations to pursue the objectives and principles of the Charter in separate instruments. These protocols envisage separate rules for more specific areas in the energy sector, or may address a particular group of countries.

Regrettably, the preamble to the ECT does not elaborate on its overall objectives. It only refers to the European Energy Charter's concept of 'catalyzing economic growth through liberalization of investment and trade in energy' and the 'necessity for the most efficient exploration, production, conversion, storage,

Afghanistan, Algeria, Bahrain, Canada, China, Iran, Republic of Korea, Kuwait, Morocco, Nigeria, Oman, Pakistan, Qatar, Saudi Arabia, Serbia, Tunisia, United Arab Emirates, USA and Venezuela.

¹⁵ For a detailed analysis of the objections of the US with respect to the rules of the Energy Charter Treaty, see W Fox, 'The United States and the Energy Charter Treaty: Misgivings and Misperceptions' in T Walde *East-West Gateway*, above n 9, at 194. Canada and Australia also failed to ratify. Members of the ECT, as of January 2007, are: Albania, Armenia, Austria, Azerbaijan, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Cyprus, Denmark, Estonia, European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkey, Turkmenistan, Ukraine, Uzbekistan, United Kingdom. On 21 November 2006 the ECT Conference invited the Islamic Republic of Pakistan to become the 53rd member of the Energy Charter.

¹⁶ See 98/181/EC, ECSC, Euratom: Council and Commission Decision of 23 September 1997 on the Conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, [1998] OJ L/69/1.

transport, distribution and use of energy'. The remainder of the preamble refers to the importance of the membership of the contracting parties in the WTO, due to the fact that the trade provisions of the ECT mirror the trade rules embodied in the GATT. The importance of competition rules, the Treaty on the Non-Proliferation of Nuclear Weapons, and the UN Framework Convention on Climate Change (UNFCCC) and the Convention on Long-Range Transboundary Air Pollution, are also referred to.

Although the Energy Charter Treaty is said to be the first and the most important treaty establishing specific rules on trade, transit and investment for the energy sector, its preamble fails to demonstrate the importance of energy and the clear aims to be pursued in developing energy cooperation. Although repeated references to the WTO in the preamble reduce the treaty to an instrument to facilitate WTO membership for those countries that are not yet members of the WTO, the provisions of the ECT bear witness to its significance in creating a unique structure for energy cooperation. If applied efficiently, this structure could increase the security of energy supply for the importing countries and economic development in the exporting countries. Considering that the ECT is the first multilateral treaty to regulate energy cooperation, it would have been appropriate to refer to the importance of energy to the world economy in general in the preamble. The preamble also places more emphasis on the importance of this treaty for the countries of the Former Soviet Union, without highlighting the more important role that the treaty plays in Europe's security of energy supply.¹⁷

The ECT aims to achieve several outstanding objectives that are spread across various provisions, namely (1) investment protection (eg by granting investors non-discriminatory treatment), (2) National Treatment and Most-Favoured Nation Treatment, (3) compensation in case of expropriation and other losses, (4) free transfer of capital; (5) trade in energy, energy products and energy related equipment, based on the WTO rules; (6) freedom of energy transit; (7) improvement of energy efficiency; (8) international dispute settlement, including investor–state arbitration and inter-state arbitration; and (9) improved legal transparency.¹⁸

There is ample literature on the ways through which various provisions of the ECT dealing with the above-mentioned objectives should be interpreted. The focus here, however, is to analyse those provisions that are important for security of energy supply. Although the ECT per se, as a set of international rules to regulate energy trade, transit and investment as important components of energy security (see Chapter 1), can be considered as a step towards security of energy supply, its provisions should be analysed in order to determine whether they

¹⁷ Art 2 of the treaty refers to the objectives and principles of the charter by providing that: 'This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter'.

¹⁸ See *The Energy Charter Treaty: The Reader's Guide*, at <<http://www.encharter.org>>.

achieve the goals intended by its founders. Ruud Lubbers, the initiator of this treaty, was of the opinion that cooperation in such a tangible area would 'undoubtedly' stabilise political relationships. He went as far as saying that 'those responsible for energy policy, through operating in quite different political systems, would detect common grounds and would find it relatively easy to communicate'.¹⁹ The analysis here sets out to assess the credibility of this statement, and to ascertain whether the treaty overcomes the harsh realities of today's political and economic energy environment by guaranteeing stable political and economic cooperation. Some believe that the ECT should theoretically result in positive benefits to foreign investors through diminishing the political risks associated with investment. However, others believe that the ECT must be viewed as only one of many components supporting a country's economic reform,²⁰ which could in turn result in political stability if other conditions are met.

The efficacy of the ECT to obtain the aforementioned objectives has not yet been tested in practice. It seems that foreign investors have not gained the necessary confidence in the ECT's ability to meet their requirements, and consequently, its real and tangible benefits are difficult to depict. Therefore, a broad analysis of the ECT's provisions is necessary. Moreover, as the treaty is based on the mutual relationship between energy producers, consumers and transit countries, the interests of each should be revealed and compared to the provisions of the ECT. The ECT is only successful if it provides benefits for these three groups similarly, which could in turn result in this treaty guaranteeing Europe's security of energy supply.

5.3. THE INVESTMENT REGIME OF THE ECT

5.3.1. Introduction

Under the category of 'risks associated with energy security' explained in chapter 1,²¹ the investment regime governing the investor–state relationship was enumerated as one of the most important components of security of energy supply. The regime through which investment is facilitated and its protection guaranteed is said to warrant this security. The reason was explained to be the importance of investing in the host country's exploration, exploitation and production of energy, based on a clear contractual relationship, and to export that energy to Europe, while the host country could in turn reap the benefits of the transfer of technology and know-how associated with such investment.

¹⁹ See the foreword by Ruud Lubbers to T Wälde, *East–West Gateway*, above n 9, at xiv.

²⁰ See A Seck, 'Investing in the Former Soviet Union's Oil Industry: The Energy Charter Treaty and its Implications for Mitigating Political Risk' in T Wälde, *East–West Gateway*, above n 9, at 121.

²¹ See ch 1.

The Energy Charter Treaty dedicated one part (Part III) to investment promotion and protection. However, pre-investment obligations, and obligations that are provided after the approval of an investment, are distinguished. This distinction is not clear in the text of Article 10 as pre-investment obligations are mixed with post-investment obligations. This Article provides that:

Each Contracting Party shall, in accordance with the provisions of this treaty, encourage and create stable, equitable, favorable and transparent conditions for Investors of other Contracting Parties to *make Investments in its Area*. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favorable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

Two aspects of investment are usually important for a foreign investor: one is whether there is open access to a country, or the host country exercises its sovereign right each time an investor chooses to invest in that country; and second are the rules that apply to this investment after it is allowed entry. What differentiates the ECT from other efforts (such as the negotiations on a multilateral investment agreement (MAI) which were halted at the end of 1990s) is that the treaty maintains the right of the host country to exercise its sovereignty by choosing investors. Therefore, the treaty is not about 'open' investment policies, but a 'managed' policy that allows some degree of regulatory intervention by the host states. This is clear from Article 18(3) on sovereignty over natural resources, which provides:

Each state continues to hold in particular the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimalization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such exploration and exploitation, *inter-alia*, through direct participation by the government or through state enterprises.

Hence, as a result of the signatories' emphasis on retaining their sovereignty, they can freely determine from whom, and under what conditions, investment is allowed entry.²² Moreover, Article 10(6) creates the possibility for signatories to voluntarily commit themselves to a binding obligation of National Treatment

²² Pre-investment covers the period where the investor is researching, visiting various sites, and negotiating (this may include transaction costs to secure a deal which could be substantial). See Seck, in T Wälde, *East-West Gateway*, above n 9, at 122.

and MFN (most favoured nation) at the pre-investment stage.²³ No contracting party has so far done so. Since no legally binding obligation is thus explicitly provided at this stage, blocking the entry of foreign investment would not trigger the dispute resolution procedures embodied in Article 26 (investor–state dispute settlement), discussed later in this section.²⁴

Some believe that the rationale behind the emphasis on a ‘regulated market access’, as opposed to ‘open access to investment’, was ‘to protect vulnerable domestic industries during the transition period’,²⁵ and was thus a short-term phenomenon that would gradually disappear. However, sovereignty over natural resources has become one of the basic principles of the ECT, to the extent that the ‘temporary’ character of providing restrictions at the pre-investment stage is no longer valid.²⁶ Claims to sovereignty can be exercised at any time and at any stage.

Since 1998, a debate has been taking place within the Energy Charter Secretariat (ECS) over how to introduce a ‘Supplementary Treaty’ with the objective of transforming the ‘best endeavours’ commitment at the pre-investment stage (Article 10(2)) into a legally binding obligation requiring the grant of ‘national treatment’ at that stage. This would in turn mean that that country follows an open investment policy. However, the Member States decided that further work on the Supplementary Treaty should only proceed once negotiations on a multilateral investment framework within the WTO are launched.²⁷ Interestingly, it seems that such reference to the WTO, as the body responsible for analysing the content of a multilateral investment agreement, suggests the impossibility of concluding such an agreement in the near future. The viability of this claim is revealed through a quick look at the contentious issues in the negotiations on a Multilateral Agreement on Investment (MAI), along with discussions at WTO level, as explained above.

²³ Art 10(6)(a) of the ECT provides: (a) A Contracting Party may, as regards the Making of Investments in its Area, at any time declare voluntarily to the Charter Conference, through the Secretariat, its intention not to introduce new exceptions to the Treatment described in para (3).

²⁴ Reference to pre-investment obligations as ‘soft law obligations’ could prompt one to attribute some binding obligations to this provision. However, the language of the provision on pre-investment is soft *language*, which does not seem to create any binding obligation comparable to those created at the post-investment stage. The option of having a ‘supplementary treaty’ in Art 10(4), through which legally binding obligations are created, bears witness to the possibility of such interpretation. However, it would not be wrong to suggest that there is some kind of obligation on the host state to ‘encourage’ the creation of desirable conditions, and to ‘endeavour’ to accord national and MFN treatment. A failure to do so could therefore be interpreted as a breach of their obligation. For a detailed analysis of this article, see T Wälde, ‘International Investment under the 1994 Energy Charter Treaty’, in Wälde, *East–West Gateway*, above n 9, at 282.

²⁵ See Seck, in T Wälde *East–West Gateway*, above n 9, at 123.

²⁶ The preamble of the ECT already explicitly provides that commitments will be applied to the ‘making of investments’ pursuant to a supplementary treaty (Para 6), unless a country decides to voluntarily commit itself to adopting an open-access policy.

²⁷ See 2002 *Annual Report of the Energy Charter Secretariat* (Brussels, Energy Charter Secretariat, 2002) at 15.

The need for a comprehensive global agreement on investment was expressed by the OECD ministers in 1995, in order to facilitate the activities of companies making cross-border investments.²⁸ The emphasis on concluding such an agreement was meant to 'level the playing field', and provide a strong and comprehensive framework for foreign direct investment, widening the scope of existing liberalisation rules and providing security for international investors.²⁹ This agreement, however, faced some significant challenges from developing and developed countries, as well as advocates of social justice, environmental and cultural protection groups.³⁰ The goal was to complete negotiations on the MAI by the 1998 ministerial meetings and for the agreement to enter into force by January 1999.³¹ However, the ministers failed to reach a compromise during the last ministerial meetings, and the latest negotiations collapsed when France decided to boycott the talks on the basis that the treaty threatened national sovereignty, and deferred the decision on the MAI until a later date.³²

On the other hand, at the WTO's Fourth Ministerial Conference in Doha in November 2001, the WTO member countries referred the negotiations on a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign investment, to the Fifth Ministerial Conference on the basis of a decision to be taken by consensus.³³ Later on, the Fifth Ministerial Declaration of August 2003 in Cancun provided that 'the situation does not provide a basis for the commencement of negotiations in this area.'³⁴ Although the second draft text of the Cancun Declaration referred to the necessity of launching negotiations on a multilateral agreement on investment,³⁵ the 'July 2004' package on the WTO's General Council's decision on

²⁸ See WH Witherell, 'The OECD Multilateral Agreement on Investment' (1995) 4 *Trans-national Cooperation* 1 at 1.

²⁹ See Witherell, *ibid*.

³⁰ See FP Gale, 'Multilateral Misgivings: Critics Argue that a Quietly Planned Globalization Agreement Amounts to a Corporate Rule Treaty', *Alternatives Journal*, (22 September 1997).

³¹ OECD, *Multilateral Agreement on Investment*, Report by the Negotiating Group, OECD Document Annex 1997 (Paris, OECD, 1997).

³² For a more detailed explanation of this issue, see AOyog, 'Agreement on Global Investment Pact Stalled', *Inter Press Service* (20 October 1998). France declared that it would no longer discuss the treaty, on the basis that it threatened national sovereignty and excluded emerging economies. It proposed moving investment talks to the World Trade Organisation (WTO). <<http://www.Islandnet.com/~ncfs/maisite>>. The governments failed to complete the agreement in time for the OECD's annual ministerial meeting in late April 1998 when negotiations lost much of their momentum. Public and parliamentary concerns were also an important factor in preventing completion. Negotiators were also stuck on a number of disagreements between governments, particularly between the United States and the European countries. Some of these disagreements centred on the extraterritorial application of investment sanctions, such as the Helms-Burton Act, provisions on labour, the environment and culture as symbols of public concern, and long lists of country specific reservations to the MAI.

³³ See the Doha Ministerial Declaration, November 2001, WT/(MIN) 01/DEC/1, paras 20–22.

³⁴ See the first Draft of the Cancun Declaration, August 2003, at <http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_e.htm>.

³⁵ See the Second Revised Draft of the Cancun Ministerial Declaration, September 2003 at <<http://www.wto.org>>.

the Doha Agenda Work Program revealed that the issue of investment will not form part of the work programme set out in the Doha Declaration. Therefore, no work towards negotiations on this issue will take place in the WTO for the time being.³⁶ This shows that the same resistance with respect to investment also occurs in the WTO context, as the notion of a 'liberalized investment regime' is approached with extreme caution. Consequently, it seems impossible to establish such a set of rules in the WTO and for that purpose, the ECT, anytime in the near future.

5.3.2. The Rules on Investment in the ECT

The Energy Charter Treaty regulates investment based on National Treatment and Most Favoured Nation (MFN). National Treatment prescribes that the same treatment that is afforded to national investors should be afforded to foreign investors, and MFN treatment prescribes that any advantage, favour, privilege, or immunity granted by any contracting party to any investor of another contracting party shall be accorded immediately and unconditionally to the investor of all other contracting parties.³⁷

Article 18(4) of the Energy Charter Treaty, which covers the ways through which the claim of 'sovereignty over natural resources' is accepted, provides that:

Contracting Parties undertake to facilitate access to energy resources by allocating in a non-discriminatory manner, on the basis of published criteria, authorizations, licenses, concessions and contracts to prospect and explore for or to exploit or extract energy resources.

This provision seeks to create a non-discriminatory situation, whereby the contracting party (ie the governments) should provide criteria permitting investment in a given area to take place.

³⁶ See the text of the July Package (ie the General Council's Post-Cancun Decision, agreed on the 1st of August 2004), WT/L/579.

³⁷ For the purposes of this treaty, investment is defined as every kind of asset owned or controlled, directly or indirectly, by an investor and includes: (a) tangible and intangible, and moveable and immovable property, and any property rights such as leases, mortgages, liens, and pledges; (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise; (c) claims to money and claims to performance pursuant to a contract having an economic value and associated with an investment; (d) intellectual property; (e) returns; (f) any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any economic activity in the energy sector. Investment should be associated with any 'economic activity in the Energy Sector', which based on Art 1(5) concerns the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of energy materials and products, except those included in Annex NI (some petrochemicals), or concerning the distribution of heat to multiple premises. Based on Annex EMI, energy materials and products are generally considered to be nuclear energy, coal, natural gas, electrical energy, petroleum and petroleum products, fuel wood and charcoal.

Host countries exercise their sovereignty through allocating licenses, contracts or concessions to prospect and explore for, or to exploit or extract, energy resources which are designed based on laws, regulations, government decrees or resolutions of the host state. Studying the provisions of these documents reveals the openness or strictness of the host country's acceptance of investment and the conditions they impose. For example, within the most important energy-producing countries, one can identify the case of the countries of the Gulf Cooperation Council, which includes the six countries of Saudi Arabia, Bahrain, Qatar, Oman, Kuwait, and United Arab Emirates, all observers at the ECS. In the 'Reference model Regulation for the Promotion of Foreign Investment in the GCC State' (ie a regulation adopted by the Gulf Cooperation Council which lays down guidelines to attract foreign investment in order to achieve economic integration), these countries have created a list clarifying those areas where investment will be favoured. They state that investment is accepted: where state-of-the-art technologies will be attracted; where the environment will be best preserved; where dependence on foreign sources for the supply of their essential and strategic requirements is minimised; where production can be diversified, where job opportunities will be best created etc.³⁸ Another example is the 2002 Iranian law on Encouragement and Protection of Foreign Investment, which prescribes that those foreign investments leading to economic growth, technological development, improvement in the quality of goods, increased investment opportunities, etc are allowed entry.³⁹

National rules governing the system of *property ownership* of a given country's energy resources can also limit the promotion of access to resources on the part of the host country altogether. The majority of laws of energy-producing countries provide that natural resources belong to the state. In exercising this right, the state grants licenses or contracts for exploration and production. The rationale for exercising control over access to resources is the threat of an influx of foreign capital, which could undermine the competitive efforts of national companies of economies in transition in exploiting their own natural resources efficiently.

The grant of contracts for exploration and production is also an example of the enforcement of sovereignty over natural resources. These contracts can take various forms, depending on the openness or conservativeness of the host countries. For example, countries traditionally offered concessions to investors or concessionaires, which consisted of a grant of large areas of investment for a very long period of time, for exploration and exploitation of petroleum, with little state control over their activities. Concessionaires would in return pay the host state a royalty. This type of contract was considered as the main threat to

³⁸ See the 'Reference Model Regulation for the Promotion of Foreign Investment in the GCC States' at <<http://www.gcc-sg.org/soon.html>>.

³⁹ For the English translation of the Iranian law see, <http://www.parstimes.com/law/ft_new_foreign_investment_law.html>.

sovereignty. Later on, and after assertion of the principle of 'permanent sovereignty over natural resources' in the 1950s,⁴⁰ a new generation of agreements developed. The old types of contracts were replaced by joint ventures, Production Sharing Agreements (PSAs), and service contracts which dictated more control by the state over the activities of investors. Through joint ventures, the foreign investor accepts all the risks of exploration, and expenses and costs are shared with the national enterprise only at the production stage. Title and ownership over installations and production are exclusive to the national enterprise. On the other hand, based on a service contract, ownership of minerals, equipment and other assets acquired for petroleum operations are retained by the government and its national enterprise. The foreign investor acts as a general contractor and carries out all necessary operations on behalf of the latter. The foreign investor will only be reimbursed if oil is found after commercial production, and the contractor can retain a certain percentage of the sale proceeds during sales.⁴¹

In contrast, through a production sharing agreement (PSAs), the investor signs a contract with the host country, which grants the investor exclusive exploration and production rights (without transferring the mineral right) for a specified period of time. Investors bear the expenses and the risks associated with this investment, but they can recover the costs (cost oil). Thereafter, following the payment of the costs, the profit will be split between the investor and the host country (profit oil) based on predetermined criteria.⁴² This latter type of contract has been considered as the most desirable among the new generation of investment contracts, as it offers the investor the exclusive right to explore and produce without too much control from the state, which retains ownership of the reserves. Depending on which type of contract is dominant in a given country, the investor can choose one country over another (eg Iran has been heavily criticised for not accepting PSAs, whereas this type of contract is widely used in the countries of the Caspian). The type of contract that is widely exercised can therefore be considered as a way to promote investment in a country's exploration and production processes.

⁴⁰ The question of permanent sovereignty was raised for the first time as a subject in itself, under the heading of 'the right of sovereign countries to nationalise and freely exploit their natural resources', and was one of the items considered during the 7th session of the UN Second Committee of the General Assembly, in December 1952. See MA Mughraby, *Permanent Sovereignty over Oil Resources: A Study of Middle East Oil Concession and Legal Change* (Beirut, The Middle East Research and Publishing Centre, 1966). For a historical overview of this concept, see K Hossain and R Chowdhury (eds), *Permanent Sovereignty over Natural Resources in International Law: Principles and Practice* (London, Pinter, 1984).

⁴¹ See in general, AFM Maniruzzaman, 'The New Generation of Energy and Natural Resource Development Agreements: Some Reflections' (1993) 11 *Journal of Energy and Natural Resources* 207. See also H Zakariya, 'New Directions in the Search for and Development of Petroleum Resources in the Developing Countries' (1976) 9 *Vanderbilt Journal of Trans-national Law* 545. See also B Taverne, *An Introduction to the Regulation of the Petroleum Industry: Laws, Contracts and Conventions* (Norwell, Graham and Trotman, 1994).

⁴² For a detailed analysis of production sharing contracts, see D Johnston, *International Petroleum Fiscal Systems and Production Sharing Contracts* (Tulsa, PennWell Pub Co, 1994).

The Energy Charter Treaty does not oblige host countries to choose one type of contract over another. Therefore, there is no interference in the legal system of a given country, apart from 'encouraging' that country to accept the least restrictive of all contracts where non-discrimination principles can best be guaranteed. This is clear from Article 10(2) of the treaty which provides:

Each Contracting Party shall endeavour to accord to investors of other Contracting Parties, as regard the making of investments in its Area, the treatment described in paragraph (3) [ie *no-less-favourable treatment*].

Hence, the ECT does not play a role in influencing the legal system of its contracting parties to adapt to its provisions on investment promotion and this effect has not yet materialised. Legislation in some countries does not promote investment, and bureaucracies further hinder progress. Therefore, access to energy reserves through less restrictive contracts, as one condition to guarantee security of supply, is not prescribed in a hard law format in the ECT. However, this does not mean that strict provisions on the protection of investment, as embodied in the Energy Charter Treaty and explained below, can be circumvented. Energy contracts can limit access to energy reserves, but if the host country is a member of the ECT, the provisions on protection of investment should be embodied in that same contract. The details of this protection will be further analysed in this section.

It is clear that the mere existence of an energy-rich country or an important transit country as a member of the ECT does not, in itself, guarantee open access to energy reserves or the possibility of investing in the transit facilities of that country. However, it could be argued that their membership would result in greater transparency and a duty of cooperation, thus facilitating access by investors. After all one justification for their membership in the ECT is to demonstrate their will to attract and protect foreign investment. This has not yet become visible, and the existing situation reveals the continued perseverance of the Member States to regulate the pre-investment stage themselves. This is due to the fact that no country has yet voluntarily committed itself to accord National and MFN treatments to an investor's entry. It remains to be seen whether this attitude changes in the future.

In any case, as soon as investment is allowed to enter, the Energy Charter Treaty prescribes detailed rules for its full protection. For example, fair and equitable treatment shall be accorded to 'investment of investors' at all times (article 10), constant protection and security should be provided, and management, maintenance, use, enjoyment or disposal of contracting parties' investment shall in no way be unreasonably impaired or discriminated against. The principles of National Treatment and the Most Favoured Nation Treatment are applied at this stage.

These are important obligations imposed on the contracting parties, and, as some believe, the negotiators of the ECT should be praised in implementing such rules in the treaty. They exceed the investment protection provisions of many

existing international agreements on protection of foreign investment.⁴³ Nonetheless, the question remains whether the host country maintains its obligations at all times. The life of ECT is still too short to give a broad overview of how, in practice, this protection is afforded through the efficient application of its provisions, and no case law yet exists to analyse this further. However, some aspects of these obligations can be highlighted here.

Article 12 covers the area of compensation for any loss that the investor suffers. If the investor suffers a loss due to political instability in a country because of war, other armed conflicts, a state of national emergency, civil disturbance, or other similar events, two different standards of compensation apply. If the government of the host country is not directly responsible, and compensation is awarded to any third state investor, the equivalent compensation should be afforded to the investor of the contracting party. If the government is directly responsible, the investor shall be afforded 'prompt, adequate and effective' compensation or restitution (the Hull Formula (Article 12(2)).⁴⁴

The provisions on expropriation (Article 13), which mirror the provisions of various bilateral investment treaties (BITs), also call for the payment of prompt, adequate and effective compensation where the investment is nationalised, expropriated or subject to any other measure with equivalent effect.⁴⁵ Other exceptions to expropriation are enumerated as purposes of public interest, expropriated in a non-discriminatory way and carried out under due process of law. It is said that although there is no precedent to evaluate this provision on compensation, the provision is consistent with recent BITs, and many international arbitration decisions have adequately analysed it.⁴⁶

Expropriation may also involve abrogation of contractual rights through the enactment of new laws or regulations, which could lead to breach of the contract

⁴³ See Seck, in T Wälde, *East–West Gateway*, above n 9, at 125.

⁴⁴ Based on the Hull formula, state expropriation of foreign-owned property required the payment of prompt, adequate, and effective compensation. Under accepted standards of international law: 'prompt' means 'without undue delay' or within a stated period; 'adequate' generally means full compensation; 'effective' means the expropriating state must pay in a form that is of practical use to the recipient (usually implying that compensation must be realisable, in a convertible currency, and remitted to the investor's home state). This formula is named after the former Secretary of the United States, Cordell Hull, and originated in a letter written by Secretary Hull to the Mexican government in 1938 demanding 'prompt, adequate, and effective' compensation for expropriation. See JD Nolan, 'A Comparative Analysis of the Loatian Law Foreign Investment, the World Bank Guidelines on the treatment of Foreign Direct Investment, and Normative Rules of International Law on Foreign Investment' (1998) 15 *Arizona Journal of International and Comparative Law* 659 at 672. See also PM Norton, 'A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation' (1991) 85 *American Journal of International Law* 474.

⁴⁵ Based on Art 13, compensation must be at a fair market value based on an assessment equivalent to a valuation prior to the expropriation, occurring in a freely convertible currency including accrued interest.

⁴⁶ See PM Norton, 'Back to the Future: Expropriation and the Energy Charter Treaty' in *East–West Gateway*, above n 9, at 367. See in general, Norton, 'A Law of the Future or a Law of the Past?' above n 44.

between the state and the investor. The famous 'stabilization clauses', guaranteeing that states agree not to alter or enact new laws that lead to abrogation of contracts, were thus introduced in investment contracts. Under Article 13(1), rights granted to investors 'shall not be subject to a measure or measures having effect equivalent to naturalisation or expropriation'. The enactment of new laws resulting in abrogation of contracts could be considered as measures with equivalent effect to expropriation.⁴⁷

One of the most important concerns for foreign investors is the possibility of transferring their capital and returns from the host country to their home country. Article 14 provides rules on guarantee for freedom of transfer of initial capital, returns, payments under a contract, unspent earnings, proceeds from sale or liquidation, payments arising out of a dispute settlement and payments of compensation. These transfers should take place without delay. However, the ECT could not find solutions for some impediments to the efficient application of this law, due to the specific situation in some countries. To use Seck's example, in the case of Russia, there existed a mandatory obligation in 1992 on all enterprises (including domestic ones) to sell 50 per cent of their hard currency receipts at the official exchange rate to the Central Bank. This was due to the fact that Russia was in dire need of hard currency. It is only when the hard currency becomes available that the ECT provides a guarantee for the right to exchange the domestic currency for foreign currency followed by repatriation. The ECT does not lessen the problem of 50 per cent mandatory hard currency conversion. Moreover, it may still be difficult to convert domestic currency back to foreign currency for repatriation due to delays, excessive transaction costs, or even a general lack of hard currency.⁴⁸ With this example in mind, it is clear that national legislation could circumvent the prompt transfer of return by imposing obligations on enterprises, which could indirectly render this transfer difficult. Clearly, the ECT could not alleviate a lack of hard currency in Russia or any other country with similar difficulty. Other countries of the Former Soviet Union that are important for security of supply reasons, such as Turkmenistan and Kazakhstan, face similar problems. A solution can only be found through economic reform of the said countries and outside the direct sphere of the repercussions of joining the ECT.

⁴⁷ For more information on stabilisation clauses, see MTB Coale, 'Stabilization Clauses in International Petroleum Transactions' (2002) 30 *Denver Journal of International Law and Policy* 217.

⁴⁸ See Seck, in T Wälde *East-West Gateway*, above n 9, at 129.

5.3.3 Settlement of Investment Disputes in the ECT

5.3.3.1. *Investor–State Arbitration*

Article 26 of the Energy Charter Treaty explains the rules for the settlement of investment disputes between an investor and a contracting party. This system of dispute settlement is the most important undertaking within the ECT framework, as the possibility of an individual investor bringing claims against the host government does not exist in any other international treaty except the North American Free Trade Agreement (NAFTA).⁴⁹ This possibility creates a strong guarantee for investors to invest and be able to compensate their losses due to a host government's harmful activities, without the necessity of its home state's involvement.

It is important to highlight here that this settlement mechanism only applies to the 'breach of an investment obligation' of the host state under Part III.⁵⁰ Obligations in other parts of the treaty, such as competition, transit, environmental issues, etc are not covered by this Article. Therefore, no other claims, except those related to investment as embodied in Part III of the treaty, are accepted. Moreover, this article excludes the possibility of the host state alleging the investor's breach of an obligation. Nonetheless, once arbitration has commenced, it is likely that the host state, party to the dispute, would raise counter-claims that might concern the contract, national law obligations, etc that should be dealt with by the arbitral tribunal.

Article 26 of the ECT provides that the investor should first seek to settle the dispute amicably. If no amicable resolution is reached in three months, the investor should either submit the dispute for resolution: (1) by the courts or administrative tribunals of the contracting party; or (2) in accordance with any previously existing settlement procedure; or (3) if the contracting party had *unconditionally consented* to submitting a dispute to international arbitration or conciliation, in which case the written consent of the investor would be necessary.⁵¹ An unconditional consent means that an already-established arbitration agreement between the contracting party and the investor is no longer necessary.⁵²

⁴⁹ See Ch 11 of NAFTA.

⁵⁰ Art 26 covers the 'investment' of an investor, and Art 1(6)(f) includes 'any right granted to pursue any economic activity in the energy sector' as an Investment. However, economic activity in the energy sector is not extended to cover activities related to products enumerated in Annex NI, such as oil from the distillation of high temperature coal tar and fuel woods and charcoal.

⁵¹ The structure of this part of the Article is taken from Ch 11 of the North American Free Trade Agreement (NAFTA). Art 1116 and 1117 of NAFTA provide that only investors who have suffered a 'loss or damage' as a result of an alleged breach of NAFTA may resort to arbitration (which was unconditionally consented to by the state).

⁵² See also AEL Tucker, 'The Energy Charter Treaty and 'Compulsory' International State/Investor Arbitration' (1998) 11 *Leiden Journal of Internantaional Law* 513 at 522 [hereinafter 'Compulsory Arbitration'].

Investors are free to resort firstly to national courts, and later move to international arbitration if they are not satisfied with the decision of the court. However, the contracting party can exclude the investor's right of direct arbitration by opting out from this provision as explained below.

Based on the third method provided by Article 26, the settlement will be carried out either through: (1) the International Centre for Settlement of Investment Disputes (ICSID), or (2) additional facility rules of ICSID (if both parties are not parties to ICSID), or (3) a single arbitrator, or (4) an ad hoc tribunal established under UNCITRAL arbitration rules,⁵³ or (5) the Arbitration Institute of the Stockholm Chamber of Commerce (Art 26(4)).⁵⁴ The degree of flexibility in choosing one of the above-mentioned fora is due to the particularities of each case as to the amount in dispute, the issues raised, nationality of the parties, desirable venue, and the effect of the choice of rules on the composition of the arbitral tribunal.⁵⁵ Moreover, the fact that 'investors' can submit the dispute for resolution by any of these settlement procedures means that resort to these mechanisms is at the sole discretion of the investor. States are bound to arbitrate in this way even if the parties had previously agreed that such disputes should be resolved through other mechanisms.⁵⁶ This has been strongly criticised by countries that join the ECT. They seek to limit the wide application of this rule as they believe that, if a specific dispute settlement mechanism is provided in the contract between the said country and the foreign investor, that mechanism should prevail. The investor should not be allowed to choose freely between various mechanisms prescribed in the treaty, without the consent of the host country. Although the ECT gives this wide discretion to investors, host countries are given the opportunity to limit it.⁵⁷

⁵³ United Nations Commission on International Trade Law Arbitration Rules, <<http://www.uncitral.org>>.

⁵⁴ The unconditional consent takes away the necessity of a written consent under the ICSID and UNCITRAL Rules, as well as the requirement of 'an agreement in writing' to submit to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (New York Convention). This means that if the investor had previously given written consent to submit to these methods of arbitration, no further written consent, as prescribed in other rules and conventions, is necessary.

⁵⁵ See J Paulsson, 'Arbitration without Privity' in *East-West Gateway*, above n 9, at 436.

⁵⁶ See Tucker 'Compulsory Arbitration', above n 52, at 522.

⁵⁷ Few arbitration cases have been commenced to date under the dispute resolution provisions of the ECT (the Secretariat enumerates 14 of them as of mid February 2007). One, which was settled in 2001, is *AES Summit Generation Ltd v Republic of Hungary*. The second case which was also settled in September 2004 is *Alstom Power Italia SpA & Alstom SpA v Republic of Mongolia* (Case No ARB/04/10). The first award was rendered in the case *Nykomb Synergetics Technology Holding v Latvia*, in December 2003 by the Arbitration Institute of the Stockholm Chamber of Commerce in favour of the investor. The second award was also rendered by the Arbitration Institute of the Stockholm Chamber of Commerce case in 2005 in the case *Petrobart Ltd v Kyrgyzstan*. Another three cases are brought against Russia by the Yukos Company which are still pending. A jurisdictional decision is reached in 2005 in the case of *Plama Consortium Ltd v Republic of Bulgaria* (ICSID Case No ARB/03/24). Another case is the ICSID case brought by HEP of Croatia against Slovenia in 2005 which is still pending. For a list of all the cases see the website of the Energy Charter Secretariat at <<http://www.encharter.org/index.php?id=213>>.

Article 26(3)(c) provides the possibility for some Member States to opt out of submitting a dispute to international arbitration if that dispute arises under the last sentence of Article 10(1):

A Contracting Party listed in Annex IA does not give such unconditional consent with respect to a dispute arising under the last sentence of Article 10(1).

This last sentence provides that

each contracting party shall observe *any obligation* it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

Reference to ‘any obligation’, as opposed to obligations arising from the ECT, shows that any obligation between respective governments or those arising from a government-investor relationship (relating to an investor or the investment of an investor) are covered. These agreements ‘typically regulate matters of administrative, tax and commercial law’.⁵⁸ There is always the possibility that the host state may revoke these types of agreements or subject them to renegotiation.⁵⁹ The drafters of the treaty intended to circumvent this by making it subject to investor–state dispute settlement. Of course, these agreements should be linked, directly or indirectly, to ‘investment’ as defined in Article 1(6), and should be legally valid under the domestic law of the host state at the time of their creation.⁶⁰ If this provision is accepted by a contracting party, it would mean that that government is responsible for any obligation of a public or private character that it has entered into,⁶¹ which is linked to an investment, eg obligations vis-a-vis private companies, whose activities are linked to the investment in that party’s energy sector. This all would mean that

even if the investment contract with the host state excludes certain disputes from arbitration or provides only for adjudication of the dispute by local courts, the investor can resort to Treaty-based arbitration by invoking article 10(1), last sentence.⁶²

This interpretation probably results in consequences far greater than initially intended by the contracting parties. Nonetheless, an ambiguous provision allows

⁵⁸ See T Wälde, ‘International Investment’ in Wälde, *East–West Gateway*, above n 9, at 296.

⁵⁹ For an analysis of the renegotiation clauses, see Z A Al Qurashi, ‘Renegotiation of International Petroleum Agreements’ (2005) 22 *Journal of International Arbitration* 261 at 288.

⁶⁰ For an analysis of this Article, see T Wälde, ‘International Investment’, in T Wälde, *East–West Gateway*, above n 9 at 296.

⁶¹ A broad interpretation of this Article suggests that the act should involve a typically governmental aspect, because the provision refers to any obligation that a state has entered into. Therefore, although the provision should cover the activities of state entities, it can be submitted that purely private acts of a commercial character are excluded. However, when this private act is tainted by even remote government interference, it seems that the provision would be applicable as the act could be attributed to the government. Art 22 provides rules on the activities of state enterprises, which will in turn raise the issue of attribution of their acts to that of the state. This Article covers both the activities of a state enterprise in relation to the sale or provision of goods and services.

⁶² Annex AI lists those countries that do not allow an investor or contracting party to submit a dispute concerning the last sentence of Art 10(1) to international arbitration. So far, these countries are Australia, Canada, Hungary and Norway, of which only Hungary has ratified the treaty.

such a broad interpretation unless otherwise limited in other provisions or in the case law. It remains to be seen how the far-reaching consequences of this interpretation will be dealt with in practice.

Article 26(3)(b)(i) provides that unconditional consent to submitting a dispute to international arbitration or conciliation can be avoided where the investor has *previously* submitted the dispute to the courts or administrative tribunals of the contracting party, or to any previously agreed dispute settlement procedure (treaty-based *v* contract-based arbitration). In this case, the contracting party that is willing to opt out from submission of the dispute to future international arbitration should inform the Energy Charter Secretariat, no later than the date of deposit of its instrument of ratification, acceptance or approval.

The clear reference to the possibility of opting out of Article 26(3)(a) could firstly mean that, as explained above, if there is no other agreement between the investor and the contracting party, the investor is not obliged to exhaust local remedies before resorting to international arbitration, something which is prescribed in many bilateral investment treaties.⁶³ Nonetheless, the prohibition also means that the investor is not allowed to resubmit the same dispute to international arbitration at a later stage if this dispute, based on a previous agreement, has been settled or is being settled in another forum. The underlying rationale is to prevent the investor from relying on international arbitration when another system is or has settled the dispute.

Some raise the question of what will happen when a domestic decision has been rendered and an investor wishes to appeal to international arbitration. In other words, what is the relation of contractual litigation and other forms of litigation with investment arbitration under Article 26? Generally, it is clear that investors cannot switch to international arbitration during litigation in another setting (*litispendence*). It is clear that if the country has not opted out of Article 26, and if the investor has initiated the dispute in either a national court or a previously agreed settlement mechanism, resort to international arbitration should await a decision or an award from those fora. If the country has opted out,⁶⁴ this possibility does not exist. In other words, this provision should be interpreted in a way that allows countries that have not opted out to rely on

⁶³ Some BITs explicitly allow for a direct right of arbitration for the investor. See, eg, K Vandeveldt, 'The BIT Program of the U.S.' (1988) 21 *Cornell International Law Journal* 201. Exhaustion of local remedies is more an option under the ECT than a mere obligation. Existing bilateral investment treaties are divided in obliging such exhaustion, or waiving it by virtue of the host state's consent or as a choice provided for the investor. See P Peters, 'The Exhaustion of Local Remedies: Ignored in Most Bilateral Investment Treaties' (1997) 2 *Netherlands International Law Review* 233. See also T Wälde, 'International Investment' in *East-West Gateway*, above n 9, at 304.

⁶⁴ As of September 2002, the countries that have opted out are: Azerbaijan, Bulgaria, Bosnia and Herzegovina, Croatia, Cyprus, Czech Republic, European Community, Finland, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Poland, Portugal, Romania, Slovenia, Spain, Sweden and the former Yugoslav Republic of Macedonia. The conditions under which they allow some manoeuvre in the application of this provision are explained in detail in their written statement to the Energy Charter Secretariat (ECS).

international arbitration after the settlement has been terminated in another previously agreed forum. For those countries that have opted out from this Article, this possibility is altogether rejected. This is clear from the title of Annex ID, which explicitly provides that countries listed in the Annex do not permit an investor to *resubmit* the same dispute to international arbitration *at a later stage*.⁶⁵

Contracting parties are allowed to provide a detailed analysis of how this issue should be approached in practice. For example, the national law of a given country can expressly provide that a foreign arbitral award cannot be acknowledged if it contradicts the final decision of a national court on the same dispute between the same parties. Alternatively, it can provide that an arbitral tribunal cannot act as a court of appeal in any case. It could also be possible for the investor and the host country to reach an agreement to set aside the final judgment of a court or not to enforce that judgment and initiate anew an arbitration procedure.

It is evident from the ECT's rules on international arbitration that there is a strong tendency to protect an investor by giving him a wide range of options as to how to settle a dispute. However, there is a kind of favouritism inherent in the treaty as the host country is not allowed to initiate proceedings against the investor. The ECT drastically alters the way international investment functions, by providing strong incentives for an investor to invest and by protection of his investment. Consequently, host countries should be cautious in analysing all their options that are provided to them at the time of ratification in order to limit investors in their investment claims or exercise their sovereignty to limit their activities.

From the above-mentioned rules on investor–state dispute settlement, it can be concluded that, from the viewpoint of the European Community, this section of the ECT should be regarded as a positive step towards guaranteeing security of energy supply. However, protection of investment cannot be guaranteed through the mere membership of energy-producing and transit countries in the ECT. Additional steps should be taken to reform the legal system of these countries in reaching their ultimate goal of promoting investment and to assist them in dealing with practical problems of economic management, corruption, corporate governance etc. Therefore, it is vital to help ECT countries in their economic transition, which is not limited to the liberalisation of investment and trade as prescribed in the ECT, but includes governmental supervision in various sectors. The ways through which the Community is capable of doing so is outside the scope of this study, but one could point to the initiative steps that have been taken in the framework of the TACIS programme at the Community level. The TACIS programme is a technical assistance programme implemented by the

⁶⁵ These countries, along with the European Community, have opted out of the application of this Article: Australia, Azerbaijan, Bulgaria, Canada, Croatia, Cyprus, The Czech Republic, Finland, Greece, Hungary, Ireland and Italy.

European Community, which seeks to contribute to the economic reform of the FSU countries while also emphasising social aspects of reform, the development of civil society, and human resources, including education and training. This programme is based on

the principles and objectives set out in the Partnership and Cooperation Agreements and Trade and Economic Cooperation Agreements in the context of which the Community, its Member States and the partner states⁶⁶ (ie the subjects of this programme) work together to support initiatives of common interest. (Article 2 of the TACIS Regulation)⁶⁷

The new TACIS programme also aims at reducing poverty in the poor countries of the FSU and stronger cooperation between the EU and the rich countries of the FSU such as Russia, Ukraine, Belarus and Kazakhstan.⁶⁸ These programmes seek to assist these countries—which are, in the case of the TACIS Programme, important energy-producing and transit countries—to become reliable for the purposes of security of energy supply. Although such security necessitates success in achieving the objectives of this programme, its mere existence and the fact that the European Union's budget is involved in its promotion, can be considered as major steps in overcoming the obstacles of economic reform in these countries. The Community also believes that the past 12 years of experience in the framework of this programme show a significant contribution to policy reform in these countries.⁶⁹

On the other hand, subjecting energy-producing countries to strict rules on protection of investment without guaranteeing the enforcement of court decisions or arbitral tribunal awards is insufficient. Thus, the European Community can pressure existing or future contracting parties of the ECT to join the ICSID or to subject themselves to the New York Convention as a guarantee of enforcement of arbitral awards. It can also encourage the creation of local avenues of arbitration in individual countries, as it is believed that local arbitration awards are more readily enforceable remedies than foreign arbitral awards.⁷⁰

⁶⁶ The Partner States are Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

⁶⁷ See Council Reg 99/2000 of 29 December 1999 concerning the Provision of Assistance to the Partner States in Eastern Europe and Central Asia, [1999] OJ L/12/1.

⁶⁸ See 'Towards a New TACIS Concept and Regulation: Outline of Issues for Web-Based Consultation' at <<http://europa.eu.int>>.

⁶⁹ See 'Towards a New TACIS', previous n.

⁷⁰ Within the system of the Gulf Cooperation Council (GCC), the ECT permits parties to elect to resolve their dispute in the GCC Commercial Arbitration Centre in Bahrain. This body would decide on a dispute, based on ECT provisions and general principles of international law. Experience has shown that arbitration awards issued in certain countries of the GCC are the most widely enforceable remedies as opposed to foreign arbitral awards, and local arbitration, such as the Bahrain Arbitration Rules, could facilitate such enforcement. This issue should also be taken up and studied by the ECS.

5.3.3.1.1. Investor–State Arbitration and Claims to Sovereignty

The investor–state arbitration mechanism in Article 26 can be seen as one of the most important elements of the ECT. In general, protection of private investors' interest in the context of an international treaty—due to the possibility of initiating arbitration against a state—is in itself a major contribution to investment protection. Nevertheless, this does not mean that the ECT does not take the interests of the sovereign host states into consideration.⁷¹ The external accountability of the host state and its diminishing claim of sovereignty, which will in turn result in protection of investors' rights, are at the forefront of the rationales for establishing investment arbitration. However, a well-balanced relationship between the host state in subjecting itself to this accountability, and investors' compliance with host states' rights, would guarantee a well functioning investment framework. The ECT seeks to achieve this balance through the adoption of Article 18 on sovereignty over natural resources.

Article 18 provides that state sovereignty over energy resources should be exercised in accordance with, and subject to, the rules of international law. In the 1970s, there was always a danger of conflict between a state's sovereign right over its natural resources and its obligations under international law. As Article 18 suggests, a claim of sovereignty should be read along with the obligations of the state as prescribed in international law. It is surprising, however, that the ECT does not refer to the link between the affirmation of sovereignty in Article 18 and other obligations undertaken by the parties elsewhere in the treaty. The danger is that, as no limit is imposed on the exercise of this right, the contracting parties can derogate from their obligations in other parts of the treaty, such as protection of investment, through claiming sovereignty and the fact that the 'public interest' so necessitated. The question then will be the supremacy of one obligation (as provided in other parts of the Treaty) over claims to sovereignty in case of conflict. Article 53 of the Vienna Convention on the Law of the Treaties prescribes that a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm, which is defined as a norm accepted and recognised by the international community as a whole (Article 31(1)), one from which no derogation is possible. Is it possible that the host country may use this right to negate its obligations in other parts of the treaty, including obligations with respect to investment protection, based on claims to sovereignty? Firstly, one should analyse the premise that 'sovereignty over natural resources' is a peremptory norm. This

⁷¹ This consideration is due to the fact that if the opportunities embodied in the treaty had referred only to the interests of the investor, there was the possibility of a backlash from the host states and 'they may undo whatever they have done'. See J Paulsson, 'Arbitration without Privilege' in *East–West Gateway*, above n 9, at 440.

idea is 'not readily defensible'.⁷² Secondly, even if this notion is accepted as *jus cogens*, it is difficult to accept (and has never been the case) that a peremptory norm actually renders a treaty or its constituent provisions void. Thirdly, not all obligations in the ECT are necessarily inconsistent with the sovereign rights of a state. Fourthly, if the peremptory characteristic of this right is accepted, the doctrine includes the standard of appropriate compensation. Even if the host country exercises this right, it has to pay compensation for the loss or the damage to the investor. Therefore, it is submitted that the conflict of rights and obligations is not really problematic in this case.

On the other hand, another problem exists in relation to payment of compensation. The well-established principle in international investment law, as mentioned above, which necessitates 'prompt, adequate and effective compensation' (the Hull Formula) in case of expropriation, can be considered as a manifestation of the exercise of sovereignty.⁷³ One author believes that through dedicating one whole provision on 'sovereignty over natural resources', parity has been created between this provision and the provision on the Hull Formula (Article 13). This creates a situation where the domestic law of the host state creeps into the international investment regime of the ECT.⁷⁴ Article 18, therefore, only prescribes 'payment of compensation', not based on international norms (such as the Hull Formula), but based on the domestic legal system of the host state. The main idea of having an international regime of investment protection is 'to lift the foreign investment completely out of the control of the host state's laws and subject it to the treaty regime'.⁷⁵ This is because 'the theory of internationalization of foreign investment works on the idea that the process of foreign investment be removed from the domestic sphere and be subject to a regime which gives it more protection'.⁷⁶ If that is true, the foreign investor may be adversely affected while the investment protection regime of the ECT can be questioned. However, this opinion cannot be accepted outright. The reality is that if an expropriation takes place, Article 13 and Article 18 will be read together as two parts of the same treaty and not as two distinct legal norms. In that case, Article 18 provides the right to expropriate and Article 13 provides the remedy. Although the doctrine of sovereignty over natural resources may have been included in order to secure widespread support for the treaty, its inclusion does

⁷² See Norton, 'A Law of the Future or a Law of the Past', above n 44, at 371. Brownlie suggests that the principle of permanent sovereignty over natural resources and the principle of self-determination are 'probably' peremptory norms. See I Brownlie, *Principles of Public International Law* (Oxford, Oxford University Press, 2003) at 513.

⁷³ For a definition of the Hull formula, see above n 44.

⁷⁴ See M Sornarajah, 'Compensation for Nationalization: The Provision in the European Energy Charter' in Wälde, *East-West Gateway*, above n 9, at 399.

⁷⁵ See Sornarajah, *ibid*, at 399.

⁷⁶ *Ibid*.

not detract from the provision requiring effective compensation. Any other interpretation undermines the structure of the ECT in guaranteeing investment protection.

Nevertheless, controversy remains over the potential problems of Article 18 in undermining the investment protection regime of the ECT through conflicting interpretations. It is clear that the existence of Article 18 as such in the ECT is the result of a political compromise between energy-rich and energy-consuming countries. It can be submitted that it is a backward step to bring sovereignty ideology to the fore in order to induce more energy-producing countries to join the treaty. It would be appropriate to clarify the extent of this Article's application at the level of the ECS and in future negotiations between contracting parties. The European Community could also request clarification of how this Article will be applied in practice, which would be vital for European investors.

5.3.3.1.2. Article 26(3) and the Status of the European Communities

The investor–state arbitration system of the ECT suggests that foreign investors, who have invested in the Community, can bring a claim in the domestic courts of the Member States and in the European Court of Justice. As mentioned earlier, one option for the investor is to submit the dispute to the courts or administrative tribunals of the contracting party to the dispute. As both the European Community and the Member States have ratified the ECT, it should be possible for an investor to raise a claim against the Community or the Member States, either in the European Court of Justice (ECJ) or before a national court. However, the possibility of such a move should be analysed here. One important aspect of this analysis is to determine whether the ECT has direct effect, ie whether the treaty receives judicial enforcement in the domestic courts of a particular state, and whether an individual is principally allowed to bring a claim against a particular European or national law as being in violation of the provisions of the ECT.

Before analysing this issue, it should be mentioned that the notion of direct effect should not be confused with that of investor–state international arbitration. The investor–state arbitration of the ECT allows the investor to bring a claim directly against the state in an arbitration setting under the ECT and without privity, whereas direct effect gives the investor the right to base an action on the ECT provisions in the domestic courts of the State or the ECJ.

Generally, one problem with arbitrating against the state is that it renders the investor unpopular with the government. A less perilous way to bring a claim against a state would be for the investor to seek the intervention of the domestic courts of the ECT Member State. It is for this reason that the issue of direct effect comes into play, as it determines to what extent such intervention is possible in the Community. One of the most important aspects of investor protection is that future laws or regulations in the host state should not be designed to harm the foreign investor who has undertaken his/her activities in the host country. The

idea is that, should the European Community or the Member States pass a law that is contrary to the provisions of the ECT, the foreign investor affected by that law, should be able to raise a claim in the national courts or the ECJ and demand the reform or abolishment of that norm. The investor is only able to demand this if the ECT is found to have direct effect. This possibility is very complex and detailed, and the following study seeks to briefly highlight the relevant laws in this field.

5.3.3.1.2.1 *Direct Effect of the Energy Charter Treaty*

i. The Concept of Direct Effect

The legal order of the European Community has been considered unique for various reasons, including its embodiment of the principle of direct effect in the interaction between various legal norms in the Community. 'Direct effect of Community law' is the capacity of a Community norm to be applied in domestic court proceedings. In practical terms, this would allow an individual to refuse to abide by a domestic norm if that norm is in violation of the EC Treaty. There are various statements found in the case law and in legal scholarship as to what the 'direct effect of international treaties' exactly means. The theme of these definitions is that 'private parties can make a claim on the basis of the international treaty norm, and governments, or different levels of the government might utilise the treaty norm as part of domestic jurisprudence'.⁷⁷ In other words, an international treaty has direct effect when the treaty rule is judicially enforceable in the domestic courts of a particular state party to that treaty or in the ECJ.⁷⁸ The direct effect of the Energy Charter Treaty would mean that an individual, here an

⁷⁷ JH Jackson, 'The Status of Treaties in Domestic Legal Systems: A Policy Analysis' (1992) 86 *American Journal of International Law* 310 at 311. See the Case 26/62, *NV Algemene Transport – en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, [1963] ECR I This case is the basis of the discussions on the direct effect of Community law in the national legal systems of the Member States. In later cases, direct effect was extended to cover a wider range of treaty articles. This issue later encompassed the direct effect of regulations, directives and decisions that, depending on their formulation, would be given direct effect.

⁷⁸ The terms used to define the legal status of international treaties in the domestic legal system are various. Some talk of 'self execution' while others mention 'direct applicability' and some call it 'direct effect'. In the United States, for example, the term used is 'self-execution'. A self-executing treaty is a treaty that operates itself without the aid of any legislative provision, and whenever its provisions prescribe a rule by which the rights of the private citizen or subject may be determined. See RA Brand, 'Symposium: Institutions for International Economic Integration: Direct Effect of International Economic Law in the United States and the European Union' (1997) 17 *Journal of International Law and Business* 556. The terms direct effect and direct applicability are often used interchangeably, but some commentators differentiate as to the differences between their implications. For example, a treaty can be directly applicable but might not have the potential to be enforced, while when we talk about direct effect the result is that the treaty can be enforced. See generally JH Jackson, *ibid.* [He believes that it is analytically preferable to separate these concepts, particularly since the policies that relate to each one differ considerably]. See also B de Witte, G de Búrca, 'Direct Effect, Supremacy, and the Nature of the Legal Order' in P Craig and G de Búrca (eds), *The Evolution of EU Law* (Oxford,

investor, should principally be allowed to bring a claim against a particular European or national law as being in violation of the ECT provisions.

The arguments in favour of direct effect of international treaties declare that such effect enhances the importance and weight of the international treaty, and decreases the likelihood that national authorities will refuse or neglect to provide for the transformation of the treaty norms into domestic law. Direct effect would also decrease the likelihood on the part of the courts to treat provisions of an international treaty as the 'children of a lesser God'.⁷⁹ Some also argue that direct effect will enhance the 'respect' for, and the general prestige of, international law 'to the benefit of the world order'.⁸⁰

On the other hand, arguments against direct effect mostly relate to the exercise of sovereignty and the fact that methods of implementing an international treaty or fulfilling the obligations therein should be determined by nations themselves, or that direct effect undermines the treaty-making process in different countries. Legislatures may wish to tailor the act of transformation in certain ways,⁸¹ perhaps by rewording the treaty to match domestic circumstances. Overall, it seems that arguments against direct effect are concerned with the degree of faith in the international system.⁸² The greater the degree of faith, the stronger the chance of accepting the treaty as directly effective.

Although the direct effect of Community norms within the national system of Member States has become the norm,⁸³ the direct effect of international treaties in state parties' domestic systems has been subject to disparate rulings and, as some declare, has been dealt with less generously.⁸⁴ While individuals, through the doctrine of direct effect of Community law, can be considered as 'the

Oxford University Press, 1999) at 181 [hereinafter 'Direct Effect']. In the context of the European Community, the common term is 'direct effect', which is interchangeably used as 'direct applicability'.

⁷⁹ KJ Kuilwijk, *The European Court of Justice and the GATT Dilemma* (Beuningen, Nexed Editions, 1996) at 343. In relation to this issue, some believe that the act of transforming an international treaty into domestic law through, for example, a parliamentary act, allows too much leeway to governments to depart from the precise wording of the treaty, and thereby, 'transform a norm that does not accord with the treaty norm itself and screen out individuals' rights'. See Jackson, 'The Status of Treaties', above n 77, at 322

⁸⁰ See Jackson, 'The Status of Treaties', *ibid*, at 322.

⁸¹ *Ibid*.

⁸² See G Bebr, 'Agreements Concluded by the Community and their Possible Direct Effect: From International Fruit Company to Kupferberg' (1983) 20 CML Rev 35 at 72. He argues that it is doubtful that the direct effect of Community law can be transposed, without any further restriction and qualification on the loose international legal system governed by different principles and concepts. The following lines discuss the attitude of the ECJ in this respect.

⁸³ See Case 26/62, *Van Gend en Loos*, above n 77.

⁸⁴ See also de Witte, 'Direct Effect', above n 78, at 185. See the Case 104/81, *Hauptzollamt Mainz v Kupferberg* [1982] ECR 3641. See also the Case 12/86, *Meryem Demirel v Stadt Schwäbisch Gmünd* [1987] ECR 3719.

guardians of Community law,⁸⁵ the same cannot be said with certainty about their role with regard to international law.⁸⁶

The effect of various policies on the acceptability of direct effect of international treaties can be analysed in so far as the policies themselves are clear and concise, which leads one to deduce some clear guidelines for the courts and individuals. However, these policies are not easily depicted, which subsequently leads to differing interpretations as to their value. The case law of the ECJ on direct effect is plagued with such differing interpretations, and there is no clear guideline on whether international treaties are given direct effect. The answers differ based on the nature of the international treaty under consideration. These issues will be dealt with below. The direct effect of the trade provisions of the ECT will be elaborated on at the end of the section analysing the trade provisions of the ECT.

ii. The Analysis of the Direct Effect of the ECT: The Provisions on Investment

In a Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Article 26(3)(b)(ii) of the Energy Charter Treaty,⁸⁷ it is provided that:

The Court of Justice of the European Communities, as the judicial institution of the Communities, is competent to examine any question relating to the application and interpretation of the constituent treaties and acts adopted there under, including international agreements concluded by the Communities, *which under certain conditions* may be invoked before the Court of Justice.

⁸⁵ L Hancher, 'Constitutionalism, the Community Court and International Law' (1994) 15 *Netherlands Yearbook of International Law* 259 at 265. See also JHH Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2405 at 2407.

⁸⁶ A related issue, which should be referred to here, is to determine who is concerned with the implications of the direct effect of international treaties in the Community legal order. The case law is most concerned with the fact that when direct effect is found to exist, the first consequence is that some individual rights are created, which can be protected by national courts. Though a treaty may be directly effective, the court should determine who is entitled to invoke or rely on the treaty norms. The concept of 'invocability' of a norm, ie the provision whereby an international treaty has the capacity to be invoked by individuals, supersedes the idea that direct effect creates rights for individuals, as it is broader than the latter concept 'because it may be invoked for other purposes, for example, as a defence in criminal proceedings or as a standard for Review of the legality of Member State's action in administrative proceedings'. See S Prechal, 'Does Direct Effect Still Matter?', (2000) 37 *CML Rev* 1047 at 1050. She believes that equating direct effect with the creation of rights does not do justice to the diversity of effects that may be produced by directly effective provisions. Jackson, 'The Status of Treaties', above n 77, at 317. See also SA Riesenfeld, 'International Agreements', (1989) 14 *Yale Journal of International Law* 455 at 462, and W van Gerven, 'The Horizontal Direct Effect of Directive Provisions Revisited: The Reality of Catchwords' in D Curtin and T Heukels (eds), *The Institutional Dynamics of European Integration. Liber Amicorum Henry G Schermers* (Dordrecht, Martinus Nijhoff, 1994). See de Witte, 'Direct Effect', above n 78, at 187. See also See FG Jacobs and S Roberts (eds), *The Effect of Treaties in Domestic Law* (London, Sweet and Maxwell, 1987).

⁸⁷ See Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Art 26(3)(b)(ii) of the Energy Charter Treaty, 9 March 1998, [1998] OJ L/69/115.

... [Any] case brought before the Court of Justice of the European Communities by an investor of another Contracting Party, in application of the forms of action provided by the constituent treaties of the Communities, falls under Article 26(2)(a)⁸⁸ of the Energy Charter Treaty. Given that the Communities' legal system provides for means of such action, the European Communities have not given their unconditional consent to the submission of a dispute to international arbitration or conciliation.

As far as international arbitration is concerned, it should be stated that the provisions of the ICSID Convention do not allow the European Communities to become parties to it. The provisions of the ICSID Additional Facility also do not allow the Communities to make use of them. Any arbitral award against the European Communities will be implemented by the Communities' institutions, in accordance with their obligation under Article 26(8) of the Energy Charter Treaty. (emphasis added)

Although this statement can be interpreted as allowing the investor to bring a claim to either national courts or the ECJ based on the ECT, the result is not outright for reasons explored below. This statement mentions that certain conditions should be satisfied in order for the ECT to be invoked before the ECJ. It should be verified to what extent these conditions hamper the objectives pursued by the ECT.

At the initial stage, in order to analyse whether an international treaty can be invoked by the ECJ, two conditions should be met. The first condition is that the Community should be a party to the international treaty. In *Kingdom of the Netherlands v European Parliament and Council of the European Union*, the ECJ stated that the legality of a Community instrument cannot be called in question on grounds of breach of international agreements if the Community is not a party.⁸⁹ The second condition is that the provisions of those agreements should have direct effect. Therefore, if the treaty has direct effect and the Community is a member to it, a Member State or an individual can attack the Community measure, based on the claim that it violates the international treaty.

In general, in order to determine whether an international agreement can be granted direct effect three issues should be analysed. Firstly, if a Community measure is found to be incompatible with a provision of an international treaty it should be decided whether the Community is bound by that provision.⁹⁰ Secondly, it should be determined whether the Community institutions, which have power to negotiate and conclude an agreement with a non-member country, agreed with that country on what effect the provisions of that agreement should have in the internal legal order of the contracting parties. If that question

⁸⁸ Art 26(2) of the ECT provides that if investor–state disputes cannot be settled amicably within a period of three months, the investor party to the dispute may choose to submit it for resolution to 'the courts or administrative tribunals of the Contracting Party, party to the dispute'.

⁸⁹ See Case 377/98, *Kingdom of the Netherlands v European Parliament and Council of the European Union*, [2001] ECR I-7079, para 51.

⁹⁰ See Case 24/72, *International Fruit Company v Produktschap voor Groeten en Fruit* [1972] ECR 1219 para 7.

has not been settled by the agreement, it falls to be decided by the courts having jurisdiction in that matter.⁹¹ Thirdly, it should be verified whether that provision of international law is capable of conferring rights on citizens of the Community which they can invoke before the courts, or in other words, as the Court ruled in 1991, whether an international agreement is of such a nature as, or is intended, to govern the legal situation of individuals.⁹² When it is found that the Community is bound by the provisions of an international treaty—for example if the Community has become a member of that treaty⁹³—and nothing with regard to the effect of that treaty in the Community has been agreed upon, the issue of whether that treaty confers rights to the citizens of the Community is left to be analysed by the Court.

With respect to the Energy Charter Treaty, the individuals involved are mainly foreign investors. The investment provisions of the treaty, including the investor–state dispute settlement system, seek to protect the rights of these investors. Therefore, it is possible to construe the agreement as bearing directly on the legal situation of individuals. Curiously, however, the question is whether the mere fact that an agreement creates rights or obligations for individuals allows those individuals to invoke it before courts, therefore, enabling one to conclude that the agreement has direct effect. The answer is surely negative.⁹⁴ If the host state fails to protect the rights of individual investors, the mere existence of rights for investors in the treaty does not necessarily mean that it is granted automatic direct effect.⁹⁵ For instance, as far as the protection of rights of individuals is

⁹¹ See Case 104/81, *Kupferberg*, above n 84, para 17, and also Case 149/96, *Portugal v Council* [1999] ECR I-8395, para 34. See also A Rosas, ‘Annotation on *Portugal v Council*’ (2000) 37 CML Rev 797.

⁹² See Case 18/90, *Office National de l’Emploi (Onem) v Bahia Kziber* [1991] ECR I-199, para 8.

⁹³ See also Art 300(7) of the EC Treaty.

⁹⁴ There are two extreme opinions on the subject of direct effect. Some believe that ‘under the normal canons of international law, even when the international obligation itself, such as trade agreement or human rights convention, is intended to bestow rights on individuals within a state, if the state fails to bestow the rights, the individual cannot invoke the international obligation before the national courts.’ See Weiler, ‘The Transformation of Europe’, above n 85, at 2414. See against, P Eeckhout, ‘The Domestic Legal Status of the WTO Agreement: Interconnecting Legal Systems’ (1997) 34 CML Rev 11 at 48 [hereinafter ‘Interconnecting Legal Systems’]. [He states that

it is obvious that if the GATT/WTO rules did lay down and define fundamental rights, and were generally acknowledged to do so, that would be a strong, if not decisive argument for accepting the direct effect of those rules. Where rights are not only rights, but are also considered fundamental—*leaving aside the question as to the exact meaning of such a statement*—a lack of justiciability amounts to a serious constitutional defect in the legal system concerned. (emphasis added)

In my view, Eeckhout’s statement can be criticised for what it ignores, ie the notion of ‘fundamental right’. Without knowing what those fundamental rights are, we cannot claim that the system is defective as it fails to protect those rights.

⁹⁵ The North American Free Trade Agreement (NAFTA) provides the same system of investor–state dispute settlement system for foreign investors. The US Congress and the President have unequivocally expressed their intention to obstruct private parties from using any of the NAFTA provisions to challenge US laws. The direct effect will only be limited to causes of action brought by the Attorney General. See in general MK Omalu, *NAFTA and the Energy Charter Treaty: Compliance with, Implementation and Effectiveness of International Investment Agreements* (The Hague, Kluwer Law International, 1999) at 94.

concerned, one can refer to the Agreement on Trade-Related Aspect of Intellectual Property Rights (TRIPS), where intellectual property rights can be considered as inherently private rights. As some suggest, the TRIPS Agreement is clearly not a 'diplomatic arrangement' or a forum for the permanent negotiation of trade issues, and therefore it could appropriately be granted direct effect.⁹⁶ However, in the *Parfums Christian Dior* case,⁹⁷ TRIPS was not automatically granted direct effect.

What if the international treaty allows the individual (both natural and legal persons) to bring a claim in a national court or an administrative tribunal, as the ECT does? Under the ECT, the foreign investor is not necessarily relying on its own state to defend his/her rights in a national court. Would the existence of such a possibility for the individual shift the balance to granting direct effect? The answer is not found in the case law of the ECJ, as none of the international treaties at issue before the ECJ had provided such an individual right. Nevertheless, it can be submitted that it should be taken into consideration by the Court, since the main rationale underlying the existence of such provisions was to allow the investor to protect his/her rights independently from the state. The statement of the European Communities to the Secretariat of the Energy Charter Treaty could be used to endorse this effect as well.

One other observation is also necessary. As mentioned above, one condition to grant direct effect to an international treaty, or to some provisions of it, is to detect a reference made in the ECT with respect to the 'effect' that the ECT should have in the Community.⁹⁸ The text of the ECT makes no explicit reference to this issue. Could the existence of Article 26(2)(a), which allows the foreign investor to submit its claim for resolution to 'the courts or administrative tribunals of the Contracting Party to the dispute', be considered as 'an agreement' that an individual may bring a claim before the courts of the contracting parties, such as the national courts of the Community Members States or the ECJ? This provision could be interpreted as granting a right to individuals to bring a claim based on the provisions of the ECT. However, as this provision only applies to Part III of the ECT (ie investment), it could be argued that only those investment provisions of the ECT found in Part III can be relied upon by the individual.

If the possibility of bringing a claim to the national courts of the Member States is not provided for the investor, one of the most important provisions of the ECT (of which the Community is a member) will be undermined, ie protection of foreign investors. Secondly, the bona fide performance of every agreement, as a general rule of international law,⁹⁹ suggests that if such a system

⁹⁶ See Eeckhout, 'Interconnecting Legal Systems', above n 94, at 33.

⁹⁷ See Joined Cases 300/98 and 392/98, *Parfums Christian Dior* [2000] ECR I-6013.

⁹⁸ See Case 149/96, *Portugal v Council*, above n 91, para 34.

⁹⁹ See the opinion in *Portugal v Council*, previous n, at para 35. See also Art 26 of the Vienna Convention on the Law of Treaties, which provides that every treaty in force is binding upon the parties to it and must be performed by them in good faith. It is not too far-fetched to conclude that

of investment dispute settlement was agreed upon by the Member States, they shall fully execute their commitments in this respect. Due to these restrictions, the investor should therefore be allowed to choose to raise his claim in the national court of a Community Member State or before the ECJ. Stripping the investor of this right would impede the protection of investors within the Community. This conclusion is of importance, because it purports to guarantee the protection of a foreign investor in the Community, which would contribute to the general stability of the ECT's system of protection.

This issue can also be linked to the opinion of some commentators, who believe that a system cannot be called 'legitimised' if a given court is not fully prepared to recognise the legal guarantees of a treaty and to confer constitutional significance on those norms. This significance is said to be provided 'when international economic provisions are construed in the light of the individual's trade' or investment for the purposes of our study.¹⁰⁰ However, even if we do not go as far as linking the issue of direct effect to the 'legitimacy' of the Energy Charter Treaty system in these terms, we should highlight that there may be a claim on the part of the energy-producing or transit countries if no direct effect is provided for those investors that wish to raise a claim against the national law of a Community Member State or a Community rule (if possible). As energy-producing countries are directly responsible to the investor for any change in laws that may adversely affect them (European investors), their counterparts, here the Community and its constituent Member States, should also be responsible for changes in Community or national measures that could violate the ECT provisions. In simple terms, if direct effect is not provided for a foreign investor in the Community, the Community runs the risk of retaliation on the part of the home country of the investor. If direct effect is not provided for the investment provisions of the ECT, the impossibility of a Turkmen investor, for example, raising his claim in the Community would create an imbalance in the relations of the two parties. This unevenness could lead to retaliation on the part of Turkmenistan. Although this scenario is raised in abstract terms, for which no past example exists, it should always be kept in mind that energy issues are strongly dealt with at the political level. Consequently some 'claims' may be raised, which could indirectly affect foreign investors. The main argument in an

this rule necessitates the granting of rights to investors in the ECT, when one of the basic principles of this treaty is the protection of investors and their investment.

¹⁰⁰ AK Schneider, 'Democracy and Dispute Resolution: Individual Rights in International Trade Organisations' (1998) 19 *University of Pennsylvania Journal of International Economic Law* 587. See also EU Petersmann, 'Constitutional Principles Governing the EEC's Commercial Policy' in M Maresceau (ed), *The European Community's Commercial Policy after 1992: The Legal Dimension* (Dordrecht, Martinus Nijhoff, 1993) at 35 [hereinafter 'EC Commercial Policy after 1992']. See M Hilf, 'New Frontiers in International Trade: The Role of National Courts in International Trade Relations' (1997) *Michigan Journal of Internantaional Law* 321 at 326. See also EU Petersmann, 'National Constitutions and International Economic Law', in M Hilf and EU Petersmann (eds), *National Constitutions and International Economic Law* (Boston, Kluwer Law and Taxation Publishers, 1993) at 50.

international setting has always been the reciprocity of rights and obligations of the parties, even if the amount of one party's investment is far greater than the other's. Therefore, even if the issue is an abstract one, it is worth emphasising. In other words, if one of the most important aspects of the ECT is considered to be the system of investor–state dispute settlement, as it seeks to protect the right of individual investors, it should be confirmed whether the Community protects the right of foreign investors investing in its territory as well as in host energy-producing countries. This would eventually lead to verification of the balanced approach of the ECT and the protection of the right of European and foreign investors, and the exercise of their rights based on reciprocity.

This being said, there are still some limitations as to establishing direct effect for the investment provisions of the ECT and the possibility to be invoked before the ECJ. The possibility of allowing an investor to bring a claim to the ECJ differs depending on whether we are dealing with national or Community law. In determining what laws can be subject to an individual's claim, it is interesting to highlight that, based on the current system of judicial review of the legality of Community acts, natural and legal persons cannot 'directly' challenge measures of 'general application' (ie regulations and directives).¹⁰¹ This principle has been attributed to the fact that so far 'no Member State of the European Union provides a general and unconditional judicial remedy against legislative acts'.¹⁰² The ECJ always acknowledged that regulations should not be put at the discretion of a vast number of plaintiffs seeking judicial protection.¹⁰³

¹⁰¹ For the view of the ECJ regarding the acceptability of an individual challenge to a decision, see the judgment of the Court of First Instance, CFI, joined cases T-172/98 and T-175/98 to T-177/98, *Salamander a.o. v Parliament and Council*, [2000] ECR II-2487. This means that the individual shall only be given a right of action against the application of unlawful acts of general nature and a right of action for damages caused by its application, but not against its enactment. See J Schwarze, 'The Legal Protection of Individuals against Regulations in European Union Law: Remarks on the ECJ Judgment in the Case UPA of 25 July 2002 in view of the European Constitutional Reform' (2004) 10 *European Public Law* 285 at 293 [hereinafter 'The Legal Protection']. Moreover, individuals can only invoke the provisions of a directive against a Member State or its agencies (vertical relationships) and not against another individual. See the Case 152/84, *Marshall v Southampton and South West Hampshire Area Health Authority*, [1986] ECR 723, para 48. See also V Skouris, 'Effet utile versus Legal Certainty: The Case-law of the Court of Justice on the Direct Effect of Directives' (2006) 17 *European Business Review* 241 at 243. See also Editorial Comments, 'Horizontal Direct Effect: A Law of Diminishing Coherence' (2006) 43 *CML Rev* 1.

¹⁰² See Schwarze, *ibid*, at 287. (He argues that as some Commission regulations are of a more technical character, which frequently have only a narrow scope and only affect a limited number of persons, concerned individuals might thus be just as affected by the measure in question, even though it is of general application, as by any concrete decision. Hence, judicial protection of the individual against those acts is strongly desirable). Moreover, Art 230(4) of the EC Treaty also provides that:

Any natural or legal person may, under the same conditions, institute proceedings against a decision addressed to that person or against a decision which, although in the form of a regulation or a decision addressed to another person, is of direct and individual concern to the former. This provision reveals that natural or legal persons cannot question the legality of a regulation or a decision unless they are directly affected by it.

¹⁰³ See Case 25/62, *Plaumann* [1963] ECR 95. For a criticism of the way through which Art 230(4) is interpreted, see A Arnulf, 'Private Applicants and the Action for Annulment since *Codorniu*' (2001) 38 *CML Rev* 7, H Rasmussen, 'Why is Article 173 Interpreted against Private Plaintiffs?' (1980)

Interestingly, the fact that measures of general application cannot be challenged by private parties, applies when no international treaty is involved.¹⁰⁴ What would be the applicable law if the Community measure is contrary to an international norm? In that case, could the individual raise a claim against that measure based on the provisions of the international treaty? Although the Community still cannot be described as purely monist, as long as the two conditions mentioned above are satisfied—the Community is a member of the international treaty, and its provisions have direct effect—such claim is possible. However, some further observation is necessary.

The case law has suggested that the possibility exists of invalidating a Community measure if it is found to be inconsistent with the international treaty based on a specific condition, which is not related to the issue of direct effect. For example, in the famous *Nakajima* case,¹⁰⁵ the possibility arose for the ECJ to invalidate a Community measure that was incompatible with GATT. In that case, the Anti-Dumping Code of the WTO had been implemented at Community level by adoption of the basic anti-dumping regulation. It is interesting that the applicant in this case did not rely on the direct effect of GATT. This may mean that the *Nakajima* doctrine can be used to review the validity of EC law with reference to international obligations, ‘without producing conflict with the denial

5 EL Rev 112; and F Mancini and D Keeling, ‘Democracy and the European Court of Justice’ (1994) 57 CML Rev 175 at 188. See Schwarze, ‘The Legal Protection’, above n 101. The ECJ has stated that, in this situation, it is for the Member States to establish a system of legal remedies and procedures based on Art 10 of the EC Treaty, which calls for the Member States to take all appropriate measures to ensure fulfillment of the obligations arising out of the treaty or ‘resulting from action taken by the institutions of the Community’ (duty of loyal cooperation). See J Temple Lang, ‘Actions for Declarations that Community Regulations are Invalid: the Duties of National Courts under Article 10 EC’ (2003) 28 EL Rev at 102. The Court of First Instance has recently interpreted the condition of ‘direct concern’ by stating that the individual’s own rights have to be affected, ie the measures should affect the legal position of the individual in a definite and immediate manner. See Case T-177/01, *Jégo-Quéré v Commission*, [2002] ECR II-2365, paras 48 ff. Therefore, the individual does not necessarily have to be ‘singled out’ in order to be able to impugn a Community measure of general application. See Schwarze, above n 101, at 291. However, this interpretation has not been adopted by the ECJ. The Court has acknowledged that although this Article does not guarantee full judicial protection for the individual, it is impossible to interpret Art 230(4) of the EC Treaty in any other way so as to expand the right of the individual to seek judicial remedy against a regulation or a decision. Thus, the only remaining possibility is for the Member States to seek reform of the treaty under Art 48. See the decision of the ECJ in Case 50/00, *UPA v Council*, [2002] ECR I-6677, para 45. See also the changes made to this Article in the Treaty Establishing a Constitution for Europe, Art III-365 where it is provided that:

Any natural or legal person may, under the conditions laid down in paras 1 and 2, institute proceedings against an act addressed to that person or which is of direct and individual concern to him or her, and against a regulatory act which is of direct concern to him or her and does not entail implementing measures.

This Article has also taken a restrictive approach to the issue of the involvement of natural or legal persons, and has not explicitly allowed the possibility of attacking measures of general application.

¹⁰⁴ See also GA Zonnekeyn, ‘The Bed Linen Case and its Aftermath: Some Comments on the European Community’s World Trade Organisation Enabling Regulation’, (2002) 36 *Journal of World Trade* 993 at 1003; and D Horovitz, ‘A Regulated Scope for EU Compliance with WTO Rulings’, (2001) 7 *International Trade Law and Regulation* 153 at 156.

¹⁰⁵ See Case 69/89, *Nakajima All Precision Co. Ltd v Council*, [1991] ECR I-2069.

of direct effect of WTO law¹⁰⁶ However, it is very important to highlight here that this doctrine envisages that ‘international obligations have been transposed into EC law’.¹⁰⁷ Returning to what was stated earlier, this transposition should have been done correctly, and its accuracy can be reviewed by the ECJ.¹⁰⁸ The important detail of this case, therefore, is that ‘the question of direct effect is a non-issue where the Community *intends to implement* a particular obligation entered into within the framework of an international treaty’.¹⁰⁹ Therefore, as long as international obligations are not transposed into Community law, no remedy exists for the individual to attack a Community measure that is in violation of an international treaty. Nevertheless, although the cases decided after the *Nakajima* case pointed in the direction of limiting, as much as possible, the ability of individuals to rely on international treaties in proceedings before the ECJ, some recent cases revived the judgment of the Court in the earlier case.¹¹⁰

For the purposes of our study, therefore, this case law suggests that where the EC intends to implement a particular obligation entered into within the framework of the ECT, one could argue for the entitlement of the foreign investor to bring a claim against a Community measure. The EC’s intention to implement such an obligation can be found, for example, in the Community measures adopted. However, as one writer rightly argues, ‘it might not always be easy to know when the EC intends to implement a particular obligation undertaken in the framework of the international treaty’.¹¹¹ It is then problematic whether the absence of such a reference justifies depriving individuals of the possibility of bringing a case before the ECJ.

The scenario above revealed that, if the Community has implemented a particular obligation within the framework of the ECT, the investor may bring his

¹⁰⁶ See generally Eeckhout, ‘The Interconnecting Legal Systems’, above n 94.

¹⁰⁷ See G.A Zonnekeyn, ‘The Bed Linen Case and its Aftermath’, above n 104, at 263. See also See P Eeckhout, ‘Interconnecting Legal Systems’, above n 94, at 45. See also A Davies, ‘Bananas, Private Challenges, the Courts and the Legislature’, in P Eeckhout and T Tridimas (eds), (2002) 21 *Yearbook of European Law* at 318. Eeckhout suggests that

[The] implementation criterion is astonishing at first sight, in that it seems self-defeating: where GATT rules are implemented there will normally be much less need for judicial review based on those rules than in other cases, where *ex hypothesis* those rules were not taken into account or observed. On reflection, however, there does appear to exist a sound justification. If GATT as such does not have direct effect, it is only where it has been transformed and incorporated into Community law by the Community legislature that it becomes part of that law in the sense that it can be relied upon in court proceedings.

¹⁰⁸ It is apparent that the Court made a clear distinction between the direct effect of an international treaty as such, which is linked to the relationship between national and EC law, and the possibility of invoking international agreements when challenging EC acts, which concerns the relationship between international law and EC law. See GA Zonnekeyn, ‘The ECJ’s *Petrotub* Judgment: Towards a Revival of the *Nakajima* Doctrine?’ (2003) 30 *Legal Issues of Economic Integration* 249 at 255.

¹⁰⁹ See Zonnekeyn, ‘*Petrotub* Judgment’, *ibid*, at 263.

¹¹⁰ See Joined Cases T-33/98 and T-34/98, *Petrotub SA and Republica SA v Council* [1999] ECR II-3837. See also the Case 70/87, *Fediol v Commission*, [1989] ECR 1781.

¹¹¹ See Zonnekeyn, ‘*Petrotub* Judgment’, above n 108, at 264.

claim before the ECJ. This possibility in turn obviates the need to analyse the direct effect of the ECT. However, in case we need to rely on the analysis of direct effect, especially when no such implementation is found to exist, another question should be answered, namely the situation where some provisions of the international treaty have direct effect and others do not. Would the ECJ review the legality of Community norms even with respect to those provisions of the international treaty that do not have direct effect?

Based on precedents dealing with the direct effect of international treaties in the Community, the Court emphasises that the fact that some provisions of the international agreement do not have direct effect does not necessarily preclude review by the courts. This last point, however, is still open to debate. On the one hand, if we divide the international treaty into those provisions that have direct effect and those that do not, we will have a mixed approach towards the domestic legal status of that treaty. In that case, at a minimum, the domestic legal status of those provisions of the treaty that fall within the ambit of the non-exclusive competence of the Community will not be clear. Some believe that, for precisely this reason, a mixed approach should be prevented.¹¹² This will in turn prevent one international treaty from being treated differently in various member countries, because the interpretation given to the provisions of the treaty will not differ between 27 Member States.¹¹³ They argue that if a uniform approach is not the desired result, the division of competences between the Community and the Member States should be clearly indicated in any international treaty.¹¹⁴ As this division is not normally undertaken by the drafters of treaties, the ECJ has created a theory for approaching these types of international agreements, which does not necessarily reflect the concern that was raised above.

As the *Hermes* case demonstrated, the ECJ is allowed to give a preliminary ruling whenever interpretation of an international legal norm is of possible relevance to EC law or a law established under it, no matter whether they fall within the competence of the Community or not.¹¹⁵ Therefore, the ECJ would deal with those provisions of a mixed agreement that can be interpreted as having a direct relation with either the EC Treaty or a law established under the treaty. In other words, the ECJ does not have jurisdiction to interpret those provisions of the international agreement for which the Community has not yet legislated, and which consequently fall within the competence of the Member States.¹¹⁶ Thus,

¹¹² See Eeckhout, 'Interconnecting Legal Systems', above n 94, at 22. See also P Eeckhout, 'Judicial Enforcement of WTO Law in the European Union: Some Further Reflections', (2002) 5 *Journal of International Economic Law* 91 at 104.

¹¹³ See also A von Bogdandy's annotation on 'Case 53/96, *Hermes International v FHT Marketing Choice BV*, Judgment of the Court of 16 June 1998, [1998] ECR I-3603' (1999) 36 CML Rev 663 at 668.

¹¹⁴ See M Hilf, 'The Application of GATT within the Member States of the European Community, with Special Reference to the Federal Republic of Germany' in M Hilf, FG Jacobs, and EU Petersmann, *The European Community and GATT* (Deventer, Kluwer, 1989) at 166.

¹¹⁵ See Case 53/96, *Hermes International v FHT Marketing Choice BV*, Judgment of the Court of 16 June 1998, [1998] ECR I-3603, para 22 ff.

¹¹⁶ See also joined cases 300/98 and 392/98, *Parfums Christian Diors*, [2000] ECR I-6013, para 32.

the possibility remains for the ECJ to distinguish between those provisions that fall within its competence and those that do not.

The analysis above reveals that there is no definite and clear answer as to when, and under what conditions, Part III of the ECT can be relied upon by an individual to attack a national or a Community measure. The approach of this study was to distinguish those provisions of the ECT that deal exclusively with investment and those that deal with trade and transit. It was argued that the investment provisions may be given direct effect, not because Part III creates rights for investors, but because an investor–state dispute settlement system exists which necessitates the possibility of an investor raising his claim before national courts or the ECJ. However, even if we accept that Part III has direct effect, it should also be examined whether the individual is allowed to bring his claim before the ECJ. If yes, can the investor also attack a Community measure that is in violation of Part III of the ECT? As explained above, it can be submitted that a link should exist between Part III and the EC Treaty, or a law adopted based on the latter. In other words, an investor can only bring a claim against a Community measure where an intention to implement the obligations of Part III in the Community can be found. A second question related to this previous point is that, as Part III does not fall within the exclusive competence of the Community, can the ECJ distinguish between those provisions that fall within its exclusive competence and those that do not? It was concluded that the ECJ would approach the ECT as a whole if the interpretation of its provisions was directly linked to the laws of the Community. Therefore, it can be submitted that a Community measure will be reviewed by the Court only when the Community as a whole is affected, or in other words, if the international legal system and the Community legal system are somehow interconnected. If those provisions of Part III that are relied upon have no effect on the obligations arising from the ECT or the laws adopted, the ECJ will not have jurisdiction.

One can conclude from the above-mentioned study that the direct effect of Part III of the ECT has many facets, and the existing rule cannot be stated in general terms. It should, however, be emphasised that Part III of the ECT creates new and exceptional situations by allowing an investor to bring a claim against a state in national courts or tribunals. The effect of such a provision is only manifested if no restriction is imposed on this possibility. The reciprocal rights and obligations of both European and foreign investors suggest that if the ECT is given direct effect in other member countries, or if the transformation of the ECT into their national legal systems has not transfigured the treaty and undermined the most important principles of investment protection, the Community should not tip the balance between these rights as this act could indirectly affect the security of Europe's energy supply. The protection of investment is one of the most important components of energy security. Through investment in exploration, production or transit facilities, the undisturbed flow of energy to

Europe can be guaranteed. By preventing foreign investors from having access to the Community court, there is a chance of retaliation. Even if this risk is slight, the repercussions could be great.

5.3.3.1.3. The Applicable Law in an Investor–State Dispute Settlement System

Article 26(6) provides that a tribunal shall decide the issues in dispute in accordance with the Energy Charter Treaty and the applicable rules and principles of a mutually agreed investment framework. This Article seems to take a completely different view of the established principles of international investment law, as seen in bilateral investment treaties. These principles are based on the free will of the parties to designate the law applicable to settle their dispute. Normally, if no applicable law is chosen by the parties, the Rules of the Washington Convention or the UNCITRAL rules provide principles to determine the applicable law. For example, Article 33 of UNCITRAL provides that the law designated by the parties or, if no such law is chosen, the law determined by the conflict of law rules, applies, which would be decided in accordance with the terms of the contract and the trade usages applicable to the transaction. Article 42(1) of the ICSID Convention provides that, in the absence of any express choice of law by the parties, the tribunal shall apply the law of the contracting state and such rules of international law as may be applicable.

In comparing these articles with the ECT's provision on applicable law, it is clear that the possibility of determining the applicable law through conflict of law rules, which could result in the importation of national law to settle a dispute, is not available in the ECT. The intention of allowing resort to the ECT principles or principles of international law could be seen as a way to render the application of conflict of law rules impossible. This reasoning, as one author believes, could be due to the fact that the signatories of the ECT were mainly FSU countries, in which reform of the legal system was under way and the rules of National or MFN Treatment had not yet been adopted in national law.¹¹⁷ The approach of conflict of law rules, which would allow the national law of these countries to be considered by an arbitration tribunal, could not fulfil the ECT's aim of protecting the investor. These provisions could also be interpreted to 'simply express priority of ECT and international norms over other rules to the extent of any conflict'.¹¹⁸ This issue, along with the possibility of investor–state arbitration, can be considered as a unique characteristic of the ECT.

¹¹⁷ See M Efremova, *Dispute Settlement under the Energy Charter Treaty* (Geneva, Graduate Institute of Geneva, 2000) at 40.

¹¹⁸ See Tucker, 'Compulsory Arbitration', above n 52, at 525.

5.3.3.1.4. The ECT and Enforcement of Arbitral Awards

The ECT prescribes the recognition and enforcement of arbitral awards by providing that each contracting party shall carry out without delay any such award and shall make provision for the effective *enforcement* of such awards (Article 26(8)). It is important to determine here not only whether all parties to the ECT are members of the New York Convention where such enforcement is prescribed, but also that nothing in their domestic legislation exists that would indirectly hamper the execution of awards. The analysis of international arbitration in general, and recognition and enforcement of arbitral awards in particular, is outside the scope and focus of this study. It suffices, however, to elaborate on one or two points with respect to this issue.

Clearly, the effectiveness of international arbitration depends on whether the arbitral award can be enforced. The recognition and enforcement of an award by a national court, for example, means that that court (or any designated court for that matter) reviews the award to ensure that there is no reason to refuse enforcement under the New York Convention standards¹¹⁹ enumerated in Article V (this is when both parties are members of the New York Convention). Article V enumerates those cases, among others, as: where the 'award has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made', or where parties were under 'some incapacity, if the agreement is not valid under the law to which the parties have subjected it or ... under the law of the country where the award was made'. Nothing outside the ambit of these exceptions will constitute a justifiable basis to refuse recognition and enforcement of an award.

The European Community, in its statement to the Energy Charter Secretariat, mentions that any arbitral award will be implemented by the Communities' institutions, in accordance with their obligation under Article 26(8) of the Energy Charter Treaty. As it is well known, however, the enforcement of arbitral awards can be rejected on public policy grounds, a concept which also finds its roots within the EU law in general and with respect to the enforcement of arbitral awards in the Community in particular. The ECJ has specifically ruled on this issue in the case *Eco Swiss China Ltd v Benetton International NV*,¹²⁰ by providing that the national court to which application for annulment of an arbitration award is sent should grant this application on the grounds of the violation of public policy. In that case Article 81 of the EC Treaty on competition was found to possess such characteristic. The issue that is raised however, is that the ECJ was not providing a formula based on which the various provisions of the EC Treaty

¹¹⁹ A court action is not always required before the arbitral award is complied with. Most awards are complied with in a large number of cases without court interference. See VO Orlu Nmehielle, 'Enforcing Arbitration Awards under the International Convention for the Settlement of Investment Disputes (ICSID Convention)' (2001) 7 *Annual Survey of International and Comparative Law* 21 at 30.

¹²⁰ See Case 126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055.

could be elevated to public policy and it only states that those provisions that 'are essential for the accomplishment of the tasks entrusted to the Community and in particular for the functioning of the internal market constitute a fundamental provision' and are given public policy status.¹²¹ The problem here is that many tasks for the functioning of the internal market could be given such 'fundamental' status but a clear demarcation is not provided in the case law and only the scholarly writing has since sought to determine a list of such provisions (eg the provisions on four freedoms, Articles 81 and 82, provisions on discrimination based on nationality or gender, etc).¹²²

The other problem, the analysis of which is beyond the scope of this study, is that arbitral tribunals cannot refer a case involving Community principles for a preliminary ruling to the ECJ,¹²³ and it is up to the national courts to exercise their powers of supervision and review. Due to this problem, the argument is raised whether an obligation could be imposed on arbitrators to analyse European competition law *ex officio* and guarantee the award's compatibility with those principles. The ECJ did not analyse this issue and there are various arguments for and against the imposition of such duty on arbitrators. The most plausible of them is to argue that 'a fundamental duty of the arbitrators as an institution would be seriously impaired if arbitrators were to render awards that would be liable to non-enforcement or annulment, because of their incompatibility with mandatory legal provisions'¹²⁴, even if the arbitrator, through exercising this task, acts beyond his powers¹²⁵ and despite the threat of damage to the uniform application and the effectiveness of Community law.¹²⁶ Regardless of the ambiguities of this judgment, it is evident that the Community's legal order suggests that the enforcement of arbitral awards be restricted on grounds of public policy. This is an issue worth analysing in depth to determine the limits of the efficiency of arbitration proceedings within the Community which in turn leads to the protection of foreign investors as prescribed in the ECT.

¹²¹ See *ibid.* paras 35 *ff.*

¹²² See TD de Groot, 'The Impact of the Benetton Decision on International Commercial Arbitration' (2003) 20 *Journal of International Arbitration* 365. See also P Mayer and A Sheppard, 'Final ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards' (2003) 19 *Arbitration International* 249 at 261. Y Brulard and Y Quintin, 'European Community Law and Arbitration: National Versus Community Public Policy' (2001) 18 *Journal of International Arbitration* 533. C Liebscher, 'European Public Policy: A Black Box?' (2000) *Journal of International Arbitration* 73. S Prechal and N Shelkopyas, 'National Procedures, Public Policy and EC Law: From Van Schijndel to Eco Swiss and Beyond' (2004) 12 *European Review of Private Law* 589.

¹²³ See the Case 102/81, *Nordsee Deutch Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG*, [1982] ECR I-1095.

¹²⁴ See AP Komninos, 'Case 126/97, Eco Swiss China Time Ltd v Benetton International NV, Judgment of 1 June 1999, Full Court' (2000) 37 *CML Rev* 459 at 475.

¹²⁵ GI Zekos, 'Eco Swiss China Time Ltd v Benetton International NV: Court's Involvement in Arbitration' (2000) 17 *Journal of International Arbitration* 91.

¹²⁶ See AP Komninos, 'Arbitration and the Modernisation of European Competition Law Enforcement' (2001) 24 *World Competition* 211.

5.3.3.1.5. The Provisional Application of the ECT

The last issue to be discussed with respect to investor–state dispute settlement is whether international arbitration would still be effective for those countries which apply the ECT provisionally. Provisional application is established when such application is not inconsistent with the constitution, laws or regulations of the signatory state.¹²⁷ The question whether the signatory states are subject to international arbitration can be answered by looking at Article 45(3)(b), which states that when a signatory state terminates provisional application, its obligation to apply Parts III (investment) and Part V (dispute settlement) remains with respect to any investments made during the provisional application of the treaty for another twenty years following the effective date of termination. This article shows that those states that apply the treaty provisionally (ie the treaty is approached as if it was in force whereas it is formally not),¹²⁸ such as Russia, are bound by the rules on investment arbitration.¹²⁹ Annex PA of the treaty lists those countries that have declared their non-acceptance of this Article’s obligation.¹³⁰

5.3.3.2. *State–State Investment Dispute Settlement System*

The state–state dispute settlement provisions of the ECT follow the pattern of most bilateral investment treaties. There are three different mechanisms provided by the ECT to regulate disputes between states: the Article 27 procedure for investment matters, the special procedure for trade-related disputes of Annex D, and the special sub-national procedure of Annex P. Before explaining these various systems, it should be pointed out that there is a difference between trade-related investment disputes and those of a pure investment nature. The former is dealt with through the Annex D regulations and the latter through Article 27. However, this distinction is not justified, as it is extremely hard to distinguish trade-related investment measures from pure investment measures in

¹²⁷ A signatory can, however, declare that it is unable to accept provisional application.

¹²⁸ Normally, the status of provisional application is adopted when urgent needs necessitate the establishment of a treaty. This system has become recently widespread, such as the original status of GATT. See also Art 25 of the Vienna Convention on the Law of Treaties of 1969.

¹²⁹ There is a case brought by Yukos (Group Menatep) against Russia based on the Energy Charter Treaty’s provisions on expropriation which clarifies some issues with respect to the use of the investor–state arbitration against those countries that apply the treaty provisionally. See also U Klaus, ‘The Gate to Arbitration: The Yukos Case and the Provisional Application of the Energy Charter Treaty in the Russian Federation’ (June 2005) 3 *Oil, Gas & Energy Law Intelligence*, issue 2. The general view is that the possibility of bringing a claim based on Art 26 ECT against a country that applies the treaty provisionally is not excluded. The other example is the withdrawal of the environmental approval of Shell’s project in Sakhalin II liquefied natural gas project in September 2006. Considering the considerable investment that Shell has already made in this project, the possibility of bringing a claim against Russia based on Art 26 of the ECT can also be argued in that situation.

¹³⁰ These countries, based on Annex PA, are the Czech Republic, Germany, Hungary, Lithuania, Poland and Slovakia.

a single activity undertaken by an investor. How to draw the line in a single undertaking of an investor, and how to determine where an activity is purely an investment or is tainted by some trade activities, is not clear from the provisions of the treaty. Trade provisions refer the investor to the WTO, where a controversy on trade-investment link is already in place, and the definition of investment as explained above does not clarify the situation. For this reason, an investing state is free to choose between the dispute settlement system of Annex D or Article 27.

Article 10 enumerates those obligations, the violation of which will result in the application of Article 27. An investor's investment should be at all times accorded 'fair and equitable treatment', 'constant protection and security' and 'no impairment of their management, maintenance, use, enjoyment or disposal'. No less favourable treatment should be applied than what is afforded to investors of the host country (National Treatment) or any other contracting party or third country (MFN Treatment). However, Article 27 is not limited to investment issues. Unlike the title of Article 26 which limits the settlement to investment matters, Article 27 can 'possibly' be extended to cover other issues such as environment and taxation.¹³¹ It is 'possible' since this provision does not explicitly enumerate the areas covered.

Article 27 firstly provides that contracting parties shall 'endeavour' to settle disputes through diplomatic channels 'within a reasonable period of time'. Unlike Article 26 on investor-state dispute settlement, which sets a three-month duration for an amicable resolution, Article 27 does not delimit this period. When this period of time elapses, an *ad hoc* tribunal should decide on the matter after submission of a written notice by the claimant party to the other.

Generally, a state not party to the dispute should be allowed to intervene in a case where the decision in that case would, directly or indirectly, adversely affect the state. However, the possibility of third party intervention is not provided in Article 27 (unlike trade disputes that are settled based on Annex D). The repercussions of the lack of reference to this intervention are especially significant in the energy sector. A dispute between an energy-producing country and a transit country (for example, between Russia and Ukraine) could have a direct effect on the security of supply of a Member State of the European Community.

¹³¹ Disputes over competition are dealt with in Art 27(1), which prescribes that these disputes should only be solved through diplomatic channels and Art 6(5). This latter article provides that if any specified anti-competitive conduct is carried out within the area of another contracting party, which is adversely affecting an important interest relevant to the purposes identified in this Article (the Article only refers to the alleviation of market distortions and barriers to competition), the contracting party may notify the other contracting party and may request that its competition authorities initiate appropriate enforcement action. It is clear from this provision that if the notified contracting party does not possess a competition authority within its territory, the competition authority of the notifying party should be consulted in order to determine the exact nature of the anti-competitive behaviour. These rules are not efficient in creating a clear obligation for parties not to undertake any anti-competitive activity. No other rules exist in the ECT with respect to competition issues. Therefore, it is not too far-fetched to submit that the ECT does not regulate competition at all.

Intervention could be arranged for that member to guarantee the security of supply exported from Russia and transited through Ukraine. However, based on Article 27, the fate of this supply is either in the hands of Russia and Ukraine in the settlement of their dispute, or the Member State can have recourse to another arbitration setting, the result of which may be different from the one between Russia and Ukraine, although the issues were the same. This last point will be discussed later in this section.¹³²

The other problem in the provisions on settlement of investment disputes is the lack of a relationship between the investor–state dispute settlement and state-state dispute settlement. In the case of non-compliance by one party with the arbitral award, the North American Free Trade Agreement (NAFTA) provides the possibility of the state of the investor requesting a panel under Article 2008 to seek a determination that the denying party’s conduct is inconsistent with its obligations and to demand further compliance (Article 1136(5)). In other words, the investor’s home state can interfere and guarantee compliance, a possibility that is not prescribed by the ECT.

5.3.3.3. *Interpretation of the Rules on Investment Arbitration of the ECT*

The existence of an effective investment arbitration system in the ECT is deemed to bring economic reform and to enhance the quality of investment conditions, which could in turn contribute to energy security. However, ‘effective’ investment arbitration in the field of energy is one that takes account of the peculiarity of the energy industry. Below, the interpretive mechanisms available to analyse the activities of the investors and host states are explained, and the best ways to render this arbitration effective are described.

The most important provisions for investment promotion and protection are national treatment, MFN treatment and ‘fair and equitable treatment’ embodied in Part III of the treaty. These principles are fundamental for the free flow of capital and resources. However, as mentioned above, these principles only apply to the post-investment phase, the stage in which the investment is actually accepted by the host government. These principles do not apply to the pre-investment phase, where preferential treatment is only encouraged. Investors would be attracted to those countries where such encouragement exists, pre-investment rules are eased, and no discriminatory behaviour in favour of their

¹³² One is reminded of the serious dispute triggered at the beginning of January 2006, when Russia cut off gas supplies to Ukraine after Ukraine refused to accept a fourfold price increase. The disagreement could have potential repercussions for Europe’s security of energy supply (especially for Hungary, Poland and France) because Ukraine halted the transit of gas that was sent from Russia and was destined for the EU. Russia and Ukraine reached an agreement on the price of gas after four days, and the transit of gas was resumed. Nevertheless, if the transit agreement between Russia and Ukraine had referred to Art 27 of the ECT as the legal basis for settlement of disputes, upon the request of one party, an ad hoc tribunal could have been established to settle the dispute. However, in that case, Europe, as the directly affected entity, could not join the procedure. For an explanation of the dispute see section 6.1 below.

own investors is exercised. A uniform approach to all signatories in the pre-investment phase is therefore not created. Hence, access to prospective hydrocarbon reserves is still subject to limitation which is due to the exercise of sovereignty over natural resources, which energy-producing countries deemed vital to preserve in the treaty.

The interpretation of the ECT provisions on investment is a difficult task. The reason is twofold. One is that some basic principles, such as national or MFN treatment, are concepts borrowed from other institutions and international documents. This is not a problem per se but, for reasons mentioned below, it necessitates a careful approach while interpreting them in the context of the ECT. Secondly, the actual treaty is strongly influenced by other international instruments on investment.

In an investment dispute settlement, in order to determine whether national or MFN treatment is complied with, the situation of the foreign investor is compared to the like domestic investor with respect to the former principle, and the investor of the third state with respect to the latter. In order to clarify the existing rules and regulations applying to foreign investment in the host country, that country is obliged, based on Article 20 of the ECT, to publish promptly, laws, regulations, judicial decisions and administrative rulings of general application and agreements made between contracting parties. This principle of transparency allows a foreign investor to depict the extent of application of the national and MFN treatment principle.

These principles are borrowed from the WTO, NAFTA and BITs rules, based on which the subject matter of the treatment can vary from goods and services to investment. In order to establish the 'likeness' argument for investment-related purposes, a different approach should exist in the energy field. Private investors and governments interact particularly closely and establish a special relationship in energy matters compared to others. The existence of natural monopolies, claims to sovereignty over natural resources, a history of energy operations dominated by state-owned operators, relations between access to energy and political stability, relations between energy production and the environment etc are just a few examples of the unique situation that we face in relation to the energy sector, the prominence of which does not necessarily exist in other fields.

Hence, in order to determine the application of national or MFN treatment, and the similarity of situations between foreign and domestic investors, references can be made to the case law of the WTO and NAFTA or to the jurisprudence of bilateral investment treaties. However, it is clear that transporting the justification adopted in the WTO case law or other sources to energy investment under the ECT should be done with the utmost care. For example, general government behaviour towards investors is scrutinised in the ECT, whereas in the WTO the specific measures that the government have taken are looked at. The former is wider in scope than the latter. A blind importation of the analysis of what constitutes national treatment from other bodies will result in negative

consequences, which would undermine foreign investors' rights and the peculiar relationship between the investor and the host state in the energy field, thus indirectly affecting security of supply.

The 'fair and equitable' treatment of an investor also has to be interpreted by looking at the special characteristics of the energy sector, which should not be undermined. The assessment of this treatment should be done by looking at 'recent' standards developed in the energy field, and specifically between the signatories of the Energy Charter Treaty. The standards developed between European Member States and the Baltic countries may be different from the standards applied between Saudi Arabia and the US, and undermining this difference would result in scrutinising treatment in a way that may be detrimental for previously established energy relations between those sets of countries.

Another important aspect, relevant to our discussion above, is to determine to what extent interpretation of the ECT's provisions in an investment dispute takes the rapid changes of the energy industry into account. One writer explains that:

[o]il and gas industry has seen unceasing change on a dramatic scale. Prices have moved unpredictably from low to high and back again to historical lows. The structure of the industry has evolved from domination by a handful of multinationals through assertive state intervention and state ownership towards—in recent years—a *new sense of partnership between state interests and private capital*. There have been enormous technical advances and gains in productivity, paralleled by radical changes in organisation and management. Through it all the upstream oil industry has shown an extraordinary track record of adaptability, sustainability, and success in meeting market requirements.¹³³

The link between state interests and private capital will be subject to change, due to host states' familiarisation with the characteristics of investment liberalisation. The transformation in the way states and investors interact should be taken into consideration in dealing with investment disputes, because an obstructive interpretation of investment provisions would create obstacles to the development of a balanced relationship between the host country and the investor.

The differentiation between the energy sector and other sectors, however, is not easily adopted in practice within the context of the ECT. The reasons are twofold. One is that the ECT fails to point out these peculiarities in the energy sector. Secondly, the actual provisions of the ECT can only be clarified by looking at the sources which initially influenced the treaty, and which did not necessarily focus on the energy sector as such.

Firstly, reference to the 'European Energy Charter Treaty' of 1991 and its preamble is inevitable in order to interpret the provisions of the ECT, as this source clarifies the real intentions behind establishing this set of rules for energy relations. Secondly, the impact of the content of the Washington Convention (ICSID) on the text of the ECT necessitates reference to this Convention for

¹³³ See D Jenkins, 'An Oil and Gas Industry Perspective' in *East–West Gateway*, above n 9 at 188.

interpretation purposes. Thirdly, various multilateral codes and guidelines on investment, such as the OECD Declaration and Guidelines on Multinational Enterprises of 1976 and the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment, have influenced the treaty. Fourthly, the impact of the Final Act of the Uruguay Round Negotiations of the GATT cannot be undermined because of the strong role that the GATT plays in the ECT trade and trade-related investment provisions. A fifth influence has been the provisions of the BITs and NAFTA, which played an extremely important role in establishing the provisions of the ECT on promotion and protection of investment. This all shows that although the ECT is 'the product of the same process towards progressive multilateral liberalization and protection of foreign direct investment',¹³⁴ its distinctive focus on the energy industry as opposed to a general code of investment protection and promotion necessitates approaching its text as an important source of law on its own. This approach can gradually create a strong set of interpretive rules, specifically designed for the energy sector, which would neglect the open-ended investment disciplines of other instruments and would in turn increase transparency and predictability, eventually contributing to overall security of energy supply.

It is regrettable, however, that the provisions of the Energy Charter Treaty themselves render the best possible interpretation difficult. There is no possibility in the treaty to accumulate the various claims of different investors against a host state: each investor has to individually refer to a dispute settlement mechanism. This independent dispute settlement could result in conflicting arbitration awards,¹³⁵ a current concern of many scholars. Some describe this possibility as 'a coming crisis in the global adjudication system',¹³⁶ which would in turn lead to a lack of coherence in the jurisprudence applicable to both investors and host states in the energy sector. Nonetheless, this conflict can be resolved by reference to existing arbitral awards. However, this task calls for the transparency of these awards and their accessibility¹³⁷ but this transparency is not prescribed in the

¹³⁴ See Muchlinski, 'The Energy Charter Treaty' in T Wälde, above n 9, at 217.

¹³⁵ Eg, in the Final Award of *The Matter of an UNCITRAL Arbitration between Ronald S Lauder and the Czech Republic* (3 September 2001 decided in a London tribunal), the tribunal acknowledged the potential problem of conflicting awards—as the same dispute was decided between a Dutch investor and the Czech Republic over the same investment—and reasoned that the second deciding court or arbitral tribunal could take the first award into consideration when assessing the final award. However, the Stockholm tribunal reached a contradictory result over the same facts and same basic legal issues. See CN Brower and JK Sharpe, 'Multiple and Conflicting International Arbitral Awards' (2003) 4 *Journal of World Investment* 211 at 213. They call the conflict between various arbitral awards the 'perils of international arbitration in an era of multiple fora for dispute resolution', for which no solution yet exists.

¹³⁶ See CN Brower, 'The Coming Crisis in the Global Adjudication System' (2003) 19 *Arbitration International* 415.

¹³⁷ Art 1121 NAFTA establishes a condition precedent to submission of a claim to arbitration. It requires investors to

waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of

treaty, and it may vary according to the settlement system that the investor chooses. Moreover, confidentiality—the obligation of the arbitrators and the parties not to divulge or give out information relating to the contents of the proceedings, documents, or the award¹³⁸—prevails as a general rule in some arbitral institutions. UNCITRAL arbitration rules forbid the parties from making the award public, unless consented to otherwise (Article 32).¹³⁹ The rules of the Stockholm Chamber of Commerce (SCC), however, provide only that the Institute and the Arbitral Tribunal must maintain the confidentiality of the arbitration, which is thus an obligation directed to Tribunal and the Institute rather than the parties (Article 9).¹⁴⁰ Access to ICSID cases is not always possible.¹⁴¹

Transparency could contribute to the development of arbitral jurisprudence, and more importantly, clarify the state of law for both investors and host states. This would in turn contribute to a more secure investment regime for energy investors. They would become familiar with the way international investment is approached in the practice of arbitration, therefore increasing their ability to predict how they should lead their activities. The lack of transparency in the ECT should therefore be addressed in future negotiations among contracting parties. Another possibility is for the ECS to provide an energy expert, familiar with previous arbitral proceedings, to assist the arbitral tribunal in reaching a decision. The expert would abide by the rules of confidentiality but would indirectly guide the panel, which would in turn lead to some coherence among various awards. This possibility should be explored by the ECS.

the disputing Party that is alleged to be a breach ... except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

Based on this Article, a NAFTA investor has four options:

1. To seek damages in a domestic court on domestic law grounds and subsequently bring a Chapter 11 (NAFTA Investment Chapter) claim for damages before a NAFTA tribunal.
2. To seek damages in domestic court based on domestic law *and* NAFTA law, but will then be barred from bringing a Chapter 11 claim before a NAFTA Tribunal.
3. To bring a Chapter 11 claim and waive its right to seek damages in a domestic court on domestic law grounds.
4. To bring a Chapter 11 claim for damages before a NAFTA tribunal immediately and simultaneously, or subsequently seek declaratory or injunctive relief in domestic court on domestic law grounds.

See Brower, *ibid.*, at 218. See also WS Dodge, 'National Courts and International Arbitration: Exhaustion of Remedies and *res judicata* Under Chapter Eleven of NAFTA' (2000) 23 *Hastings International & Comparative Law Review* 357 at 372. These set of clear options do not exist in relation to investment claims within the ambit of the ECT.

¹³⁸ See H Banger, 'Confidentiality: A Fundamental Principle in International Commercial Arbitration?' (2001) 18 *Journal of International Arbitration* 243 at 243.

¹³⁹ See Banger, previous n, at 244.

¹⁴⁰ *Ibid.*

¹⁴¹ For a list of concluded cases and the text of some decisions, see <<http://www.worldbank.org/icsid/cases>>. For the last example of the ECT in an ICSID case, see *Plama Consortium Limited v Republic of Bulgaria*, (ICSID Case No ARB/03/24 – 8 February 2005).

5.3.4 Conclusion: the Investment Regime of the ECT and Europe's Security of Energy Supply

What is a desirable investment framework and to what extent is the ECT successful in creating such a framework? How does this framework, if in place, contribute to the security of European energy supply? As mentioned earlier in discussing the concept of security, the most important components of security are access to energy reserves through foreign investment and a high level of investment protection, which could in turn contribute to an unrestricted flow of energy to Europe. The possibility of investing in the energy sector of energy-producing countries was found essential in order to provide those countries with latest technology and upgrade their energy exploration and production system on the one hand, and safeguard energy flow on the other. Therefore, it was said that an investment framework, backed by sufficient rules to regulate the activities of investors and host countries, is crucial.

The treaty's inclusion of a chapter on investment promotion and protection, along with other provisions dealing with trade and transit, seeks to contribute to energy security. For the purposes of our study, it must be determined whether, apart from the insertion of crucial provisions in the treaty text, this security is actually assured in practice.

An analysis of the treaty's provision on investment promotion and protection reveals that the treaty has its merits, but there are also causes for concern. The treaty 'lessens' but does not 'eliminate' political risks associated with investment.¹⁴² Treaty assurances, as they stand, can give comfort to foreign investors. However, this not only depends on the ways through which arbitration tribunals interpret these guarantees, but also depends on the willingness of the host states to take steps towards reform. The means by which individual governments implement the provisions of the treaty in national legislation are also of importance, given the fact that they must keep in mind the goal of achieving liberalisation in investment and trade and promoting long-term energy cooperation. As one writer correctly states, 'windfall of oil revenues and taxes through investment is not going to rescue mismanaged governments or regional blocks'.¹⁴³

The ECT seeks to establish rules on investment in order to create competition between various countries to attract investment. There is a theory that those states which impose some obstructions to investment will lag behind in this competition, and investment will be directed to other countries where it is better safeguarded. If we accept this theory, the ECT can be considered as a step towards creating competition for foreign capital and technical expertise in the energy

¹⁴² See also Norton, 'A Law of the Future or a Law of the Past', above n 44, at 377. See also T Wälde and S Dow, 'Treaties and Regulatory Risks in Infrastructure Investment: the Effectiveness of International Law Disciplines versus Sanctions by Global Markets in Reducing the Political and Regulatory Risk for Private Infrastructure Investment (2000) 34 *Journal of World Trade* 1 at 11.

¹⁴³ See Jenkins, 'An Oil and Gas Industry Perspective' in *East-West Gateway*, above n 9, at 191.

industry. Therefore, the ECT theoretically represents the best means of achieving liberalisation in the field of investment, and it provides the most significant multilateral provisions that could be negotiated. However, these goals cannot be realised if they are not interpreted in a manner that strikes a balance between the interests of the investor and the host state on the one hand, and the characteristics of the energy industry and its rapid change on the other. When one speaks of the importance of investment for Europe's security of energy supply, and the fact that the ECT creates competition among the energy-producing and transit countries to attract investment, it should also be determined whether this investment is necessary at that moment in time for those countries. It is sometimes presumed that energy-producing and transit countries are in dire need of investment. However, an important energy-producing country's need of investment changes depending on the domestic possibilities of such investment at a given time. In guaranteeing its energy security, Europe therefore has to consider a policy of diversifying energy sources. This means that it has to have the capability to switch from one supplier to another where, due to the investment needs of the latter, energy relations can be bargained. This consideration leads one to conclude that 'energy cooperation' cannot be encouraged only by the comprehensive investment provisions of the treaty. Such an observation suggests that the ECS should not concentrate on the efficiency of the investment provisions in order to induce more energy-producing countries to become members. No matter how well the ECT's provisions on investment are designed, the country or region in need of energy should take other characteristics of the energy industry into account and pay attention to the fact that no 'general' theory of energy cooperation, which highlights the importance of foreign investment for energy or transit countries 'at all times', can be established without due attention to the rapid change of other constituents in such relations. For this reason, the ECS should follow closely the demands of the energy-producing countries at a given time in order to reflect them in its overall cooperation framework.

On the other hand, security of energy supply cannot be guaranteed if obstacles exist to the trade of the produced energy product or the extracted raw material. The next part analyses the trade provisions of the ECT, in order to determine to what extent these provisions assist in strengthening the relationship between energy-consuming and energy-producing countries and how they contribute to the security of energy supply. This section is followed by the rules on transit, another important component of energy security. The final part determines the contribution of these measures to Europe's security of energy supply.

5.4. THE TRADE REGIME: ECT AND GATT/WTO COMPARED

5.4.1. Introduction

The inclusion of trade rules within the ambit of the ECT is not surprising. Petroleum alone is considered as ‘the single most important commodity both in value and volume terms, traded internationally, accounting for nearly a third of world seaborne trade’.¹⁴⁴ The goal of the ECT, in including a trade regime, was to introduce GATT/WTO standards of international trade into the realm of energy. The initiative was to integrate those members of the ECT that are not yet members of the WTO into the multilateral trading system via the introduction of GATT/WTO rules into the ECT and to facilitate their future accession to the WTO system.¹⁴⁵ The idea was not to extend GATT rules to non-parties of GATT, but to make them acquainted with their application in the energy sector.¹⁴⁶ Clearly, this goal cannot be named as the only objective pursued by the ECT. Free flow of trade in energy and energy products contributes to Europe’s overall security of energy supply; and the more FSU countries adapt themselves to GATT rules, the better this flow is guaranteed.

Energy trade has not been a special focus of the GATT/WTO. Although some energy exporting countries were originally members of the GATT, specific petroleum issues were not added in the initial negotiation rounds of 1973 and 1979. This was allegedly because a gentlemen’s agreement was reached between the members to keep oil issues outside of GATT.¹⁴⁷ In the 1982 Ministerial Declaration, discussions were focused on the problems of trade in natural resource products, but these products were named as non-ferrous metals and minerals, forestry products, and fish and fisheries products only.¹⁴⁸ In 1986, the Ministerial Declaration of Punta del Este referred to the aim of achieving ‘fullest liberalisation of trade in natural resource-based products, including in their processed and semi-processed forms’. The Declaration also provided that ‘the negotiations shall aim to reduce or eliminate tariff and non-tariff measures,

¹⁴⁴ See the Note by the Secretariat, Uruguay Round—Group of Negotiations on Goods—Negotiating Group on Natural Resource-Based Products—Energy Products, (1988) GATT Doc. MTN.GNG/NG3/W/16 at 12. In 2004, fuel exports accounted for 10.3% of world merchandise exports, while agriculture accounted for 9.2%. See WTO, *International Trade Statistics* (Geneva, WTO, 2004) at 112.

¹⁴⁵ Only in the context of trade in nuclear materials can the parties deviate from the GATT 94 rules and apply any bilateral agreement that exists between them. For example, the European Community on the one side, and the Russian Federation, Ukraine, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan on the other, have deviated from the application of GATT rules in applying the rules of their respective bilateral agreements. See Annex G(4) of the ECT.

¹⁴⁶ See in general, I Frasl, ‘The Trade Rules of GATT and Related Instruments and the Energy Charter Treaty’ in *East–West Gateway*, above n 9, at 459.

¹⁴⁷ See UNCTAD, *Trade Agreements, Petroleum and Energy Policies* (New York, UN, 2000) at 15 [hereinafter ‘UNCTAD Report on Trade’].

¹⁴⁸ See the 38th Session at Ministerial Level: Ministerial Declaration, 29 November 1982, L/5424, at <<http://www.jus.uio.no/lm/wto/gatt.thirty.eighth.session.ministerial.declaration.1982/landscape>>.

including tariff escalation'. Later, in 1989, a Negotiating Group on Natural Resource-Based Products was established, which also examined market access policies of energy products. However, GATT members could not reach agreement on how to include these products in the overall framework of GATT. Some believed that specific rules should be designed to address the energy products and petroleum policies of member countries, whereas others found it more appropriate to restrict the trade liberalisation objectives to non-ferrous metals and minerals etc, and not refined petroleum products. The strong resistance of the latter countries did not allow an agreement to be reached on the trade policies applicable specifically to refined petroleum products or natural gas.¹⁴⁹ Nevertheless, the practical outcome was that energy and energy products are now considered as goods for the purposes of GATT/WTO, and nothing prevents petroleum policies being part of the overall WTO framework. However, very few occasions have occurred where the WTO actually deals with these products and takes their special characteristics into account, as explained below. For this reason, the ECT's treatment of these provisions can establish some guidelines for their interpretation when applied to the energy sector.

At the time of drafting the ECT in 1991, negotiators based the trade rules on the then-existing GATT 1947 and Related Instruments. Later, in 1998, they took account of the new provisions contained in the 1994 Marrakech Agreement Establishing the World Trade Organization and its annexes. These new provisions replaced the old trade rules of the ECT, and are elaborated on in the 'Amendment to the Trade-related Provisions of the ECT' (the so-called 'Trade Amendment').

The Trade Amendment (TA) prescribes that all WTO provisions are applicable pursuant to Article 29(2)(a) of the ECT, except those which were excluded or modified by virtue of Annex W.¹⁵⁰ Article 29(2)(a) provides:

Trade in Energy Materials and Products between Contracting Parties at least one of which is not a party to the GATT or a relevant Related Instrument shall be governed ... by the provisions of GATT 1947 and Related Instruments, as applied on 1 March 1994

¹⁴⁹ See the submission of the United States, MTN.GNG/NG3/W/2 (1 July 1987), MTN.GNG/NG3/W/13 (8 June 1988) and MTN.GNG/NG3/W/23 (12 July 1989) cited in the UNCTAD Study, 'UNCTAD Trade Agreements', above n 147, at 15–16. See also the submission of Indonesia, MTN.GNG/NG3/W/8 (13 November 1987), MTN/GNG/NG3/W/18 (14 December 1988), and MTN.GNG/NG3/W/19 (30 March 1989).

¹⁵⁰ For an EU document enumerating the amendments to the trade-related provisions of the ECT, see Final Act of the International Conference and Decision by the Energy Charter Conference in respect of the amendment to the trade-related provisions of the Energy Charter Treaty—Joint Declarations—Annex I: Amendment to the Trade-Related Provisions of the Energy Charter Treaty—Annex II: Decisions in connection with the Adoption of the Amendment to the Trade-Related Provisions of the Energy Charter Treaty, [1998] OJ L/252. See also the 2003 report of the Energy Charter Treaty, *Applicable Trade Provisions of the Energy Charter Treaty* (Brussels, Energy Charter Secretariat, 2003). For the incorporation of this change into Community law, see Council Decision of 13 July 2001 on the Conclusion by the European Community of Amendment to the trade-Related Provisions of the Energy Charter Treaty, [2001] OJ L/209/32.

and practiced with regard to Energy Materials and Products by parties to GATT 1947 among themselves, as if all Contracting Parties were parties to GATT 1947 and Related Instruments.

Annex W provides a long list of provisions of the WTO that are not relevant to the energy sector or are exempted from the ambit of the ECT's application, such as the Agreement on Trade-related Investment Measures, or rules on custom valuation etc. Moreover, the TA clarifies the extended scope of the ECT's trade regime to trade in energy materials, products and energy-related equipment (Annex EMI and Annexes EQI and EQ II, respectively).¹⁵¹

Article 30 of the ECT provides that the future development of these agreements within the WTO should be taken up by the ECT, and it prescribes that the ECT should be further amended in line with future changes of the Final Act of the Uruguay Round.¹⁵² According to Annex W of the ECT, this amendment should be related to Article 29(2)(a) of the ECT on provisions on trade-related matters only. However, a contracting party is allowed to request the Charter Conference not to apply or modify such an amendment.¹⁵³ Moreover, relations between members of the ECT, who are also members of the WTO, are not to be interfered with by the trade provisions of the ECT (Article 4 ECT). As the trade rules of GATT develop, the rights and obligations of the GATT Member States develop correspondingly. The ECT may add to these obligations but should not diminish them.

As mentioned in its preamble, the ECT seeks to liberalise energy markets between its contracting parties, and the liberalisation of trade in energy products, materials and energy-related equipment could not be left out of this process.¹⁵⁴

¹⁵¹ Annex EQ I provides a long list of energy-related equipment which was more extensively listed within the World Customs Organisation Nomenclature headings or the Harmonised System codes. Plates to be used for oil and gas pipelines and sea lines protection, tubes and pipes, reservoirs, tanks, containers, wires, cables, nuclear reactors, and steam turbines, are but a few examples. Based on the amended Art 1(11) of the ECT, a reference to the WTO means the World Trade Organisation established by the Agreement Establishing the World Trade Organisation; and the 'WTO Agreement' means the 1994 Agreement Establishing the World Trade Organisation, its Annexes and the decisions, declarations and understandings related thereto, as subsequently rectified, amended and modified from time to time; and 'GATT 1994' means the General Agreement on Tariffs and Trade as specified in Annex 1A to the Agreement Establishing the World Trade Organisation, as subsequently rectified, amended or modified from time to time.

¹⁵² Based on Annex W of the ECT, which enumerates the exceptions and rules governing the application of the provisions of the WTO Agreement in accordance with Art 29(2)(b) of the ECT, 'interpretation of the WTO Agreement adopted by the Ministerial Conference or the General Council of the WTO under para 2 of Art IX of the WTO Agreement, insofar as they interpret provisions applicable under Art 29(2)(a), shall apply.

¹⁵³ See Annex W (B)(10)(b).

¹⁵⁴ Energy products and materials are broadly classified as nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, or other energy (fuel and charcoal). Electricity is included in the framework of the ECT. Nuclear energy is also included in the list of energy products and materials. However, it is not covered by the WTO rules, but by other agreements referred to in Declarations in the Final Act of the European Energy Charter Conference of 1994. Trade in nuclear energy is not covered in this study.

However, although the trade rules of the GATT are incorporated into the ECT, it was inevitable that clear rules specifically designed for energy trade would be established. This was due to the peculiarities of the energy sector in general and energy trade in particular. As the Energy Charter Secretariat provides, the unique characteristics of many energy products must be taken into consideration. For instance, the method of their transportation differs (oil is transported with both trucks and pipelines whereas electricity and natural gas cannot be transferred with trucks across borders); not all types of energy, such as electricity, can be stored; there is a long history of state-owned and vertically-integrated operators that controlled, or still control, the sector; monopolies play a dominant role etc.¹⁵⁵ One may also point to the strong role that politics plays in this sector, which would in turn affect a given country, region or the world's economy.

The possibilities of interruption of energy trade, and the ways through which this disruption should be dealt with, are very different from that of other products precisely because of the unique characteristics of energy trade. Liberalisation in energy trade may be facilitated by adopting GATT/WTO rules, because the success they achieved renders them a viable source. However, the ways through which liberalisation of energy trade is hampered are peculiar, and should be resolved by specifically-created GATT/WTO rules. Generally, WTO rules address barriers to import whereas trade restrictions in the energy sector are more related to export barriers. In addition, removing government restrictions on trade in energy products does not necessarily result in the free flow of energy. Physical barriers exist that are inherently linked to trade in energy, and GATT rules should be interpreted in a way that incorporates these differences. Some may disagree with this distinction between trade in goods in general and trade in energy, but recent WTO negotiations signal a new approach to the energy sector, both through revising the classification of services and inclusion of energy services in the General Agreement on Trade in Services (GATS), and also due to the accession of new energy-producing members (such as Saudi Arabia). It is true that GATT trade rules will ultimately dominate the energy sector as well, but this is not due to the fact that trade in energy is similar to trade in other products. Rather, it is because the GATT rules are gradually adapting themselves to reflect the concerns of this sector, both in their content and in the WTO jurisprudence. It is for exactly this reason that the ECS could play an important role in clarifying the peculiarities of the energy sector to the WTO.

¹⁵⁵ See *Trade in Energy: WTO Rules Applying under the Energy Charter Treaty* (Brussels, Energy Charter Secretariat, 2001) at 9–11 [hereinafter ECS Report on *Trade in Energy*]. They later elaborate on why trade in energy is special by enumerating the various concerns and sensibilities associated with this trade. As peculiarities, they mention claims to national sovereignty, social welfare concerns, political stability, energy being a scarce product, which should be dealt with differently than any other product, the economic role of energy, environmental issues associated with exploration, production, and use of energy, and the social function of energy to ensure for everyone secure access to energy at a reasonable price. The following discussion on energy trade and the role of the WTO in the ECT is a summary of the above-mentioned study by the Energy Charter Secretariat.

The discussion on the specificities of energy trade also becomes relevant in the framework of the security of Europe's energy supply. It is argued that trade liberalisation has positive effects on the world economy. It is said that the creation of new market entrants, due to trade liberalisation, eradicates the problem of attributing energy security issues to a small set of state monopolies that may or may not guarantee security of supply. Therefore, the discussion of energy security circles around the contribution of trade liberalisation, as embodied in the provisions of the GATT/WTO Agreements, to guarantee security as opposed to strict government regulatory control of this trade. As there is still strong governmental regulation of the energy sector to ensure the fulfilment of many objectives, such as the level of production, environment, consumer protection etc., the extent to which a move away from this involvement and towards trade liberalisation can positively contribute to Europe's energy security should be analysed. It is for this reason that the discussion on energy trade, specifically in the framework of the ECT, becomes relevant. In the following lines, the trade provisions of the GATT/WTO, as reflected in the ECT, will be analysed in detail, and their relevance for Europe's energy security will be revealed.

5.4.2. National and MFN Treatments

National and MFN treatments are the two most important principles applied in the context of the WTO, which are incorporated into the framework of the ECT (Article 29(2)(a)).¹⁵⁶ Their application is similar to what was previously said regarding the rules on non-discrimination in the investment sector. Based on MFN treatment,¹⁵⁷ products from the territory of any contracting party imported into the territory of any other contracting party shall be afforded treatment no less favourable than that accorded to 'like products' of national origin. Therefore, if any advantage or privilege is given to any Contracting Party, this advantage should be given to any 'like' product of any other contracting party, both at the border and in the market of the receiving contracting party.

The national treatment principle in trade in energy prescribes that imports of energy products should be treated similar to like domestic products.¹⁵⁸ The

¹⁵⁶ See GATT Art I GATT Art III provides: 1. The contracting parties recognise that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production. 2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in para 1.

¹⁵⁷ See GATT 1994, Arts I and III (4).

¹⁵⁸ The WTO Appellate Body described the aim of the national treatment principle as follows:

importing contracting party is allowed to tax the product, here an energy product, or subject them to internal regulation, as long as the same tax or regulation applies to like domestic products.¹⁵⁹ Similarly to MFN treatment, the ‘likeness’ of various products in determining national treatment is at issue here as well.¹⁶⁰

Two schools of thoughts exist for determining the definition of ‘like’ products.¹⁶¹ One school is of the view that in order to distinguish ‘like products’ under the WTO, one should look at the products’ end-uses in a given market, consumer’s tastes and habits, products’ properties, nature and quality, and a product’s precise tariff classification.¹⁶² The second school established a rather short-lived idea, by stating that the fiscal and regulatory powers can differentiate between different products as long as this differentiation does not lead to protection of domestic products. Based on this latter definition, therefore, the only rationale for determining ‘likeness’ was whether the measure favours domestic production, and if that is not the case, the measure is not in violation of Article III (‘aims and effect’ doctrine).¹⁶³ doctrine was short-lived because it was not considered by

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III is to ensure that internal measures not be applied to imported or domestic products so as to afford protection to domestic production.

See the Report of the Appellate Body in *Japan—Taxes on Alcoholic Beverages*, adopted on 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R at 16.

¹⁵⁹ For an analysis of the ‘likeness’ concept, see R Zedalis, ‘A Theory of the GATT “like” Product Common Language Cases’ (1994) 27 *Vanderbilt Journal of Trans-national Law* 33 [hereinafter ‘A Theory of the GATT’]. See GATT 1994, Art III (2) and (4). This treatment necessitates the ‘best’ of national treatments. This means that if there is discrimination between products of two different regions in the same country, the best treatment afforded to one should be given to the imported product. See Panel Reports on *Canada—Imports, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, DS17/R, BISD 39S/27, 75 and on *United States—Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, DS23/R, BISD 39S/206, 274, para 5.17.

¹⁶⁰ It should be added that, based on Art III (4), different charges imposed on the transmission or distribution of energy are justified if they are exclusively based on the *economic operation* of the means of transport and not on the nationality of the product concerned. Art III(4) provides:

the products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of *differential internal transportation charges* which are based exclusively on the economic operation of the means of transport and not on the nationality of the product. (emphasis added)

¹⁶¹ For an extensive analysis of these ideas, see G Verhoosel, *National Treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (Oxford, Hart Publishing, 2002) at 23.

¹⁶² See the Working Party on *Border Tax Adjustments*, adopted on 2 December 1970, L/3464, BISD 18S/97, at 102. For jurisprudence related to this issue, see the Panel Report *Spain—Tariff Treatment of un-roasted Coffee* (L/5135, adopted 11 June 1981, BISD 28S/102), or, *EEC—Measures on Animal Feed Proteins* (L/6627, adopted 25 January 1990, BISD 37S/86).

¹⁶³ See the Panel Report on *US—Measures Affecting Alcoholic and Malt Beverages* (DS23, adopted 19 June 1992, 39S/206).

future Panels as consistent with the wording of Article III (2), which provides for specific obligations regarding internal taxes and internal charges which are applied to ‘like products’.¹⁶⁴ Therefore, an analysis of ‘likeness’ should also be undertaken. Article III provides:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to *internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products*. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1. (emphasis added)

Based on Article III(2) first sentence, an examination should be made to determine whether the taxed imported and domestic products are ‘like’ products, similar to Article III (4) on non-fiscal regulatory measures, and second, whether the taxes applied to the imported products are in excess of those applied to like domestic products. Based on Article III(2) second sentence, it should also be determined whether in that case the dissimilar regulation is applied in order to afford protection to domestic products.¹⁶⁵

For energy purposes, reference is generally made to the degree of competitiveness through the method of tariff classification of various types and also their nature and quality. For example, tariffs imposed on electricity differ from tariffs on nuclear energy or natural gas and their physical characteristics are not the same. On the other hand, it is impossible to distinguish between renewable-based electricity and nuclear-generated electricity. Their end-use is the same, and so are their physical characteristics and their tariff classification.¹⁶⁶ The electricity is electricity, no matter what its source (see more on this issue in the section on trade-environment relations below).¹⁶⁷ Therefore, they could be considered ‘like products’ for the purposes of MFN treatment.

Article III of GATT 1994 on national treatment has also been interpreted to refer to the prohibition of tax differences, not only between ‘like products’ but also between the broader categories of ‘*directly competitive or substitutable products*’.¹⁶⁸ In the field of energy products, this category reveals some interesting points. Historically, in 1947, this sentence—specifically in relation to energy goods—was elaborated on by stating that:

¹⁶⁴ See the Panel Report on *Japan—Taxes on Alcoholic Beverages* (WT/DS28/R, adopted 1 November 1996) para 4.16. For a different interpretation of the definition of ‘likeness’ relating to Art III(2) on national treatment and Art III(4) on MFN treatment, see Verhoosel, *National Treatment*, above n 161, at pp 24–33.

¹⁶⁵ The Report of the Appellate Body in *Japan—Taxes on Alcoholic Beverages*, above n 158, at 19–24.

¹⁶⁶ See the ECS Report, *Trade in Energy*, above n 155, at 21.

¹⁶⁷ See also J Bielecki and LK Ervik, ‘Environment-Related Restrictions to Electricity Trade’ (2003) 21 *Journal of Energy and Natural Resources* 413. See also J Bielecki and MG Desta, *Electricity Trade in Europe: Review of Economic and Regulatory Challenges* (The Hague, Kluwer Law International, 2004).

¹⁶⁸ See Appellate Body Report on *Japan—Taxes on Alcoholic Beverages*, above n 158, at 25.

[a] decision could not be made as to whether two products were directly competitive or substitutable except in relation to a factual situation. It might be held that a tax on coal was in a particular case designed to protect the fuel oil industry, but that would have to be determined in relation to the particular case.¹⁶⁹

For substitutability of energy products, it should be determined whether consumers would consider two products as alternative ways of satisfying a particular need or taste.¹⁷⁰ This is confirmed by the WTO jurisprudence that ‘potential competition’ is also sufficient to establish ‘direct competitiveness’, as they are capable of being substituted by one another.¹⁷¹ This principle should be approached with caution with respect to oil and natural gas. Gas and oil are substitutes in a range of energy uses but there is an ‘asymmetry’. ‘Oil can easily replace gas in virtually all sectors where gas has an established market, but gas has greater difficulty in replacing oil in the transport sector where gasoline, automotive diesel and jet kerosene have their stronghold’.¹⁷² Here again, therefore, depending on the energy source and the sector in which that energy is used, the principle is approached differently. As technological advances mean there is growing flexibility in switching from one source of energy to another,¹⁷³ the analysis of dissimilar taxes changes over time and it should be done on a case-by-case basis.¹⁷⁴

One may argue that, based on the WTO jurisprudence, ‘the requisite relationship may exist between products that are not, at a given moment, considered by consumers to be substitutes but “which are nonetheless *capable* of being substituted for one another”’.¹⁷⁵ It is doubtful that oil and gas could at this moment be considered as ‘capable’ of being substituted in the transport sector. Capability should mean that if the consumer wishes, he can use electricity for his car instead of gas. This is not yet the case. Nonetheless, this should not mean that various

¹⁶⁹ See the *Commercial Policy*, Summary Record of the Fortieth Meeting, *UN Conference on Trade and Employment*, 3d Comm, UN Doc E/Conf.2/C.3/SR.40 at 1, 1947, cited in Zedalis, ‘A Theory of the GATT’, above n 159, at 73.

¹⁷⁰ Eg, this is the case regarding alcoholic beverages and the preference given by consumers to whisky, brandy, rum etc. as explained in the Panel Report on *Korea—Taxes on Alcoholic Beverages*, adopted on 17 September 1998, WT/DS75/R, para 5.53 (the Panel refers to the fact that ‘an Art III examination must be carried out on a case-by-case basis, noting in particular that ‘consumers’ tastes and habits . . . change from country to country). See also the Report of the Appellate Body in *Canada—Certain Measures concerning Periodicals*, WT/DS31/AB/R, 30 June 1997, at 21. See also the ECS Report, *Trade in Energy*, above n 155, at 29. See in general, WM Choi, *Like Products in International Trade Law* (Oxford, Oxford University Press, 2003).

¹⁷¹ See Panel Report on *Korea—Taxes on Beverages*, *ibid*, at 114.

¹⁷² See R Mabro, ‘Saudi Arabia’s Natural Gas: A Glimpse at Complex Issues’ (October 2002) Oxford Energy Comment at <<http://www.oxfordenergy.org/comment.php?0210>>.

¹⁷³ See also OECD, *Environmentally-Related Taxes in OECD Countries: Issues and Strategies* (Paris, OECD 2001) at 100.

¹⁷⁴ See S Zarilli, ‘Domestic Taxation of Energy Products and Multilateral Trade Rules: Is this a Case of Unlawful Discrimination?’ (2003) 37 *Journal of World Trade* 359 at 382 [hereinafter ‘Domestic Taxation’].

¹⁷⁵ See the ECS Report, *Trade in Energy*, above n 155, at 29 and see also the Panel Report, *Korea—Taxes on Beverages*, above n 170, at 114.

sources of energy are not *capable* of being substituted. As a result, for energy purposes, the analysis of dissimilar taxes should be case-specific.¹⁷⁶

Another important feature of Article III (5) GATT is the prohibition of '*local content requirement*', which could be referred to for energy purposes. This principle requires the use of a minimum amount of domestic product in the said product or in relation to the mixture, processing, or use of that product. The prohibition on an obligation on electricity producers to use a certain percentage of domestic renewable sources of energy could fall within the ambit of this Article.¹⁷⁷ However, countries could be exempted based on Article XX GATT and claims to protect the environment. This issue is discussed later in this chapter.¹⁷⁸

The issue of discrimination between various sources of energy has also been raised by the oil-exporting or gas-exporting countries with respect to the domestic taxation of their imported energy in consuming OECD countries. They claim that OECD countries tax various sources of energy differently, not necessarily for environmental reasons. For example, oil-exporting countries claim that oil and refined petroleum products are taxed much higher than natural gas, electricity and coal. They argue that high taxes on oil will ultimately reduce the demand for oil, which would in turn lower the income that they gain through sale of those products. Based on the analysis of national treatment above, if the importing OECD country is also an energy producer, an analysis of 'likeness' can be applied to determine whether the consuming country taxes the imported energy differently than the 'like' energy of national origin. If the importing country is not a producing country, it should be verified whether discriminatory taxation between various energy sources is justified based on environmental reasons. It is interesting, however, that in some of the OECD countries, energy sources that are more polluting than others, such as coal, (in the absence of technological innovation through which coal could be used in an environmentally friendly way) are taxed lower than petroleum products (this differentiation

¹⁷⁶ See Zarilli, 'Domestic Taxation', above n 174, at 382.

¹⁷⁷ See the ECS Report, *Trade in Energy*, above n 155, at 30.

¹⁷⁸ Another important exemption to national treatment is provided in para (8), which relates to payment of subsidies to domestic producers and not to foreign producers. Such payment is allowed and discrimination against foreign producers is therefore not a violation of national treatment in this respect. However, these subsidies should be exclusively addressed to domestic producers and not to domestic purchasers of the goods produced. (See the Panel Report on Italian Discrimination against Agricultural Machinery, L/833, adopted on 23 October 1958, BISD 7S/60, para 14). There is also a difference between tax exemptions in the form of subsidies and direct payments. Payments to domestic producers only—from taxes previously collected on a non-discriminatory basis—are justified under this exception. This exemption is extremely important for energy purposes, since governments tend to subsidise those energies that are environmentally friendly more than other types of imported energy. For example, governments tax electricity generated from renewable sources and electricity from nuclear energy equally (therefore there is no violation of Art III(2)), but later subsidise domestic producers of the former from tax money collected. It has to be added here that if both types of electricity are taxed differently (which would be a violation of Art III (2)), this discrimination could be justified, if all other conditions are met, based on Art XX and environmental concerns.

is mainly in order to protect the domestic production of coal etc.).¹⁷⁹ Although discrimination is not always unlawful in this case (as they are not necessarily in conflict with National or MFN treatment because discrimination is not between 'like' products, as mentioned before), oil-producing and gas-producing countries demand that consuming nations take their vital interest in maintaining their stable income into account and abandon such a practice. However, the fact remains that consuming nations are not necessarily eager to change their taxation system based on this demand. Nevertheless, the possibility of making changes to this system due to bargaining between consuming (eg Europe) and producing countries to guarantee long-term security should not be discarded. A role can be designed here for the ECS to reflect upon the ways that such concerns could be balanced and an efficient cooperation could be established. This role has not yet been undertaken by the ECS.

5.4.3. Quantitative Restrictions under GATT

One of the most important principles of the GATT, relevant for our discussion on trade in energy products and materials, is the prohibition on imposing quantitative restrictions (such as bans, quotas or licenses or other measures that have equivalent effect)¹⁸⁰ on the importation or exportation of energy products, based on Article XI GATT.

The imposition of quantitative restrictions results in discrimination between imported and domestic products and is deemed to cause

nullification and impairment of benefits accruing under GATT not only because of any effect such restrictions have on the volume of trade but also for their role in increasing transaction costs and creating uncertainties, which could affect investment plans.¹⁸¹

¹⁷⁹ See the WTO document, *Energy Taxation, Subsidies and Incentives in OECD Countries and their Economic and Trade Implications on Developing Countries*, in particular *Developing Oil Producing and Exporting Countries*, Submission by Saudi Arabia, WT/CTE/W/215, TN/TE/W/9, 23 September 2002 [hereinafter Saudi Arabian submission on 'Energy Taxation']. See also Zarilli, 'Domestic Taxation', above n 174. For the EC legislation with respect to taxation of energy, see Council Dir 2003/96/EC of 27 October 2003 Restructuring the Community Framework for the Taxation of Energy Products and Electricity, [2003] OJ L/283/51. See also F Asche, P Osmundesn and R Vtereras, 'Energy Taxes and Natural Gas Demand in EU Countries', CESifo Working Paper No 516, July 2001. Developing countries in the WTO could also take advantage of Art XXXVII of the GATT, which provides that the developed countries shall, to the fullest extent possible, refrain from imposing fiscal measures, which would hamper, or which hamper significantly, the growth of consumption of primary products, in raw or processed form, wholly or mainly produced in the territories of less-developed contracting parties, and which are applied specifically to those products. Although this Article is not mandatory, it should be insisted upon by countries whose product is being discriminated against.

¹⁸⁰ Quantitative restrictions do not apply to price-based restrictions, ie duties, taxes, or other charges. These fall under Art II on tariff binding or Art III on internal taxes. See also the ECS Report, *Trade in Energy*, above n 155, at 40.

¹⁸¹ See Panel Report on *Japan—Measures on Imports of Leather*, L/5623, adopted on 15/16 May 1984, 31S/94, paras. 47–48, 53–55.

The non-discrimination principle under Article XI should not be confused with the National Treatment principle of Article III. Quantitative restrictions are applied as border measures, while national treatment is applied to products as soon as they pass the border control and when they circulate in the market of the contracting party. Therefore, the 'like' product analysis, as applied to determine compliance with national treatment, is not applied to quantitative measures.

The ECS provides a good example of the difference between measures that fall under provisions on national treatment and quantitative measures.¹⁸² Although this example only refers to imports, exports of energy goods will also fall under this Article. The ECS provides:

[a] measure, regulating imports, will only be subject to Article XI if it applies to imports and not to domestic products. Import bans, import quotas, and import licenses are some examples of measures subject to Article XI. However, when faced with a product regulation that applies to all products brought on the market of the ECT Contracting Party concerned, then even if, for imports, compliance with these standards is checked at the border, the regulation will be subject to the more lenient Article III, not the stricter Article XI.

The exceptions provided for in the context of Article XI are relevant for energy purposes. One exception is that export restrictions are justified if they are adopted in order to 'prevent' or 'relieve critical shortages of products' essential to the exporting ECT contracting party. The restriction of oil exports in order to prevent a crisis, for example, is a good illustration of the application of this exception. These restrictions should be applied on a temporary basis until the time that the condition no longer justifies their maintenance.¹⁸³

The second exception provided for in Article XI(2)(b) deals with import and export prohibitions or restrictions 'necessary to the *application of standards* or regulations for the classification, grading, or marketing of commodities in international trade' (emphasis added). This prohibition can be applied where the contracting party aims to maintain the quality standards of a given product and prohibit the export of those products if they do not meet those standards when this act is *necessary* for internal marketing purposes.¹⁸⁴ This exception could be applied to a situation where the export of energy from an energy-producing country is limited because they do not maintain some quality standards, which, if not prohibited, reduce the country's ability to keep its share in the international market.

The third exception deals with the use of quantitative restriction for balance of payment purposes (GATT Article XII). When a country has inadequate foreign currency, it may be allowed to impose import restrictions. Such restrictions may

¹⁸² See ECS Report, *Trade in Energy*, above n 155, at 42.

¹⁸³ Art XII(2)(b).

¹⁸⁴ See Panel Report on *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, adopted on 22 March 1988, L/6268, BISD 35S/98, 112, para 4.3. See also the ECS Report, *Trade in Energy*, above n 155, at 43.

not exceed those necessary to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or it may not exceed a reasonable rate of increase in reserves when the country has very low monetary reserves. They can only be justified on an MFN basis and should apply to all imported products (Article XII (2)). However, as the import of energy could be vital for an importing country, that country may exempt the import of such products from this rule. Exactly related to this issue is GATT Article XII (3)(b), which allows the contracting parties to decide not to impose import restrictions on certain products that can be categorised as ‘essential products.’ ‘Essential products are those products that meet basic consumption needs or which contribute to the member’s effort to improve its balance of payment situation.’¹⁸⁵ Energy products could fall squarely into this category.¹⁸⁶

Export restrictions are used by many energy-producing countries. This problem is highlighted in the policy of the Organization of Petroleum Exporting Countries (OPEC) with regard to the establishment of production quotas. Before analysing this issue, which reveals another peculiarity of the energy sector, regulations on the general exception embodied in GATT will be discussed, which is relevant for the analysis of OPEC practice as well.

5.4.4. Article XX GATT and General Exceptions

Some of the exceptions provided by Article XX GATT are relevant for the discussion on energy trade, and consequently, as explained later, for the purposes of security of energy supply. Apart from the exceptions enumerated in this Article, it was found necessary that where a measure falls within the ambit of this Article, it should not be applied in a manner which would ‘constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail’, or ‘constitute a means of disguised restriction on international trade’ (the so-called Chapeau of Article XX). Therefore, the measure should firstly fall under one of the exceptions of this Article, and secondly it should be analysed whether the requirement of the Chapeau is satisfied.

Five exceptions are most relevant for trade in energy:

1. Measures necessary to protect *human, animal, or plant life or health* (Article XX(b)): the adoption of trade restrictions to protect the above-mentioned

¹⁸⁵ See WTO, ‘*Understanding on the Balance of Payments Provisions of the General Agreement on Tariffs and Trade 1994*’, Art 4.

¹⁸⁶ The Charter Secretariat Report provides an example to show that application of the MFN rule to import restrictions for balance of payment purposes ‘does not serve efficiency’. The reasoning is that if a country decides, exceptionally, to impose such restrictions, it can allocate tariff quotas on imports of, for example, natural gas. But applying the same quota to all member of the ECT does not make sense, as some countries are involved in trade of energy, or the amount of imports from one country is far larger than another. This would make the application of MFN rather unreasonable. It remains to be seen how this exception is applied in practice under the ECT.

objectives should be 'necessary'. This is interpreted to mean that no GATT-consistent alternative should have existed, and if no such alternative existed, the restriction should entail the least degree of inconsistency with other GATT provisions.¹⁸⁷ Imposing higher taxes on oil that was produced in a non-environmentally friendly manner can be justified, for instance, only if other alternatives—labelling the product as having been produced in an environmentally unfriendly manner—do not exist.

Increasing concern about the safety of some nuclear power plants and emissions from most thermal power plants¹⁸⁸ has resulted in regulations being adopted by some countries to restrict or prohibit trade of these types of energy which have not yet been addressed by the WTO.¹⁸⁹ Nuclear power plant risks could be classified as (a) their potential to explode (b) nuclear radiation or, (c) the problem of nuclear waste. The risk of thermal power plants is the sulphur dioxide and nitrogen compounds that they produce. Both risks can extend from the place they occur to other places.¹⁹⁰ Therefore, prohibitions on the import of this type of electricity can be justified under Article XX(b). However, this prohibition is better justified in theory than practice. As mentioned before, it is difficult to distinguish between so-called 'dirty' electricity (ie electricity produced with least concern for environment), and the non-dirty.¹⁹¹ What the consumer at the end of an electricity grid receives is electricity, no matter what its source, and if this electricity does not come directly from the neighbouring country where it is generated, it is impossible to trace its source and distinguish the dirty electron from the clean variety when technical means for this purpose do not yet exist.

¹⁸⁷ See Panel Report on *Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes*, adopted on 7 November 1990, DS10/R, BISD 37S/200, paras 74–75.

¹⁸⁸ The major source of thermal pollution is electrical power plants. In most electrical power plants, heat is produced when coal, oil, or natural gas is burned or nuclear fuels undergo fission to release huge amounts of energy. This heat turns water to steam, which in turn spins turbines to produce electricity. After doing its work, the spent steam must be cooled and condensed back into water. To condense the steam, cool water is brought into the plant and circulated next to the hot steam. In this process, the water used for cooling warms 5 to 10 Celsius degrees, after which it may be dumped back into the lake, river, or ocean from which it came, thus warming up those waters. See *Microsoft Encarta Encyclopaedia*, 2003.

¹⁸⁹ For example, as explained in ch 4.2.1.1 above, the Austrian and Luxembourg laws contain a provision that allows the government to reject contracts for electricity from countries outside the European Union, if it is determined that the power would come from facilities whose technology does not correspond to 'state-of-the-art', that pose a 'direct or indirect danger' to persons, or that fail to demonstrate a state-of-the-art waste management plan or concept'. See Bielecki and Desta, *Electricity Trade*, above n 167.

¹⁹⁰ There are many nuclear reactors in operation in both Central and Eastern Europe, some which are not upgradeable. See <http://www.europa.eu.int/comm/external_relations/nuclear_safety/intro/index.htm>. See Communication from the Commission to the Council and the European Parliament, Commission Support to Nuclear Safety in the Newly Independent States and Central and Eastern Europe, COM (2000) 493 Final.

¹⁹¹ However, to facilitate trade in electricity produced from renewable energy sources and to increase transparency for the consumer's choice between electricity produced from non-renewable sources and electricity produced from renewable energy sources, the guarantee of origin of such electricity is necessary.

Moreover, if we assume that an importer is successful in determining the source of electricity, it should be determined what type of alternative could be accessible to the importer. The GATT-consistent alternatives, as mentioned in the WTO Panel Reports, could be adopted, such as the imposition of higher, but non-discriminatory taxes, or the negotiation of an agreement to combat energy-generating mechanisms that are environmentally unfriendly.¹⁹²

It is worth briefly mentioning here that the initiative adopted by the Community in Directive 2001/77/EC could be adopted by the WTO system. The directive provides that, in order to facilitate trade in electricity produced from renewable energy sources and to increase transparency for the consumer's choice, a 'guarantee of origin of such electricity' should be issued by Member States of the Community. Such a guarantee of origin shall specify the energy source from which the electricity is produced along with the date and place of its production (the section on the relationship between trade and the environment provides a closer perusal of this issue).¹⁹³

2. Measures *relating* to the conservation of *exhaustible natural resources*, if such measures are made effective *in conjunction* with restrictions on domestic production or consumption: this exception can be widely used by energy-producing countries where they restrict exports of energy because their reserves are in danger of depletion or because exploration techniques are not sufficiently developed to circumvent the loss of energy, among other things. If it is shown that the measure is extended to cover a decrease in domestic consumption (non-discrimination principle), the country can invoke this exception.

The fact that energy reserves are exhaustible is common knowledge,¹⁹⁴ and only its degree and the time period after which a reserve will be depleted is

¹⁹² See Zarrilli, 'Domestic Taxation', above n 174, at 388. She is of the view that a taxation system to combat environmental problems should be adopted in the framework of a multilateral environmental agreement, such as Kyoto. This would achieve the goal of preserving the environment, and it would not unduly penalise the energy exporting countries. Moreover, within the European Community there are rules to regulate activities in line with preservation goals. See, eg, Dir 2001/80/EC of the European Parliament and of the Council of 23 October 2001 on the Limitation of Emissions of Certain Pollutants into the Air from Large Combustion Plants, [2001] OJ L/309/1. See also the 1979 UNECE Convention on Long-Range Trans-boundary Air Pollution (CLRTAP) (18 *International Legal Materials* 1442) and subsequent Protocols. This Convention provides that:

The Contracting Parties, taking due account of the facts and problems involved, are determined to protect man and his environment against air pollution and shall endeavor to limit and, as far as possible, gradually reduce and prevent air pollution including long-range trans-boundary air pollution.

Art 3 stipulates that:

the Contracting Parties, within the framework of the present Convention, shall by means of exchanges of information, consultation, research and monitoring, develop, without undue delay, policies and strategies which shall serve as a means of combating the discharge of air pollutants, taking into account efforts already made at national and international levels.

¹⁹³ See Dir 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the Promotion of Electricity Produced from Renewable Energy Sources in the Internal Electricity Market, [2001] OJ L/283/33.

¹⁹⁴ See Appellate Body Report *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, 12 October 1998, WT/DS58/AB/R Reference is made in this case to the fact that petroleum

controversial.¹⁹⁵ Hence, it is doubtful that the degree at which the exhaustion rate is determined will be used in order to accept a claim based on this provision. Therefore, it seems that an energy-producing country can rely on this provision to protect its energy reserves without having to satisfy the burden of proof.

The ECT has also provided more stringent rules with respect to protection of natural resources which are linked to the exception mentioned above by providing, in Article 18, that each state preserves the right to decide the recovery rate of a reserve found in its territory and geographical area to be made available for exploration and development of energy resources, and to regulate the environmental and safety aspects of these activities. This Article is not only related to claims of sovereignty but also to preservation of its exhaustible energy reserves.

Furthermore, this exception's examination from the importing country's perspective is interesting. This could mean that energy imports are prohibited if they endanger the natural reserves of the importing country. In the WTO, the term 'exhaustible natural resource' has been found to cover, for example, 'clean air', 'living resources' etc. Therefore, the importation of 'dirty' energy could be prohibited in order to protect these types of 'exhaustible natural resources'. It would be unlikely for a country, in dire need of energy, to resort to such a prohibition, especially for oil and natural gas imports, unless these measures are adopted to reach other goals unrelated to the objectives of this provision. It is only when other forms of energy are accessible to a country that a ban on the importation of poorly generated nuclear electricity or any other 'dirty energy' (that is considered as 'non-green') becomes probable.

3. Measures necessary to *secure compliance with laws or regulations* which are not inconsistent with GATT, including those relating to customs enforcement and enforcement of monopolies: for instance the application of some laws and regulations which aim at maintaining a monopoly, or those which are found *necessary* to secure compliance with the foreign investment law of the host state could fall within this category. A measure is found necessary only if other alternatives that a country could be expected to employ, and which are not inconsistent with other GATT provisions, are not reasonably available. This does not mean that a contracting party is asked to change its substantive law or its desired level of enforcement of that law, provided that such a law does not

is an exhaustible natural resource as the Appellate Body explicitly provided that 'living resources are just as finite as petroleum', see para 128. Electricity is also an exhaustible resource since the sources through which it is produced, such as natural gas and coal, are exhaustible.

¹⁹⁵ The controversy is over the method used to determine the time during which the reserve will be exhausted. This is a ratio of reserve to production (R/P ratio) that necessitates knowledge about the capacity of a reserve and the rate of production from that reserve. This method is not accepted by many as the most accurate way to determine the rate of exhaustion of a reserve. For more explanation see ch 1.2.2.1 above.

discriminate between domestic and foreign products. It means that if the measure could be secured in a manner consistent with GATT, the country would be required to do so.¹⁹⁶

4. Measures involving restrictions on exports of domestic materials necessary to *ensure essential quantities of such materials to a domestic processing industry* during periods when the domestic price of such materials is held below the world price as part of a *governmental stabilisation plan*; provided that such restrictions shall not operate to increase the exports of, or the protection afforded, to such domestic industry, and shall not depart from the provisions of GATT relating to non-discrimination: where there is a need for an industry to use a domestic energy source as an input, an export prohibition is allowed only if that ban is taken according to a governmental stabilisation plan which seeks to keep domestic prices of energy below world market prices.

5. Measures essential to the acquisition or distribution of products *in general or local short supply*. This measure, similar to the one explained in relation to Article XI, can be applied by the energy exporting country at the time of a shortage of supply due to, among other things, war or natural disaster.

Article XXI (b) also adds another category of exception as those related to security matters, and allows a member country to take action which it considers necessary for the protection of its '*essential*' security interests. These measures could be related to fissionable materials. For example, a country could ban the import of nuclear energy for security purposes. They could also be related to implements of war or direct or indirect supplies to a military establishment. If a country believes that the export of energy is related to the establishment of a military, it could prohibit such exports. Similarly to the exception in Article XX, these measures can also be taken in time of war or other emergency situations in international relations.

Measures to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security is another permitted act in the ambit of which, for example, an UN-based embargo would allow limits to be imposed on energy trade with the embargoed country (Article XXI(c)).

5.4.5. The Special Case of OPEC: Quantitative Restrictions and Obligations under the WTO

OPEC is an international organisation of 11 members and membership is open to those countries 'with a substantial net export of crude petroleum, which has

¹⁹⁶ See GATT Panel Report, *United States—Section 337 of the Tariff Act of 1930*, L/6439, adopted on 7 November 1989, 36S/345, paras 5.25–5.27.

fundamentally similar interests to those of Member countries of OPEC.¹⁹⁷ The principal aim of the organisation is (1) coordination and unification of the petroleum policies of member countries, and (2) determination of the best means for safeguarding their interests, individually and collectively (Article 2). The organisation shall¹⁹⁸:

B. Devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations.

C. Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries, an efficient, economic and regular supply of petroleum to consuming nations, and a fair return on their capital to those investing in the petroleum industry.

In order to pursue the price-stabilisation objectives, OPEC adopts the policy of management of supplies through supervision of production in each member country. In order to compare these activities with WTO obligations, two issues should be mentioned:

Firstly, in 1950 a Report of the Working Party of the GATT examined the use of export restrictions that are applied for protective, promotional, or other commercial purposes, two of which are relevant here:¹⁹⁹ (1) export restrictions on the export of raw materials, in order to protect or promote a domestic industry (through reduction of supply or price advantage to the industry for the purchase of its materials), or (2) export restrictions used to avoid price competition among exporters (through maintenance of export price).

Secondly, as far as WTO law is concerned, 'price setting techniques' are prohibited based on Article XI on quantitative restrictions. In a GATT Panel Report, it was mentioned that the 'import regulation allowing the import of a product in principle but not below a minimum price level constituted a restriction on importation, and the same principle was found to cover restrictions on *exports* below certain prices.²⁰⁰ Therefore, the extent to which OPEC decisions that restrict supplies are linked to prices within an OPEC-approved price range or any other threshold, such measures, as applied by those Members of OPEC that are WTO members, could well constitute quantitative restrictions affected through setting export price requirements.²⁰¹

¹⁹⁷ See Art 7 of the OPEC Statute at <<http://www.opec.org>>. The current members of OPEC are Algeria, Angola, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

¹⁹⁸ See the OPEC Statute, Art 2, at <<http://www.opec.org>>.

¹⁹⁹ See GATT, *Analytical Index: Guide to GATT Law and Practice*, 6th edn (Geneva, 1994) at 297.

²⁰⁰ See Panel Report, *Japan—Trade in Semi Conductors*, L/6309 BISD 35S/116, adopted on 4 May 1988, para105.

²⁰¹ See also MG Desta, 'The Organisation of Petroleum Exporting Countries, the World Trade Organisation, and Regional Trade Agreements' (2003) 37 *Journal of World Trade* 523 at 534 [hereinafter 'OPEC']. See also the WTO evaluation of Venezuela and Nigeria's production quotas in the framework of their obligations under OPEC in documents WT/TPR/S/10 and WT/TPR/S/39.

Another application of Article XI to OPEC activities is the management of supplies by issuing production quotas. Although Article XI prohibits export quotas, the direct link between production quotas and export quotas cannot be overlooked, especially when a large amount of domestic production is used for export, which is the case in most exporting country members of OPEC. Therefore, it is submitted that there is nothing ambiguous about the fact that OPEC activities are in contradiction with Article XI of the WTO,²⁰² and for that purpose, the ECT regulations. However, it is interesting that OPEC's practice, as applied by its Members, has never been raised as a violation of WTO rules in a GATT or WTO Panel.²⁰³ The non-existence of any such claim to date is clearly due to political considerations playing a role outside the ambit of the WTO.²⁰⁴

This issue is also interesting from the perspective of the European Community's efforts to secure energy supply. In the history of the Community's external relations with OPEC energy producers, no reference has been made to the anti-competitive behaviour of OPEC. This is even more interesting when we look at the crisis of 1973, and the adverse economic effects that it had for Europe. The absence of an action by the Community is more interesting when one looks at the extraterritorial reach of EC law on the basis of the 'effects' doctrine, based on

²⁰² See, eg, the WTO evaluation of Venezuela and Nigeria's production quotas in the framework of their obligations under OPEC in WT/TPR/S/10 and WT/TPR/S/39.

²⁰³ There are claims against OPEC based on the anti-competitive behaviour of this organisation. Linked to this claim, there is controversy over whether OPEC is a cartel. OPEC argues that it is not a cartel, firstly because it controls only less than one half of the petroleum market and secondly it responds to both low and high oil prices. See luncheon address by former OPEC Secretary General, R Lukman, to the 16th World Petroleum Congress, Calgary, Canada, 13 June 2000. For counter-arguments, see Desta, 'OPEC', above n 201, at 547.

²⁰⁴ However, OPEC's activities were challenged as anti-competitive in the United States. The first claim was brought in 1978 by a US labour union before the US District Court for the Central District of California (*International Association of Machinist and Aerospace Workers v OPEC and Member Countries*). This claim was dismissed by the Court, on the ground inter alia that the activities of OPEC members were within their acts as sovereign states to which no claim could be made. The Appellate Court accepted the lower court's judgment but based its argument on the 'act of state' doctrine, which does not allow a court of one country to judge the legality of the sovereign acts of a foreign state. The second claim was brought in the United States before the District Court for the Northern District of Alabama in April 2000 by Prewitt Enterprises, a company operating a gas station in Alabama (*Prewitt Enterprise Inc. v OPEC*). This company claimed that the activities of OPEC were adversely affecting its company because of price fluctuation. The District Court accepted the claim and ruled that neither Foreign States Immunity Act nor 'Act of State Doctrine' apply and called OPEC's practice illegal under the Sherman and Clayton Acts. OPEC condemned this decision and filed an appeal in April 2001. The Appeals Court ruled that procedural regulations were not previously properly complied with and summons had not been correctly served because the headquarter agreement between OPEC and Austria required that all such processes pass through diplomatic channel and not, as was done in this case, by registered mail. The Supreme Court, without providing a rationale, refused to hear the case. It remains to be seen how this challenge will be brought up again. The third claim was raised in December 2005 against Pemex, Mexico, Statoil, Norsk Hydro, Norway, Sonangol, Angola and Oman, based on the fact that they conspire with OPEC to violate the American antitrust norms. The case is yet to be decided. See also the 'OPEC Accountability Act' which was a bill introduced on 11 April 2005, which required that US Trade representatives pursue a complaint against certain oil exporting countries for their anti-competitive practices based on GATT Art XI on quantitative export restrictions, 109th US Congress (2005–2006), S752.

which activities outside the Community could be considered as ‘affecting’ the Community and thus prohibited. For example, in the case of *Gencor v Commission*,²⁰⁵ the application of the EC Merger Regulation resulted in the EU’s prevention of a merger between two South African mining companies which would have left them with 30–35 per cent of world production. On appeal, the Court of First Instance found the application of the Merger Regulation justified under public international law ‘when it was foreseeable that the proposed merger would have an “immediate and substantial effect in the Community”’.²⁰⁶ Considering the possibility of the extraterritorial application of EC regulations based on the ‘effect’ doctrine, and the consequences for competition within the Community, it does not seem too far-fetched to conclude that, if the activities of OPEC also have a direct impact on trade in energy products—for example due to high prices or limitations on production—the Community could also pressure OPEC, based on its domestic competition laws. However, the reality is that OPEC’s management of the majority of the world oil supply necessitates a rather cautious approach to its activities. Here again the peculiarity of energy sector and its ability to circumvent established rules are revealed.

Nevertheless, where the activities of OPEC are considered to be in violation of the WTO rules on quantitative restrictions in the future, there is an argument as to the possibility of using the Article XX exception to GATT trade rules in order to exempt the activities of OPEC Member States in establishing production quotas from Article XI obligations on the prohibition of quantitative restrictions. As mentioned above, one possible exception to GATT rules is when a specific measure is undertaken to conserve exhaustible natural resources. As energy reserves are exhaustible, some believe that the OPEC’s production quota policy can be linked to conserving the energy reserves of each Member State. They argue that

conservation of a mineral resource, such as oil, cannot be seen in isolation from the financial return of its exploitation for its owners, and production restriction decisions caused by falling market prices should be construed as relating to the conservation of the resource.²⁰⁷

However, it is very unlikely that this argument could be sustained at the time of a dispute, because clearly the main objective of OPEC’s production management is not necessarily concerned with conserving the energy resources of OPEC member countries. These countries have been eager to increase production whenever supply has not been adequate to meet demand without ever mentioning the lack of this possibility due to concerns for the exhaustion of their resources.²⁰⁸ The

²⁰⁵ See Case T-102/96, *Gencor v Commission* [1999] ECR II-753.

²⁰⁶ See also E Ukpanah, ‘OPEC as a Cartel: Can US Antitrust Laws Be Applied Extraterritorially?’ (2002) CEPLMP, at <<http://www.dundee.ac.uk/cepmlp>>.

²⁰⁷ See Desta, ‘OPEC’, above n 201, at 536.

²⁰⁸ See the increase in production by OPEC members after the rise in prices in 2003 and subsequent years.

argument can be sustained when an oil-exporting country sets production ceilings to 'maintain a reasonable rate of oil depletion, or to avoid wasting oil resources in times of unusually low prices'.²⁰⁹ As this is not always the case, the argument of linking production quotas to the conservation of natural resources in abstract is too remote to be sustained.

5.4.6. Developing Countries in the ECT and the GATT/WTO

In the early years of GATT, no group of countries was exempted from the basic rules of the multilateral trading system and they applied to all contracting parties uniformly, regardless of the level of their economic development. It was only in the Draft Charter of the International Trade Organisation (that never came into existence) that the use of protective measures for the establishment, development or reconstruction of particular industries or branches of agriculture was allowed, provided that countries obtained the permission of other contracting parties. Moreover, the emphasis was on 'reconstruction', which focused mostly on recreating industries damaged during the Second World War, and countries were considered 'different' based on the degree of destruction.

Soon afterwards, however, and still in the early days of the GATT, the economic differences between developed and developing countries were revealed.²¹⁰ This caused some to argue that the ways through which the trade policies of the GATT should be approached ought to be different, and that special challenges that developing countries face should not go unnoticed. At a later stage, and after depicting the real differences that lie between these two sets of countries, the multilateral trading system faced another, more important question of how and through what means these differences should be tackled. What obligations should be imposed on these countries, without undermining the basic trade policies and objectives on which the multilateral trading system is based? This latter task became the subject of fierce debate, not only among the developing members of the WTO in their negotiations, but also among scholars writing on this topic.

Finally, developing countries came forward with a set of proposals and they requested special treatment (which later, during the Tokyo Round, became known as 'Special and Differential Treatment (S&D)'). The trade strategies they were willing to pursue were concentrated in four main areas: (1) improved

²⁰⁹ See H Abdallah, 'Oil Export under GATT and the WTO' (2005) 29 *OPEC Review* 267 at 276.

²¹⁰ See generally, C Michalopoulos, 'Trade and Development in the GATT and the WTO: the Role of Special and Differential Treatment for Developing Countries', 18 (19 April 2000), available at <http://www.wto.org/english/tratop_e/devel_e/sem01_e/sdt_e.htm>. The linkage between trade and development and the particular situation of developing and least-developed countries in the WTO has long been debated. UNCTAD deals specially with this issue from various perspectives. See the UNCTAD note by the Secretariat, 'Review of Developments and Issues in the Post-Doha Work Program of Particular Concern to Developing Countries', TD/B/52/8, 26 August 2005. See also the UNCTAD Report, 'Trade and Development: New Features of Global Interdependence', UNCTAD/TDR/2005.

market access for developing country exports of manufactured goods to developed markets,(2) non-reciprocity between developing and developed countries, (3) flexibility in the application of agreements, and (4) stabilisation of world commodity markets.²¹¹ The relationship between trade and development was, therefore, highlighted within these settings, and they were anchored in the understanding that ‘the principle of non-reciprocity or less-than-full reciprocity in concessions and commitments was needed if developing countries were to realise their development goals.’²¹² Eventually, the GATT review session in 1954–55 reflected some of these demands and introduced a few provisions addressing those countries that were ‘at the early stages of development or could only support low standards of living.’ This initiative was a clear sign of awareness that some countries have faced difficulties in implementing the basic trade policies established by the GATT system.

GATT included some provisions, such as Article XXVIII and Part IV, which specifically deal with the link between trade liberalisation and economic development. Article XXVIII considered the needs of ‘least-developed countries’ for a more flexible use of tariff protection to assist them in their economic development and the special needs of these countries to maintain tariffs for revenue purposes, which suggests that the reciprocity in tariff negotiations—that this Article recommends—should not strictly apply to them. Part IV emphasised the particular role that increasing the exports of less-developed countries can play in their economic development. It highlighted the necessity to adopt a joint action to further develop the economies of these countries. For these reasons, it urged developed countries to allow access to their markets of those products of interest to least-developed countries and emphasised the fact that the economies of these countries should be diversified away from an extensive dependence on the export of one primary product.

Later, in 1964, the Committee of Trade and Development was established in order to undertake the necessary research on the relationship between trade and development and the implications of liberalised trade on the economic development of countries with lower standards of living. This initiative was followed by the creation of the ‘UN Conference for Trade and Development’ (UNCTAD) in 1964, which, as its objective, aimed at the full integration of developing countries into the world economy in general, and dedicated a substantive part of its work to activities at the level of GATT in particular. The Generalised System of Preferences (hereinafter GSP), which is the most important undertaking on behalf of developed countries to provide preferences for developing country access to their markets, was created in 1971 following the emphasis of the Working Group on Preferences on the necessity of establishing such a system to improve the situation of developing countries. The GSP was designed to allow

²¹¹ See Michalopolous, *ibid*, at 4.

²¹² See A Breckenridge, ‘Developing and Issue-based Approach to Special and Differential Treatment’ at 3, available at <<http://www.iadb.org/int/DRP/ing/Red1/tradedocument3.htm>>.

developed countries to accord preferential treatment to developing countries, and it actually operated as a waiver under Article XXV(5) of GATT, which allows waivers of obligations in exceptional circumstances.²¹³ Normally all imports are subject to duty unless designated as duty-free or given a duty exemption or 'preference', and the GSP provided duty-free treatment 'under certain criteria for an eligible good originating in a specific place'.

In 1979, another important step was taken towards guaranteeing better protection for developing countries: the Enabling Clause. The Enabling Clause directly addressed the role of developed countries in the economic progress of developing countries, and it became known as the 'permanent legal basis' for S&D and the continuation of the GSP. On 28 November 1979, the Decision on 'Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries'²¹⁴ was established. This Decision expressly provided that 'special and differential treatment' can be provided for developing countries without according such treatment to other contracting parties. This clause also provided that preferential tariff treatment should be accorded by developed contracting parties to products originating in developing countries and that favourable treatment concerning 'non-tariff measures' be given to these countries. This means that any non-tariff measure that can be considered as an obstacle to the trade of developing countries should be abolished (such as strict technical regulations for the import of products of interest to developing countries etc). This clause also asked developed countries not to expect 'reciprocity' and to exercise 'utmost restraint' in demanding concessions from these countries. Around 155 provisions, spread across various WTO agreements, currently deal with the Special and Differential Treatment Provisions. Efforts were made in the Doha Negotiations Rounds to place greater emphasis on the role of these provisions in economic development and to create more legally binding obligations for developed countries (eg mandatory obligations, less voluntary, address problems of implementation in developing countries etc.).²¹⁵ An agreement is yet

²¹³ Art XXV(5) provides that:

in exceptional circumstances not elsewhere provided for in this Agreement, the Contracting Parties may waive an obligation imposed upon a contracting party by this Agreement; Provided that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties.

The contracting parties may also by such a vote

(i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and (ii) prescribe such criteria as may be necessary for the application of this paragraph.

²¹⁴ See L/4903, The Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries of 28 November 1979.

²¹⁵ See Panel Report European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/R, 1 December 2003 and the Appellate Body Report, WT/DS246/AB/R, 7 April 2004.

to be reached among member countries of the WTO to amend some of the existing provisions and create new ones.²¹⁶

Most of the energy-producing countries are developing countries and therefore, the application of these provisions to their activities in the energy sector could be relevant.²¹⁷ For example, it was mentioned before that energy-producing countries have raised their concerns over the taxation policies of developed countries with respect to petroleum products, and the effect that this taxation has had on their income. Interestingly, Article XXXVII of GATT provides that developed countries shall, to the fullest extent possible, refrain from imposing new fiscal measures which would hamper significantly the growth of consumption of primary products, in raw or processed form, wholly or mainly produced in the territories of less-developed countries. This provision can be used by energy-producing countries to address their concern over taxation policies. However, the obligation imposed by this Article on developed countries uses the wording 'to the fullest extent possible.' Legally speaking, this creates less of an obligation, if justified by those countries. Other examples of special arrangements for developing countries can be found in the context of the discussion on energy services (GATS, Article XIX:2) and domestic energy pricing (Subsidies Agreement, Article 27(2)(b)), which are separately discussed in the following sections.

The ECT has incorporated the 1979 Decision taken by the GATT contracting parties, which refers to the 'enabling clause'.²¹⁸ However, any other exception specifically designed to favour developing countries is excluded from the ambit of

²¹⁶ See 'WTO-Implementation-Related Issues and Concerns' (Decision of 14 November 2001) WT/MIN(01)/17, 20 November 2001. The European Community adopts a Generalised System of Preferences, see Council Reg (EC) 2501/2001 of 10 December 2001 Applying a Scheme of Generalised Tariff Preferences for the period from 1 January 2002 to 31 December 2004—Statement on a Council Reg Applying a Scheme of Generalised Tariff Preferences for the period from 1 January 2002 to 31 December 2004, [2001] OJ L/346/1. See also Council Reg (EC) 416/2001, of 1 March 2001, Extending Duty-Free Access Without Quantitative Restriction to Products Originating in Least Developed Countries, [2001] OJ L/60/43.

²¹⁷ Surprisingly, no definition of which countries are developing is provided by the WTO Members announce themselves whether they would like to be considered as 'developed' or 'developing' countries. If no other member challenges this option, the status is accepted. On the other hand, even if the country is accepted as a 'developing country', this does not mean that the country will benefit from the unilateral preference schemes of some of the developed country members. In practice, it is the preference-giving country which decides the list of developing countries that will benefit from the preferences. To determine which countries are developing countries in the WTO, see <http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm>. See WTO, 'Implementation-Related Issues and Concerns', *ibid*. On the other hand, for the least developed countries the situation is different. The WTO refers to the list provided by the United Nations Economic and Social Council where these countries are enumerated. See <http://www.spc.int/mdgs/MDGIs/indicator_33_definition.htm>.

²¹⁸ See ECS Report, *Trade in Energy*, above n 155, at 66.

the ECT.²¹⁹ In other words, none of the S&D provisions are applicable under Article 29(2)(a) of the ECT. This suggests that in a wide area of disciplines, the developing countries of the ECT shall abide by the same rules as the developed countries. The repercussions of such treatment, considering that the majority of energy-producing countries are developing countries, are elaborated further in the example of the Agreement of Subsidies and energy services later in this chapter.

5.4.7. Regulating the Activities of State-Trading Enterprises

The activities of state-trading enterprises (STEs) are regulated in the WTO agreements. Due to the fact that these enterprises are active in the field of energy, especially in the energy-producing countries, it is important to determine the limits imposed on their activities by the WTO. It is believed that governments use these enterprises to achieve some policy objectives that could not be attained otherwise. In some countries trade in general and trade of energy materials, products and equipments in particular are required to be conducted through a limited number of STEs that can affect this trade through their purchasing or selling decisions, which may eventually distort trade. Due to the fact that GATT/WTO rules could be easily circumvented if there was no control on the activities of STEs, their activities are scrutinised and their possible unfair trading analysed.²²⁰ Moreover, energy enterprises in general are important players for trade purposes because historically they have played a very important role in managing the energy market and they have mostly been in the form of monopolies that fully dominated the market while governments have exercised a substantive measure of control over their activities.²²¹

The activities of state enterprises in the field of energy have not been scrutinised as such by the WTO system. However, the more energy markets liberalise and as energy-producing countries join the WTO, the more likely it is that their activities are examined. In addition, there will be ample opportunity for the inspection of these activities within the framework of the ECT.

²¹⁹ See Annex W of the Applicable Trade Provisions of the Energy Charter Treaty entitled 'Exceptions and Rules Governing the Application of the Provisions of the WTO Agreement' in the *Applicable Trade Provisions of the Energy Charter Treaty* (Brussels, Energy Charter Secretariat, 2003) at 26.

²²⁰ See Arts 22 and 29(2)(a) of the ECT See also *Operations of State Trading Enterprises as they Relate to International Trade*, G/STR/2 (1996) [hereinafter 'WTO Background paper on STEs].

²²¹ Some believe that security of energy is better guaranteed if the energy trade is not left to the market and there is strong governmental control as well as monopolies that guarantee reliable supply by preventing consumers from being affected by the uncertainties of the market and high price fluctuations. Although this belief is somewhat eroded in some countries as these enterprises have not guaranteed security, it is still visible in others.

Obligations are imposed on STEs which are, based on Article XVII, either 'state enterprises' or 'those enterprises to which the government grants exclusive or special privileges'.²²² The Understanding of Article XVII defines these enterprises to include

governmental and non-governmental enterprises [...], which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence, through their purchases or sales, the level or direction of imports or exports.

Although this Agreement tends to clarify the vagueness surrounding the definition and the activities of STEs, some ambiguities prevail. For example, it is not yet clear what the scope of 'exclusive or special rights or privileges' is, and at what degree the 'influence' is established.²²³ The only guidance to these privileges in the energy sector is found in paragraph 1(a) of Ad Article XVII, Annex I, which provides:

privileges granted for the exploitation of natural resources but which do not empower the government to exercise control over the trading activities of the enterprise in question, do not constitute 'exclusive or special' privileges.

Therefore, the mere grant of a right is not problematic but control over commercial activities based on that right can be scrutinised.

Nothing in the WTO system limits a government's right to establish these types of enterprise. However, based on Article XVII, these enterprises shall, in their purchases or sales involving imports or exports, act in a non-discriminatory manner. Any purchase or sale by these enterprises shall be solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation, and other conditions of purchase or sale. It is also not clear what is meant by 'commercial consideration' but, as one Panel suggested, this requirement could be considered as an interpretation of the non-discrimination provisions, applicable only if the action at issue falls within the scope of the general principles of non-discriminatory treatment²²⁴ (eg when an STE charges different prices for goods that are destined for different export markets). This said, however, controversy exists with regard to the obligation of non-discriminatory treatment imposed upon these enterprises. This controversy is about the issue of whether the non-discrimination principle applies to both

²²² There is no consensus reached as to the definition of a state-trading enterprise. Although the first and second paras of Art XVII seek to provide a definition, the provision is too broad to clarify the exact scope and definitional criteria of these enterprises.

²²³ See T Cottier and PC Mavroidis (eds), *State Trading Enterprises in the Twenty-First Century* (Ann Arbor: University of Michigan Press, 1998) at 25 [hereinafter STEs].

²²⁴ See the FIRA dispute in *Canada Administration of the Foreign Investment Review Act*, GATT BISD (30th supp. 1984). See also Mavroidis, *STEs*, previous n, at 27. They mention that as the interpretive notes and the drafting history indicate, Art XVII:1(b) would not preclude the charging by a STE of different prices in different export markets, nor consideration of the advantages of receiving a 'tied loan' in connection with a purchase.

national and MFN treatment, or only to the latter. The discussion arises due to the fact that the case law has indirectly declined to rule that the national treatment obligation is part of Article XVII.²²⁵

Differences existed as to what type of entities actually fell under Article XVII obligations. This problem remains. A WTO working party is responsible for establishing an illustrative list of relationships between governments and state-trading enterprises, and the kinds of activities engaged in by these enterprises, in order to clarify which entities fall within the WTO's definition of STEs. It is believed that this list will eventually clarify the type of enterprises that fall within this category. Nevertheless, the activities of state enterprises that are involved in both upstream and downstream energy activities could fall within the ambit of this rule. These enterprises can act, for example, as a monopoly that would engage in all activities, from energy exploration and production to transmission and distribution. The importing countries also establish these enterprises to reach the best deals with exporting enterprises for energy trade, and also to guarantee secure distribution of that energy in their domestic market. These enterprises can also act in the form of a national oil company that functions in a nationalised industry, or they can act as a marketing entity, or oil stock-holding body.²²⁶ Although Article XVII does not prohibit a member from establishing energy import and export monopolies, it regulates their operation and effects on trade when they make purchases or sales. On the other hand, through the establishment of STEs, states can implement policy objectives related to energy and consider these enterprises as an appropriate means of pursuing some objectives in industries with strategic importance.

It is also interesting here to identify the link between Article XVII on STEs and Article XI on quantitative restrictions. Where a state monopoly undertakes both importation and distribution of energy products, which is mostly the case, measures can be adopted that may restrict the 'distribution division' of the activities of the enterprise. It was mentioned earlier that Article XI applies only to measures exclusively addressed to importation and exportation, but, where there is a monopoly involved, this monopoly can create a scenario in which Article XI can be applied even to an activity indirectly linked to imports. Consequently, a violation of Article XI (1) can result from restrictions made effective through the

²²⁵ For the exclusion of application of national treatment, see GATT Panel Report, *Belgian Family Allowances*, adopted on 7 November 1952, BISD 1S/59, 60, para 4, and *Canada—Administration of the Foreign Investment Review Act*, adopted on 7 February 1984, BISD 30S/140, 163, para 6.16. For the application of this principle, see the Panel Report on *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, 31 July 2000. It is clear, however, that these enterprises shall afford other enterprises of other Contracting parties adequate opportunity, in accordance with customary business practice, to compete in purchases or sales. This obligation, however, does not extend to products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale: See Art XVII (2).

²²⁶ The WTO Secretariat Background Paper on STEs divides STEs in several major categories: (1) marketing boards, (2) fiscal monopolies, (3) canalising agencies, (4) foreign trade enterprises; (5) nationalised industries, 'WTO Background paper on STEs', above n 220.

operations of state-trading enterprises.²²⁷ The ECS Report provides an example that is worth mentioning here. A monopolised electricity operator that both imports and distributes electricity may at some point refuse to distribute electricity. In that case, as there is no other operator to undertake this task, an indirect import restriction will be created in violation of Article XI on quantitative restrictions.²²⁸ Thus, it is important to determine what the source of the import restriction is, which could easily be traced back to the abuse of dominant position by a monopolised state-trading enterprise.

The other issue related to our study on security of energy supply is that these enterprises could play an important role in endangering this security. Where these enterprises enjoy a huge amount of market power, the problem will arise that these enterprises restrict sales in order to increase profits by increasing selling prices and/or reducing purchase prices. Although this issue may not necessarily create problems with regard to the availability of some goods, it could be problematic in relation to the availability of energy and energy products. This could be particularly problematic when demand for energy is high, and these enterprises exploit the situation in order to increase their profits through sale at higher prices. The abuse of their position may lead to undesirable results in a given economy, due to the lack of immediate access to reasonably priced energy. Although where these enterprises are considered as 'state trading enterprises' for the purposes of the WTO law, they should be notified to the WTO in order to create more transparency, it is not clear how this transparency can actually rectify security problems. Their activity may not necessarily be in contradiction with their obligations under GATT Article XVII.²²⁹

Looking at the existing notifications of the STEs of Member States of the WTO that are energy-producing reveals some interesting issues. For example, some major energy-exporting countries, such as Indonesia, Nigeria, Qatar, United Arab Emirates, Venezuela, and Saudi Arabia have complied with the obligation of notification whereas Kuwait has yet to do so. Algeria (a country in the process of negotiation), Nigeria, UAE, Saudi Arabia and Qatar (all possessing national oil companies) have announced that they have no STEs as defined by GATT in their country. On the other hand, Venezuela has declared its national oil company, '*Petroleós de Venezuela S.A.*' (PDVSA) as a STE, on the basis that 'the oil industry

²²⁷ See Panel Report on *Canada—Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, adopted on 22 March 1988, BISD 35S/37, 89, para 4.24; and *Japan—Restrictions on Imports of Certain Agricultural Products*, adopted on 2 February 1988, 35S/163, 229, para 5.2.2.1. See also Panel Report on *Republic of Korea—Restrictions on Imports of Beef—Complaints by the United States*, adopted on 7 November 1989, BISD 36S/268, 301–302, para 114.

²²⁸ See ECS Report, *Trade in Energy*, above n 155, at 49.

²²⁹ This notification requirement does not apply to imports of products for immediate or ultimate consumption in governmental use, or in use by an enterprise as specified above, and not otherwise for resale or use in the production of goods for sale. See 'The Understanding on the Interpretation of Art XVII of General Agreement on Tariffs and Trade 1994', Art 1.

is reserved for the Venezuelan State, owing to the sectors' importance to Venezuela and for reasons of national security'. They mention that administering the petroleum industry is a 'business' of the Venezuelan State. Therefore, the imported products and inputs for its activities and export of petroleum products are done by this enterprise, and the private sector is only authorised to play a role in part of the marketing process.²³⁰ Although the same line of reasoning can be applied to the situation of national oil companies in other energy-producing members of the WTO, they have not found it necessary to declare these companies as STEs. Moreover, Russia (in the process of accession) has also announced three companies dealing with natural gas (Gazprom), electricity (UES) and coal (Rosugol) as STEs.²³¹ Norway, on the other hand, has not described its state-owned energy enterprise (Statoil), as a STE, as they have argued that this enterprise neither receives a privilege nor is granted an exclusive right by the government.²³²

A quick look at the notification status of some energy-exporting countries shows that national oil companies, which may or may not be monopolies, are not automatically considered as STEs. The vagueness of Article XVII with respect to both the exact nature of the enterprise and the perceived obligations have created a disparity among contracting parties' notification of STEs to the WTO. Although the reasons for declaring some enterprises as STEs by Member States may be justified, the rationale for not declaring some companies as STEs by others is not always clear. It can be submitted that the vagueness of the law has made a uniform approach by the Member States to the issue of notification rather difficult. On the other hand, the overall law of the STEs in the WTO demonstrates that the potentially damaging effect of their activities is not necessarily diminished if such activities are in compliance with the basic obligations imposed by Article XVII. Again, the ECS could take up a thorough analysis of the status of national oil companies and their activities in order to determine whether they fall within the provisions of the WTO and, for that matter, the ECT.

²³⁰ State trading—Notification Pursuant to Art XVII:4(a) of the GATT 1994 and Paragraph 1 of the Understanding on the Interpretation of Art XVII-Venezuela, G/STR/N/1/VEN, 13 August 1996. See also G/STR/N/1/VEN/Suppl.1, 3 March 1997. And also G/STR/N/2/VEN & G/STR/N/3/VEN, 27 November 1998, G/STR/N/4/VEN, 17 February 1999, G/STR/N/5/VEN and G/STR/N/6/VEN, 18 July 2000, G/STR/N/7/VEN, 6 December 2001.

²³¹ Accession of the Russian Federation, Information on State-Trading Enterprises of the Russian Federation, WT/ACC/RUS/18, 11 March 1997.

²³² See State trading, Notification Pursuant to Art XVII:4(a) of the GATT 1994 and Paragraph 1 of the Understanding on the Interpretation of Art XVII-Norway, G/STR/N/1/NOR, 22 August 1995, and See G/STR/N/2/NOR, 12 September 1996. For notification of the European Community of Gaz de France and Electricité de France as STEs, see State Trading—New and Full Notification and Updating Notification Pursuant to Art XVII.4(a) of the GATT 1994 and Paragraph 1 of the Understanding on the Interpretation of Art XVII, European Communities- European Communities, G/STR/N/5/EEC & G/STR/N/6/EEC & G/STR/N/7/EEC, 23 January 2002, at 3.

This analysis would create transparency in both the relations between government and national oil companies and the activities of these companies themselves, which have consequences for security of energy supply.

In the section on subsidies, explained below, the activities of these enterprises will be further elaborated on, in order to determine exactly when and how a state-trading enterprise could distort trade through the provision of subsidies.²³³ These enterprises may be granted exclusive or privileged rights to process domestic commodities for export, or they may be granted subsidies to undertake their activities. It should be clarified when and how these activities would distort trade. This issue is analysed with respect to the activities of Saudi Arabia and their production of energy, as it creates a peculiar and complex case where the inadequacies of the GATT rules on these issues are revealed.

5.4.8. The Agreement on Technical Barriers to Trade

The Agreement on Technical Barriers to Trade (TBT Agreement) came into existence in order to prevent the use of barriers that adversely affect the free flow of goods through protection of domestic producers to the disadvantage of importers, and tends to prohibit technical regulations,²³⁴ standards²³⁵ and conformity assessment procedures²³⁶ that could be imposed by importing countries or non-governmental bodies,²³⁷ for reasons other than protection of human health or safety, national security requirements, prevention of deceptive practices, animal or plant life or health, or the environment.²³⁸ For energy purposes, the complexity of technical regulations, standards and procedures necessitated a comprehensive set of provisions to be applied to the energy sector. The abolition of restrictions embodied in GATT is not adequate to guarantee the free flow of energy, and the regulations based on which, for example, electricity is transmitted, should also be reviewed to determine their effect on free trade in electricity.

²³³ See below, section 5.4.9.

²³⁴ Technical Regulations are defined as documents that lay down product *characteristics* or their related *processes* and *production methods*, including the applicable administrative provisions, with which compliance is *mandatory*. See the TBT Agreement, Annex 1, Para 1. See also Arts 2.3 of the TBT Agreement.

²³⁵ Standards are documents approved by a recognised body that provides, for common and repeated use, rules, guidelines, or characteristics for products or related processes and production methods, with which compliance is *not mandatory*. It may also include or deal exclusively with terminology, symbols, packaging, marking or labeling requirements as they apply to a product, process or production method. See the TBT Agreement, Annex 1, Para 2. See also Art 4 and Annex 3 of the Agreement.

²³⁶ Conformity assessment procedures are any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled. See the TBT Agreement, Annex 1, Para.3. See also Arts 5–9 of the Agreement.

²³⁷ A non-governmental body is defined as a body other than a central government or local government body, which has legal power to enforce a technical regulation. See TBT Agreement, Annex 1, para 8.

²³⁸ See the TBT Agreement Art 2.2. This list is not exhaustive.

For this very purpose, the TBT Agreement was incorporated into the ECT. Since the ECT also covers ‘energy-related equipments’, those equipments—involvement in energy exploration, production, transmission and distribution—fall under the incorporated provisions of the TBT (eg how they should look, be composed or operate etc.).²³⁹

With respect to technical regulations, contracting parties should respect national treatment and MFN treatment (Article 2.2.1)) and should avoid unnecessary obstacles to trade in the adoption of these regulations. Parties are also required to use international standards ‘as a basis’ for their technical regulations, except when they would be ineffective or inappropriate for the fulfilment of legitimate objectives (Article 2.2.4). Contracting parties should also inform one another of the new set of regulations they plan to enact, or explain or prepare justification for certain measures, and provide opportunities for other parties to comment on these plans.

For energy purposes, the legitimate objectives (referred to above) for the imposition of technical regulations, most importantly regulations related to the protection of environment, are relevant. Since environmental protection is directly linked to the means of producing, transporting and trading energy, a regulation which aims to protect the environment could fall under the ambit of the TBT agreement. Based on the UNCTAD Report, there is one subject on technical regulations which is of particular relevance to energy-exporting countries. This is the issue of ‘the impact of technical regulations and standards on the competitive position of the exporting countries and their access to their main trading partners’ markets’. Regulations that demand higher environmental standards for the production of a specific type of imported energy, such as gasoline, could be justified, if the importing country applies the same or higher standards to its domestic production.²⁴⁰ Second, and more relevant for importing countries that are imposing these regulations, is the question of the harmonisation of standards and regulations.²⁴¹ The TBT encourages participating countries to base their domestic regulations on international standards,²⁴² which could lead to the harmonisation of those standards. However, uniform regulations on the environment may not necessarily be optimal because the particularities of the energy industry in each country may necessitate different standards. Therefore, ‘there should be a balance struck between the advantages that harmonisation yields in

²³⁹ See the list of energy-related equipments in Annex EQ I and EQ II. See also the ECS Report, *Trade in Energy*, above n 155, at 68.

²⁴⁰ See WTO Panel Report on *US—Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WTO/DS2/R, paras 6.5–6.16). In this case, the US had imposed stricter standards on imported gasoline from Venezuela and Brazil than on domestically produced gasoline. Although the claim of the US as to the relation between this regulation and protection of ‘clean air’ was accepted by the Panel, the regulation did not comply with the national treatment principle.

²⁴¹ See ‘The UNCTAD Report on Trade’, above n 147, at 38.

²⁴² A set of principles are put in place to measure the compliance of a regulation with international standards. These principles are transparency, openness, impartiality, consensus, effectiveness, relevance, coherence, and the development dimension.

terms of trade and transparency, and the environmental advantages that flow from allowing legitimate differences in national standards and regulations',²⁴³

Based on the definition of a technical regulation, a technical energy regulation should address product characteristics or their *related* 'processes' and 'production methods'.²⁴⁴ In other words, the product should have gained a characteristic due to the process and methods through which it was made. According to this definition, a technical regulation can be imposed on the imported energy if its production process or the method affects the characteristic of that energy. For this definition to apply, various sources of energy should be dealt with differently. As the ECS Report rightly highlights, the way electricity is produced does not alter the physical characteristic of the final product of electricity.²⁴⁵ The final product is electricity no matter whether it is produced by renewable or nuclear energy. Therefore, if one adopts a strict interpretation of the word 'related process' mentioned above, it will be hard to convey any such regulation to this type of energy because the process is not related to the end result. Thus with respect to electricity the adoption of a technical regulation will not be accepted under the TBT Agreement, exactly because the 'process' is not related to the characteristic of electricity. However, the way natural gas and crude oil are produced could change their characteristics. Natural gas, after extraction, is processed in a unit to remove the non-hydrocarbon components of it, such as hydrogen sulphide and carbon dioxide. After the impurities are removed, compounds (such as propane, butane, ethane and other substances) are separated and used for different uses, including the petrochemical industry. It is possible that an inefficient processing system does not extract all the impurities. A technical regulation could address this processing method and restrict its import. Here, depending on how the regulation addresses the issue, its acceptability can be justified. For example, the regulation can require a specific percentage of carbon dioxide in the imported natural gas, or can prohibit the product reaching a minimum level of pollution or flammability (its performance rather than the quantity of its impurities), depending on which measure has a less distorting effect on trade. The same analysis is applicable to crude oil and its refining process. It is clear that each energy source should be dealt with differently, and the issue should be approached on a case-by-case basis as there are various methods and processes through which energy is produced.²⁴⁶

²⁴³ See 'The UNCTAD Report on Trade', above n 147, at 38.

²⁴⁴ See the definition of a technical regulation in Annex 1 of the TBT Agreement. This Annex defines a technical regulation as a

document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labeling requirements as they apply to a product, process or production method.

²⁴⁵ See the ECS Report, *Trade in Energy*, above n 155, at 69.

²⁴⁶ The Doha Round of negotiations discussed the definition of 'environmental goods'. Para 31 (iii) of the Doha Declaration calls for negotiations on reducing tariffs and non-tariff barriers on these types of goods. In other words, there is an attempt to create a privileged status for these goods. The

It is very likely that refined petroleum products, as opposed to raw materials, face such obstacles. In order to decrease the influx of refined petroleum products produced in another country (whose import, due to their possibly cheaper price, may be disadvantageous for the petroleum industry of the importing country), that country could impose burdensome environmental standards to gradually lessen the degree of import of such products. The WTO and the ECT does not accept this measure, unless the same standards are applied to the domestic petroleum industry of the importing country (the US had imposed environmental standards on gasoline imported from Brazil and Venezuela, which were mainly aimed at protecting the US petroleum industry).²⁴⁷

At first sight, some may argue that technical barriers to trade should not necessarily create 'security of supply' concerns, as those countries that are dependent on energy would not create additional obstacles to the already difficult process of supplying energy or its related products from energy-producing countries through the imposition of 'technical barriers'. However, others may argue that, considering the obligations that a country gradually undertakes with respect to the protection of the environment and the inevitability of imposing such barriers in line with environmental objectives, efforts will be concentrated on increasing the use of renewable sources of energy rather than importing fossil fuel energy or related products, which would in turn decrease concerns over dependence on their import. An unreasonable emphasis on these types of energy sources with no concern over their real efficiency at a given time, through the imposition of legal obligations on Member States, could indirectly lead to a shift in efforts from concentrating on the best available and secure source of energy to inefficient ones. Nevertheless, the link between restricting imports of these sources through the imposition of technical barriers and advancement to the use of renewable sources of energy can be drawn only when the will to switch to these types of sources eventually materialises, a will that has not yet become fully visible in practice.

Doha Round sought to create a 'WTO list' for these goods. Various countries have provided a list of these goods but agreement has not yet been reached on a final list. However, it is interesting that the possibility of listing goods based on their production and processing methods were avoided in the negotiations. Nevertheless, the possibility remains of favouring these types of goods through the imposition of the provisions of the TBT agreement, as long as the importing country imposes the same requirements on its domestic production. See 'Liberalizing Environmental Goods in the WTO: Approaching the Definition Issue' Submission by the United States, TN/MA/W/18/add.4, TN/TE/W/34. See also the 'Synthesis of Submissions on Environmental Goods', Informal Note by the WTO Secretariat, TN/TE/W/63 where it has been stressed that goods that rely on product distinctions based on processes or production methods (PPMs) should be excluded from the list. See the Submission by the United States, TN/TE/W/52, para 2; and by Korea, TN/TE/W/48, para 5.

²⁴⁷ See Panel Report, *US—Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WTO/DS2/R.

5.4.9. The Agreement on Subsidies and Countervailing Measures

5.4.9.1. Introduction

Because of the strategic importance of energy and its related products, they have been specifically provided for in some bilateral as well as multilateral agreements. Some of these special treatments have been acknowledged to carry some trade-distorting effects, and one has been considered as a subsidy. Although the WTO law on subsidies is not designed to expressly reflect upon subsidies granted in the energy sector, its general provisions apply to such subsidies.

Subsidies are mostly used by governments as instruments of economic, social and political policy and serve a variety of purposes, 'including benefiting underdeveloped regions, combating pollution, favouring particular constituents or economic sectors and developing new technologies and products.'²⁴⁸ Moreover, the main rationale for regulating subsidies is that their elimination will reduce energy consumption, raise economic growth,²⁴⁹ and contribute to the liberalisation of energy trade by reducing trade-distorting effects, which will all ultimately contribute to energy security.²⁵⁰

One of the important features of the energy sector is that it has always been strongly subsidised. Reasons for subsidisation include the creation of better energy security through increased energy production, or permitting a given country to diversify its energy sources from, for example, coal to gas, through subsidisation of gas production, or to keep up with environmental standards through subsidising those industries that, for example, use renewable energy to produce electricity, etc.²⁵¹ Moreover, the indirect link between an energy subsidy and its effect on another economic sector where energy is strongly used is clear. Subsidies are also strongly linked to the development of the domestic industry of a given country. These are all reasons why the use of subsidies is closely supervised in both the WTO and the ECT.

²⁴⁸ See M Matsushita, TJ Schoenbaum, PC Mavroidis, *The World Trade Organisation: Law, Practice, and Policy* (Oxford, Oxford University Press, 2003) at 261 [hereinafter *WTO Law and Practice*].

²⁴⁹ The IEA Study reveals the disadvantages of subsidies and argues that when energy is sold below its cost, its use imposes a burden on the economy.

This burden can be expressed as increase in growth that would occur if subsidies were removed... Annual growth will range from a high of 2.22 per cent in Iran, and 1.54 per cent in Russia. Reduction of subsidies gives rise to changes in attitude and behaviour to the extent that prices begin to fulfil the function of providing information about opportunity costs, they will increase the confidence of investors and consumers, reduce information costs, further investment and boost growth.

See IEA Report, *World Energy Outlook, Looking at Energy Subsidies: Getting the Prices Right* (Paris, IEA, 1999) at 66 [hereinafter 'IEA Report on Subsidies'].

²⁵⁰ See 'IEA Report on Subsidies', *ibid*, at 10.

²⁵¹ See also WTO Report, *Environmental Benefits of Removing Trade Restrictions and Distortions: the Energy Sector*, WT/CTE/W/200, dated 18 September 2001.

The definition of subsidies is an unsettled issue, and various definitions are provided by different institutions dealing with energy. One definition adopted by the International Energy Agency is that: 'an energy subsidy is any government action that concerns primarily the energy sector and that lowers the cost of energy production, raises the price received by energy producers or lowers the price paid by energy consumers'.²⁵² This definition tends to cover a vast array of activities in the energy sector, which can be considered as interfering in the way prices would otherwise have been attributed to a given act, such as consumption or production.

Within the WTO, however, a narrow approach to the definition of subsidies is taken.²⁵³ As defined by Article 1.1 of the 'Agreement on Subsidies and Countervailing Measures', subsidies are (1) financial contributions (2) by a government or any public body within the territory of a Member State, which (3) confer a benefit.²⁵⁴ All three requirements mentioned above should be satisfied for an act to be considered a subsidy. A contribution may be in the form of a direct or potential transfer of funds, forgone or relinquished government revenue, provision of goods or services or the purchase of goods by the government for an entity, and making payments to a funding mechanism.²⁵⁵

One negative aspect of subsidies is their trade-distorting effects. An energy-exporting country can raise its share in the energy market through subsidising its energy production where a majority of energy production is dedicated to export. The subsidy that is contingent upon the use of domestic energy rather than imported energy in a specific sector could also indirectly affect energy imports. Moreover, if the importing country takes up production activities, it will be adversely affected through the import of cheaper subsidised energy products from other energy-producing countries that satisfy the remainder of its domestic demand. Energy subsidies could also be dedicated to energy transportation and marketing of energy. They could also indirectly affect other industries where

²⁵² See the 'IEA Report on Subsidies', above n 249, at 43.

²⁵³ For the reasons for the difficulties in defining a subsidy, see G Depayre and R Petriccione, 'Definition of Subsidy' in JHJ Bourgeois (ed), *Subsidies and International Trade: a European Lawyer's Perspective* (Deventer, Kluwer Law and Taxation Publishing, 1991) at 67.

²⁵⁴ In order to determine whether a subsidy confers a benefit, ie an advantage, it is necessary to determine whether the financial contribution places the recipient in a more advantageous position than would otherwise have been the case. The logical basis for this comparison is found to be the market. This means that the advantage should be given on terms more advantageous than those that would have been available to the recipient on the market. See the WTO Analytical Index, the SCM Agreement at <<http://www.wto.org>>.

²⁵⁵ See Agreement on Subsidies and Countervailing Measures, Art 1(1)(a). There are two types of subsidies in the energy sector: the producer subsidy, which seeks to boost production, and the consumer subsidy, which seeks to boost consumption. In both cases, the effect of a subsidy on production and consumption should be analysed. For this reason, the source of subsidy, its mode and incidence should be traced. Usually it is more difficult to determine subsidies that are addressed to producers because more data is needed compared to consumer subsidies. See RO Steenblik, 'A Note on the Concept of Subsidy' (1995) 23 *Energy Policy* 483 at 483.

energy is used. Thus, it is clear that energy subsidies occupy a wide variety of activities and touch upon many other economic sectors.

Subsidies that boost energy production can be said to be in line with concerns of consuming nations over security of energy supply.²⁵⁶ This point, however, should be read along with the fact that an increased flow of the volume of crude oil or natural gas does not necessarily guarantee security unless the price of that energy is also reasonable for the consumer. However, assuming that the price is reasonable, the subsidy, although trade distorting, could guarantee security by increasing imports up to the limit of their demand. One author is of the opinion that:

[i]f a country is a net exporter of a product, the rest of the world as a whole must be a net importer of it. Thus an export promoting subsidy for a product of which a country is a net exporter, must improve the terms of trade of the rest of the world as a whole. Net importers of the product thus benefit from improved terms of trade arising from countries' export subsidies.²⁵⁷

Based on this example, export subsidies could be considered as benign from the point of view of international trade. However, the energy-producing countries seek to limit their production and adjust their level of production to meet demand. Exporting beyond demand would result in lower prices for energy, which will in turn lower their income from that export. That is why OPEC countries undertake studies to lower or increase production based on a supply–demand analysis.

The use of subsidies in energy-related activities has not yet been analysed within the context of the WTO. However, these types of subsidies were specifically addressed in the context of negotiations on the accession of Saudi Arabia and Russia. The analysis of the law of subsidies in the WTO, as incorporated into the ECT, is elaborated on below, followed by an analysis of the circumstances in which the activities in some energy-exporting countries could be considered as subsidies.

²⁵⁶ It should be mentioned here that energy consumption is subsidised in many developing countries where, because of cheaper price for energy, the import of that energy is encouraged. In India, for example, kerosene and liquefied petroleum gas are imported and subsidised upon import (53% of the world market price for kerosene and 32% on LPG) which will in turn encourage consumption. The IEA study provides an economic analysis of how the elimination of subsidies in importing developing countries could contribute to lesser imports and therefore, energy security (ie less dependence on imports). On the other hand, subsidies on energy consumption in some net energy exporting countries, such as Iran or Russia, are very high as well, and reductions of subsidies on energy products in these countries contributes to the availability of such products for export, which will indirectly contribute to the energy security of energy-consuming countries. At the same time, reductions of subsidies on energy consumption in these countries contributes to their energy security, ie less energy used but in a more efficient way which would in turn satisfy some environmental objectives as well.

²⁵⁷ See RH Snape, 'International Regulation of Subsidies' (1991) 14 *World Economy* 139 at 147.

5.4.9.2. *A General Overview: Energy Subsidies in the WTO and the ECT*

Under the Agreement on Subsidies and Countervailing Measures (hereinafter the SCM Agreement) a subsidy is deemed to exist when a benefit is conferred on an industry as a result of (Article 1.1):

- A direct transfer of funds from the government (eg grants, loans, and equity infusion), or potential direct transfers of funds or liabilities (eg loan guarantees);
- Foregone or uncollected government revenues (eg fiscal incentives such as tax credits);
- Government providing goods or services other than general infrastructure or purchasing goods;
- Government making payments to a funding mechanism or to a private body to carry any of the three functions described above; or,
- Where there is any form of income or price support in the sense of Article XVI of GATT 1994.

WTO Panels and the Appellate Body have extensively elaborated on these forms of subsidies in their rulings. However, the cases are very specific and in order to analyse whether a certain activity is considered as a subsidy or not, the conditions surrounding each case should be similar to those found in other cases already decided. The reason is that the SCM Agreement tends to adopt a rather ambiguous wording in defining subsidies in order to cover as many subsidies as possible, and the Panels have tended to restrict its scope by limiting their application. These restrictions, as found in the rulings of the WTO, should become an important reference point.

The SCM Agreement distinguishes three types of subsidies: (1) prohibited; (2) actionable; and (3) non-actionable. Based on Article 3 of the SCM Agreement, prohibited subsidies are:

- (a) Subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in *Annex I*;²⁵⁸
- (b) Subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Those subsidies that are conditional upon either export performance or the use of domestic over imported goods are prohibited, and Member States should neither grant nor maintain such subsidies. A Member State that believes this type of subsidy is granted or maintained can request consultation, and if no mutually agreed solution is found, the matter will be referred to the Dispute Settlement Body of the WTO (Article 4).

²⁵⁸ The SCM Agreement provides an illustrative list of prohibited subsidies in Annex I of the Agreement, which details all subsidies that are considered as prohibited. This Annex is also incorporated in the ECT.

Actionable subsidies are those subsidies that (1) injure the domestic industry of another member, or (2) nullify or impair benefits accruing directly or indirectly to another member or (3) inflict serious prejudice upon the interests of another member (Article 5).²⁵⁹ If a subsidy has these effects, the other contracting party has the right either to bring its claim in a dispute settlement body, or to impose countervailing measures on imports of subsidised products to an amount not in excess of the subsidy (Article 10–23 of the SCM Agreement). By doing this, the price of imported energy increases and the injury is alleviated.²⁶⁰ The Dispute Settlement System will decide on the effect of a subsidy and if a violation is established, the violating contracting party can either withdraw or rectify its adverse trade effects. Non-actionable subsidies are ‘tolerable subsidies’ and are defined as those activities that provide certain assistance for research activities for disadvantaged regions, or are those in line with promoting the adaptation of existing facilities to new environmental requirements (Article 8 of the SCM Agreement).²⁶¹

Only specific subsidies are subject to the rules on prohibited and actionable subsidies as laid down in Parts II, III and V of the SCM Agreement respectively (Article 1.2). The argument for this distinction is that ‘multilateral rules are needed only to regulate subsidies that distort the allocation of resources within

²⁵⁹ Pursuant to Art 6, *serious prejudice* shall be deemed to exist when

(a) the total *ad valorem* subsidization (footnote omitted) of a product exceeding 5 per cent (footnote omitted); (b) subsidies to cover operating losses sustained by an industry; (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures, which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; (d) direct forgiveness of debt, ie forgiveness of government-held debt, and grants to cover debt repayment. (footnote omitted) (Art 6.1)

When none of the conditions of Art 6.1 exists, a Member can otherwise establish that a serious prejudice exists if it demonstrates that the subsidy results in one or several of the following effects: (a) the imports of a like product of another Member into the market of the subsidising Member are displaced or impeded; (b) the exports of a like product of another Member are displaced or impeded from a third country market; (c) there is a significant price undercutting by the subsidised product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market; (d) there is an increase in the world market share of the subsidising Member in a particular subsidised primary product or commodity (Art 6.3). The Agreement talks of the fact these subsidies ‘may arise’ and therefore, they are not automatically established and their effect should be proved by the claiming party. For recent proposals on the definition of ‘serious prejudice’, see the Communication of Brazil, TN/RL/GEN/81 and Canada, TN/RL/GEN/14.

²⁶⁰ See the ECS Report, *Trade in Energy*, above n 155, at 76.

²⁶¹ For a list of non-actionable subsidies, see Art 8(2) of the SCM Agreement. Since 1 January 2000, non-actionable subsidies have become actionable because the WTO members failed to reach agreement on the fate of these types of subsidies. Five years after the establishment of the WTO, Members were asked to decide upon the extension of the application of non-actionable subsidies but in the run-up to the Seattle Ministerial Conference, WTO Members could not agree on a recommendation, and the provisions consequently expired on 1 January 2000. In 2003, new proposals (eg, from Cuba and Venezuela) sought to re-introduce these types of subsidies in the Agreement. See the WTO documents TN/RL/W/41. See also the Doha Round Briefing Series, vol 2, no 7, August 2003.

an economy' and not any type of subsidy.²⁶² A specific subsidy exists 'when the granting authority explicitly limits access to a subsidy to certain enterprises' (Article 2(1)(a)) or when the granting authority establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy.²⁶³

In order to better clarify the rules on subsidies and its link to energy security, one example will be provided below, which has been a topic of controversy, especially during the WTO accession negotiations of Saudi Arabia and Russia. This issue is the pricing of energy in these countries and its link to the law on subsidies.

5.4.9.3. *A Specific Analysis: Dual Pricing and the Question of Subsidies*

5.4.9.3.1. A Brief Remark

One activity directly linked to our energy discussion is 'dual pricing', which is argued to be a 'hidden subsidy'. Dual pricing is practised in various economic sectors including energy. This practice is usually aimed at providing lower prices for products for export and higher prices if they are for domestic consumption or vice versa, and the rationale is to boost either exports or domestic production and consumption. This activity has been subject to scrutiny in the WTO negotiations of Saudi Arabia and Russia, two major energy-producing countries.

The analysis of dual pricing is important for few reasons: one is directly linked to the study of the various provisions of the WTO as incorporated into the ECT, and dual pricing is one good example of the inter-relation between these two frameworks. Secondly, the dual pricing practice of some important energy-producing countries has raised some interesting issues in negotiations on the accession of these countries to the WTO, that not only question the adequacy of the WTO rules to deal with the energy sector (and the ECT for that matter) but also shows where the interests of consuming and energy-producing countries really lie. It can be argued that this analysis provides a good occasion for highlighting the missed opportunity that the ECS had in emerging as an institution, distinct from the WTO, where consuming and producing countries alike can bring their claims and highlight their interests with its obvious link to the issue of security. These points will be elaborated on further below.

²⁶² See WTO Secretariat Report, *Guide to the Uruguay Round Agreements* (The Hague, Kluwer Law International, 1999) at 93.

²⁶³ For the different opinions of the WTO Member States in codifying additional disciplines regarding the application of the specificity requirement, see the Communication from Brazil, TN/RL/W/191 and the Communication from Canada TN/RL/GEN/6.

5.4.9.3.2. Dual Pricing in the Energy Sector of the Energy-Producing Countries: Saudi Arabia and Russia

Dual pricing, as practised in Saudi Arabia, favours natural gas liquids (NGLs) (hereinafter feedstock) for use in domestic production over those for export. For example, the NGLs (ethane, propane, butane) are sold more cheaply if used in the petroleum industry of that country, and at a higher price, if exported. One example provided by UNCTAD could clarify this issue.²⁶⁴

The United States imports Methyl Tertiary-Butyl Ether (MTBE), a petrochemical product made from methanol, from Saudi Arabia. Saudi Arabia provides cheaper feedstock to those producers (either domestic or foreign) that use them in Saudi Arabia's petroleum industry and export the final product abroad. The feedstock is sold higher to those entities that want to export it abroad without producing the product in Saudi Arabia. American producers of ethanol (ie a product that competes with MTBE) claim that the 'dual pricing' system, which exists in Saudi Arabia, subsidises the MTBE through low-cost provision of the raw material (ie natural gas and methanol) to refiners in Saudi Arabia and therefore, the US ethanol industry suffers as the import of the competing product from Saudi Arabia increases.²⁶⁵ This means that, through this practice, the final goods exported from Saudi Arabia will increase and compete with like products in importing countries. On the other hand, Saudi Arabia argues that, by providing cheaper feedstock to domestic producers, more investors are attracted to invest in its petroleum industry and, therefore, this country can reap the benefits of the foreign investment that will then ensue. They believe that this investment cannot be otherwise encouraged.

The European Union has also raised concerns that this practice is indirectly affecting the European petrochemical industry. The Association of Petrochemical Producers in Europe (APPE) has been demanding an end to such a practice through lobbying, as they found themselves at a comparative disadvantage with respect to the cheap import of refined petroleum products from Saudi Arabia. The executive director of this association has raised his concern by stating that 'the dual pricing is an obvious distortion of competition and free trade. Once it is abandoned we will have more of a level playing field in the world petrochemicals

²⁶⁴ NGLs are products of gas separation. This separation results in access to propane, ethane, butane, and methanol (NGLs). On the other hand, the mixture of butane and propane is called 'liquefied petroleum product' (LPG). LPG is used in the petrochemical industry, and through stream crackers they result in products such as propylene and butadiene. As opposed to natural gas, the refining of crude oil results in naphtha and gas oil.

Crude Oil → Refinery → Naphtha & Gas Oil

Natural Gas → Gas Separation Unit → Ethane, Propane, Butane, Methanol → Polyethylene, Ethanol etc.

Propane + Butane = Liquefied Petroleum Gas (LPG)

²⁶⁵ See 'UNCTAD Report on Trade' above n 147, at 35.

market.²⁶⁶ For this reason, dual pricing is addressed in the EU–Saudi Arabia bilateral market access negotiations for the accession of Saudi Arabia to the WTO. There have been promises on the part of Saudi Arabia to abolish ‘a number of obstacles to international trade, such as dual pricing of gas products.’²⁶⁷ The negotiations, however, failed in August 2005, the EU surprisingly abandoned its efforts, and Saudi Arabia’s accession agreement was signed.

Before examining the compatibility of this practice with the WTO, a brief reference to the subject of dual pricing in Russia is also useful for the sake of comparing the issues at stake in the two countries. Russia’s dual pricing is concerned with natural gas itself. Dual pricing takes place because Russia charges lower prices for natural gas destined for domestic consumption than for export. As one writer analyses, differentiated wholesale prices are set by the Russian Federal Agency Commission and this differentiation is controlled on the basis of numerous legislative and administrative acts.²⁶⁸ There is also a special export tax on gas exports. Moreover, the market of the Commonwealth of Independent States is charged less than other markets, such as Europe.

Russia was not willing to fully abandon this practice, as a result of which their accession negotiations in the WTO had faced obstacles. They have raised many arguments to suggest that dual pricing does not fall within any category of subsidy as defined in the WTO Agreements. Moreover, a World Bank study enumerated the merits of dual pricing of Russian natural gas by explaining that if Russia eliminates this practice and unifies the price of natural gas—thereby charging the same price for exports of its natural gas as it charges in its home market- it would lose between 5 to 7 billion dollars per year, an amount that cannot be overlooked in any given economy.²⁶⁹ Russia believes that domestic prices of natural gas should be raised, but find no rationale for unified pricing between gas that is sold domestically and exported gas.²⁷⁰

Interestingly, the European Union intervened in this debate through the framework of the EU–Russia bilateral trade talks, and reached an agreement with Russia. Europe previously argued, similar to what was mentioned above, that

²⁶⁶ See ‘Saudi Arabia agrees to concessions on dual pricing of gas liquids. Chemical Market Reporter, September 8, 2003. He went on by saying that until a few years ago, the discounting was not having a major impact on European petrochemicals producers, but once Saudi Arabia started using gas liquids to make their feedstock more flexible, then it was much more in direct competition with the range of petrochemicals made by Europe’s naphtha-based producers. Europe’s ability to make a variety of petrochemicals from ethylene, propylene and butadiene is one of its big competitive advantages.

²⁶⁷ See ‘Accession of Saudi Arabia to the WTO: Conclusion of the EU–Saudi Arabia Bilateral Market Access Deal’ Brussels, 30 August 2003.

²⁶⁸ For a detailed analysis of the practice of dual pricing in Russia, see J Selivanova, ‘World Trade Organisation Rules and Energy Pricing: Russia’s Case’ (2004) 38 *Journal of World Trade* 559.

²⁶⁹ D Tarr and P Thomson, ‘The Merits of Dual Pricing of Russian Natural Gas’, World Bank Study, July 2003, <[http://www.worldbank.org/eca/Russia.nsf/0/45c4201c4617bfc3256e27004536c7/\\$FILE/russia_natural_gas_eng.pdf](http://www.worldbank.org/eca/Russia.nsf/0/45c4201c4617bfc3256e27004536c7/$FILE/russia_natural_gas_eng.pdf)> [hereinafter ‘World Bank Study on Dual Pricing’].

²⁷⁰ ‘World Bank Study on Dual Pricing’, *ibid*, at 3.

domestic energy prices in Russia are much lower than the world prices, which led to unfair competition. It therefore proposed their elimination during the WTO accession agreement. The reason was said to be that as the Russian government has a monopoly over the energy industries, it imposes very high export taxes to support a domestic price of gas at a level below the market price, which was found to be inconsistent with WTO principles. On the other hand, Russia argued that firstly, this practice is not undertaken to support domestic markets and secondly, it is impossible for Russia to move to world energy prices in a single day. Finally, Europe managed to convince Russia to increase the price of natural gas for industrial users from the current 27–28\$ to 37–42\$ by 2006 and 49–57\$ by 2010.²⁷¹ While this increase was previously established in Russia's energy strategy and domestic plan, Europe sought to expedite the process.²⁷² The rationale behind this increase is not readily available, or can only be explained through complex economic terms, but this achievement was claimed to bring Russia 'a step closer to the WTO membership',²⁷³ It was also claimed that the other advantage of this outcome is that the increase in domestic energy prices encourages a more efficient use of energy resources in Russia, which would also be in line with Russia's obligations under the Kyoto Protocol, which they ultimately ratified.²⁷⁴ of this agreement, a concrete result of an increase in prices is yet to become visible.

That being said, in order to approach the issue of dual pricing, as practised in these countries, and to compare it to the WTO regulations, the rationale for the use of dual pricing should also be looked at (eg boosting the petrochemical industry through the attraction of investment, etc.), because based on this rationale the activity could be exempted or eliminated altogether. The issue will be elaborated on below, with a particular emphasis on dual pricing in Saudi Arabia.

²⁷¹ See 'Press Conference on Russia WTO Accession', speaking points by EU Trade Commissioner, Pascal Lamy, Moscow, 21 May, 2004.

²⁷² For a discussion of the advantages of Russia's accession to the WTO, see V Kharitonov and TL Walmsley, 'Impact of Russia's WTO Accession on the Structure of the Russia Economy', at <<http://www.gtap.agecon.purdue.edu/resources/download/1843.pdf>>.

²⁷³ See 'Russia–WTO: European Union–Russia Deal Brings Russia a Step Closer to WTO Membership', Brussels, 21 May 2004.

²⁷⁴ Interestingly, some believe that although the price differential inherent in dual pricing can be expected to diminish over time as Russia moves to a market economy, the system of dual pricing remains the most efficient environmental policy for Russia in the short term, and the difference between domestic and exported natural gas should be kept, no matter if it is very small. See D Dudek, A Golub and E Strukova, *Environmental Aspects of Dual Pricing for Natural Gas in Russia*, Environmental Defense, at <http://www.environmentaldefense.org/documents/3679_DualPricing0404.pdf>.

5.4.9.3.3. Dual Pricing as a Hidden Subsidy?

It is argued that dual pricing has some effects similar to a subsidy. The price of feedstock is determined by the government at a level that could not be maintained if it was otherwise exposed to market forces. Through this activity, the feedstock will be used for domestic production, because it is cheaper than the feedstock destined for export.²⁷⁵

Granting the status of a subsidy to dual pricing as practised in Saudi Arabia is complicated, and the indirect complaints by the WTO or the EU are not forthright. There is no express provision in the WTO that prohibits this activity. Although dual pricing is referred to in the SCM Agreement, it is defined differently from what occurs in the pricing of feedstock in Saudi Arabia.

As mentioned above, a subsidy that is prohibited is either conditional upon export performance or the use of domestic over imported goods. Moreover, Annex I of the SCM Agreement provides a list of prohibited subsidies. As the provision of cheaper feedstock is not conditional upon the two issues mentioned, we should look at Annex I to determine its compatibility with its rules. Paragraph (d) of this Annex elaborates on one type of prohibited subsidy as:

The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of *imported or domestic products or services* for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available²⁷⁶ on world markets to their exporters.

This provision can be named as one example of dual pricing. As mentioned in this Article, in order for this activity to constitute a prohibited subsidy, several conditions should be met. In simple terms these conditions are: (1) the government or its agencies address domestic or imported products *for use in the production of exported goods* in more favourable terms; (2) preference is given to these types of products only, and not to those like products or directly competitive ones that are used for domestic consumption; (3) in order to determine whether this discrimination exists, the terms and conditions based on which preference is given to goods for export should be more favourable than those 'commercially available' on world markets to their exporters.

The last condition means that there should be unrestricted access to both domestic and imported products, and the only way to prefer one product over

²⁷⁵ Another restraint is imposed on the export of raw materials that are kept in the country for use in domestic production, which lessens the availability of these products in the world market. This issue will be discussed later in this section in the analysis of dual pricing and its link with the WTO provisions on quantitative restrictions.

²⁷⁶ The term 'commercially available' means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations.

another is based on *commercial consideration*. One commercial consideration can be named as the price of the product.²⁷⁷ For example, an exporter is attracted to export domestic products to a given country because that product is cheaper compared to similar products on world markets due to a preference given to that product. Here, the cheap price of the product makes it commercially available to the exporter. Hence, dual pricing has taken place because the government treats products for export more favourably than those destined for domestic consumption through cheaper prices. It should be highlighted here that this provision expressly deals with the favourable treatment of products that are destined for export and not those that are destined for domestic consumption. The Saudi activity, for example, could fall within the ambit of this provision (Annex I(d)) if the feedstock that is used in the production of refined petroleum products for export is cheaper than the feedstock that is used for the production of refined petroleum products for domestic consumption. As explained earlier, in the sale of feedstock in Saudi Arabia there is a difference in price between the feedstock itself, which is higher, and the feedstock that is domestically used in the Saudi petroleum industry, which is lower. Surely, only a very broad interpretation of this Article could encompass the Saudi practice. It is curious to see the extent to which the existing provisions of the SCM Agreement could be interpreted to prove these activities as against the basic provisions of the WTO. If this violation is found to exist, it should still be determined what exemptions are available to these countries to maintain this activity as an incentive to attract foreign investment. The latter issue is discussed later in this section.

On the other hand, for the activity to fall within the ambit of this Annex, the condition of 'specificity' should be satisfied, which necessitates the grant of a subsidy to certain enterprises only. In relation to the sale of NGLs (feedstock) in Saudi Arabia, specificity would exist if feedstock is only sold more cheaply to particular enterprises. Therefore, some kind of discrimination should exist between various enterprises in receiving this benefit. This discrimination does not exist in the method of dual pricing in Saudi Arabia. The raw material is available at a cheaper price for any enterprise established in Saudi Arabia no matter if they are linked to the petroleum industry or fertiliser industry or any other industry that uses the feedstock.

The second condition established by Article 2(b) is also not satisfied. Article 2(b) provides that when a granting authority establishes objective criteria or conditions governing eligibility for a subsidy, 'specificity' does not exist if eligibility is *automatic*. Automatic eligibility means that the criteria and conditions governing eligibility are neutral and do not favour certain enterprises over

²⁷⁷ See also S Haghghi, 'Dual Pricing of NGLs in Saudi Arabia and the Rules of the World Trade Organisation on Subsidies', *Middle East Economic Survey*, vol XLVIII, no 17 (25 April 2005) and S Haghghi, 'The Relevance of the Energy Charter Treaty for the Countries of the Gulf Cooperation Council' paper submitted within the Framework of the EUROGULF Project, Kuwait City, April 2005, <http://europa.eu.int/comm/energy_transport/doc/2005_04_eurogulf_kuwait.pdf>.

others (eg based on nationality or when locating a new petrochemical plant close to available sources of feedstock of a given country is restricted to some enterprises). This discrimination does not exist in Saudi Arabia.²⁷⁸ Cheaper feedstock is available to both domestic and foreign producers on equal terms.

The third condition is more challenging. Article 2(c) provides that there are cases where, although an activity may not fall within the first two parts of Article 2 on specificity, there are reasons to believe that the subsidy is in fact specific. The factors to determine specificity are:

1. Use of a subsidy programme by a limited number of certain enterprises,
2. Predominant use by certain enterprises,
3. The granting of disproportionately large amounts of subsidy to certain enterprises,
4. The manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.

In applying this subparagraph, account shall be taken of *the extent of diversification of economic activities within the jurisdiction of the granting authority*, as well as of the length of time during which the subsidy programme has been in operation.

The first paragraph is ambiguous. It is not clear what exactly amounts to 'certain enterprise'.²⁷⁹ Whatever the interpretation, it should be different from Article 2(1)(a) where specificity exists where there is an 'express limitation' on the use of subsidy for some enterprises. Therefore, it can be submitted that there should be an indirect limitation on certain enterprises and an indirect specificity should thus exist. In this respect, the only possibility that comes to mind is that the subsidy could only be used by some enterprises due to the 'nature' of that enterprise. For example, the subsidy can only be provided for those enterprises that use feedstock due to the nature of those enterprises, as opposed to other enterprises engaged in activities for which no feedstock is needed. However, one should also link this result to the second sub-paragraph of Article 2(c), which talks of the 'predominant use by certain enterprises'. This could mean that since a subsidy can only be used by some enterprises, an indirect specificity is established.

Through this last interpretation, however, as many subsidies as possible could be included since the probability of any activity falling under this category is relatively high. Although it may have been the will of negotiators to include a priori as many subsidies as possible under the term 'specific',²⁸⁰ it seems dubious that the WTO Panel accepts such a broad interpretation. This is more so the case when we look at the last sentence of this paragraph, where 'the extent of

²⁷⁸ There are no documents available to the author to cite here as to the exact nature of the Saudi activity, the details of this activity were provided to the author by energy experts who had done research in this field.

²⁷⁹ See also Matsushita *et al*, *WTO Law and Practice*, above n 248, at 271.

²⁸⁰ *Ibid*.

diversification of economic activities of the jurisdiction of the granting authority' should be taken into account in addressing the 'specificity' issue. The Agreement suggests that, in calling a subsidy specific, some factors should be taken into account, as mentioned above, and in applying them, the extent of economic diversification should be taken into consideration. This sentence would mean that the more the economy is diversified, the more enterprises exist in that economy, and, therefore, it is easier to verify those enterprises that take advantage as opposed to others. On the other hand, if the economic activities of a given country are not diversified, it would be impossible to favour one enterprise over another, since there will be only one or two major sectors in the country on which the economy is dependent. This consideration could be directly linked to the situation of energy-producing countries, where their efforts to diversify their economies from energy is common knowledge. Those countries, where dependence on energy profits is high, have great difficulties in departing from the old patterns of their economy and have little possibilities to promote new ones. Therefore, it is doubtful that the subsidy is called specific in that situation. If one accepts the arguments above, none of the conditions in the definition of a subsidy applies to the practice of dual pricing of this country, and therefore, the practice can be maintained.

As mentioned above, on the other hand, the rules on actionable subsidies (ie only when the requirements of specificity are satisfied) should also be analysed to verify their applicability to the practice of dual pricing. However, even if an activity falls under the provisions of the WTO on actionable subsidies, the so-called 'injured member state' can counter that practice through the adoption of countervailing measures, which are also subject to various conditions as prescribed in the WTO. For example, the European Union and the WTO argue that the pricing system of feedstock in Saudi Arabia creates a preferential treatment for those that buy the cheaper feedstock, which indirectly damages the petrochemical industry of other countries that do not have access to such cheap feedstock. However, this 'preferential treatment' should be evaluated in detail, and a totality of factors is necessary to establish the existence of such a benefit provided for the recipients of cheap feedstock in Saudi Arabia to allow other members to impose countervailing measures. One issue that could be looked at is the difference between the prices of feedstock, because the main argument with respect to dual pricing is the question of Saudi Arabia's differential pricing system.²⁸¹ For example, imports should be looked at to verify whether they are entered at '*prices*' that will have a significant depressing or suppressing effect on domestic prices and would be likely to increase demand for these cheaper

²⁸¹ Eg, Art 15(7) of the SCM Agreement provides that, in making a determination regarding the existence of a threat of material injury to another country (here the European or the American petrochemical industry), the investigating authorities should look into the trade effects of this practice, as well as the determination of whether there is a significant rate of increase of subsidised imports into the domestic market of complainants indicating a substantial increase in importation.

products. These issues could then be analysed to determine whether, for instance, the European petrochemical industry is seriously injured as a result of this practice. Therefore, one issue to be analysed here is whether the price charged to the feedstock sold to producers, which was less than the one sold for export, really enjoys a preferential rate.

The SCM Agreement does not provide adequate information on how and against what benchmark the difference in prices should be compared. One could argue that the mere fact that the government, or the state-trading enterprise, is selling feedstock at a lower price to selected companies is adequate to determine preferential treatment. However, for an actionable subsidy to be established, an 'injury' should exist. Therefore, charging less should amount to 'charging less than adequate', which in turn results in an injury.

In the past, the Saudi Arabian government issued a decree that dedicated a 30 per cent discount (based on the lowest export price) to the feedstock used for domestic production. Later, in 2003, they abandoned this practice and substituted it with a mechanism which ties the prices of products, such as LPG and other natural gas liquids, to the price in the Far Eastern LPG markets. How would this pricing mechanism be analysed for the purposes of our study on subsidies? One could argue that an international price could be used, in order to have a yardstick against which the prices of feedstock can be compared. However, this is particularly problematic because there is no international price of LPG, and prices still vary depending on their location and trading conditions. There is, therefore, a high price volatility, which had made the price of butane (one type of LPG), for example, to be 185\$/t in the Gulf in 2002 compared to 175\$/t in North West Europe.²⁸² This example shows that a 'generalised' approach to the issue of dual pricing is not valid. Imposing lower prices on feedstock for domestic production rather than for export in Saudi Arabia does not necessarily mean that prices in Europe are higher. Hence, in order to determine the discrimination, they should be compared either with each other or with other competitive feedstock such as ethane, naphtha and gasoline and at a given point in time. In this case, if the price of the Saudi LPG is based on a link to naphtha prices in Japan, the possibility remains that this price is higher than the price of LPG in North West Europe. Therefore, the dual pricing practice does not necessarily create a competitive disadvantage for Europe's petrochemical industry because they have access to cheaper feedstock compared to that sold in Saudi Arabia.

The complexities of the issue of dual pricing in Saudi Arabia demonstrates that this practice can neither be considered as a prohibited subsidy nor necessarily as creating an injury to the European or the American petrochemical industries.

²⁸² See G Luciani and N Abi Aad, 'Promoting Economic Diversification as a Tool to Encourage Countries Holding Major Hydrocarbon Reserves to Increase Production in Line with Growing Global Demand and Stable Prices', paper submitted for the final workshop of the EUROGULF Project, Kuwait City, April 2005, at 18, <http://europa.eu.int/comm/energy_transport/doc/2005_04_eurogulf_kuwait.pdf>.

The issue has to be decided on a case-by-case basis. An outright ban of this practice is therefore not justified and it is surprising that this issue has come up as a 'legal issue' in the negotiations on Saudi Arabia's accession to the WTO.

Two other issues related to dual pricing should be highlighted. One is a reminder of the fact that the WTO and the ECT only regulate the activities of states and not private bodies. Hence, it is important also to look at the entity that undertakes the dual pricing activity, an issue that was mentioned in the discussion on state-trading enterprises above.

The second issue is the application of the rules on quantitative restrictions on export to the practice of dual pricing. It would have been more appropriate to approach the issue of dual pricing through the channel of other provisions of the WTO, such as those on quantitative restriction. The next section briefly highlights the relevance of these provisions. Interestingly, the issue of dual pricing within the domestic market of the European Union has been approached through the analysis of export restrictions. They argue that such activity indirectly restricts exports, which is in turn linked to the underlying principles of free trade.

5.4.9.3.4. Dual Pricing, the Provisions on Quantitative Restrictions and the European Community

The practice of charging various prices depending on their end use, domestic or export, has been analysed by the Commission in a number of its decisions. In this context, dual pricing has been criticised as anti-competitive, and if the exceptions of Article 81 of the EC Treaty on competition were not applicable to this practice,²⁸³ the Member State was asked to abandon such activity. The approach to this issue in the context of the Community is interesting. Although the main theme of this approach has been the effect of dual pricing on parallel trade (a phenomenon that exists within an integrated market), other aspects of this practice have also been looked at by the Commission.

In one particular case, the national authority of a given country has established a maximum price based on which the price for products could be set. A private company had established conditions for sale of specific products based on this benchmark, only if the product is marketed domestically. They therefore imposed higher prices than those prescribed by the national authority, if the products were

²⁸³ See Art 81, which describes rules on competition applying to undertakings, prescribes those activities that are incompatible with the rules of common market. The provisions of this Article are applicable between (1) any agreement or category of agreements between undertakings, (2) any decision or category of decisions by associations of undertakings, (3) any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

destined for export. This issue is similar to the way the sale of NGL is dealt with in Saudi Arabia.²⁸⁴ On the other hand, it was declared that due to the discrimination in prices based on their end use, an *indirect export ban* existed that eventually distorted trade. In other words they argue that obliging exporters to purchase products at prices which are higher than the prices for marketing domestically impedes exports, and a pricing policy which makes it economically uninteresting for exporters to engage in exporting must be considered to be at least as effective as an outright contractual export ban.²⁸⁵ A refusal to grant cheaper prices for export makes the export less attractive and exports are no longer viable without discounts.²⁸⁶ This export ban was found to be in contradiction with Article 81 EC, based on which there was no need for an assessment of their actual effects. An agreement between two undertakings, which makes exports more expensive and less profitable, is contrary to Article 81 since the object and effect of such an agreement is to protect a higher price level in the countries of destination.²⁸⁷ 'It is irrelevant that the exports are not formally prohibited by the agreement but are simply made less profitable.' The actual agreement between a company and its wholesalers per se produces a restrictive effect on competition in the Community, by excluding or limiting the possibilities of export of those products.²⁸⁸

The same line of reasoning can be adopted by the WTO. The main rationale for prohibiting the practice of dual pricing in the EC has been its negative effect on competition, as the arrangement between undertakings had made exports more expensive and less profitable. The same rationale can be applied to the practice of dual pricing in Saudi Arabia, through reference to Article XI of the

²⁸⁴ Although the private company argued that dual pricing only takes place when the company can set both prices, ie domestic and export, the Commission did not accept this argument. It declared that the private company had the power to bargain with the national authority to set the maximum price, and was therefore involved in setting the domestic price as well. See the Commission Decision of 8 May 2001 relating to a proceeding pursuant to Art 81 of the EC Treaty Cases: IV/36.957/F3 *Glaxo Wellcome* (notification), IV/36.997/F3 *Aseprofar and Fedifar* (complaint), IV/37.121/F3 *Spain Pharma* (complaint), IV/37.138/F3 *BAI* (complaint), IV/37.380/F3 *EAEP* (complaint) OJ L/302/1.

²⁸⁵ See *Glaxo Wellcome*, *ibid*, para 118.

²⁸⁶ See the Commission Decision 91/335/EEC of 15 May 1991 relating to a proceeding pursuant to Article 85 of the EEC Treaty (IV/32186 *Gosme/Martell—DMP*), [1991] OJ L/185/23 at para 20. See The Commission Decision 82/203/EEC of 27 November 1981 Relating to a Proceeding under Article 85 of the EEC Treaty (IV/30.188 – *Moët et Chandon (London) Ltd*), [1982] OJ L/94/7 at para 13.

²⁸⁷ See also *Gosme/Martell – DMP*, previous n, para 32.

²⁸⁸ Art 81(3) EC provides for some exemptions, based on which the practice of dual pricing could be maintained. This article provides for exceptions when such practice contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit. For example, if the company proves that this discrimination increases consumer welfare, through enhancing research and development and maintaining investment in R&D, the practice can be maintained. However, there should be a causal link between this practice and the argued consumer welfare. Moreover, if the company undertakes to guarantee consumer welfare, which is mostly considered as a government policy, there should be a link between the activities of this company and those policies of the government. Therefore, it was argued that the activity of a private company cannot be justified as the link between their activity and the government policy is not established.

GATT prohibiting quantitative restrictions on export, as explained in detail above. Dual pricing indirectly affects exports as they make the use of feedstock in the domestic market more attractive than for export, and therefore, potentially limit or restrict exports. It can be submitted that the analysis of the effect of dual pricing in the WTO is less complicated and straightforward from the point of view of an 'export ban' rather than a 'subsidy'. Nevertheless, the exceptions applied to the obligations related to quantitative restrictions and subsidies, along with the general exceptions embodied in Article XX, should also be studied in order to determine the possibilities through which Saudi Arabia could maintain this practice after accession. The exceptions, related to Article XI on quantitative restrictions and Article XX, were mentioned before (see sections 5.4.3 and 5.4.4.). Here those exceptions related to the obligations on subsidies are mentioned.

5.4.9.3.5. The Exceptions to the Rules on Subsidies and the Issue of Dual Pricing

If 'dual pricing' is considered as a subsidy (either prohibited or actionable), either through the addition of new provisions to the SCM Agreement or through a broad interpretation of the already existing ones, some exceptions are available to maintain this technique for a specific period of time. The reason for emphasising the continued use of this practice is due to the advantages that energy producing countries can gain through dual pricing that would otherwise be more difficult to obtain, such as attracting foreign investment to petrochemical or fertiliser industries. The risk is that investment would be concentrated only on the exploration of energy and its direct export, without the involvement of the production industries of these countries, which would in turn leave these industries under-developed.

Based on Article 27 of the SCM Agreement, the role that subsidies play in the economic development of a given country is recognised and developing countries of the WTO can take advantage of special treatment provided for in this Agreement. Based on Article 27(2)(b), the subsidies of Annex I are not prohibited for developing countries for a period of eight years from the date of entry into force of the WTO Agreement. Moreover, if a developing country member deems it necessary to apply such subsidies beyond the eight-year period, it shall, not later than one year before the expiry of this period, enter into consultation with the WTO Subsidies Committee, which will determine whether an extension of this period is justified after examining all the relevant economic, financial and development needs of the developing country member in question. Low-cost gas liquids have become an important factor in attracting foreign investment in order to expand the petrochemical industry in many petroleum-exporting countries and these countries could claim to be eligible to use this exemption based on a legitimate development goal, such as regional growth, technological research

and development funding and production diversification.²⁸⁹ Interestingly, as section 5.4.6 above provided, apart from the possibility of providing tariff reductions to developing countries for imports of natural gas or oil, the ECT does not allow for any other exception embodied in the WTO for developing countries, including Article 27 of the SCM Agreement on 'special and differential treatment of developing countries'. Therefore, the members of the ECT are not given the possibility of relying upon this exception if the practice of dual pricing is eventually interpreted as a subsidy.

It is, however, noteworthy, that recent WTO discussions have addressed the further clarification, development and improvement of the SCM agreement. It is argued that:

While the principle that trade flows should be determined by comparative advantage is broadly accepted, it must also be accepted that *preferential natural resource pricing* has been and, if not addressed, will continue to be a source of *considerable trade distortion and friction*. Simply put, there is no difference between the government provision of a natural resource at less than fair market value and the government provision of a cash grant allowing the purchase of a natural resource at less than fair market value.²⁹⁰

As is clear from this statement, the issue of dual pricing may come on the agenda of the WTO especially when more energy-producing countries seek to join this organisation. Greater disciplines are suggested on those types of subsidies that most directly and substantially contravene market-determined economic growth and international trade patterns,²⁹¹ and dual pricing could then fall within this category.

Before concluding our discussion of dual pricing, it should be mentioned that this activity should be undertaken by governments or governmental bodies, since the WTO and the ECT only govern the activities of these entities. As explained above in relation to the activities of state-trading enterprises (STEs), governments can achieve some policy objectives through assigning some activities to STEs, which could be considered as trade distorting and in violation of GATT/WTO rules. For the purposes of our analysis of dual pricing, such a practice should be linked to the government, either directly or indirectly. If the practice is undertaken by an enterprise, the activity of which is stripped from government

²⁸⁹ See WTO Document 'Implementation-Related Issues and Concerns', draft Decision, WT/MIN(01)/W/10 (10 November 2001) at page 6.

²⁹⁰ See 'Subsidies Disciplines Requiring Clarification and Improvement: Communication from the United States' TN/RL/W/78, 19 March 2003.

²⁹¹ See Communication by the US on Subsidies, *ibid.* For a general overview of the reform of laws on subsidies in the WTO, see MJ Trebilcock and R Howse, *The Regulation of International Trade* (London, Routledge, 1995) at 153.

control, WTO law or the ECT does not apply.²⁹² It is for this reason that the exact nature of the relationship between the government and any given enterprise should be determined.²⁹³

5.4.9.3.6. Conclusion: Dual Pricing and Europe's Security of Energy Supply

The discussion of dual pricing, as raised in the negotiations between the WTO on the one hand, and Saudi Arabia and Russia on the other hand, creates the best opportunity to determine the interests of consuming and producing nations alike. Why are arguments on 'dual pricing' raised in a country's accession negotiations in the WTO? Is there not a threat of preventing accession altogether through repeated emphasis on this issue? The claim of Saudi Arabia to attract more investment in the petrochemical industry of this country, which is directly linked to the transfer of technology and expertise in this field, has been unanswered. This claim is related to the fact that energy-producing countries are eager to develop their energy-related industries, and they find the objective of 'diversification of production' a legitimate developmental goal that needs to be taken into consideration in a multilateral trade setting. On the other hand, the worry of importing nations over the disadvantages that this practice might bring to their petrochemical industries has raised concerns. After the failure of the two-year bilateral accession negotiations between Saudi Arabia and the EU in August 2005, and after the acknowledgment by the EU that the dual pricing practice, as it takes place in Saudi Arabia, is not in violation of the WTO law on subsidies, the European Commission issued a proposal for a regulation on the imposition of balancing mechanisms on the products of third countries in which dually priced raw materials were used.²⁹⁴ The proposal addressed two different countries and exempted one set of countries. It provided that such balancing mechanisms, in the form of anti-dumping or countervailing measures and upon 'injury', will be imposed on the products of non-WTO members, or those WTO members that

²⁹² It should be mentioned that the relationship between the activities of government-owned enterprises and subsidies have been the subject of debate, especially with respect to those enterprises whose activities are not necessarily commercially motivated. Hence, the activities of government-owned enterprises will normally be closely scrutinised to determine the influence of the state on their activities.

²⁹³ See, eg, *United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products in France, Germany and the United Kingdom*, 15 November 1984, GATT Doc. SCM/185 (not adopted). In the European Union, for example, the rules governing the functioning of the entity providing the funds, the composition of the management boards, and the powers of intervention of public organs in the decision-making process of those entities are mainly looked at in order to determine the government influence. See, eg, the Joined Cases 67/85, 68/85 and 70/85 *Van der Kooy and Others v Commission* [1988] ECR 219. In that case, the Court looked at the fact that the government of the Netherlands holds 50% of the shares of the company and appoints half the members of the supervisory. Moreover, it is also important that the 'notification requirement' as established in Art XVII, is also complied with.

²⁹⁴ See Proposal by the Commission for a Council Regulation concerning Balancing Mechanism Applicable to Imports from Certain Countries not Members of the European Community, COM (2005) 398 Final.

have accepted the imposition of such balancing mechanisms on their exported products in their Protocol of accession to the WTO. In other words, for the latter set of countries, the proposal provides an indirect condition for accession. The proposal exempts those countries with which the EU has already reached an agreement on the issue of dual pricing, namely Russia, the details of which were explained above.²⁹⁵

Although dual pricing may not be considered by some as the most efficient way to attract investment to the petrochemical industry of energy-exporting countries, concentrating on the development of petrochemicals is the natural, immediate, and inevitable choice in the overall economic diversification goals of these countries.²⁹⁶ On the other hand, the limits to the accession of Saudi Arabia to the WTO through such defensive mechanisms runs counter to the basic policies of the Union in supporting the efforts of developing countries to better reap the benefits of trade and investment. The EU explicitly mentions that countries that have integrated into the world economy through trade and investment have enjoyed higher economic growth and improvement in many key social indicators, and for exactly that reason the Union identified trade as one of the six priority areas for development.²⁹⁷ Efforts by developing countries to reform need to be accompanied by 'additional external assistance from developed nations, that complements market access opportunities,'²⁹⁸ especially in those sectors where these countries enjoy a comparative advantage. Although the Member States did not approve this regulation, and Saudi Arabia's accession negotiations went ahead and the accession agreement was eventually ratified, the EU has warned that the abandonment of the Saudi case by the EU should not be considered as a precedent for other energy-producing countries in the process of WTO accession (namely Iran, Iraq and Algeria). In any case, this case highlights where the interests of consuming and producing countries lie.

It is interesting that Europe could link this issue to overall security of energy supply. The limits to the import of refined petroleum products, as opposed to crude oil or natural gas, can themselves be linked to the issue of security. Those countries that find dual pricing mechanisms disadvantageous to their petrochemical industry could either adopt anti-dumping or countervailing measures (if the activity can be so labelled) for which they need to establish that a material injury has been inflicted upon their industry, or raise the import of crude oil and

²⁹⁵ See S Haghghi, 'The 2005 Proposal of the European Commission for a Regulation to Impose Balancing Mechanisms on Imports from Certain Countries and the Question of Energy Pricing', (May 2006) 4 *Oil, Gas & Energy Law Intelligence*.

²⁹⁶ For a comprehensive study on this issue, see 'Economic Diversification in the Oil Producing Countries: the Case of the Gulf Cooperation Economies, UN, Economic and Social Commission for Western Asia', E/ESCWA/ED/2001/1, January 2001.

²⁹⁷ See, eg, the Communication from the Commission to the Council and the European Parliament, Trade and Development: Assisting Developing Countries to Benefit from Trade, COM (2002) 513 Final.

²⁹⁸ See the Communication, *ibid*, at 12.

natural gas and not the refined products (feedstock), and refine them in their own refineries. The first option is complicated for the reasons mentioned above, and the second option (ie the EU paying for more expensive raw materials), could become a security problem if the refining capacities of Europe do not function at full capacity. Strict environmental standards could pressure the refining industry, or overcapacity could lead companies to lose profits and shut down refining operations, or the use of the costlier petrochemical industry of Europe could not be justified by operators. Therefore, energy-producing countries should advance their refining and petrochemical industries to be able to make good use of their comparative advantage, which is the availability of oil and gas, in order to reach their developmental goals. This could in turn contribute to the EU's security of energy supply. As the section on the relationship between energy security and economic development, explained later in this study, argues, there is also a link between the economic development of these countries and Europe's energy supply security. The issue to pay attention to here is the link between energy security and the mutual interdependence of producing and consuming countries, which was discussed in chapter 1. This interdependency calls for cooperation between these countries. Producing countries should play a role in stabilising the world economy to increase production or spare capacity, whereas the consuming nations should be also responsive to the demands of exporting countries. Neglecting these demands threatens energy security. These issues will be discussed in more detail in the conclusion to this chapter.

5.4.10. The Agreement on Anti-Dumping Measures

Article VI of GATT 1994 establishes the rule on anti-dumping measures. Anti-dumping is another type of trade remedy, which takes place when certain producers export their products at a price much lower than the 'normal value' of the product (dumping). Based on Article 1 of the Agreement on Anti-Dumping:

A product is to be considered as being dumped, ie introduced into the commerce of another country at less than its normal value, if the *export price* of the product exported from one country to another is less than the *comparable price*, in the ordinary course of trade, for the *like product* when destined for consumption in the exporting country.

This practice is to be condemned 'if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry'. This act of dumping can be countered through an anti-dumping measure, which allows the importing country to impose additional duties over and above customs duties, to an amount not exceeding the dumping margin. In this case, an analysis should be done to determine a 'normal value' and the 'injury' suffered by the importer. The

Agreement on the Implementation of Article VI of the GATT 1994 establishes detailed criteria to facilitate the interpretation of Article VI, which is incorporated into the ECT.

The benchmark to determine whether energy is dumped is to look at the normal value of the good, eg electricity sold for domestic consumption. If the electricity or a 'like product' is more expensive in the domestic market of the exporter than the electricity exported, dumping has taken place. However, if the exporting country establishes environmental standards that are different from those in the importing country and renders the price of electricity in the exporting country higher, the difference between the domestic price without environmental considerations and the price of the exported electricity should be looked at.²⁹⁹ Therefore, no dumping takes place if the price of electricity in the exporting country is higher than the price of imported electricity due only to the imposition of higher environmental standards in the exporting country.³⁰⁰

If there is no domestic sale of the product in the market of the exporting country, or when the market situation is particular or the volume of the sales in the domestic market of the exporting country is low, the comparison should be made between the imported price and the price of the product exported to a third country; or between the price of the imported product and the cost of production in the country of origin, plus a reasonable amount of other costs (Article 2.2). The footnote to this Article provides that if such sales constitute only 5 per cent or more of the sales of the products under consideration to the importing member, a comparison can be made.

The UNCTAD report provides that 'the threat of anti-dumping measures against refined petroleum products, especially those with higher value added (such as petrochemicals) is a real one and should be a matter of concern for exporting countries, especially petroleum producing countries.'³⁰¹ A good example of claims of dumping took place in 1999, when a group of American independent oil producers called 'Save Domestic Oil' (SDO) has filed a petition with the US Commerce Department claiming that oil from Iraq, Mexico, Saudi Arabia and Venezuela were dumped. They mentioned that the rationale behind dumping was a conspiracy among the oil-producing countries to drive small producers out of business. The United States Department of Commerce dismissed the petition based on the fact that the 'opposition to the petitions

²⁹⁹ See ECS Report, *Trade in Energy*, above n 155, at 74.

³⁰⁰ This is when there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of the sales in the domestic market of the exporting country, such sales do not permit a proper comparison. See Implementing Agreement of Art VI, Art 2(2.2.). If this method is not useful and no domestic price exists, two other methods are in place. Either the highest comparable price for the like product for export to any third country should be looked at, or a calculation based on the cost of production in the country of origin plus a reasonable addition for selling and profit should be taken into account.

³⁰¹ See 'UNCTAD Report on Trade', above n 147, at 36.

exceeded support'. Without adequate industry support, the department was prohibited by law from initiating investigations. Nevertheless, if such support existed the petitioner had to firstly prove dumping and secondly prove injury to the industry as a whole. In that case, anti-dumping measures could be imposed on those oil exporters. It should also be mentioned that the price of petroleum or refined petroleum products for export in energy-producing countries is normally less than the price of like products elsewhere but that does not mean that the product is dumped. As Article 2.2 provides, the price of export product should be 'less' than the price of the same product 'destined for domestic consumption'. Thus concerns should only be raised when the energy-producing country decides to designate a higher price for its energy or its related products for domestic consumption. And up to now, petroleum pricing policies of energy producing countries have not been considered in the framework of the anti-dumping agreement as such and the concern over the cheap price of energy and energy products in energy-producing countries were more directed to 'subsidies' that these countries, directly or indirectly, provide for their energy industry. This issue was explained in the previous section in discussing the Subsidies Agreement. Nevertheless, the development of the anti-dumping agreement in the WTO should be closely followed, and the possible changes and new proposals by Member Countries that could alter the ways that a product's price is considered as 'dumped' should be analysed.

5.4.11. Energy Services and the GATS

The energy industry employs various energy services which play an extremely important role in this sector. Energy services are required in every step of the energy process, from exploration to production, refining, marketing, pipelines transportation, distribution, and services related to LNG. These services are those without which the explored energy cannot be provided to the consumer. These services were, and in some countries still are, undertaken by monopolies or state-owned enterprises that thoroughly dominate the services sector. Due to increasing competition in some countries, existing integrated services are being divided into various parts, each part accepting a distinct responsibility in the energy process from other services. Furthermore, this competition has led to the creation of new services, such as the operation of power pools, energy trading, energy management, and services for greenhouse gas emissions trading.

Each energy source has its specific service for supplying the energy market. Petroleum services include drilling services, well casing, and pipeline construction, among other things. Although natural gas exploration and production involves the same services, its transmission and distribution necessitates a different range of services due to the specific characteristic of transportation of natural gas, which is more rigid compared to oil (see Chapter 1 on this issue). The services in the coal industry are very similar to those of any other good, and the

services involved in generation, transmission and distribution of electricity³⁰² undertake a different range of activities such as metering and billing or direct trading and brokering via the internet.

Services can be traded, and therefore, within the framework of the WTO, an Agreement is specifically designed to regulate this type of trade. GATS defines trade in services as the supply of a service a) from the territory of one Member into the territory of any other Member; (b) in the territory of one Member to the service consumer of any other Member; (c) by a service supplier of one Member, through commercial presence in the territory of any other Member; (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member. For energy purposes, supply of services, such as transmission or distribution of natural gas or electricity through pipelines or grids, falls within category (a) as they are supplied from the territory of one member state into the territory of another. Category (c) covers all different forms of foreign commercial presence that are practised in the energy sector, where an operator or contractor is present in the territory of the host country and builds an energy facility and operates it until the period of the contract lapses and the facility is transferred to the host country.³⁰³ Mode (d) covers the presence of persons involved in technical and managerial professions that render their services in supervising activities in the energy sector. Specific barriers to the delivery of energy services include limited access to electricity transmission grids, discriminatory transmission fees, restricted cross-border trading, which could be subject to commercial presence, limitation to cross-border transfer of capital to finance the transaction, etc.³⁰⁴ Within the ambit of GATS, the main obligations are MFN treatment, transparency and specific commitments, such as market access and national treatment, which do not apply automatically but are only applicable to sectors that WTO members have included in their national schedules through the 'sectoral classification list'. Due to this characteristic of GATS, Member States are free to choose which services they want to commit to.³⁰⁵ Moreover, the ancillary provisions of GATS are also highly significant for the elimination of trade barriers in the field of services. These provisions supervise fairness of domestic regulations, payment and transfers, government procurement, subsidies, criteria for licences and approvals, actions of monopolies, mutual recognition, etc.

³⁰² Electricity is a secondary energy, which means that it is derived from a primary energy source such as natural gas or coal. Transportation and distribution of electricity are considered as services.

³⁰³ A dominant form of commercial presence is the 'Build, Operate & Transfer' (BOT) system where the contractor finances an energy facility, operates it for a long period and recovers the costs of its investment during this time. After this period, ownership is transferred to the host country.

³⁰⁴ See also S Zarilli, 'International Trade in Energy Services and the Developing Countries', in *Energy and Environmental Services: Negotiating Objectives and Development Priorities* (Geneva, UNCTAD, 2002) at 11 [hereinafter 'International Trade in Energy Services'].

³⁰⁵ See, eg, the commitments by Australia or Hungary in pipeline transportation sector, or by the US or Australia in services incidental to energy distribution, Background Note by the WTO Secretariat on *Energy Services*, S/C/W/52, 9 September 1998.

The Agreement on Services (GATS) does not dedicate a separate list to specific energy services. Article I(3)(b) GATS defines a service as any service in any sector except services supplied in the exercise of governmental authority. Hence, one could assume that all energy services could fall within this category unless exercised by governmental authority, an exercise which should also be undertaken neither on a commercial basis nor in competition with one or more service suppliers (Article I(3)(c)). Energy services were not negotiated as a separate sector during the Uruguay Round. However, a few members undertook sparse commitments in various energy-related services but 'the majority of the global energy services industry is not covered by the GATS specific commitments'.³⁰⁶

However, some energy services are embodied in the ambit of the WTO provisions. In order to classify a service as distinct from other services, it is necessary for that service to possess some characteristics to justify the creation of a separate category. This classification is justified for electricity, based on specific characteristics such as the impossibility of its storage. In the case of natural gas, it is possible to store it only in a gaseous form or the so-called Liquefied Natural Gas. The nature of their networks, which are quasi-natural monopolies, is also one of their distinct characteristics.³⁰⁷ Separate sub-sectors in the 'Services Sectoral Classification List' of the WTO list three specific energy-related services as 'transportation of fuel' (eg via pipeline), 'services incidental to mining' (eg drilling) and 'services incidental to energy distribution' (eg distribution of electricity to households).³⁰⁸ It is not clear why this Classification List only enumerated three services in the energy sector. One could assume that, due to the fact that at the time of the Uruguay Round liberalisation of energy markets was not dealt with as extensively as other sectors, a comprehensive listing of these services was left out. However, by mentioning only three sub-sectors in energy some practical problems will arise.³⁰⁹ Energy services are interrelated, not only in one country but between various countries, and a guaranteed market access necessitates the transparency and predictability of all access conditions for each service. Moreover, the three services mentioned above are not classified under one category but under categories of 'Transport' and 'Other Business Services'. Reservations or restrictions imposed by a member state in one category could lead to the restriction of another, although no restriction is implemented in that sector.³¹⁰ Moreover, commitments made by the WTO Members in these sub-sectors are very limited.³¹¹ Therefore, the present situation is not entirely in the

³⁰⁶ *Ibid.*

³⁰⁷ See WTO, *Energy Services*, n 305, at 1.

³⁰⁸ For the 'Services Sectoral Classification List' see, GATT document MTN.GNS/W/120, dated 10 July 1991.

³⁰⁹ See Zarilli, 'International Trade in Energy Services', above n 304, at 20.

³¹⁰ See GATS Art XX on schedules of Specific Commitments. Only a few Member Countries made specific commitments in energy services under diverse headings of business services, construction services, and transport services.

³¹¹ See Zarilli, 'International Trade', above n 304, at 22.

direction of full liberalisation in energy services compared to trade in energy products, materials and equipment explained above. However, the ongoing debate within the WTO on creating an exhaustive list of the specific sector of energy services aims to resolve this problem (see the last part of this section for details)³¹².

The General Agreement on Trade in Services (GATS) is not incorporated into the ECT. The text of the ECT was already put in place in 1991 before the creation of GATS in the framework of the WTO. However, within the ambit of the ECT, energy services are not left out and the definition of 'Economic Activity' covers energy services. An economic activity in the ECT means an activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, and marketing which can be considered as energy services. Moreover, the final Act of the European Energy Charter Conference has to be looked at in identifying the precise scope of the ECT. This text explicitly provides that the treaty confers no rights to engage in activities other than *Economic Activities* in the energy sector, and for that matter, provides an illustrative list of economic activities in the energy sector, within which some energy services are included, which are divided into 7 different categories. These are activities ranging from exploration to distribution of finished products such as drilling, processing, refining, transport, transmission, distribution, waste management and storage, maintenance of networks, decommissioning of energy facilities, marketing and sale, research, and consulting.³¹³ Moreover, the ECT, in enumerating energy services (although in a non-exhaustive way), has overcome one of the traditional problems of the energy industry where no distinction could be easily made between goods and services.³¹⁴

This inclusion in the ECT being plausible, one could assume that the ongoing debate within the WTO to list energy services in the Sectoral Classification of Services could lead to consideration of the new Agreement by the ECT. One could argue that the full incorporation of GATT into the ECT on the one hand, and the trade–service linkage on the other, necessitates that the development of GATS in the WTO be followed closely by the ECT in order to guarantee a satisfactory result for the liberalisation of the energy sector of the ECT members. However, the direct incorporation of provisions of GATS into the ECT is problematic. For example, in the energy process, the restriction on supply of services through the first mode, such as pipeline, is linked to the possibility of the commercial presence of the technical engineer (involvement of persons) to supervise this transportation. The fourth mode on presence of natural persons in

³¹² See the proposals of various Contracting parties of the WTO, for example, Communication from the US on Energy Services: Negotiating Objectives, JOB (01) 167, 4 December 2001 and also Communication from the European Communities and their Member States, GATS 2000: Energy Services, S/CSS/W/60, 23 March 2001.

³¹³ See the Final Act of the European Energy Charter Conference, Understandings with respect to Art 1(5).

³¹⁴ See also 'UNCTAD Report on Trade', above n 147, at 39.

the GATS suggests engaging in questions of policies on visas and immigration. Not all of these are applicable under the ECT. Requests for entry of individuals, such as investors, within the ECT, are subject to the laws and regulations of the host country, and the only obligation imposed on the host country is to examine the request of the individual in good faith (Article 11). Hence, in order to implement the four modes of supply of services of the GATS in the ECT, it is necessary to establish new rules within that framework. The objective should be to create an efficient list of new services that Member States can adopt and abide by in their national schedule of commitments. In this respect, the ECT can use the new GATS negotiations as a model and seek to establish a comprehensive set of rules applied specifically to energy services. For this reason, a comprehensive study on ways through which energy services are impeded should be adopted by the ECS. Each member of the ECT should quantify the value of their energy services and identify the particular barriers to their trade in energy services. Nonetheless, the task should be accomplished at one point in time if the ECT's objective of maximising the efficiency of production, conversion, transport, distribution and use of energy is to be achieved.³¹⁵

The Doha Round of WTO negotiations on trade in services, and the various proposals of member countries, both consumers and producers of energy, to expand the list of services should be a good starting point for the ECT to reform its provisions if necessary. The idea of expanding the list of services in the WTO is based on the belief that the opening up of the services sector to competition and private participation has been advantageous for members, as it has contributed to their economic growth. Due to this effect, the energy-consuming and energy-producing countries became active in proposing a new 'WTO Services Sectoral Classification List', which Member States use as a reference point in adding specific commitments to their 'national schedule of commitments'.³¹⁶ For example, Norway took a very broad approach and proposed that all services in the energy sector be included in the classification list,³¹⁷ whereas Venezuela suggested that classification be adopted through three criteria: the energy source, the phases of energy process, and a distinction between core energy services and non-core energy services. The reason given is that higher transparency through such classification reveals the problems in each sector, and can be considered as a necessary pre-condition for liberalisation while taking national development strategies into account. They also link the opening up of their services to

³¹⁵ See also the Concluding Document of the Hague Conference on the European Energy Charter in *The Energy Charter Treaty and Related Documents* (Brussels, Energy Charter Secretariat, 2004) at 217.

³¹⁶ See the Background Note by the WTO Secretariat on 'Energy Services', S/C/W/52, 9 September 1998. See also M Gibbs, 'Energy Services, Energy Policies and the Doha Agenda' in *Energy and Environmental Services: Negotiating Objectives and Development Priorities* (Geneva, UNCTAD, 2003).

³¹⁷ See Communication from Norway, 'Proposal on Classification of Energy Service', S/CSS/W/59, 21 March 2001.

achievement of their development goals, which are shared by other energy-producing countries such as technology transfer, protection of natural resources, emergency safeguard measures, etc.³¹⁸ In the same vein, Indonesia suggests that as trade in services is growing in importance, 'it is important to ensure that developing countries can fully participate in trade in services through the expansion of their services exports'. This, they believe, 'requires the strengthening of developing countries' domestic services capacity, notably through increased efficiency and competitiveness'.³¹⁹ Hence, they link the opening up of their energy services sector to the satisfaction of development goals. The United States, on the other hand, suggests that opening up the energy services sector should not be conditional upon anything, such as the transfer of technology in that specific service, except when it compromises public policy objectives; energy service providers should have the right to bring their necessary personnel to provide a service, and tariffs on energy-related goods that are linked to the activity of the service provider should be abolished.³²⁰ The European Community suggests that further restrictions, such as restrictions on the legal forms of business of the service provider, licensing, or restrictions on foreign investment should be altogether reduced.³²¹ No agreement has yet been reached on the list of services. On the other hand, in 2005 there were proposals in establishing plurilateral request-offer agreements in order to advance the services negotiations among bigger group of countries and to complement the bilateral request-offer system by establishing a collective process identifying areas of common interests among member states. Any market access commitment within this agreement will be extended to all other members through the MFN clause.

The issue of the liberalisation of energy services in the WTO and the ECT is of great importance for exporting countries. As long as the link between an efficient cooperation framework between importing and exporting and security of energy supply is accepted, it is vital that the demands of energy-producing countries in this debate be taken into account by the WTO, where the ECS could also play an important role in bridging any gap between the two. The energy-exporting countries need to take a prudent approach to the opening up of their energy services to liberalisation: like any other sector, a rapid opening may not allow them to protect their domestic industries. Although it is claimed that the opening up of energy services is advantageous in the long-term (as acknowledged by some of the energy-producing countries of the WTO), issues of interest to developing countries, such as access to technology in this field, or protection of natural

³¹⁸ See Communication from Venezuela, 'Proposal on Classification of Energy Services', S/CSS/W/69, 15 October 2001.

³¹⁹ See Communication from Indonesia, 'Proposal on Classification of Energy Services' S/CSC/W/42, 27 November 2003. See also S/CSC/W/42/Rev.1, 23 November 2004.

³²⁰ See Communication from the European Communities, 'Proposal on Classification of Energy Services', S/CSS/W/60, 23 March 2001.

³²¹ See Communication from the United States, 'Proposal on Classification of Energy Services', S/CSS/W/24, 18 December 2000 and S/C/W/58, 20 October 1998.

resources, should be emphasised.³²² Developing countries, which include the majority of energy-producing countries, need to only expand their supply in line with the objectives of economic growth. Clearly, these countries need to link the export of energy sources with the import of human resources, technological improvements, stimulation of investment and competitiveness. Energy services liberalisation should provide them with this opportunity because trade in energy services is technologically intensive. Therefore, the conditionality of their opening up for having access to these technologies could be justified.

Clearly, the opening up of the energy services sector of energy-producing countries contributes to Europe's security of energy supply. However, for such liberalisation to materialise, the Community needs to satisfy the conditions imposed by energy-producing countries to eventually reach a balanced status, where the demands of both parties are satisfied. The ECS could play an important role in highlighting the demands of both sides in opening up their energy services, in analysing its costs and benefits, and in assisting developing countries in meeting their demands in multilateral trade negotiations.

5.4.12. The TRIMs and the ECT

Discussions on the establishment of an agreement on trade-related investment measures (TRIMs) within the ambit of the WTO did not occur until 1981, when a committee, set up to study the export potential of less-developed countries, had before it a study of TRIMs. This task was undertaken together with the World Bank and the International Monetary Fund (IMF), who concluded that TRIMs produced trade-distorting economic effects. The Group reached no conclusion

³²² See Communications from Venezuela on Negotiating Proposal on Energy Services, WTO Document, S/CSS/W/69, 29 March 2001. During the negotiations on energy services, Venezuela suggested that

the outcome of these negotiations should be instruments, commitments and measures designed to: (a) facilitate the effective participation of all Members in the supply of energy services, and in particular liberalise access to energy service markets for suppliers from developing countries, and eliminate the barriers which have prevented these countries from benefiting from trade opportunities in these services; (b) strengthen the capacities, efficiency and competitiveness of suppliers of energy services from developing countries and improve instruments for their access to technology on a commercial basis; (c) improve the transparency of government measures which affect the supply of energy services; (d) implement GATS Articles IV and XIX through significant trade commitments, and provide for the Council for Trade in Services to assess on an ongoing basis the effective application of these Articles and the extent to which developing countries are benefiting from increased participation in trade in energy services.

This proposal goes in line with Art XIX(2) of the GATS, which is a provision of special and differential treatment that allows the developing countries to open up their services sector gradually, conditional upon the criteria embodied in Art IV, which concentrates on developing the economy of developing countries through the strengthening of their domestic services capacity and its efficiency and competitiveness, improvement of access to distribution channels, and liberalisation of market access in sectors and modes of supply of interest to them.

until the significant FIRA case³²³, which placed the TRIMs issue squarely onto the GATT agenda. After negotiations over investment were completed and a compromise by the GATT contracting parties was reached, the TRIMs Agreement came into existence in 1994. The preamble to the TRIMs Agreement states that the Ministers of the contracting parties agreed on the fact that

following an examination of the operation of GATT articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.

The TRIMs Agreement therefore only applies to investment measures as they relate to trade in goods, which is clearly emphasised in Article 1.³²⁴ The agreement also provides that no signatories shall apply any TRIM inconsistent with Articles III and XI (National Treatment and General Elimination of Quantitative Restrictions) of the GATT 1994. An Illustrative List of these measures, which are deemed to be inconsistent with the above articles, is annexed to the Agreement.

There is no consensus on how best to determine the effects of TRIMs. There is disparity in the data submitted by different firms on how, and to what extent, TRIMs affect their activities. Some trade effects of TRIMs may be only indirect and their effects relatively indiscernible. Sometimes 'the interdependence between the intervention and other instruments of policy applied by governments or firms complicates the analysis considerably'.³²⁵ Some TRIMs, such as local content requirements and minimum export requirements, are quite common and their trade effects clear. Local content requirements mandate that the investor purchases inputs locally that it might otherwise import from another country. Consequently, this TRIM reduces or displaces imports. It also impacts on the investor's purchasing, sales and manufacturing decisions. This may, for example, make the investor do business by sourcing locally, which might increase the investor's cost of investing in the host country. This measure is prohibited in the TRIMs Agreement³²⁶ and some disputes have gone before the WTO Panel

³²³ In 1982, investment issues were formally raised in the framework of the GATT for the first time in a dispute between the United States and Canada. In this case, the United States alleged that Canada's administration of its Foreign Investment Review Act (FIRA) violated GATT obligations. See the Canadian Foreign Investment Review Act CS 1973, c. 46 which was repealed by Section 46 of the Investment Canada Act, S.C 1985, c. 20 which was then codified in RSC 1985, c. 28 (1st Supp.). See the FIRA dispute in Canada Administration of the Foreign Investment Review Act, GATT BISD (30th supp.) at 140 (1984).

³²⁴ Art I of TRIMs provides that 'this Agreement applies to investment measures related to trade in goods only'.

³²⁵ See D Greenaway, 'Trade Related Investment Measures: Political Economy Aspects and Issues for GATT' (1990) 13 *World Economy* 367 at 375.

³²⁶ See TRIMs Agreement Annex, Art 1(a).

dealing with this issue.³²⁷ Trade balancing requirements, another measure prohibited by TRIMs, can also affect trade flow as they displace exports. With respect to this measure, an 'investor's purchase or use of imported products might be limited to the volume or value of local products that it exports'.³²⁸ The greater the limitations imposed on imported products, the more exports will be affected.

Some other measures, such as export performance requirements and product mandate requirements, have the effect of increasing exports. The former obliges the investor to export a certain share of its outputs, which displaces other exports, and the latter requires that the investor 'supplies certain markets with a designated product or products manufactured from a specified facility or operation'.³²⁹ The product mandate requirement may result in an increase in exports if, for example, there is 'insufficient demand in the local market for the mandated product'.³³⁰ Although having trade-distorting effects, these measures are not prohibited in the TRIMs Agreement.

The TRIMs Agreement does not sanction other forms of trade-distorting TRIMs. Export performance requirements, which explicitly distort trade, are not prohibited under TRIMs. Manufacturing requirements, which require that some products be manufactured locally, and consequently displace imports, are also not prohibited.³³¹ Investment incentives are among other measures that are

³²⁷ See *India—Measures Affecting the Automotive Sector, complaint by the European Communities* (WT/DS146/1). This dispute, dated 6 October 1998, concerns certain measures applied by India that affect the automotive sector. India grants import licenses to investors only if the foreign company agrees to enter into a joint venture with a local manufacturer. Furthermore, the grant of import licenses is made conditional upon local content requirements and export balancing requirements. The EU alleges violations of Art II of TRIMs. This measure adopted by India clearly matches with the measure illustrated in TRIMs Annex, art 1(a). Another dispute was brought before the WTO Panel in which Japan alleged a violation of the TRIMs agreement by Indonesia because of the application of certain measures affecting the automobile industry. Indonesia was applying local content requirements to favour domestic producers of automobile inputs. The WTO panel ruled that these measures contravened Indonesia's obligations under the TRIMs agreement. *Indonesia—Certain Measures Affecting the Automobile Industry* (WT/DS 54, 55, 59 & 64). Panel Report 2 July 1998.

³²⁸ The TRIMs Agreement Annex, Art 1(b).

³²⁹ A Subramanian and P Low, 'TRIMs in the Uruguay Round: An Unfinished Business', in W Martin and LA Winters (eds), *The Uruguay Round and the Developing Countries* (Cambridge, Cambridge University Press, 1996) at 417. See also S Haghighi, 'A New Proposal for an Agreement on Investment in the Framework of the World Trade Organisation', LL M thesis, (Montreal, McGill University, 1999).

³³⁰ RH Edwards Jr and SN Lester, 'Towards a More Comprehensive World Trade Organisation Agreement on Trade Related Investment Measures' (1997) 33 *Stanford Journal of International Law* 169 at 202.

³³¹ The effects of some other TRIMs, which are not mentioned in the Agreement, are not quite clear, such as local equity requirements. This measure mandates that local investors hold a certain percentage of ownership of a company created by foreign investment. The impact of a local equity requirement on the management decisions of the foreign direct investor is uncertain, because it depends on a large number of variables, including the 'percentage ownership of the local investor and whether the foreign investor favours local companies when sourcing inputs'. Furthermore, the effect is uncertain as the data on firm's responses to TRIMs shows conflicting results. Some data indicates that 'changes in international corporation operations, attributable to TRIMs requirements, are relatively small'. The effects of technology transfer and licensing requirements are also less than clear. See also

sometimes related to TRIMs and ignored in the TRIMs Agreement. These measures basically benefit both the investor and host countries that apply them. Tax holidays, cash grants and loan guarantees are a few examples. The application of such measures is often accompanied by certain conditions that must first be satisfied.³³² Conditions upon which incentives are granted may distort trade.³³³ All violations resulting from the application of these measures would undermine GATT's objective of stimulating economic growth. These distortions might hinder GATT from pursuing its objectives of developing the economy of contracting members, particularly developing countries, one objective that is clearly stated in the Preamble of the Final Act of the Uruguay Round.

The TRIMs Agreement is not incorporated into the ECT but some of its provisions are incorporated in Article 5. This Article enumerates some of the possible measures as local content requirements, trade-balancing requirement, foreign exchange requirement and domestic sales requirements. The enumeration of only four measures shows that not all other measures with trade-distorting effects mentioned above are prohibited under the ECT. These types of trade-related investment measures are very common in the energy sector and their inclusion in the framework of the ECT is therefore justified. However, the only difference between the TRIMs Agreement and the ECT is found in Article 5(3), where a specific exception is established for contracting parties to apply a trade-related investment measure as a condition of eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes.

The existing TRIMs agreement has proved to have many shortcomings and has been strongly criticised. The main problem with respect to these measures is that

the UN document, 'The Impact of Trade Related Investment Measures on Trade and Development', UN Document ST/CTC/20 (New York, UN Publications, 1991).

³³² Eg, the host country agrees to reduce tax rates on the income of certain investments or to exempt the investor from custom duties, so long as the investor agrees to comply with certain requirements, such as local content or trade balancing requirements. Therefore, there is sometimes a strong correlation between TRIMs and investment incentives.

³³³ See S Guisinger, 'Do Performance Requirements and Investment Incentives Work?' (1986) 9 *World Economy* 79 at 90. Guisinger is of the view that 'on the basis of plausible assumptions about corporate taxes and capital output ratios, a 30 percent cash grant is equivalent to an effective tariff of 18 per cent'. While the TRIMs Agreement does not specifically deal with investment incentives per se, its Annex prohibits TRIMs that are 'mandatory', or those with which compliance is 'necessary to obtain an advantage'. The Agreement does not define the term 'advantage', but it is understood to cover all forms of advantages, including those of fiscal nature. See P Sauvé, 'A First Look at Investment in the Final Act of the Uruguay Round' (1994) 28 *Journal of World Trade* 5 at 8. On the other hand, the Uruguay Round Agreement on Subsidies and Countervailing Measures introduces some disciplines that may concern investment incentives (eg financial contributions by a government that confers a benefit). Furthermore, this Agreement prohibits all subsidies that are contingent on export performance, as well as subsidies that are contingent on the use of domestic rather than imported goods. Therefore, one can assert that, although the TRIMs Agreement does not regulate investment incentives, any measure considered to be an 'advantage' under this Agreement may be regarded as a subsidy. As such, these measures can be regulated under the Subsidies Agreement, and are consequently prohibited. P Sauvé, 'Qs and As on Trade, Investment and the WTO' (1997) 31 *Journal of World Trade* 55 at 61.

their trade-distorting effect is not at all clear in many areas or sectors. It is vital to approach the issue on a sectoral basis. As some believe, 'TRIMS are not necessarily bad'.³³⁴ They conclude that a balance should be struck between investment incentives that are badly required by some members of the ECT and investment disincentives 'while still allowing free trade flows'. If all trade-related investment measures are outlawed, there is the risk that those that are beneficial for the host country are eliminated when their real trade effect is not proved. Therefore, the limit imposed by the ECT on the vast number of TRIMS should be welcomed. This issue can further be linked to energy security, because one aspect of this security is to create the best environment for investment from both the investing and host country's perspective, an issue extensively discussed in the first chapter.

5.4.13. The Trade-Related Dispute Settlement Mechanism and the Direct Effect of the GATT-ECT

Based on Article 29(9) of the ECT on trade, Annex D on interim provisions for the dispute settlement of the ECT applies to disputes (1) not in compliance with provisions applicable to trade, or (2) if the measure is not in conflict with the provisions of Article 29 but directly or indirectly nullifies or impairs any benefit accruing to a contracting party, and (3) unless agreed otherwise, disputes regarding compliance with Article 5 (trade-related investment measures) between contracting parties, at least one of which is not a WTO member. Annex D does not apply to disputes arising within a Free Trade Area or Customs Union or within an agreement based on Article 29(2)(b), which is related to trade agreements among several countries.³³⁵

Based on Annex D, contracting parties should make every effort to resolve their disputes through cooperation and consultation. If the dispute is not resolved within 60 days through either conciliation, mediation, arbitration or other methods, the complainant should submit a written request to the ECS for the establishment of an in-house panel.³³⁶ Unlike investment disputes, a third

³³⁴ ME Footer, 'Trade and Investment Measures in the Energy Charter Treaty', in *East-West Gateway*, above n 9, at 458.

³³⁵ Based on this Article, trade agreements that have entered into force on or before 1 December 1999 (or their accession to the WTO whichever is earlier) among the Republics of the former USSR are not governed by the trade rules of Art 29. The detailed provisions of the procedure through which these agreements can be entered into are described in Annex TFU of the ECT.

³³⁶ Panelists are GATT or WTO panellists designated by each Contracting Party or approved by the Energy Charter Conference unanimously. A panel is composed of three members who are chosen by the Secretary General of the Charter Secretariat from the roster.

party that may have a substantial interest in the disputed matter has the right to be heard by the Panel. The Panel is composed of three members designated by the ECS.³³⁷

The Annex prescribes that the ECS shall adopt rules of procedure for confidential panel proceedings, which shall be 'as close as possible to those of the WTO Agreement'. Panels shall be guided by the 'interpretations' given to the WTO Agreement within the framework of the WTO Agreement. The Panel conclusion shall be adopted by the ECS 30 days after it has been provided to all contracting parties. Any contracting party that objects can inform the ECS within 10 days of the date on which the report is to be considered for adoption. The Annex does not elaborate on the ways through which the report should be dealt with when there is an objection by a contracting party. If the non-complying party fails to comply with a ruling or recommendation of a final panel within a reasonable time, the injured contracting party may request that the non-complying party enters into negotiations with a view to agreeing upon mutually acceptable compensation. If the non-complying party refuses to negotiate, the injured contracting party is allowed, based on a specific procedure, to temporarily suspend its obligations towards the other party.

One issue that is linked to the discussion of the dispute settlement system of the ECT on trade provisions is the possibility of referring to the trade rules of the GATT as incorporated into the ECT by the national courts of the EC Member States or by the ECJ. As explained above in discussing the direct effect of the ECT in the Community, one international treaty can be divided into various sections and some provisions can possess direct effect while others do not. With regard to the investment provisions of the ECT, the previous section concluded that direct effect should be granted. Therefore, a foreign investor should be given the right to raise his claim before national courts or the ECJ, based on the conditions that were not very straightforward and were extensively discussed. The other important reflection here is to determine whether such direct effect can be provided for the trade provisions of the ECT, which could in turn allow an individual to raise a claim based on these provisions before the national courts of the Member States or the ECJ.

Unlike the ambiguity over the direct effect of the investment provisions of the ECT, the case law of the ECJ as well as scholarly writings are clearer in helping one to determine the direct effect of the trade provisions of the ECT. It was stated, in 1972, that in order to determine the direct effect of an international treaty 'the spirit, the general scheme, and terms' of an international treaty should

³³⁷ Each Contracting Party member of the WTO shall designate two individuals who shall be persons whose names appear on the indicative list of governmental and non-governmental individuals, referred to in Art 8 of the Understanding on Rules and Procedures Governing the Settlement of Disputes contained in Annex 2 to the WTO Agreement or who have in the past served as panellists to the GATT or WTO dispute settlement panel. (See subpara 7 of Annex D).

be examined.³³⁸ For this purpose a few basic principles of an international treaty, such as flexibility of its provisions, principle of negotiations, possibility of derogation etc. were looked at. Simultaneously, an examination was undertaken as to the general structure of an international agreement. For this purpose, the provisions of the agreement were analysed in light of its object and purpose.³³⁹

With respect to GATT, the ECJ established a test in the *International Fruit* case,³⁴⁰ which was applied in later cases for quite some time. The ECJ, in evaluating the criteria of 'spirit, the general scheme, and terms of the international treaty' (ie GATT 1947 in the case) found the GATT to be based on the principle of negotiations 'undertaken on the basis of reciprocal and mutually advantageous arrangements'.³⁴¹ The Court later elaborated on this issue, by providing that

when a Member State fails to fulfil its obligations to implement a ruling against it in a dispute settlement system, it can enter into negotiations with any party having invoked the dispute settlement procedures, with a view to finding mutually acceptable compensation.³⁴²

The mere fact that the parties could disregard their obligations and rely on mutually acceptable arrangements was considered as one problem in granting direct effect to such an international treaty, due to the flexibility that was provided, with the possibility of derogation from its obligations. Moreover, the Court referred to the dispute settlement system of the GATT and enumerated the possibilities of consultation, negotiation, and unilateral action. Based on these four issues, ie reciprocity, great flexibility of the provisions, possibility of derogation and the dispute settlement method, the Court concluded that the GATT is not capable of conferring citizens with Community rights that they can invoke before the courts.³⁴³

The issue of reciprocity later came to the fore, and it was asked whether the fact that one contracting party does not grant direct effect whereas another does should deny the direct effect of the agreement altogether. Although the Court had previously sidelined reciprocity as a factor in determining direct effect,³⁴⁴ it decided otherwise in the 1999 case of *Portugal v Council*. In that case, the Court

³³⁸ Case 24/72, *International Fruit Company v Produktschap voor Groeten en Fruit* [1972] ECR 1219.

³³⁹ See also D McGoldrick, *International Relations Law of the European Union* (Harlow, Longman, 1997) at 127.

³⁴⁰ Case 24/72, above n 338.

³⁴¹ *Ibid.*

³⁴² See Case 149/96, *Portugal v Council*, above n 91, at 39.

³⁴³ See Case 24/72, above n 338, para 27. The ECJ has enumerated two exceptions based on which the GATT can be given direct effect. The first exception is when the Community intends to implement a particular obligation assumed in the context of the GATT/WTO as prescribed in the *Nakajima* case, and the second is where a Community measure refers expressly to provisions of the GATT/WTO as prescribed in the *Fediol* case. These exceptions have been rarely applied. See the *Nakajima* case, above n 105 and see the *Fediol* case, above n 110.

³⁴⁴ See Case 104/81, *Kupferberg*, above n 91, para 3663–3664, the Court explains that

applied the principle of reciprocity for the determination of direct effect and also analysed the differences between GATT 1947 and the new WTO system of international trade. However, it concluded that the WTO system is still founded on the principle of 'negotiation' and is thus distinguished from agreements concluded between the Community and non-member countries that introduce certain asymmetrical obligations.³⁴⁵

Articles 2 and 3 of the ECT outline the scope and objectives of the treaty, based on which the 'spirit, general scheme and the wording' criteria can be examined. The purpose is stated as the 'establishment of a legal framework in order to promote long-term co-operation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Energy Charter'. The question here is to what extent the relative lack of binding character of GATT/WTO, which was declared by the Court to arise from the 'reciprocal' nature of the obligations among the parties, can be extended to the ECT.

According to the general rules of international law there must be bona fide performance of every agreement. Although each contracting party is responsible for executing fully the commitments which it has undertaken, it is nevertheless free to determine the legal means appropriate for attaining that end in its legal system unless the agreement, interpreted in the light of its subject matter and purpose, itself specifies those means. Subject to that reservation the fact that the courts of one of the parties consider that certain of the stipulations in the agreement are of direct application whereas the courts of the other party do not recognise such direct application is not in itself such as to constitute a lack of reciprocity in the implementation of the agreement. The Court further explained that the mere fact that the contracting parties have established a special institutional framework for consultations and negotiations is not in itself sufficient to exclude all judicial application of that agreement. The Court went on to say that any given agreement can be split; while some provisions can receive direct effect, some others cannot.

³⁴⁵ See Case 149/96 *Portugal v Council*, above n 91 para 42. In association agreements between a third country and the Community, direct effect was granted since it was found that a 'link' exists between the two parties (ie through reference in the agreement to an article of the EC Treaty, or the similarity of both the wording and the function of the provisions of the agreement with those of the EC Treaty). The link was deemed to be the peculiar relationship between the Community and those third countries, which necessitated direct effect in order to allow individuals to challenge Community measures that are inconsistent with those agreements. See Case 87/75, *Bresciani* [1976] ECR 129 at 141. In this case, the Court found particularities in the Yaoundé Convention that linked the Community to the former colonies of some Member States. For this reason, direct effect was granted to this Convention. Compare to Case 270/80, *Polydor Ltd v Harlequin Record Shops Ltd* [1982] ECR 329. In this case, the Court ruled that mere similarity between provisions of the Agreement between the Community and Portugal and those of the EEC Treaty was insufficient to establish direct effect. See, inter alia, Case 262/96 *Sürül* [1999] ECR I-2685, para 60, and Case 63/99 *Głoszczuk* [2001] ECR I-6369, para 30. See also Case 162/00 *Pokrzeptowicz –Meyer* [2002] ECR I-1049 para 19. These cases suggest that a provision in an agreement concluded by the Community with non-member countries must be regarded as being directly applicable when, having regard to its wording and to the purpose and nature of the agreement itself, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure. See Case 17/81, *Pabst & Richarz v Hauptzollamt Oldenburg* [1982] ECR 1331. The Court examined the nature of the Agreement at issue and ruled that there were similarities, not only between the wording of the agreement between the Community and Greece but also in their function. Therefore, direct effect was granted. See also the opinion of the Advocate General in Case 53/96, *Hérmes v FHT* [1998] ECR I-3603 at para 28.

It is clear that the ECJ dealt not only with the issue of direct effect with respect to the give-and-take characteristics of a treaty, but also decided on its relevance in relation to the existence of other issues, such as safeguard clauses and dispute settlement provisions.

Safeguard measures, as embodied in the Safeguards Agreement, are those measures that are applied to products being imported into a given country. They are adopted when there is an influx of imports to a given country, which seriously affects its domestic industry. The condition for the adoption of this type of measure is that if the influx of the source of energy is deemed to damage the domestic energy market of the importing country, this latter country should prove 'serious injury' to the market. If this condition is met, the import of that type of energy could be banned. The Court has reasoned that the existence of safeguard provisions in an international treaty reduces its binding effect.

Some argue that the case law of the ECJ dealt with this issue before the establishment of the Safeguard Agreement (ie before 1994), which sets out new firm commitments which render this aspect of the treaty 'forceful' for the purposes of analysing direct effect. However, on closer perusal, it becomes clear that the Member State's only serious obligation is to prove the existence of serious injury to justify the application of safeguards (Article 4), but the determination of this is left to the competent authorities of the Member State imposing the safeguard. Therefore, 'these requirements do not seem to be as strong as those found in *Kupferberg* where a safeguard measure could not generally be imposed unless approved by the Joint Committee'.³⁴⁶

It can be submitted that, in analysing the safeguard clauses as incorporated into the ECT, the degree to which a member country can derogate from the obligations of a specific agreement should be determined. The greater the leeway provided by a treaty, the lesser the likelihood of that treaty having direct effect. The Energy Charter Treaty has incorporated the Safeguard Agreement—therefore, the same non-binding effect of the safeguard clauses, which renders the treaty 'not good enough' for direct effect purposes, has been transformed in the ECT. The ECT provisions on safeguards could thus contribute to the lack of direct effect of the trade provisions of the ECT. This in turn would mean that an individual would not be able to base his/her claim on those clauses before the national court or the ECJ. It remains to be seen to what extent the Court will refer back to previous cases (such as the *Sevince case*) where the mere existence of a power to derogate, as embodied in the safeguard clauses, were not always deemed to prevent direct effect.³⁴⁷

³⁴⁶ JO Berkey, 'The European Court of Justice and Direct Effect for the GATT: A Question Worth Revisiting' (1998) 9 *European Journal of International Law* 626 at 635 [hereinafter 'ECJ and Direct Effect']

³⁴⁷ See Case 192/89, *Sevince v Staatssecretaris van Justitie* [1990] ECR I-3461.

The other important issue discussed by the ECJ to determine the direct applicability of the GATT/WTO Agreements was the issue of the dispute settlement system embodied in the GATT and in recent WTO cases. The ECJ has favoured a more adjudication-oriented approach, rather than a negotiation-oriented one, to settle disputes. After the establishment of the WTO, the dispute settlement system became a more rule-oriented system as opposed to GATT 1947, which was only based on negotiations. However, negotiation still plays an important role in the panel procedure of the WTO. The ECJ referred to this in the *Portugal v Council* case³⁴⁸ as one reason for not granting direct effect. The adoption of the panel report is not the only option available to the parties in dispute. First, there exists consultation, good offices, conciliation and mediation as alternatives to panel proceedings. Based on Article 3(7) of the Dispute Settlement Understanding of the WTO, withdrawal of the incompatible measure, or its full implementation, is provided. However, mutually acceptable compensation is considered as an alternative, which can again take place through negotiations between the parties.³⁴⁹ Therefore, a more legalistic dispute settlement system does not change the fact that dispute settlement in GATT 94 may still involve political negotiations between members.³⁵⁰

The same line of reasoning can be applied to the dispute settlement system of the ECT. Placing the 'investor-state dispute settlement system' aside (as it was earlier mentioned that the direct effect of this part of the treaty can be established), the states, contracting parties of the ECT, can, based on Article 27 of the ECT, bring their claim to international arbitration (eg cases on investment, taxation and the environment). This Article, however, speaks of the settlement of disputes through 'diplomatic channels' for a reasonable period of time. If this channel is not successful in settling the dispute, the dispute should be submitted to an ad hoc arbitral tribunal, whose award is final and binding.³⁵¹ It could be submitted that, although the arbitral award is final and binding, Article 27's dispute settlement mechanism is plagued with some 'flexibility' described above

³⁴⁸ See Case 149/96 *Portugal v Council*, above n 91.

³⁴⁹ See *contra*, Eeckhout, 'Interconnecting Legal Systems', above n 94, at 55: he is of the opinion that there is clear preference in Art 22(1) of the Agreement for full compliance, as that article states that 'neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements'. He therefore concludes that it is difficult to accept that it is 'open' to WTO Members to choose between compliance and offering compensation. However, it is clear from the article and the practice of the Member States that compensation is an option although compliance is preferred, and Member States are not forced to fully comply with the decision. If Member States did not have a choice, the ECJ would probably not give so much weight in *Portugal v Council* to the 'negotiation-orientation' of the WTO dispute settlement.

³⁵⁰ See also Berkey, 'ECJ and Direct Effect', above n 346, at 640.

³⁵¹ The NY Convention does not define the notions of 'final' and 'binding'. However, being binding may mean that the award would not be open to ordinary means of recourse, and is final which means that they are no longer open to extraordinary means of recourse such as the setting aside procedure. See in general, P Sanders, 'Commentary on New York Convention for the Enforcement of Arbitral Awards' (1976) 1 *Yearbook of Commercial Arbitration* 207 at 214.

due to the possibility of negotiations through diplomatic channels, which could mean that this part of the treaty is not directly effective. For trade matters, Annex D of the treaty sets down rules and procedures for the settlement of trade disputes.³⁵² Yet again, this Annex provides that contracting parties should make every effort to resolve their disputes through cooperation and consultation. If the dispute is not resolved through either conciliation, mediation, arbitration or other methods, the complainant should submit a written request to the ECS for the establishment of an in-house panel. The flexibility referred to by the ECJ in its jurisprudence could be found to exist in this type of settlement as well.

It can be stated here that the direct effect of the ECT can be split between those provisions with less negative aspects, ie less flexible, more asymmetrical with unconditional obligations, and those with negative ones. The ECT is divided between various parts on investment, trade etc and each part, depending on the amount of these negative aspects that it embodies, could be granted or refused direct effect.

Some believe that the dispute settlement system of the WTO is a full-blown system and it is questionable whether domestic courts (or the ECJ, in case of direct effect) should become day-to-day operators and interpreters of the WTO Agreements.³⁵³ When all members of the ECT become members of the WTO, their energy-related disputes will be decided upon in the WTO dispute settlement system. Therefore, this worry can be extended to the ECT as well. The result would be that the Community courts would become courts of the WTO, which is said to be an undesirable result because domestic courts are unfamiliar with its context and practice.³⁵⁴ It is not clear why this option is undesirable. Courts in general are not necessarily familiar with all the cases that come before them, and in the course of time, they become familiar with their context. If the Community courts' decisions on the WTO Agreements can have a better effect within the Union than the Panel Reports of the WTO, why not allow these Courts to deal with these agreements? It has been said that interpretations of the WTO Agreements that were handed down by national courts could pose serious problems to the overall system; but, as some suggest, the existence of a Panel or Appellate Body Report does not necessarily remove serious problems of interpretation.³⁵⁵ Therefore, it seems that the lack of direct effect cannot be justified merely as a result of the argument that national courts should not become WTO courts.

³⁵² Annex D of the ECT applies to disputes regarding (1) compliance with provisions applicable to trade or (2) if the measure is not in conflict with the provisions of Art 29 but directly or indirectly nullifies or impairs any benefit accruing to a Contracting Party, and (3) unless agreed otherwise, disputes regarding compliance with Art 5 (trade-related investment measures) between Contracting parties at least one of which is not a WTO member. Annex D does not apply to disputes arising within a Free Trade Area or Customs Union or within an agreement based on Art 29(2)(b).

³⁵³ See Eeckhout, 'Interconnecting Legal Systems', above n 94, at 50.

³⁵⁴ *Ibid* at 32.

³⁵⁵ A Rosas, 'Annotation on *Portugal v Council*' (2000) 37 CML Rev 797 at 816.

A better reasoning for balancing the advantages and disadvantages of direct effect, in light of what has been said so far, is explained by the ECJ in *Portugal v Council*. The Court in this case stated that ‘to accept direct effect would deprive the legislative or executive organs of the Community of the scope for manoeuvre enjoyed by their counterparts in the Community’s trading partners’.³⁵⁶ This reasoning of the Court is defended by many. Zonnekeyn believes that if direct effect is allowed, the legislative and executive bodies will no longer be able to enjoy the same discretionary powers as their counterparts. He sees this argument as non-legal and an obvious assault on the ‘*trias politica*’ principle, but still regards it as necessary.³⁵⁷ Negotiations between the European Union and the United States in the *Ban on Hormones* case are a good example of where the payment of compensation has enabled a ban to be maintained. Direct effect would challenge this ban and interfere with the conclusion of negotiations among the states concerned. As Louis explains, many conflicts between countries, such as the EU and the US, have been of great economic and political importance, transcending private interests.³⁵⁸ Consequently, balancing the advantages and disadvantages of direct effect in this light creates some justification for not granting this effect to some international treaties, where the possibility of mutual arrangements between the Community and the international parties should be preserved.³⁵⁹

It is regrettable that there is no clear answer as to the direct effect of international treaties, which affects the status of the ECT as well. The reasoning against granting direct effect to some international treaties is elaborated in greater detail in scholarly comment than in the case law of the ECJ. This reasoning should at one point be adopted by the Court for the sake of predictability.

Based on the previous jurisprudence of the Court, the reality is that it is unlikely that the ECT will be given direct effect in its entirety. If the ECJ adopts a

³⁵⁶ See Case 149/96 *Portugal v Council*, above n 91, para 46.

³⁵⁷ See GA Zonnekeyn, ‘The Status of WTO Law in the EC Legal Order: The Final Curtain’ (2000) 34 *Journal of World Trade* 111 at 121. Ehlermann warns against the danger of interference with the GATT dispute settlement, as the judgment of the ECJ would ‘tie the hands of the Community negotiators’ in C de La Torre, ‘The Status of GATT in EEC Law: New Developments’ (1992) 26 *Journal of World Trade* 35. See also JH Jackson, ‘The United States of America’ in FG Jacobs and S Roberts (eds), *The Effect of Treaties in Domestic Law* (London, Sweet and Maxwell, 1987) at 136.

³⁵⁸ See JV Louis, ‘Some Reflections on the Implementation of WTO Rules in the European Community Legal Order’ in M Bronckers and R Quick, *New Direction in International Economic Law: Essays in Honour of J. J. Jackson* (Boston, Kluwer Law International, 2000) at 503. For example, he mentions the Helms–Burton Act, the Banana Import regime from non-ACP Countries, the prohibition of imports into the EC of hormone-treated meat, and the tax preferential regime of US multinational companies.

³⁵⁹ See also Case 377/02, *Leon van Parys NV v Belgisch Interventie-en Restitutiebureau (BIRB)* [2005] ECR I-1465 at para 53. See in general F Di Gianni and R Antonini, ‘DSB Decisions and Direct Effect of WTO Law: Should the EC Courts be More Flexible when the Flexibility of the WTO System has Come to an End?’ (2006) 40 *Journal of World Trade* 777 [hereinafter ‘DSB Decisions’].

textual approach,³⁶⁰ emphasising the provisions rather than the treaty, some provisions are likely to be given direct effect, such as the investment provisions. Moreover, the mere existence in the ECT of the possibility of a foreign investor bringing his claim to national courts, the ECJ, or arbitration and the statement of the Community in that regard, signals the direct effect of Part III of the ECT on investment.³⁶¹

Most of the provisions in other parts of the ECT could easily be challenged by the ECJ and not granted direct effect, especially those on competition and the environment, which are viewed as 'soft law.'³⁶² During negotiations on the provisions of the treaty, legal advice was sought to assure that neither provision was laid down in a manner likely to be judicially enforceable in the domestic courts of a state party.³⁶³ In any case, these provisions are hedged with numerous words such as 'endeavour' and 'encourage', which is too 'flexible' a provision for the purposes of determining direct effect.³⁶⁴

³⁶⁰ Pierre Pescatore uses this expression. See P Pescatore, 'Treaty-Making by the European Communities' in FG Jacobs and S Roberts (eds), *The Effect of Treaties in Domestic Law* (London, Sweet and Maxwell, 1987) at 171. He is of the opinion that two distinct approaches should be identified. The *International Fruit* decision represents a contextual approach, while *Bresciani* and *Kupferberg* signify a textual approach. He believes that comparison of these two approaches may lead to contradictory results and it is therefore better to apply a textual approach. This is supported by the Vienna Convention on the Law of the Treaties (Art 31), which suggests a progression from text to context and not the reverse.

³⁶¹ See also MK Omalu, *NAFTA and the Energy Charter Treaty: Compliance with, Implementation and Effectiveness of International Investment Agreements* (The Hague, Kluwer Law International, 1999) at 88 [hereinafter *NAFTA and the ECT*].

³⁶² CS Bamberger, 'Epilogue: The Energy Charter Treaty as a Work in Progress' in T Wälde, *East-West Gateway*, above n 9, at 595.

³⁶³ See Bamberger, *ibid.* See also Omalu, *NAFTA and the ECT*, above n 361, at 89.

³⁶⁴ Instead of analysing the Court's possible approach to the issue of direct effect in a contextual or textual way, some commentators give weight to the ruling in the *Hermés* case (and also *Kupferberg*) that the duty of uniform interpretation of international agreements should overcome any problematic issue with regard to direct effect. For example, Dashwood says

[I] am beginning to wonder whether it is worth spilling so much learned ink over the WTO's direct effect. The lesson might be drawn from the *International Dairy Agreement* case and from *Hermés* that the duty of consistent interpretation can do pretty much the same job, while sparing the Court's intellectual acrobatics. (A Dashwood, 'Treatment of Public International Law by European Community Law', paper presented on 21 October 1999 at the Jean Monnet Symposium on the 'Fundamental Principles as Inspiration and as Source of Law in the Systems of the European Union and the WTO', cited in Zonnekeyn 'The Status of WTO Law', above n 357, at 124)

This means that the effect of a provision of an international agreement should not be allowed to vary according to whether its application is in practice the responsibility of the Community institutions or of the Member States. Therefore, it is for the ECJ, within the framework of its jurisdiction in interpreting the provisions of agreements, to ensure their uniform application throughout the Community. See *Kupferberg*, above n 84, para 2. This alternative of 'indirect effect' may not be insignificant, but it is not an entirely clear alternative to substitute for direct effect. Heliskoski, on the other hand, rightly believes that uniformity in interpretation is a purely formal assertion of legal policy and he hardly sees it as an absolute requirement. See also Eeckhout, who is of the same opinion, 'Interconnecting Legal Systems', above n 94, at 41. Neuwahl also rightly explains that the duty to interpret Community law in conformity with international law is not sufficient, and is not as effective as the principle of direct effect in creating confidence on the part of the Community's trade partners 'as the limits of the duties of interpretation are to be found in the flexibility of national law

The ECT manifests a delicate balance between the rights and obligations of energy-consuming and producing nations and in this respect, a very important issue is at stake, ie the energy security of the European Community. How would the lack of direct effect of the ECT endanger this energy security?

The reasoning is not straightforward, but it can be argued that energy security is subject to rapid change due to developments in the economic and political relations of consuming and producing nations. This relation has always been characterised as one of give-and-take. There is always bargaining in international relations and in the ratification of international treaties. This is even more the case in energy relations, due to the strong role that politics plays in this field. With respect to the direct effect of the ECT, it could be argued that the Community institutions should maintain some discretionary power in those areas of the ECT where the same power could be exercised in corresponding situations. For example, they are capable of exercising their discretionary power in negotiations on trade provisions of the ECT as they are the mirror image of the WTO provisions, where the possibility of mutual arrangements exists to some extent. Moreover, unlike an individual investor, an individual trader is not given the right by the ECT to bring his claim directly against a state without the involvement of his home state. Therefore, negotiations between states would continue to be the recurring practice. This flexibility should also be exercised by the Community institutions, as otherwise the hands of the Community negotiators will be tied, which would be disadvantageous in their dealings with energy trade. The conferral of direct effect would limit this possibility. The same argument does not apply to the investment provisions because the possibility of bringing a claim is generally available in the ECT and should be practised by the European counterparts, and striking a balance between the rights of investors on both sides would create a better environment for investment, which would eventually lead to better security of energy supply.

or Community legislation'. Therefore, the problem of the direct effect of international treaties cannot necessarily be solved through uniform interpretation. Direct effect, after all, imposes an obligation on the courts to interpret international treaties and to become familiar with their context. Uniform interpretation runs the risk of resulting in a superficial reading of the treaties. J Heliskoski, 'The Jurisdiction of the European Court of Justice to Give Preliminary Rulings on the Interpretation of Mixed Agreement' (2000) 69 *Nordic Journal of International Law* 395 at 409. See also N Neuwahl, 'Individuals and the GATT: Direct Effect and Indirect Effects of the General Agreement on Tariffs and Trade in Community Law' in N Emiliou and D O'Keeffe (eds), *The European Union and World Trade Law* (Chichester, John Wiley & Sons, 1996) at 323. Another recent issue in the framework of the direct effect of GATT/WTO agreements is the WTO's dispute settlement mechanism which may establish binding decisions on Member States, and their possible implication on the case law of the ECJ regarding direct effect. See Di Gianni and Antonini, 'DSB Decisions', above n 359.

5.4.14. The Trade–Environment Link

The Energy Charter Secretariat also included measures with respect to energy efficiency in its overall energy cooperation framework. In 1998, along with the ECT, the relatively unknown Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) entered into force. The objective of the protocol was said to be ‘the promotion of energy efficiency policies consistent with sustainable development and the creation of framework conditions which induce producers and consumers to use energy as economically, efficiently and environmentally sound as possible and also foster cooperation in this field’.³⁶⁵ The charter created a forum in order for the transition economies to share experiences and policy advice with other states. A particular focus was placed on ‘national energy efficiency strategy as taxation, pricing policy in the energy sector, environmentally-related subsidies and other mechanisms for financing energy efficiency objectives.’ The ECS has issued a series of energy efficiency reviews advising governments how to improve their energy efficiency strategies.³⁶⁶ Moreover, one of the basic principles of the protocol is to reduce barriers to energy efficiency (Article 3(2)(b)). The Annex of the protocol also identifies one area of cooperation in this field as cooperation in identifying the potential and existing barriers and the development of energy labelling and efficiency standards. The efforts of the ECS in linking the energy sector to the protection of the environment are limited to some in-depth, country-specific reviews of energy efficiency measures. Nonetheless, the importance of the link between trade, environment and the energy sector should make an analysis relevant in the context of the overall activities of the ECS. This issue is discussed below.

The potential conflict between the WTO/ECT rules on liberalisation of trade and multilateral agreements on the environment, such as the Kyoto Protocol, which could erect barriers to the free movement of goods, has gained importance, especially in light of growing concern to protect the environment. Although neither the ECS nor the WTO aspire to act as an environmental agency, the environmental objectives pursued by contracting parties, and their direct effect on international trade, necessitates their constant analysis by these two bodies. While the trade and environment debate and its link to activities in the energy sector is a lengthy debate that necessitates another thoughtful study of its

³⁶⁵ See The Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, at <<http://www.encharter.org>>.

³⁶⁶ The website of the ECS states that ‘The UN–ECE ‘Environment for Europe’ Ministerial Conference, which was held in Kiev, Ukraine, in May 2003, based its findings in the area of energy efficiency on the work carried out to implement the Protocol on Energy Efficiency. In addition to the efforts of the ECS to provide an in-depth review on a country-specific basis of activities in the area of energy efficiency, some individual reports have also been adopted, such as *Advice on Developing a Energy Efficiency Strategy*, *Financing Energy Efficiency—An Application Manual*, *Fiscal Policies for Improving Energy Efficiency*, *Impact of Market Liberalization on Energy Efficiency Policies and Programs*, *the Road Towards an Energy Efficient Future*, *Third Party Financing—Achieving its Potential*. See also *Integration of Energy Efficiency and Renewable Energy Policies* (Brussels, ECS, 2005).

own, reference to some aspects concerning the energy sector is important here. This is especially relevant due to the repercussions of implementing environmental measures for exporting countries.

The inclusion of references to energy efficiency within a framework that involves energy cooperation between consuming and producing nations is definitely plausible, considering the strong link between energy and environment. However, what is unfortunately missing from the overall debate within the ECS is the identification of the interface between liberalisation of trade within the framework of the WTO/ECT and the environment. In one document issued by the ECS, seeking to clarify the relevance of international trade rules for the energy sector, there is a short and insignificant reference to the Kyoto Protocol, under the title of 'why energy trade is so special?' This statement reads as follows:

[i]n setting energy policies, an increasingly important consideration is the environmental degradation caused when producing and consuming certain energy products. Some are more environmentally friendly than others, even though their production may cost more. With the signing of the Kyoto Protocol to the UN Framework Convention on Climate Change, countries made legally binding reduction commitments for the six main greenhouse gases, including carbon dioxide (CO₂). Thus, when introducing energy policies, countries also need to take account of their international environmental obligations.³⁶⁷

Later in the same report, there is another rather vague statement that seems to be related to the trade-environment interface. This statement provides:

Environmental protection in the energy sector may lead also to increased trade, instead of trade protectionism. The substitution of environmentally unfriendly energy sources with green energy production (but often more costly and less available) may necessitate more and more imports to maintain the total energy supply. Environmental protection is, in this sense, bound to stimulate trade in energy.³⁶⁸

The link between increases in the use of green energy followed by its increased import to meet demand is not outright, because it is not yet clear what the increase in the use of such energy will be in the future, and the possibility of using green energy in all sectors is not clear. Moreover, the same report later provides a contradictory statement, by indirectly referring to environmental protection as a type of obstacle to trade by stating that the WTO members can maintain trade barriers to serve a legitimate objective, such as health and environmental protection, which would suggest some kind of trade protectionism.³⁶⁹ In any case, the scattered references to trade and environment in the document of the ECS, which seeks to address the relevance of trade provisions for the overall energy cooperation framework, does not at all reflect the heated

³⁶⁷ See ECS Report *Trade in Energy*, above n 155, at 11.

³⁶⁸ *Ibid* at 14.

³⁶⁹ See ECS Report *Trade in Energy*, above n 155, at 17.

debate that takes place within both the WTO and the UN Framework Convention on Climate Change (UNFCCC). This debate will be briefly elaborated on below.

The paradox of trade and environment lies in the fact that proponents of liberalised trade argue that increase in trade raises world welfare, which would in turn contribute to protection of the environment through the efficient use of resources by using better technologies. In other words, they link economic welfare to the use of more environmentally friendly ways of living. On the other hand, advocates of environmental protection argue that economic growth results in the increased use of non-environmentally friendly devices, which have previously been used by a small group. Due to liberalised trade and economic welfare, everybody could have access to these devices, which would in turn pollute the environment. This debate is ongoing.

It is clear in this debate, however, that the ways in which contracting parties implement multilateral environmental agreements could have direct implications for trade, including trade in energy goods and services. Moreover, these agreements could change the form of the market for trade of energy goods and services, which calls on the WTO to take them into account. On the other hand, the use of green energy will reduce the demand for oil or fossil fuels that would adversely affect the economy of developing countries which export energy. This latter point can be considered as a limited aspect of a general concern of developing countries, as the use of environmental measures could restrict their goods' access to the market of developed countries. It is for this reason that paragraph 32 of the Doha Declaration suggested that particular attention be paid to the effects of environmental measures on developing countries' market access, with strong emphasis on sustainable development in these countries (para 51), and the mandate to encourage technical assistance and capacity building in the field of trade and the environment for developing countries (para 33).

At the centre of discussions on trade and environment linkage, the Kyoto Protocol is one agreement, among many other multilateral environmental agreements, that has specific trade implications. The successful implementation of the Kyoto Protocol³⁷⁰, ie an amendment to the UNFCCC, which was negotiated in 1997 and came into force in February 2005, is said to reduce the average global rise in temperature and contribute to climate change protection.³⁷¹ Article 2 of the protocol provides that the objective of the UNFCCC is 'stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system'. The parties to the Kyoto Protocol agree to collectively reduce emissions by 5 per cent below 1990 levels by 2008 to 2012. This convention distinguishes between three types of

³⁷⁰ For the text of the Kyoto Protocol, see the website of The United Nations Framework Convention for Climate Change, at <<http://www.unfccc.int>>.

³⁷¹ It is said that the temperature will be somewhere between 0.02 and 0.28 C by the year 2050 compared to an increase of 1.4 to 5.8 C between 1990 and 2100. See the *Nature* (October 2003).

parties: (1) Annex I parties that are industrialised countries, including the OECD; (2) Annex II parties (OECD parties); and (3) non-Annex I parties (mostly developing countries). Although all countries are subject to obligations to apply national climate change programmes and to report greenhouse emissions, only Annex I parties are subject to specific emission reduction commitments, which is to reduce emissions to the year 1990 levels by 2000 (based on Annex B of the protocol). Annex II parties are required to provide financial assistance to help non-Annex I parties to meet their general obligations.

The Kyoto Protocol allows countries to address climate change issues in two ways: through flexibility mechanisms, or through the use of domestic climate change measures, such as the adoption of domestic tax measures, procurement policies, and regulatory measures. Three mechanisms to contribute to climate change protection are: (1) *emission trading*, allows Annex I parties to acquire units (trade) from other Annex I parties where they have already complied with their assigned amount of emission reductions; (2) *joint implementation Mechanism*, which allows Annex I parties to implement projects that reduce emissions in other Annex I countries, and obtain units in return, in line with their climate change obligations (Article 6); and (3) the *Clean Development Mechanism*, which allows Annex I parties to implement projects in non-Annex I parties in return for certified emissions reduction and to assist the host parties in sustainable development.³⁷² The possible implications of the trade effect of these mechanisms are linked to the policies and measures that parties may take at domestic level to reduce greenhouse gas emissions. This is especially important as the Kyoto Protocol itself does not provide guidance on how domestic climate change policies should be coordinated among parties to reduce their trade effects. Therefore, the WTO regime could play the important role in judging the effect on trade of various instruments adopted by the parties.³⁷³

Those trade restrictions that can be adopted in order to achieve the environmental objectives of the Kyoto Protocol could be energy taxes, subsidies, or technical barriers to trade in the form of environmental standards. Subsidies could be granted to those industries that use renewable sources of energy rather than fossil fuel in order to promote the use of such energy, which would be directly in line with the climate change objectives of the Kyoto Protocol. Energy taxes could be introduced in various forms: tax on the carbon dioxide emissions on energy unit emitted by a source, tax on the carbon content of fossil fuels, or an energy tax on the energy content of fuels.³⁷⁴ These taxes could be adopted in

³⁷² For a description of these mechanisms, see <http://unfccc.int/kyoto_mechanisms/items/2998.php>.

³⁷³ See also T Voon, 'Sizing up the WTO: Trade-Environment Conflict and the Kyoto Protocol' (2000) 10 *Journal of Transnational Law and Policy* 71. See also the 1999 WTO report, *Trade and Environment*, Special Studies Series 4, at <<http://www.wto.org>>. See also S Shaw and R Schwartz, 'Trade and Environment in the WTO: State of Play' (2002) 36 *Journal of World Trade* 129.

³⁷⁴ See also M Lodefalk and M Storey, 'Climate Measures and WTO Rules on Subsidies' (2005) 39 *Journal of World Trade* 23 at 26.

order to increase revenue, protect a specific domestic source of energy and a related domestic sector or to pursue environmental goals.

Another system of taxation that is used is the border tax adjustment, which is adopted by the importing country at the point of export in order to undermine the lax tax policy of another country. This is done to render the domestic product more competitive with the imported product and to allow the exported domestic product to compete with other products abroad. For these taxes to conform with trade policies, they should be in line with environmental concerns and they should not be directed to energy-intensive industries.³⁷⁵ With respect to the flexible mechanisms of Kyoto, it should be verified whether relations between parties are conditional and whether those conditions are in any way in contradiction with WTO rules. Moreover, it should be determined whether the allocation of emissions trading could be considered in any case an actionable subsidy, due to the possible involvement of a financial contribution with little consideration for climate change objectives (eg the host country makes investment in its country conditional upon using its own products and services). It was previously decided in the *Superfund case* that excise taxes on inputs are allowed based on their polluting effects in the foreign country of production, as long as the amount of the tax does not exceed the amount imposed on like domestic inputs. Hence, the Panel decided that the right of border tax adjustment exists as a general rule.³⁷⁶

Technical barriers to trade could be directed to products that are given preferences for import, based on them being less emission-intensive. This takes place either through the adoption of standards that the goods need to comply with, or eco-labelling, which is linked to the import of those goods that carry labels informing consumers about the ways the goods have been produced. The compatibility of these standards with the obligations embodied in the Agreement on Technical Barriers to Trade could be another aspect of the interface between trade and the environment. Apart from these laws, Article XX GATT on general exceptions is also of relevance as it allows some exceptions to the trade obligations of contracting parties if the measures adopted were necessary to protect human, animal or plant life and health. Any climate change measure could be additionally justified based on this provision, provided they conform to the conditions that this provision imposes.

The compatibility of the environmental measures adopted by the parties to the Kyoto Protocol with the international obligations of the WTO/GATT should be evaluated in detail to determine the ways through which a balance can be

³⁷⁵ For a detailed analysis of border tax adjustment see, G Goh, 'The World Trade Organisation, Kyoto and Energy Tax Adjustments at the Border' (2004) 38 *Journal of World Trade* 395.

³⁷⁶ For a very good and comprehensive analysis of this issue, see R Howse, 'World Trade Law and Renewable Energy Sources: the Case of Non-Tariff Measures', Post-Hearing Submission to the International Trade Commission, by the Renewable Energy and International Law Project (REIL), 5 May 2005.

achieved to satisfy both objectives at the international level. This evaluation is briefly explained here in relation to taxes.

What is at stake here is whether taxation of renewable sources of energy could be GATT/WTO inconsistent and if yes, whether the exceptions in Article XX, as explained above, are applicable.³⁷⁷ As mentioned above, the analysis of the 'likeness' of various energy sources also becomes relevant here. It can be said without hesitation that those energy sources that are physically different, such as oil, natural gas and electricity, will not be called 'like products' for the purposes of Article III and the differentiated taxation could be upheld. The issue becomes more complicated when taxation is imposed, based on the source of energy generation, which applies in the case of electricity. This taxation system discriminates between domestic and imported energy based on the generation source, whether renewable or non-renewable. This issue will be linked to the discussion that was raised earlier in the analysis of 'likeness', and whether electricity generated from renewable sources is 'like' those generated from non-renewable ones. There is controversy over admitting the production method as a yardstick against which 'likeness' should be determined. It was previously mentioned that the physical characteristics of electricity do not change based on its source of generation. However, some believe that if the yardstick of 'production method' is accepted, the application of which was never excluded by the GATT/WTO jurisprudence, these two types of electricity would not be considered as 'like' products. If 'all relevant factors' such as 'consumer choices' are taken into consideration, the fact that a consumer chooses to use electricity based only on renewable sources to contribute to the protection of environment would distinguish this type of electricity from others.³⁷⁸ Therefore, differentiated taxation would be allowed as long as the generation source is determined. Nevertheless, as the case law is not yet very clear on this point the issue needs to be examined on a case-by-case basis.

However, it is important here to determine the effect of the adoption of environmental measures (that will be considered, for one reason or another, compatible with the GATT/WTO) on the energy-producing countries. Clearly, the adoption of environmental measures will reduce demand for those energy sources that are not environmentally friendly, such as conventional fuels of coal, natural gas and oil. As the parties to Kyoto are committed to reducing their use of fossil fuels due to their direct environmental effects, the demand for such fuels decreases (as explained previously), which will in turn affect the income revenues of energy-exporting countries. This effect will be different in various sectors. For

³⁷⁷ In the analysis of the 'likeness,' the legal basis for fiscal and non-fiscal measures are different: the former is Art III:2 and the latter is Art III:4 of the GATT.

³⁷⁸ See the *Japan-Alcoholic Beverages* case, above n 158, and the Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001 (the EC-Asbestos Case). See also *Mexico—Taxes on Soft Drinks and Other Beverages*, WT/DS308/R, 7 October 2005.

example, as there is currently no substitution of oil with other sources of energy in the transport sector, the function of which is dominated by oil, the threat to oil-exporting countries is largely diminished. Therefore, the degree of harm to oil exporters is 'directly linked to stringency of transportation sector policies'.³⁷⁹ On the other hand, however, the growing use of other sources of energy will impact upon these countries in the long run. Although the real long-term effect of such a shift necessitates in-depth analysis, especially from an economic point of view, it seems that the energy-exporting countries need to integrate themselves in the international process for environmental protection and seek the potential advantages that such a process creates, because this path is one of no return and countries will gradually strengthen their policies to protect the climate.

The options available to these countries are two-fold:

1. They would scrutinise the domestic policies of the importing countries to determine their conformity with the law of the WTO/GATT.³⁸⁰ Those contracting parties that adopt measures that are discriminatory, based on the use of subsidies, technical barriers etc. should justify their actions. Within this context, for example, Saudi Arabia and Qatar have submitted communications to the WTO Secretariat. A Communication from Saudi Arabia to the WTO in 2002 sought to reveal the domestic policies of OECD countries with respect to taxation of energy products. They stated that 'taxes are generally biased against petroleum products and taxes on coal and gas are negligible compared to oil' (eg tax on natural gas in the UK is 4.8 per cent and 85 per cent for oil etc.).³⁸¹ They attacked such a practice and argued that such discrimination is not based on mere environmental objectives. A communication from Qatar also claimed that energy-related fiscal measures and policies concerning imports to developed countries are distorted and do not clearly reflect the benefit of enhanced utilisation of efficient lower-carbon and pollutant-emitting fuels and technologies such as natural gas. They argue that the taxes should be carbon and pollutant content reflective in order to realise the objectives of global environmental protection in developing countries.³⁸² The compatibility of such measures with GATT/WTO law can be analysed and the environmental justifications verified.³⁸³

³⁷⁹ See WD Montgomery, 'Choice of Policy Measure in Annex B Countries and Impacts on Non-Annex B Countries' Workshop on Mitigation of Climate Change: Socio-Economic Impacts of Mitigation, Bonn 2000.

³⁸⁰ For the potential constraints imposed by WTO commitments on the ability of countries to adopt domestic policies and measures to address climate change issues, see A Green, 'Climate Change, Regulatory Policy and the WTO' (2005) 8 *Journal of International and Economic Law* 143. See also Z Zhang and L Assunção, 'Domestic Climate Policies and the WTO', Nota di Lavoro 91.2001, Paper of the *Fondazione Eni Enrico Mattei*, December 2001.

³⁸¹ See Saudi Arabian submission on 'Energy Taxation', above n 179.

³⁸² See Negotiations on Environmental Goods: Efficient, Lower-Carbon and Pollutant-Emitting Fuels and Technologies, Submission by the State of Qatar, Paragraph 31 (iii), TN/TE/W/19, TN/MA/W/24, 28 January 2003.

³⁸³ One example of the application of the environmental standards to energy products that were found incompatible with WTO law was the US measures imposing environmental standards on the import of gasoline from Venezuela and Brazil. The US law was said to impose stricter environmental

2. They would take advantage of several opportunities provided to them through implementation of the Kyoto Protocol. Based on the Clean Development Mechanism [Article 12 of the Protocol, Annex I Parties (mostly developed countries) implement project activities that reduce emissions in non-Annex I parties (eg energy-exporting countries that are members of the Kyoto)] in return for certified emissions reductions.³⁸⁴ The Article also stressed that such projects should assist these host countries in achieving sustainable development and contribute to the goals of the UNFCCC. One aspect of this assistance is the transfer of clean oil technologies. The main rationale for the reduction in the use of conventional sources of energy such as oil, natural gas and coal is their contribution to increased CO₂ emissions. Clean energy technologies would lessen the degree of such emissions. If such fuels could emit less CO₂ by using such technologies, their notoriety as environmentally unfriendly sources of energy would disappear.³⁸⁵ Widespread use of such technologies could therefore be achieved without the need for rapid change in the energy supply infrastructure. This would create a carbon-free energy system rather than a non-fossil energy system. In this way, the economy of countries exporting conventional energy would continue to develop. Mechanisms that create assistance for the use of energy-efficient projects and any other technology that could decrease CO₂ emissions (including the CO₂ capture and sequestration projects)³⁸⁶ would be beneficial for energy-exporting countries and could no longer hamper the trade of energy goods and services linked to those conventional sources. For this to

rules on imported energy products compared to domestic ones, and therefore a violation of Art III on national treatment was established. Although the US sought to justify its acts based on Art XX(g) on the protection of exhaustible natural resources, the Appellate Body (while agreeing with the link between such measures and protection of the environment) found unjustifiable discrimination based on the origin of the energy product. See the Appellate Body report on *US—Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, pp 22–29.

³⁸⁴ See also B Müller, 'The Kyoto Mechanisms: Linking Technology to Ratification' (2002) 36 *Journal of World Trade* 57.

³⁸⁵ The World Bank has also undertaken a study on the worldwide evaluation of the 'extractive industries'. The Bank has made it clear that extractive industries can contribute to sustainable development and that there is a continuing role for the World Bank Group in supporting these industries. The Bank's support for sustainable development means that countries should have access to the most cost-effective, best-performing and reliable sustainable energy technologies that are economic, affordable and best-suited to their needs. See 'Striking a Better Balance: the World Bank Group and Extractive Industries: The Final report of the Extractive Industries Review', 17 September 2004.

³⁸⁶ Through the carbon sequestration projects, CO₂ is captured at the time of emission and sequestered in major reservoirs to be kept for thousands of years without reaching the atmosphere. Underground storage could also take place through injection of the CO₂ into the oil or gas reservoirs. The main obstacle, however, is to reduce the heavy cost of such technologies. There are several R&D projects that focus on CO₂ capture and storage, such as the CO₂ Capture project (CCP) which is undertaken by major oil companies, such as BP Chevron, ENI, Norsk Hydro, EnCana, Shell, Statoil, Suncor, Texaco Inc. The finance for this project is provided by the European Commission Research Directorate, US Department of Energy, KLIMATEK, and participating companies. The second project is the NorCap Project, between Statoil, KLIMATEK and other industrial partners. For details see <<http://www.CO2captureandstorage.info>>.

happen, and conditional upon all the countries involved joining the Kyoto Protocol, the Kyoto mechanisms need to be implemented and practised efficiently while creating incentives for both industrialised and non-Annex I countries to cooperate.

This brief reference to the trade–environment interface demonstrated that this relation should be analysed by the responsible institutions, such as the WTO and the ECS to determine the effects of Kyoto policies on supply of energy, demand and prices. Projections should demonstrate to what extent oil demand will decrease, to what extent prices will be reduced, and to what extent such price reductions affect the energy-exporting countries. In this analysis, the possible indirect advantages of implementing the Kyoto Protocol for energy-exporting countries should be examined. Energy-exporting countries that are highly dependent on income generated from fossil fuels are more vulnerable to the potential impact of climate change measures. Therefore, technology transfer and possible funding should help them address specific needs and concerns. After all, it is not too far-fetched to expect the ECS to design a framework to reflect upon the repercussions of such development on energy-exporting countries and to identify necessary strategies for potential cooperation between exporting and consuming nations in this field in order to achieve sustainable development in those countries and at the same time meet the objectives of both the WTO and the Kyoto Protocol. The ECS, as an important institution dealing with cooperation between energy-producing and consuming nations, should undertake this research.

5.4.15. Conclusion: The Trade Regime of the ECT and Europe's Security of Energy Supply

The trade rules of GATT and other WTO Agreements, as reproduced in the ECT, seek to promote trade. Provisions designed for this purpose are deemed to implement the necessary reforms in the energy sector of the ECT members. If these members are not yet members of the WTO, the ECT assists them in carrying out domestic reform in their energy sector and in their subsequent membership of the WTO. The ultimate objective of the ECT is to create a liberalised energy market across borders, and surely a stable and transparent framework for energy trade contributes to this liberalisation through the adoption of WTO rules. However, WTO rules cannot be applied to energy trade outright as the unique characteristics of energy trade necessitate special attention in interpreting the relevant laws and regulations. This is specially the case considering the reluctance of many players in the market to obstruct this trade for various security reasons as energy plays an important role in any country's economy. As the ECT study provides,

removing all obstacles to trade between countries under the traditional GATT approach, that prohibits the imposition of some trade-restrictive measures, is not

enough, and positive actions, such as the construction of interconnected networks and pipelines and harmonization of transmission standards become important.

The economic, environmental, social, and especially political, dimension of energy trade necessitates very close cooperation of the Energy Charter Secretariat with the WTO in order to inform the latter of the peculiarities of this trade and to make it aware of the ways through which the WTO rules should be interpreted and approached in everyday practice.

This being said, in applying the rules on trade in goods and services, or subsidies and technical barriers to trade etc., the concerns of both consuming and producing countries should be looked at. The strict interpretation of WTO rules may not necessarily take the specific demands of both sides into account. For example, discriminatory methods of taxing energy sources within the OECD countries may not become problematic from the WTO point of view, because the analysis of 'like products' may allow such discrimination. However, this strict application does not take into account the possibility that such measures may adversely affect the demands of energy-producing countries and deprive them of the stable revenue that they gain from the sale of energy. In addition, the strict application of the rules on subsidies or services may not provide adequate space for these countries to pursue their developmental goals.

This task has not been undertaken by the ECS. For example, with respect to the issue of dual pricing, we could expect an active role for the ECS in reflecting upon the interests of both parties in the accession negotiations of Russia and Saudi Arabia. Regrettably, the ECS has always acted as a passive institution in energy discussions at these levels, although its mere creation should be considered as the most important undertaking with respect to energy cooperation between consuming and producing countries. As the following discussion in relation to transit also reveals, detailed and difficult arguments between consuming and producing nations were left to be resolved within the framework of other bilateral or multilateral settings such as EU–Russia relations, or the WTO. The ECS has never acted as a mediator in trying to reach an arrangement between these two sets of countries. However, due to the fact that the trade provisions of the ECT mirror image the WTO rules, the development of international trade in energy products was left to the WTO without the participation of the ECS to highlight the peculiar characteristics of this trade in which the WTO has no expertise. Therefore, the lack of efficient cooperation between the ECS and other trade-related institutions renders one uncertain with respect to added value that the ECS can provide in achieving the objective of consumer/producer cooperation.

5.5. THE TRANSIT REGIME OF THE ENERGY CHARTER TREATY

5.5.1. Introduction

One of the most important components of an energy policy is the possibility of transit of energy from the country where the energy is explored to the consumer. The uninterrupted transit of energy is, therefore, carefully looked at in designing an energy policy that aims to secure energy supply. It can also be submitted that, without the possibility of transit of energy, the analysis of the initial investment opportunities for exploration and production of energy in a given country becomes obsolete.

Substantial investment is dedicated to studying various countries' proven and potential energy reserves, which is followed by a cost-effective analysis of the most appropriate routes for transportation of oil and natural gas to the destined markets and the upgrading of the export infrastructure to guarantee energy flow. What is involved in such study is not only the economic aspect of building or upgrading potential or existing infrastructure but also the geopolitical repercussions of such activity. The political relationship between host, transit and the destination countries is a yardstick against which the possibility of various transit routes is examined. Before analysing the rules on transit and the Transit Protocol in the Energy Charter Treaty, some examples should be given to reveal various concerns over this issue.

The most important energy-producing members of the Energy Charter Treaty are those of the Caspian Region (excluding Iran, which is not yet a member of the ECT but an observer). For this reason, the study of transit routes in the framework of the Energy Charter Treaty mostly concerns transit of energy originating from these countries. In addition, as many countries are situated 'on the way' between the countries of the Caspian and those of Western Europe, the transit issues are extended to cover other countries such as Turkey and Russia, or Eastern European ones, such as Ukraine, Bulgaria or Romania. Therefore, the issue of transit of energy from these countries to European consumers becomes relevant as well.

During the Soviet era, oil and gas from Eastern regions of the Caspian, namely present-day Kazakhstan, Turkmenistan and Uzbekistan, were directed through Russia (eg through Atyrau–Samara pipeline: from Samara, oil would join the export routes of Russia).³⁸⁷ After the collapse of the Soviet Union, these countries are either seeking to diversify their export routes to other countries in the region, thus lessening their dependence on Russia (ie the political aspect of transit); or they are entering into transit agreements with Russia in order to use the already existing transit routes of this country (for instance, Kazakhstan and Russia signed

³⁸⁷ Atyrau, formerly known as Guryev, is a port city west of Kazakhstan, and Samara, formerly known as Kuybychev, is in South Central Russia.

a 15-year transit agreement in June 2002 under which Kazakhstan exports at least 350,000 b/d of oil annually via Russia).³⁸⁸ On the other hand, the acceptance of some other proposals for access to Russia's transit routes has met resistance. For instance, gas exports from the gas-rich country of Turkmenistan have been denied access to the main Russian natural gas export system due to a dispute over payment for transit. Although this dispute was finally resolved and export of Turkmen gas to Russia was resumed, the potential for denial of access has always been a major concern in transit issues. For this reason, efforts were made to bypass reliance on Russia through diversification of transit routes. For example, Turkmenistan sought to launch the Korpezhe–Kurt Kui Pipeline to Iran in order to bypass Russia and supply Armenia. On the other hand, the construction of a pipeline from Iran to Armenia to supply this country by Turkmen gas has not yet materialised, and substantial foreign investment in Iran's oil and natural gas has been limited by US economic sanctions (ie another example of the political aspect of transit). Another option has been the Trans-Caspian Gas pipeline that would bring Turkmen gas via Azerbaijan and Georgia to Turkey.

Regarding the Western countries of the Caspian, namely the energy-rich country of Azerbaijan and the potential transit countries of Armenia and Georgia, the possibility will exist of transporting not only Azeri oil but also oil from the Eastern countries of the Caspian to the Western part and from there to the Mediterranean Sea and to Europe. There is an agreement between Georgia, Azerbaijan and Turkey, signed in 1999, to transport Azeri oil from Baku to Ceyhan (the South Central Turkish city close to the Mediterranean Sea).³⁸⁹ Moreover, the Baku–Novorossiysk pipeline route going North via Chechnya has been built, but due to the conflict in Chechnya the use of this pipeline has been restricted. Moreover, after exploration of the Shah Deniz Field in Azerbaijan, the possibility of transporting this gas to Europe has become extremely relevant. This field has already been developed for the export of gas to Turkey. Moreover, the countries of the Caspian are competing to supply the Turkish market, and Georgia and Azerbaijan have reached a transit agreement to supply Turkey by Azeri gas via Georgia. There is also an agreement between Turkey and Greece to build a pipeline, a Memorandum of Understanding having been signed between Turkey, Azerbaijan, and Greece in 1999.

Moreover, considering the importance of the Caspian Region for the purposes of the EU's energy security, the EU is not only studying closely the development of reserves in the Caspian but is also financing the construction of export infrastructure in this region through the Interstate Oil and Gas Transport to Europe (INOGATE) programme. This programme aims to promote regional integration of the oil and gas pipeline systems and to facilitate energy transport,

³⁸⁸ The other pipeline possibility for Kazakhstan oil has been the Caspian Pipeline Consortium (CPC) from Tengiz, in the Western part of Kazakhstan, to Novorossiisk, a Russian port city in the Black Sea.

³⁸⁹ This pipeline was opened in May 2005.

both within the region in question and towards the consuming nations. It also 'acts as a catalyst for attracting private investors and international financial institutions to these pipeline projects'.³⁹⁰ Twenty-one nations of Central Asia, the Caucasus region, Eastern Europe and the European Union have also entered into a treaty, called the 'Umbrella Agreement', on the Institutional Framework for the Establishment of the INOGATE programme. The Umbrella Agreement came into force in 2001. This agreement is 'aimed at rationalizing and facilitating the development of interstate oil and gas transportation systems and to attract the investments necessary for their construction and operation'. It introduces a 'common operator' between contracting parties to avoid the inefficient operation of one system by various national authorities. It also sets out commonly agreed technical specifications and environmental protection regulations. It is contemplated that this agreement will be followed by a series of protocols to deal with specific cross-border pipeline projects.

From what was said above, it is clear that issues related to energy security are strongly linked to the establishment or upgrading of potential or existing export infrastructure, not only in the energy-producing countries but also in the transit countries. For this reason, the ECT provisions on transit are of great relevance for our discussion.

5.5.2. Transit in the ECT

Article 7 of the Energy Charter Treaty on transit of energy products, materials and equipments is one of the most controversial articles in the treaty, and the negotiations on approving a protocol on transit are still ongoing. Article 7 of the ECT obliges contracting parties to take 'necessary measures' to 'facilitate transit'. In doing so, they shall apply the principle of freedom of transit and they should not distinguish between materials, products and equipments as to origin, destination, ownership, and pricing, and they should allow transit without imposing any unreasonable delays, restrictions or charges. Compared to Article V of the GATT,³⁹¹ some argue that Article 7 of the ECT imposes a less strict obligation. Article V of GATT provides that 'there shall be freedom of transit' through the

³⁹⁰ The rationale for the establishment of an interstate transportation system is to synchronise not only the construction of the transportation system but also the operation of such a system. Orders and deliveries should be coordinated and the system should be regularly maintained. The ways through which this system can best work is discussed in the INOGATE programme. For more information on this project, see <<http://www.inogate.org>>. There have been negotiations between the European Union and the countries of Azerbaijan and Armenia for the development of their export infrastructure and there has been development in this project with regard to the natural gas interconnection between Turkey and Greece and also the development of Constanza-Omisalj Oil pipeline Project involving Romania, Croatia and Italy.

³⁹¹ For proposed amendments to this Article, see 'Clarification and Improvement of GATT Arts V, VIII, and X and S&D Matters—Proposals Made by WTO Members', TN/TF/W/43/Rev.1, 20 July 2005 at 47.

territory of each contracting party for goods, vessels and other means of transport, whereas Article 7 ECT refers to facilitation of transit and does not create an absolute right of transit. However, the detailed provisions on transit, and the positive measures that contracting parties have to undertake to guarantee transit, presuppose more concrete measures.³⁹² The following paragraphs of Article 7 elaborate on the fact that contracting parties shall ‘encourage’ cooperation in activities related to transit, which goes further than a passive obligation, extending to the modernisation and development of energy transport facilities, mitigating the effects of interruption and facilitating interconnections.

Transit, for the purposes of Article 7, means:

[t]he carriage through the Area of a Contracting Party, or to or from facilities in its Area for loading and unloading, of Energy Materials and Products originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a Contracting Party. Transit also means the carriage through the Area of a Contracting Party of Energy Materials and Products originating in the Area of another Contracting Party and destined for the Area of another Contracting Party, unless the two Contracting Parties concerned decide otherwise.

Transit in the ECT takes place through energy transport facilities including ‘high-pressure gas transmission pipelines, high voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines, and other fixed facilities specifically for handling energy materials and products.’³⁹³

An indication of the imposition of an outright obligation on contracting parties to facilitate transit is the necessity ‘not to place obstacles in the way of new capacity being established’ (Article 7(4)), which means that construction of new transit facilities should not be hindered. This Article seeks to regulate those situations where the contracting parties have not entered into any transit

³⁹² See MM Roggenkamp, ‘Transit of Network-bound Energy: the European Experience’ in *East–West Gateway*, above n 9, at 509.

³⁹³ See Art 7(5)(b). With respect to the issue of the convenient transit routes within the context of the WTO, there has been already a dispute between Slovenia and Croatia over transit of oil and oil products, where Croatia, as a transit country, had disrupted this transit through an administrative order. Croatia maintained a partial ban on the road transit of oil and oil derivatives and maintained a general clause that road transit, import and export of oil and oil derivatives shall be carried out under provisions established by the Government, Ministry of the Interior, Ministry of Maritime, Transport and Communications, Ministry of Health, Ministry of Finance, Ministry of Environmental Protection and Physical Planning, and the State Inspectorate. Only oil and oil products were treated in such an exceptional way. The result was a much higher total cost of transport through Croatian territory, causing it to be uneconomical. Croatia justified the measures with environmental protection arguments. The case was not brought to the dispute settlement body because the Croatian government justified its measures by explaining that no new fees have been introduced, all charges and regulations imposed by Croatia in transit to or from the territories of other parties were reasonable, and the determined corridors were the most convenient international roads for international transit as far as safety of transit was concerned. See ‘Road Transit of Hazardous Materials in Croatia’, Communication from the Republic of Croatia, G/C/W/360, 18 March 2002. See also Roggenkamp, previous n, at 510.

agreement, or where the national legislation of the transit country does not regulate the ways through which new facilities should be constructed. Evidently, a contracting party can exempt itself from this obligation if the establishment of new facilities contravenes its environmental rules or regulations on security.

If a dispute arises between the transit country and the exporting country, Article 7(6) and (7) provide methods for its settlement. One method that is prescribed in this Article is the settlement of disputes through conciliation. The dispute will be referred to the Secretary General of the Secretariat of the Charter by a contracting party to the dispute, and a conciliator will be appointed. The conciliator shall seek to reach an agreement between the parties, and if unsuccessful, a resolution or a procedure to achieve a resolution would be recommended. Based on Article 7(7), conciliation will only take place when the relevant contractual or other dispute resolution remedies that were previously agreed upon between the contracting parties are exhausted. One possibility for this prior settlement is the insertion of the dispute settlement system as prescribed in Article 27(3) of the ECT into the transit agreement, where the contracting parties agree, upon failing to reach agreement through diplomatic channels, to submit the dispute to an ad hoc tribunal where, in the absence of an agreement to the contrary, the rules of the UNCITRAL shall govern. As Article 27 does not explicitly enumerate the type of disputes to which it applies,³⁹⁴ transit disputes could fall within its ambit (as well as state–state investment disputes, disputes on environmental issues, etc.).

5.5.3. Transit Issues in the Transit Protocol of the ECT

5.5.3.1. The Introduction to the Transit Protocol

The Transit Protocol purports to develop some additional provisions of international law in the area of energy transit, which applies to energy carriers of crude oil, oil products, natural gas and electricity only. Article 3 of the protocol reveals the relationship between the Transit Protocol and the ECT by providing that nothing in the protocol shall derogate from the provisions of the ECT and shall only complement, supplement, extend or amplify the provisions of the treaty. In this respect, additional provisions on utilisation of available capacity, imposition of transit tariffs, energy swaps, and related activities are established in the protocol.

Firstly, the Transit Protocol does not contain any obligation on mandatory third party access to energy transport facilities for transit. A good faith obligation applies during negotiations with regard to requesting access to and use of

³⁹⁴ For the interpretation of Art 27, see section 5.3.3.2 above.

available capacity for transit (Article 8(1)).³⁹⁵ Moreover, the protocol is not to be interpreted in a way that derogates from or affects the interpretation of existing international law governing submarine pipelines and cables. Secondly, there are no provisions codifying a common approach to the public regulation of natural monopolies and only a reference is made to prohibition of the abuse of a dominant position in the transit sector (Article 2(2)).

The issue of third-party access to energy facilities is of relevance to energy security. Energy is a network-bound sector, which means that, similar to telecommunications and railway sectors, it has some certain characteristics, namely that they are strongly dependent on a fixed network, which represents either a natural monopoly or a de facto monopoly.³⁹⁶ Within the European Union, competition policy tends to regulate the activities of these network-bound industries and guarantee competition. In the effort to bring the national energy regulatory systems of each Member State into line with principles of the internal market, one important step was to guarantee access to these networks to new market entrants, or in other words, third-party access. First of all, if this access is not provided, the new entrant has to build new networks, which not only involves huge investments but also will face environmental, zoning and safety constraints.³⁹⁷ Secondly, lack of access to an energy facility does not promote efficient use of available capacity in existing transit infrastructure, something that would otherwise be provided.³⁹⁸ Thirdly, realisation of the benefits of completion of the internal market led policy-makers to believe that third-party access contributes to such accomplishment. In other words, competition can only come from new entrants that rely upon their main competitor, the monopoly, for access. Therefore, the existence of a natural monopoly can be acknowledged, but a policy should also face the task of protecting both entrants and consumers from the potentially harmful effects of the monopoly.³⁹⁹

It is correct to say that regulation of third-party access should be approached with caution, in order not to impose too many strict regulations on the incumbent, which could in turn lead to an inefficient system,⁴⁰⁰ but at the same

³⁹⁵ See Draft Final Act of the Energy Charter Conference with Respect to the Energy Charter Protocol on Transit at <<http://www.encharter.org>>. A duly substantiated explanation in case of refusing access to, and use of, available capacity for transit should be provided (Art 8(2)). The advantages of access to existing transport facilities shall be denied if the denying party establishes that the entity or the Contracting Party is owned or controlled directly or indirectly by an entity of a third state in respect of which the denying Contracting Party either does not maintain diplomatic relations or adopts or maintains measures that prohibit transactions with entities of that state or would be violated or circumvented if the benefits of this Article were accorded to entities of that state.

³⁹⁶ See PJ Slot and A Skudder, 'Common Features of Community Law Regulation in the Network-Bound Sectors' (2001) 38 CML Rev 87 at 87.

³⁹⁷ *Ibid.*

³⁹⁸ *Ibid.*

³⁹⁹ See C Lapuerta Boaz Moselle, 'Network Industries, Third Party Access and Competition Law in the European Union' (1999) 19 *Journal of International Law and Business* 454 at 456.

⁴⁰⁰ See Moselle, *ibid.* See also Council Reg No 1775/2005 of 28 September 2005 on *Conditions for Access to the Natural Gas Transmission Networks* [2005] OJ L/289/1.

time the 'good faith' principle embodied in the Transit Protocol, as opposed to strict third-party access rules, does not sufficiently meet the needs of either guaranteed access of new market entrants or energy security. Access to existing facilities guarantees a constant flow of energy, which is an important element of energy security. Hence, this issue should be approached with much rigour in the ECT negotiations. The enlargement of the European Union to include ten Eastern European Countries (most importantly the potential transit countries for Russian gas, such as Lithuania, Latvia, Estonia, Poland and Czech Republic) will eventually be subject to the principles of the internal market where third-party access to existing or future energy facilities is guaranteed. However, this issue should also be addressed for new entrants in the Caspian Region, the most important of which are members of the ECT (such as Kazakhstan, Azerbaijan, and Turkmenistan), to guarantee access to energy facilities in those countries as well, which would in turn contribute to the security of Europe's energy supply.⁴⁰¹

The Transit Protocol also regulates international energy swaps. Based on Article 17 of the Draft of the Final Act of the Energy Charter Treaty with Respect to the Energy Charter Protocol on Transit:

'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.

Energy swaps takes place when, for example, Turkmenistan, rather than exporting its own gas through the territory of Iran, which necessitates the transit of its gas through pipeline via Iran, exchanges a specific quantity of Turkmen gas with Iran. Through this swap, Turkmen crude oil is delivered to Northern Iran and exchanged for equivalent volumes of crude oil by the Iranians, which is exported at the southern ports in the Persian Gulf. The economic rationale for swaps is said to be the creation of win-win transactions, without the use of the energy transport facilities of the transit country (here Iran), by the country from which the energy originates (here Turkmenistan).⁴⁰² Based on the Transit Protocol, contracting parties shall not place obstacles to the conclusion or execution of international energy swap agreements, except as may be otherwise provided in applicable legislation, and they shall not take or interfere with energy products and materials exchanged in a manner inconsistent with the provisions of the ECT or the Transit Protocol. A contracting party, in whose territory energy is

⁴⁰¹ This study does not expand upon competition policy in the European Union's energy market. For a complete analysis of this issue, see PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (Oxford, Oxford University Press, 2002).

⁴⁰² For more detail on different types of swaps and the characteristics of gas, oil and electricity swaps, see KP Waern, 'Transit Provisions of the Energy Charter Treaty and the Energy Charter Protocol on Transit' (2002) 20 *Journal of Energy and Natural Resources* 172.

exchanged, should take all necessary measures to prohibit the unauthorised taking of energy (ie theft). The exchanged energy should be of an equivalent 'quantity' and of the same 'type' to fall under the obligations of the Transit Protocol (ie gas exchanged with gas, or electricity exchanged with electricity and with the same quantity).

5.5.3.2. *The Obstacles to Ratifying the Transit Protocol*

The most important obstacles faced by the Energy Charter Secretariat in its December 2003 meeting to ratify the Transit Protocol have been named as the 'right of first refusal' and the following complaint of the European Community, the 'Regional Integration clause', which is related to transit in the European Community, and Russia's complaint, and the issue of transit tariffs and Russia's complaint. Eventually, due to these complaints, the protocol was not ratified and was postponed until later clarifications.

5.5.3.2.1. Right of First Refusal

The objection by the European Community addressed Article 8 (4) on the 'Utilization of Available Capacity'. This Article provides that:

when the duration of a transit agreement relating to transit of hydrocarbons does not match the duration of a supply contract, the contracting party through whose area the hydrocarbons transit, shall ensure that the owners or operators of energy transport facilities under its jurisdiction, who are in negotiations on access to available capacity, consider in good faith and under competitive conditions the renewal of such transit agreements. This means that the existing user upon the expiry of the transit agreement shall be treated neither better nor worse than other potential users at that time, *except that the existing user shall be given the first opportunity to accept the conditions offered for any new transit agreement for that available capacity.* (emphasis added)

This situation can arise when the term of the supply contract is longer than the term of the transit agreement. For instance, the situation may arise where Azerbaijan has a gas supply contract with a country in Europe and the Azeri gas should transit via Turkey based on a transit agreement. The term of the supply contract is arranged for 10 years whereas the transit agreement with Turkey is for 5 years. Upon expiry of the transit agreement, the entity or the contracting party that had previously used Turkey's transit facility, ie Azerbaijan, should be given priority (unlike what the provision curiously calls 'neither better nor worse treatment'), to accept the new transit agreement announced by Turkey. The rationale for this right is that security will be provided for the supplier of energy, because access to transit facilities will be guaranteed within the period of the supply contract, and no competition would be created to hinder this supply flow.

Evidently, this 'right of first refusal' is not accepted by the European Community because it is in conflict with established rules on competition. The new users

of a given transit facility are at a competitive disadvantage due to the constraints that this provision imposes. In addition, it could be claimed that such right is incompatible with the obligation of non-discriminatory treatment of Article 7(1), as well as Article 8(1) of the Transit Protocol, which prohibits discrimination for those seeking access to available capacity for transit.

While studying this problem, one is reminded of the controversial 'destination clauses' in energy contracts. These clauses, as they appeared in supply contracts between major energy producers (mostly Russia and Algeria) and gas companies provided that the energy sold to a given buyer should not be resold to another country. For example, Russia would impose an obligation on Germany not to resell to Austria gas bought from Russia. The rationale was that suppliers wanted to maintain certain control over their end markets, and wanted to prevent 'initial buyers finding extra value by reselling gas on other markets where prices are higher'.⁴⁰³ The abolition of these clauses would allow competition between gas companies in having access to gas bought by the initial buyer. After long discussions between Russia's main gas company, Gazprom, and Algeria's main energy company, Sonatrach, Russia agreed to relinquish this condition because they were against European competition rules⁴⁰⁴ Algeria reached an agreement with the EU in January 2005 which provided that 'the EU will continue to allow destination clauses, and Algeria will share the profits of any gas sales to third parties with the original buyer'.⁴⁰⁵

The issue of destination clauses is a good example in determining the extent to which the European Union could accept infringement of some of its established rules for the sake of energy security and in obedience to the demands of the major energy suppliers. The result has been a clear 'no' to their request. As a matter of fact, the way in which European laws and regulations are developing is one of no return. Insisting on the right of major suppliers to challenge the European Community to accept clear infringement of established rules will eventually fail. The same fate will befall the 'right of first refusal'. Although it can be argued that the right of first refusal can bring better security for the supplier within the term of the supply contract, the established principles of competition suggest that healthy competition will better guarantee energy security in the long term.

⁴⁰³ See D Finon and C Locatelli, 'Liberalization of the European Gas Markets and its Consequences for Russia', (2002), Study of 'Institut d'Économie et de Politique de l'Énergie' at <http://www.upmf-grenoble.fr/iepe/textes/CL_DF_GasRusse_02engl.pdf>.

⁴⁰⁴ See 'Gazprom Drops Territorial Restriction Clauses in Future Contracts', in *Gas Matters Today* (18 July 2002).

⁴⁰⁵ See the EIA Country Analysis Brief, Algeria, March 2005.

5.5.3.2.2. The Regional Economic Integration Clause and the European Community

The second controversial issue was the 'Regional Economic Integration Clause' (REIC) as provided in Article 20 of the Transit Protocol. This Article provides that the 'Area' of a contracting party referred to in Article 7(10)(a) (ie where transit take place) shall, as regards contracting parties which are members of a Regional Economic Integration Organisation (REIO), cover the area to which the treaty establishing such a REIO applies. The obligation on such REIO is that they should ensure that the provisions of their establishing treaty treat energy materials and products originating in another contracting party and in free circulation in its area *no less favourably* than energy materials and products originating in its constituent Member States.

A Regional Economic Integration Organisation is defined in Article 1(3) of the ECT as an 'organisation constituted by states to which they have transferred competence over certain matters, a number of which are governed by this treaty, including the authority to take decisions binding on them in respect of those matters'. In other words, some supranational authority should exist that regulates some specific areas of state activity. The fact that state competence has been transferred to the European Community in a number of areas (for instance in the Common Commercial Policy), and the exclusive competence of the Community in those areas, makes the European Community a Regional Economic Integration body as defined by Article 1(3) of the ECT. The European Community is the only REIO subject to the rules of the ECT.⁴⁰⁶

The European Community will be considered as 'one Area' within the definition of Article 20 of the Transit Protocol. Therefore, energy that is originated in a third country, which is passing through the territory of the European Community and is destined for another third country, will be subject to the rules of the Transit Protocol. In this case, the European Community as a whole is considered as a transit country and subject to the rules of the Transit Protocol. Hence, the constituent members of the European Community will not be considered as transit countries. For example, when Russian gas is crossing Austria and is destined for Switzerland, the Transit Protocol applies to this transit because the gas is destined for a third country. However, the constituent members of the Community will be considered as transit countries if the energy is originated in a third country and is destined for a member of the European Community, crossing their territory. In this case, the Transit Protocol will not apply and the

⁴⁰⁶ The only other regional agreement that comes to mind is the customs union established between the countries of the Gulf Cooperation Council (GCC) since January 2003. Although it is not clear whether this customs union matches the definition of the customs union in the WTO and, for that matter the ECT, in case the member countries of the GCC become members of the ECT, the rules on REIC does not apply to them because there is no supranational authority to which some state competence has been transferred.

Community rules on transit will apply. This will be the case when the Russian gas is crossing Germany and is destined for Austria or when it is crossing Lithuania and is destined for Poland.⁴⁰⁷

Due to the fact that Community law will apply in cases where the energy is crossing the borders of the Community and destined for a Community Member State, it is important to verify what those rules are and how they differ from the rules embodied in the Transit Protocol.

5.5.3.2.2.1. The Applicable Rules on Transit of Energy in the European Community

The movement of energy is regulated in several articles of the EC Treaty. Article 23 on free movement of goods prohibits the imposition of customs duties on imports and exports between Member States of all trade in goods. Moreover, Article 24 provides that products originating in a third country should be considered to be in free circulation in a Member State based on two conditions: (1) if the import formalities have been complied with and (2) any payable customs duties and charges have been levied and (3) if they have not benefited from a total or partial drawback of such duties and charges. More importantly, Article 30 allows the prohibition or restriction of imports and exports, or '*goods in transit*' on grounds of public security, protection of industrial and commercial property, and protection of health and life of humans, animals and plants, among other things.

Apart from the provisions of the EC Treaty, several Directives also deal with the issue of transit of energy across the borders of the EC Member States. These are the Electricity Transit Directive of 1990, the Gas Transit Directive of 1991,⁴⁰⁸ (which lay down conditions according to which the transit of natural gas and electricity between high pressure electricity and gas transmission grids should be facilitated), the Electricity Directive of 1996, the Gas Directive of 1998, and the amended versions of the last two directives in 2003 (see chapter 4 above).

The provisions on transit, as found in the EC Treaty and the directives mentioned above, regulate the way through which transit of goods within the European Community should take place. These provisions prescribe the facilitation of transit and the obligation that no obstacles should be imposed on the way goods are transported across the borders of the European Community. For that matter, transit is meant to be the transportation of goods, which involves the crossing of at least one intra-Community frontier.⁴⁰⁹

⁴⁰⁷ It should be emphasised here that the possibilities available to energy carriers to cross countries are subject to extensive feasibility studies. Therefore, the examples given above are hypothetical and may not be feasible in practice.

⁴⁰⁸ See Council Dir 91/296/EEC of 31 May 1991 on the Transit of Natural Gas through Grids, [1991] OJ L/147/37.

⁴⁰⁹ See, eg, Directive on Transit of Natural Gas through Grids, *ibid*, Art (c). The transit, as defined in the Energy Charter Treaty, necessitates the energy crossing two borders rather than one. See Art 7

More importantly, the European Court of Justice has decided (based on a 1983 precedent established in the *SIOT* case)⁴¹⁰ that those goods that are intended for export to a non-member country fall within the scope of the provisions of the EC Treaty on the free movement of goods between Member States.⁴¹¹ Moreover, the Court ruled that the regulations on Customs Union, which imply the free movement of goods between Member States, cannot be ensured and the freedom cannot be completed if it be possible for Member States to impede or interfere in any way with the movement of goods in transit, no matter if the good was destined for another Community Member State or for a third country.⁴¹² Therefore, the existence of a general principle of freedom of transit of goods within the Community, even if the goods in transit were intended for a non-member country, was acknowledged. The fact that in these cases the goods originated or manufactured within a Community Member State and destined for another Member State or a third country should not be interpreted to limit freedom of transit to those goods which originated in the Community. The established rule is one of general character and provides that ‘the Member States would contravene the principle of freedom of transit within the Community if they were to apply to goods in transit through their territory, transit duties or other charges imposed in respect to transit’. This general principle applies, therefore, to goods originating in non-EU energy-producing countries. These efforts are also backed by a series of measures in the framework of ‘trans-European energy networks’, which establish guidelines for improvement of interconnections of electricity and gas transmission networks in the Community, and urges the continuous updating of projects of common interest.⁴¹³ These regulations highlight the strong emphasis in the Community on freedom of transit.

(10)(a) where the good for transit should originate in one country and be destined for a third country, which necessitates crossing at least two borders.

⁴¹⁰ See Case 266/81 *SIOT* [1983] ECR 731 (*Società Italiana per l’Oleodotto Transalpino (SIOT) v Ministero delle finanze, Ministero della Marina mercantile, Circostrizione doganale di Trieste and Ente autonomia del port di Trieste*). See also Case 367/89 *Richardt and Les Accessoires Scientifique* [1991] ECR I-4621, para 14. See also Case 350/97, *Monsees* [1999] ECR I-2921.

⁴¹¹ See Case 115/02, *Administration des Douanes et Droits Indirects v Rioglass SA & Transremar SL*, [2003] ECR I-12705, para 17.

⁴¹² See Case 115/02, *ibid*, para 18.

⁴¹³ See, eg, Decision No 1254/96/EC of the European Parliament and the Council of 5 June 1996, laying down a Series of Guidelines for Trans-European Energy Networks [1996] OJ L/161/147. See also 96/537/EC: Commission Decision of 30 July 1996 defining the Specifications of Projects of Common Interest Identified by Decision No 1254/96/EC of the European Parliament and of the Council laying down a Series of Guidelines for Trans-European Energy Networks, [1996] OJ L/230/16. Decision No 1047/97/EC of the European Parliament and of the Council of 29 May 1997 Amending Decision No 1254/96/EC laying down a Series of Guidelines for Trans-European Energy Networks, [1997] OJ L/152/12. See Decision No 1741/1999/EC of the European Parliament and of the Council of 29 July 1999 Amending Decision No 1254/96/EC laying down a Series of Guidelines for Trans-European Energy Networks, [1999] OJ L/207/1. See also Decision No 1229/2003/EC of the European Parliament and of the Council of 26 June 2003 laying down a Series of Guidelines for

Curiously, what was considered as problematic in establishing two different rules depending on the destination of the energy in transit was the introduction of REIC into the Transit Protocol, with which Russia had great difficulty. This inclusion, as explained above, excludes the application of the Transit Protocol where energy originated in a third country and is crossing the border of the European Community, but is destined for a Community Member State (as opposed to the application of the Transit Protocol where the energy is destined for another third country). However, this exclusion should be problematic only where Community law is not as protective as the Transit Protocol. As mentioned above, freedom of transit, *regardless of the origin and the destination* of the energy, is guaranteed in the Community. Nevertheless, as a member of the industry advisory panel to the Energy Charter explains, 'Russian gas exporters cannot rely on the goodwill and even on the wisdom of the creators of the EU Directives on Gas and prefer to have a say in discussing issues which are of vital importance for them'.⁴¹⁴

5.5.3.2.3. Transit Tariffs

The third controversial issue in the negotiations on the provisions of the Transit Protocol was related to transit tariffs. The Transit Protocol provides rules for the imposition of tariffs by the transit country. Usually the transit country can either impose tariffs on the energy in transit or take some of the energy in transit for its domestic use. The transit tariff design of the Protocol provides that each state shall take such measures that are necessary to ensure that transit tariffs are objective, reasonable, transparent, and non-discriminatory. Transit tariffs are cost-reflective, and the amount is calculated using objectively determined costs, which include 'operational and investment costs, and a reasonable rate of return' (Article 10(3)). It is believed that through supervising the transit tariffs of each country, the scope of abuse of a dominant position through an arbitrary tariff determination by natural monopolies is reduced.⁴¹⁵

The Transit Protocol also mentions that transit tariffs 'may be determined by appropriate means, including regulation, commercial negotiations or *congestion management mechanisms*'. The latter suggests the existence of 'auctions' (for access to available capacity by potential users) as one means through which tariffs can be imposed. If auctions are used, they should also be cost-effective. However, the problem that Russia has with this provision is that there is the potential for tariffs to be unpredictably high, which 'may result either in extremely high consumer prices or in unreasonable financial losses of shippers who will have to

Trans- European Energy Networks Decision No 1254/96/EC, [2003] OJ L/176/11. See also Communication from the Commission to the Council and the European Parliament, the External Dimension of Trans-European Energy Networks, COM (1997) 125 Final.

⁴¹⁴ See TI Shtilkind, 'Energy Charter Treaty: A Critical Russian Perspective', (March 2005) 3 *Oil, Gas & Energy Law Intelligence*, issue 1.

⁴¹⁵ See Waern, 'Transit Provisions of the ECT, above n 402, at 183.

pay such tariffs' and both create risks for the security of European gas supplies.⁴¹⁶ The disagreement between Russia and the EU over this issue is the reluctance of Russia to accept auctions as one legal means of congestion management mechanisms and the insistence of the EU that such mechanisms increases competition.

Due to the above-mentioned points of disagreement the Transit Protocol was not ratified. The hope of the Energy Charter Secretariat was to have Russia ratify this Protocol. Although Russia has not ratified the ECT, it applies the treaty provisionally, and for that reason can ratify the protocols that the ECS establishes. Russia can be considered an important transit country for the transit of oil and gas from Turkmenistan and Kazakhstan. However, non-ratification of the protocol means that Russia is not yet subject to hard law rules of the Transit Protocol, specifically those found in Part III of the protocol on specific provisions (eg negotiations in good faith to give access to the available capacity, objective, reasonable and transparent transit tariffs, etc.). It remains to be seen what changes the Energy Charter Conference will provide in the protocol for it to become acceptable to all contracting parties of the ECT. Clearly, better energy security will be guaranteed upon Russia's ratification of the ECT.

5.5.4. Conclusion: the Transit Regime of the ECT and Europe's Security of Energy Supply

It is clear from what is described above that the mere existence of an energy-rich country as a member of the ECT does not, in itself, guarantee security. The involvement of transit countries in this framework should also be encouraged. A duty of cooperation between supplier and transit countries should be established to facilitate the necessary energy flow to Europe to guarantee security of energy supply.

There are several examples where transit meets difficulties or obstacles: Transit can be disturbed for political reasons. For instance, as one study shows, until the end of 1995, every one of the eight international pipelines in the Middle East was shut down at least once during the period since the first pipeline was built in 1931. Transit can also be disturbed due to demands for negotiation or re-negotiation of transit agreements during which the transit will be halted. It can also be disturbed due to a cut in supplies for various reasons. For example, it is recorded that there were twenty-seven natural gas 'transit events' in the Former Soviet Union Countries between 1 January 1992 and 31 December 1994. '10 of these disturbances were related to negotiations or re-negotiations of transit agreements, 6 were threats to supply, 3 were irregularities in supplies and 8 were

⁴¹⁶ See Shtilkind, above n 414.

actual cuts or reductions in supply'.⁴¹⁷ Transit can also meet difficulties when the necessary transit connections are not in place due to financial problems.

Could the ECT prevent these incidents? This question should be answered by first enquiring whether other options, such as bilateral or regional transit relations, would solve these disturbances. Firstly, the supplier in a bilateral relationship needs to explore options for a code of conduct for transit in each transit country. It should again examine the need for, and quality of, transit tariff guidelines in each country. It would become necessary also to revise certain laws and regulations in each of these countries through which transit takes place. The second step is to determine how various domestic laws address the settlement of any conflict between these countries. This being said, it should also ensure that investors investing in the new transit routes take into account such factors as the stability of a country or a region in their investment decision-making processes. No matter how countries seek to cooperate, political tensions in one country may discourage the investor from investing if he is not guaranteed that profits will ensue. One could argue that in order to circumvent all these new problems, and to become subject to one set of rules that applies to all (ie the provisions of the ECT), and save countries from struggling with these various issues, membership of the ECT would be welcomed. However, as the decision to lessen the flexibility provided in the bilateral agreement and to abide by the multilateral rules is a matter of political will, nothing would force these countries to choose the ECT over those frameworks.

Nonetheless, the transit provisions of the ECT, along with those of the Transit Protocol, as elaborated on above, have compiled the most important and relevant issues to be considered in transit of energy across borders, and they surely contribute to the energy security of Europe. However, for these provisions to become fully operational, it is necessary that all relevant countries for such transit become members of the ECT or its protocol (if ratified). The role of the Secretariat of the Energy Charter, therefore, is to seek the membership of these countries, which also necessitates a thorough study of existing transit infrastructure of relevance for Europe, the necessary ones that need to be built, and the countries where these routes are laid or should be created. The ECS is in the best position to engage in such activity, and the Community could cooperate in this field with the Secretariat. Clearly, this effort also needs to take into account 'all' the major energy-exporting countries, whose energy could be important for Europe's security of energy supply. The necessary rules are in place, and efforts should concentrate on attracting more membership. If that takes place, the transit rules and the Transit Protocol can be considered as the most important contribution to Europe's security of energy supply.

⁴¹⁷ See the Document of the Energy Charter Treaty entitled 'Energy Transit: the Multilateral Challenge' at <<http://www.encharter.org>>.

5.6. CONCLUSION: THE ECT AND EUROPE'S SECURITY OF ENERGY SUPPLY

The Energy Charter Treaty is first and foremost a treaty that governs the conditions under which investments in the energy sector can be made with minimum risk. At the second level, the treaty governs transit and trade in energy products. The ECT, by virtue of the membership of the various states party to it and the impact that it has on the national laws of those states, has become a unique legal document, and it is definitely a success compared to previous attempts to create a multilateral legal regime, particularly for the protection of foreign investment. The importance of this treaty is due to its aim of supervising its contracting parties in forming and executing their investment, transit and trade policies in the energy sector and its endeavor to set standards for energy cooperation between energy-producing and consuming states, which meet the expectations of both sides.

In the preamble to the Community Decision on the conclusion of the Energy Charter Treaty, it is mentioned that the principles and objectives of the ECT are of fundamental importance to Europe's future, allowing the members of the Commonwealth of Independent States and the countries of Central and Eastern Europe to develop their energy potential, while helping to improve security of supply of Europe.⁴¹⁸ The analysis of the provisions of the ECT demonstrates that the most important and basic rules on protection of investment, trade and transit are contained in its framework and it is not too far-fetched to state that if the contracting parties fully abide by its provisions, and the ECT succeeds in attracting the most important energy exporting and transit countries, it can be regarded as one of the major achievements of the Community in guaranteeing security of energy supply at the external level.

The investment rules of the ECT seek to create a balance between the concerns of the energy-exporting countries in maintaining their sovereignty over natural resources and the demand of consuming nations to have access to energy resources and invest in the exploration and production of those reserves. The ECT creates a 'managed' investment policy, which allows the host countries to regulate where, and under what conditions, investment should be allowed, but as soon as the investment takes place they must abide by the rules established in the ECT to provide full protection to those investments. The system of investment dispute settlement is another positive innovation of the treaty, allowing investors to bring a claim against the host state for violating its investment obligations. Although the principles on the protection of investment seek to guarantee full transparency in this field, the mere existence of an energy-rich country as a member of the ECT does not, in itself, guarantee open access to its energy reserves. Access to reserves is still based on the national rules and regulations of

⁴¹⁸ Council and Commission Decision of 23 September 1997 on the conclusion by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (CE) (98/181 /EC, ECSC, Euratom).

the host state where the geographical area for investing, type of contracts, rate of recovery etc. are determined. Some may argue that this managed investment policy may not be the desired framework for securing energy supply at all times, but the membership of both sets of countries in the ECT would create a duty of cooperation on their behalf, allowing reserves to become accessible based on various advantageous terms. Nonetheless, it is clear that the major shortcoming of the ECT is that it has not yet encompassed these countries. Russia applies the treaty provisionally and the GCC, Iran and Algeria are only observers to the ECT. The ECS has only been successful in attracting Kazakhstan, Azerbaijan and Turkmenistan to join the treaty. Although these countries play an important role in Europe's security of supply, their geographical situation (not sharing borders with the European Union) renders the transit of their energy to Europe more difficult, unless other countries, such as Iran and Russia, also join the treaty to facilitate transit or swap agreements, the regulation of which is covered by the ECT.

There is reluctance on the part of the Gulf countries to join the ECT. Regarding their unwillingness to become members, they have pointed to the fact that the ECT was negotiated in 1991 between Europe and the FSUs, and the Gulf countries were not at all involved in those negotiations. Therefore, their interests were not reflected in the provisions of the ECT. Before elaborating on this criticism of the GCC countries, it should be mentioned that the ECT does not impose strict obligations in the areas of investment, trade and transit. The investment provisions of the ECT are similar to those found in bilateral investment treaties. With respect to trade rules, all members of the GCC are also members of the WTO and they have already incorporated the trade principles of the WTO into their national systems (or will soon do so in the case of the newly acceding countries) and they have gradually become acquainted with these rules. The transit provisions also seek to guarantee a minimum protection that is vital for both supplying and transit countries. Moreover, if there are details of the ECT on which some countries do not agree, the treaty, similar to any other international treaty, can be amended (Art 42) and its structure can be reformed. In any case, its day-to-day legal development necessitates such flexibility. Nevertheless, it seems that the lingering question posed by energy-producing countries circles around the real added-value that the ECT brings to their relations with energy consuming and transit countries. It appears that the reasons that the GCC or Russia raise for their reluctance to join the ECT are not very well grounded as long as their attack on the text of the ECT itself is concerned, as they generally talk of the harsh investment and transit provisions of the ECT whereas the above-mentioned study detailed the real effect of relevant provisions and concluded that these provisions do not undermine sovereignty over natural resources and talk of managed policy as opposed to an open and fully unregulated framework. Nonetheless, they question whether the ECT brings such value that they cannot obtain otherwise through bilateral relations with consuming nations. For instance, one of the most important demands of the energy-producing

nations is economic development. To what extent does the ECT contribute to this development? After all, cooperation in the field of energy, where both exporting and consuming countries are members, necessitates a reflection upon the concerns of both parties. In this way, the balanced relationship between both sets of countries creates a more stable cooperation framework, where its contribution to consuming nations' security of energy supply becomes apparent. This question is an important one to be tackled in our analysis of the relevance of the ECT for the energy-exporting countries.⁴¹⁹

Clearly, the uniform application of the provisions of the ECT on trade, transit and investment encourages the contracting parties to cooperate and better reveal their economic demands. This will in turn pave the way for gradual economic development. Protection of investment, transit and trade attracts more investment, guarantees a steady flow of income through the secure provision of energy supply, and ensures competition. However, this can all be achieved through bilateral or regional relations, albeit with greater difficulty. Hence, the Energy Charter Secretariat needs to take an active role in creating an added value for this cooperation framework. Otherwise, it becomes increasingly difficult to induce the energy-exporting countries to join.

One of the best opportunities for the ECS to emerge as an independent institution is to reflect upon the concerns of energy-exporting countries that are made known in other international institutions (eg WTO, UN Commission for Sustainable Development, etc), and to provide its own analysis of those concerns and make the result of the analysis known to those countries and the respective institution. One example of this situation was the controversy over the issue of dual pricing that was claimed to be in violation of WTO law. Saudi Arabia claimed that the purpose of dual pricing is to attract foreign investment in the petrochemical industry, something which they found to be in line with their goals of economic diversification as well. They claimed that they could not attract such investment otherwise. Regardless of the analysis of WTO law, which concluded that this practice, as it occurred in Saudi Arabia, is not incompatible with this law, it is not too far-fetched to expect the ECS to provide a timely comprehensive analysis of this issue to reveal all the legal and economic aspects of this practice and to analyse the claims of both the WTO and Saudi Arabia. As the only institution that is designed to deal specifically with the energy sector,

⁴¹⁹ For the opinion of Vladimir Putin on the subject see <http://www.kremlin.ru/eng/speeches/2006/07/13/1416_type82916_108575.shtml>. He mentions that 'The Energy Charter and the Additional Protocol refer to granting access to infrastructure for extracting and transporting gas. And so we ask our partners: "Very well, we shall give you access to this infrastructure and where will you allow us access?" And they answer: "We will reciprocate". And I ask you: "Where are these deposits? Where are the huge gas pipelines and infrastructure like that we have?" Our partners do not have such infrastructure. For that reason signing and ratifying the additional protocols with the Russian party is a unilateral decision, and we shall not accept unilateral decisions... And so if at one point we go to sign and ratify the agreement then we must know that if we allow our partners into the crucial sectors of our economy then our partners would allow us into crucial sectors of your economy so that the cooperation was on an equal footing.'

with strong links to both the WTO and the EU, and as an institution that claims to guarantee the economic development of its member countries, the ECS should have actively participated in this debate. Although Saudi Arabia is not yet a member of the ECT, its membership is without doubt desirable in this framework. Witnessing an effort on the part of the ECS to confirm its mission would have sent the right message to the right country.

Although some may argue that the initial idea of the ECT did not embody such a task for the Secretariat, the ECS has changed its path in encompassing not only relations between Europe and the FSU countries, but with the whole world. Moreover, recent developments highlight an opportunity for this institution to mark its important existence for such cooperation.

It can be submitted that the fact that very few important energy-producing countries are members of the ECT is not due to the inadequacy of the provisions of the treaty in reflecting important trade, transit and investment concerns, but it is due to their lack of belief in the ECT system as a framework which encompasses their concerns as well. Their claim is based on the one-sidedness of the ECT in protecting the interests of consuming nations. This being said, and regardless of the fact that the text of the ECT is the best possible multilateral framework for energy cooperation, until the ECS takes an active role in energy relations and emerges as the most important organisation to guarantee efficient and balanced energy relations between consuming and exporting nations, the EU should determine whether it needs to consider the ECT as a receptacle full of possibilities for guaranteeing its security of energy supply, or whether it should obtain such security through other frameworks. In doing so, the Community does not need to reject the ECT, but could invigorate it by proposing new ways of approaching important energy-rich and transit countries. It should continue to provide financial support, while at the same time securing its relations with major energy-exporting countries on a regional or bilateral level, since the lack of membership of these countries in the ECT renders this treaty, at least for the moment, only a potential guarantee of energy security.

The next chapter analyses the special relations of the Community with major energy-exporting countries and determines their sufficiency to guarantee Europe's security of energy supply at the external level.

6

EU Relations with Russia, the Mediterranean and the Persian Gulf Countries: The Missing Elements

THIS CHAPTER IS dedicated to the relationship between the European Union and the most important energy-producing countries, namely Russia, the energy-producing and energy transit countries of the Mediterranean, and of the Persian Gulf. The study has chosen these three areas due to the significant role that they play in the world energy market in general, and in Europe's security of energy supply in particular. The study seeks to demonstrate differences in the EU's approach to these countries and regions and to highlight the major shortcomings of the existing framework for energy cooperation with some of these countries. Clearly, a thorough analysis of the relations of the EU with each region or country would require a separate lengthy study, which is not intended here. This study only highlights the most relevant aspects of these various relations for Europe's energy security and makes a comparison between them in the last section, in order to generate broader policy proposals and recommendations. In that section, it is argued that the adoption and implementation of measures to guarantee security of energy supply should not only be analysed within the framework of pure economic relations with energy-producing countries but it should also be approached taking the political as well as development cooperation policies of the EU into account. The study argues that the most efficient energy security framework should encompass all these three aspects, which are referred to in this study as the 'triangular' approach. In the last section, this inter-relation is highlighted and its importance for security purposes is analysed.

6.1. EU–RUSSIA ENERGY RELATIONS

Russia is one of the most important energy producers in the world, and the most important country for the purposes of Europe's security of energy supply. Europe is also the major destination for Russia's energy exports and this complementary

economic interdependence has created a strong relationship between the two. The EU has stated that there is a vital interest in

maintaining and enhancing Russia's role as a supplier of gas and oil on favourable commercial conditions to the EU market and in strengthening Russia as a secure and reliable supplier through technology transfers and investment¹ to that country and upgrading its energy infrastructure.²

Modernising the energy industry of Russia and making it more efficient is believed to facilitate the integration of energy markets on both sides, which would in turn enhance Europe's energy security. This objective is of greater importance considering the fact that Russia shares borders with the enlarged European Union as well.

58 per cent of Russia's oil exports and 88 per cent of its natural gas were destined for the EU in 2003. This contributed to 22 per cent of total net EU oil imports and 32 per cent of EU gas imports in that year, which represented 16 and 19 per cent of total EU consumption respectively.³ Such reliance on Russian imports of energy has led the EU to design specific cooperation frameworks in various fields with that country, considering, as previously explained, that Russia has not yet ratified the Energy Charter Treaty (ECT) and is not a member of the World Trade Organization (WTO).

Although the European Community had to deal with a country engaged in further disintegration after the fall of the Berlin Wall, and further struggle to adapt to the process of globalisation, the creation of a strong link with Russia as its immediate neighbour with vast human and natural resources was nevertheless strongly pursued by the EU.⁴ After a long time, Russians also became 'familiar' with the objectives pursued at European level, and they found that 'they are both more concerned with domestic structures and economic interests rather than military threats and territorial control'.⁵ Hence, they established relations with the European Community by means of a Partnership and Cooperation Agreement (PCA), which was signed in 1994,⁶ and within the framework of which an

¹ The International Energy Agency has set the average of the investment needs of Russia as 726 billion Euro between the years 2001 and 2020, of which 28% is for oil, 27% for gas, 25% for electricity, 12% for renewable energies, 5% for nuclear power plants, and 3% for coal.

² See <<http://europa.eu.int/scadplus/leg/en/lvb/l27055.htm>>.

³ *Ibid.*

⁴ On the other hand, it took Russia a long time to realise the value of a strategic dialogue with the EU. Russia previously played the 'European card' in US–Soviet relations only, and a separate, strong relationship with the EU was not pursued for quite some time. H Haukkala and S Medvedev (eds), *The EU Common Strategy on Russia* (Helsinki, Finnish Institute of International Affairs, 2001) at 15 [hereinafter *Common Strategy on Russia*].

⁵ O Wæever, 'Imperial Metaphors: Emerging European Analogies to Pre-Nation-State Imperial Systems' in O Tunander, P Baev, and VI Einagel, *Geopolitics in Post-Wall Europe: Security, Territory and Identity* (Oslo, PRIO, 1997) at 72, reprinted in H Haukkala and S Medvedev (eds), *Common Strategy on Russia*, *ibid.*, at 15.

⁶ See Agreement on Partnership and Cooperation Agreement establishing a Partnership between the European Communities and their Member States, of the one part, and the Russian Federation, of

Energy Dialogue was established in 2000. Alongside this Agreement, the European Union also unilaterally adopted a Common Strategy with Russia in 1999. These three instruments are in turn examined below.

6.1.1. The Partnership and Cooperation Agreement with Russia

The Partnership and Cooperation Agreement with Russia came into force in 1997. This agreement is considered as the legal basis for the relationship between the EU and Russia. Its main objective is to create an economic and technical assistance framework, to ultimately establish a free trade area with Russia, and to further facilitate Russia's accession to the WTO. The first war in Chechnya in December 1994 held up the ratification process. This war called into question one objective of the PCA: supporting human rights in Russia. The existence of a signed PCA of 1994 did not assist the Community in guiding Russia in its actions, and the need to have a 'strategy' was raised. However, the importance of facilitating trade made itself felt, and an interim treaty was adopted in 1996, which sought to bypass the human rights provisions of the PCA and allowed the trade clauses to enter into force prior to the whole treaty.⁷ Later that year, an action plan was adopted which accentuated the development of a substantial partnership with Russia in order to promote democracy, economic reform and human rights.⁸ The importance of human rights was therefore repeatedly emphasised in order to underline that the PCA should not function without concern for human rights. After such emphasis, the Interim Agreement on Trade eventually came into force in 1997 with the aim of strengthening economic and political cooperation between the EU and Russia but including also a special reference to the 'paramount' importance of the rule of law and human rights.

The agreement took account of the willingness of the EU to provide technical assistance for the implementation of economic reform in Russia and for the development of economic cooperation. Regarding energy relations, Article 65 of the PCA designed the cooperation to include 'improvement of the quality and security of energy supply'. The Cooperation tends to strike a balance between

the other part, [1997] OJ L/327/3. There already existed a Trade and Co-operation Agreement (TCA) with the Soviet Union, which was signed before the fall of the Berlin Wall on 9 November 1989, and the only other instrument in place was the Technical Assistance for the Common Wealth of Independent States Programme (TACIS) which was initiated in 1991.

⁷ See Interim Agreement on Trade and Trade-related Matters between the European Community, the European Coal and Steel Community and the European Atomic Energy Community, of the one part, and the Russian Federation, of the other part—Protocol 1 on the establishment of a Coal and Steel Contact Group—Protocol 2 on Mutual Administrative Assistance for the Correct Application of Customs Legislation—Final Act—Joint Declarations—Exchange of Letters in relation to Art 15—Exchange of Letters on the Consequences of Enlargement, [1995] OJ L/247/2. The Agreement suggested that, considering the importance of developing trade between Russia and the EU, 'it is necessary to implement as speedily as possible, by means of an Interim Agreement, the provisions of the Agreement on Partnership and Cooperation concerning trade and trade-related matters'.

⁸ See *European Action Plan for Russia*, (May 1996) *EU Bulletin*.

security of energy supply and assisting Russia in overcoming its shortages in the energy sector. In this vein, the Agreement recognised the necessity of formulating an energy policy towards Russia, and introducing a range of institutional, legal, fiscal and other conditions necessary to encourage increased energy trade and investment. The Agreement also emphasised the importance of modernising the energy infrastructure. On the other side of the scale of cooperation, Europe was meant to assist Russia in improving management and regulation of the energy sector in line with market economy principles, promoting energy saving and energy efficiency, improving energy technologies in supply and end use, and also assisting Russia in technical training in the energy sector. The Agreement's ten-year duration comes to an end in November 2007 and there are negotiations on designing a new agreement to strengthen cooperation between the two parties 'with a particular focus on progressive deepening and development of trade relations and fair and open development of the energy relationship between the EU and Russia'.⁹ The PCA will remain in force until a new agreement is put in place.

6.1.2. The EU–Russia Energy Dialogue

Energy was too important a sector to be dealt with by only a small section of the PCA. Therefore, during the EU–Russia bilateral summit of October 2000, an energy dialogue was instituted based on Article 65 of the PCA, which sought to improve energy relations between the two sides and to assist Russia's market integration. The Summit announced the decision 'to institute, on a regular basis, an energy dialogue which will enable progress to be made in the definition of an EU–Russia energy partnership and arrangements for it'. Through this, an opportunity was provided to raise all the questions of common interest related to the sector, including 'the introduction of cooperation on energy saving, rationalization of production and transport infrastructures, European investment possibilities, and relations between producer and consumer countries'. Since then the emphasis has been on identifying areas of common interest and preparing specific proposals and projects in this framework. The joint Russia–EU statement of 2001 provides that:

⁹ See the approval of the terms of a new agreement on cooperation between the EU and Russia <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/910&format=HTML&aged=0&language=EN&guiLanguage=en>> (3 July 2006). The EU–Russia Summit of November 2006 sought to prepare for a new EU–Russia agreement to replace the Partnership and Cooperation Agreement where integrating energy issues into the future partnership and cooperation agreement was at the forefront of negotiations. On the eve of the summit Poland vetoed the launch of the agreement raising their concerns over Russian embargo on the import of Polish meat and vegetables and requested Russia to ratify the ECT. An agreement regarding the Siberian overflight payments was established but the summit did not agree to launch negotiations for a new framework agreement between the EU and Russia and therefore no consensus was reached for designing a new PCA and a new framework for energy security.

Russia and the European Union share the same concerns regarding the stability of energy markets, the reliability and growth of imports and exports, the need to modernise the Russian energy sector, to improve energy savings and reduce greenhouse gas emissions from energy production and use. The EU recognises Russia as an important partner, a close, reliable and major source of energy resources and a growing supplier of energy products to the European Union. Russia, for its part, acknowledges that the development of the EU's internal market is building the world's largest and most integrated energy market in its immediate proximity. For this reason, the energy dialogue between the two Parties should be seen not only in the light of the establishment of an energy partnership but also as a contribution towards achieving the concept of a *common economic area*.¹⁰ (emphasis added)

This statement clarifies that the ultimate goal of the energy partnership between Russia and the EU is the integration of their energy markets, reform of the Russian energy industry and the incorporation of the existing rules of the European energy market in Russia. An interesting aspect that has been emphasised by the Directorate General of Energy and Transport of the European Commission, ie the body that specifically deals with this energy dialogue, is that this dialogue should not be considered as replacing private companies in contracting supplies of energy and it is not a master plan for future gas and oil pipelines and power transmission lines. The Commission is clear in insisting that these issues remain a matter for the private sector, based on their economic and commercial judgment.¹¹ Therefore, the dialogue was said to be a platform where common interests are highlighted, through the recognition of the complementarities of the respective energy markets and identification of the potential for cooperation in the energy field, which would ultimately guarantee Europe's security of energy supply. The distinction between what the dialogue is about and what it is not about is important. It defines the areas of common interest for the political institutions, but at the same time leaves actual participation in the energy sector, in terms of upgrading the energy infrastructure, obtaining long-term gas contracts and building new energy transportation facilities, to the private sector and the energy companies.

Within the context of the energy dialogue, several issues of great importance for both parties were addressed and some concrete results have been achieved. For example, Russia has insisted on the use of coal as the major source of electricity production in its country and because of coal's known polluting effects, efforts have been concentrated on encouraging the use of modern,

¹⁰ See the Joint Statement by the EU and Russia in the Summit of 3 October 2001 at <http://europa.eu.int/comm/external_relations/russia/summit_10_01/dc_en.htm>.

¹¹ The presentation by C Cleutinx, ex-Head of the Oil and Coal Unit of the European Commission's Directorate General of Energy and Transport, in the Conference organised by Aspen Institute-Italia entitled, *Emerging Challenges in the Field of Energy Policy for Europe, the US and Russia*, Florence, July 2002.

efficient and cleaner coal combustion technologies. For that purpose, the European Union approved a multi-annual programme of technological actions promoting the clean and efficient use of solid fuels (referred to as the CARNOT Programme) and considered Russia as a priority in the call for proposals to promote this activity.¹² In addition, the interconnection of Russian and continental electricity grids has been recognised as an area of common interest with the ultimate goal of integrating two electricity markets. Efforts have been made by the EU to transfer its knowledge and expertise in pooling the electricity markets, which was acquired in the internal EU context, to Russia, and to advise Russia on the necessary reforms for such integration. Russia has also shown its interest in 'profiting from the Commission's experience in preparing legislative proposals to address the issue of energy efficiency and energy savings in the construction and renovation of buildings as well as in the transport sector',¹³

There were also various 'round tables' on gas (December 2002), energy strategies (October 2003) and electricity (October 2003). In these round tables, the state of play of the electricity and gas markets, along with the energy strategies of the current year of both sides, have been discussed and the latest developments in each sector have been communicated. These round tables are designed to keep both parties up-to-date about recent events and developments in the energy sector. Moreover, a quick look at the fifth progress report of the EU–Russia energy dialogue reveals that measures are taking place on a constant basis within this framework that strengthens the dialogue. In addition, the EU is playing an extremely important role in facilitating Russia's accession to the WTO, within the context of which they reached an agreement to increase the domestic price of natural gas by 2010.¹⁴ The ratification of the Kyoto Protocol by Russia in October 2004, which came into force in February 2005, was also facilitated through the efforts of the EU. The European Union has also proposed the creation of an 'Observation System for Oil and Gas Supply'¹⁵ in order to assist in 'designing and properly applying Community legislation regarding oil supplies, monitoring the application of this legislation and helping to evaluate the effectiveness of the measures in force, as well as monitoring more closely the changes with regard to the security of oil supplies in the framework of the internal

¹² The programme will be open to all Member States of the European Union and to associated Central and East European Countries in accordance with the conditions, including financial provisions, laid down in the Association Agreements. See <<http://europa.eu.int/comm/energy/en/carsum.htm>>.

¹³ For more information on the issues being addressed in the EU–Russia energy dialogue, see the list of the progress made within this dialogue at <http://europa.eu.int/comm/energy/russia/issues/efficiency_en.htm>.

¹⁴ For a detailed analysis of this agreement, see above, ch 5.4.9.3 on dual pricing and subsidies. The tangible consequences of such reduction are yet to be felt.

¹⁵ See Art 12 of the Proposal for a Directive of the European Parliament and of the Council concerning the Alignment of Measures with regard to Security of Supply for Petroleum Products, COM (2002) 488 Final

market.¹⁶ In this manner, the Commission has thought of associating Russia with the work of this observatory and establishing a link with the hydrocarbon observation system, which the Russian Federation plans to create.¹⁷ This is deemed to enhance transparency, which would in turn contribute to security of supply because this constant cooperation framework of monitoring changes in the oil market creates confidence on the part of both consuming and producing nations to better predict changes in the market and act accordingly.

The other important step taken within the context of the EU–Russia energy dialogue was the creation of the EU–Russia Technology Centre in November 2002. The main objective of the centre is to strengthen co-operation between Russia and the EU in the sphere of advanced energy technologies in the sectors of oil, gas, coal, electricity, new and renewable energies and energy savings. Progress has been made, especially in the electricity sector and in funding short-term projects.¹⁸ One of the most important concerns of the energy-producing nations is having access to state-of-the-art technology in the energy sector, and the establishment of such a centre in Russia, which is co-funded by the two parties, is an indication of the will of the EU to satisfy this crucial demand. This initiative should be considered as the most important step in the EU's efforts to guarantee security of energy supply and it is in line with the underlying principle of 'mutual interdependency' between consuming and producing nations. Nevertheless, the real contribution of this centre to the EU–Russia partnership and the efficacy of the activities at this centre to enhance the dialogue and cooperation are yet to be determined.

The other relevant field of cooperation is to improve the investment climate in Russia. For that reason, an energy industry 'steering group' was initiated within the framework of the EU–Russia energy dialogue, which would contribute to the continued improvement of the investment climate and identify more clearly the

¹⁶ This system would: (a) monitor the functioning of the internal market and the international oil markets; (b) contribute to the setting up of a system for the physical monitoring of the infrastructures inside and outside of the Community which contribute to the security of oil supply; (c) monitor the security of oil supply and the procedures intended to guarantee security of oil supplies in crisis situations; (d) study the development of effective security measures in the oil sector; (e) monitor the level of security stocks of oil and petroleum products and the procedures for their use, and the implementation of measures to reduce consumption; (f) create objective, reliable and comparable databases to fulfil its tasks.

¹⁷ See Communication from the Commission to the Council and the European Parliament, *The Energy Dialogue between the European Union and Russian Federation between 2000–2004*, COM (2004) 777 Final at 6 [hereinafter the *Communication on Energy Dialogue*].

¹⁸ The EU–Russia Technology Centre carries out three main types of activities: exchange of know-how and information on new technologies through the organisation of events, development of publications and preparation of studies; project facilitation for projects of common technological interest with a view to attracting investment to these projects through supporting industrial actors in preparing the projects in accordance with international financial standards and promoting them to financial institutions for uptake; co-ordination centre for technology transfer issues for the European Commission and the Russian Ministry of Industry and Energy within the framework of the EU–Russia Energy Dialogue through regular meetings with all key policy and industrial actors. For further information, see <<http://www.technocentre.org>>.

issues to be tackled in this field. A round table of industrialists has also been created, which is comprised of senior representatives of European and Russian companies. They annually develop recommendations to Russia and the European Commission on trade and regulatory barriers between the two blocs.¹⁹

The above-mentioned measures took place within a short period, which shows a noticeable progress in the energy dialogue between Russia and the EU. Certainly, such progress should be considered as an important model for other energy-producing countries and is evidence of the type of additional measures that the Union itself can undertake to guarantee security of energy supply. Although the energy dialogue is not meant to replace the private sector in carrying out projects, as the Commission also highlights,²⁰ it identifies 'common interests', which are established through constant negotiations between the two blocs which could in turn facilitate the activities of the private sector as well. This will indirectly contribute to security of energy supply. Although the actual link between the existence of these measures and security of supply cannot be depicted at this moment, assisting Russia in satisfying its demands in the energy sector, such as upgrading its energy infrastructure, or establishing new transport routes for the carriage of energy, will definitely enhance security of supply in the long run.²¹

The two inter-related frameworks mentioned above, ie the PCA with Russia and the energy dialogue, were initiated as economic cooperation and were based on the provisions of the Treaty Establishing the European Community (TEC). One may wonder why such separate EU–Russia energy relations were initiated when the Energy Charter Treaty could have been used as the platform for such cooperation. After all, the ECT was designed to encourage cooperation in the energy sector, and it was initially drawn up to link Europe to the countries of the Eastern Europe and Russia. The fact is that ratification of the ECT met resistance in Russia. Major energy companies in Russia, such as Transneft and Gazprom, opposed ratification, arguing that 'it would oblige them to open their network to lower cost gas from Central Asian countries'²² that became members of the ECT.

¹⁹ For further information on the activities of the industrialists' group, see <http://europa.eu.int/comm/energy/russia/reference_texts/industrialists_en.htm>.

²⁰ See the 2004 Communication on Energy Dialogue, above n 17, at 11.

²¹ The Commission has highlighted the reasons for such progress and ambition in establishing an energy cooperation framework with Russia. One Communication of the European Commission refers to progress made between the year 2000 and 2004 and explains that the energy dialogue arose from the notion that the European continent constitutes a broad geopolitical area linked culturally, historically and economically and that the complementarity in terms of energy between the Eastern and Western parts of the continent should be developed in a sustainable way in the future... the Russian Federation could be in some ways the most promising, and geographically the closest, alternative to the Middle East as energy supplier to Europe.

See the Communication on Energy Dialogue, above n 17.

²² See D Johnson, 'The EU–Russia Energy Links: A Partnership Made in Heaven or Hell?' (draft), Hull University, prepared for Conference on Resource Policy and Security in a Global Age, Sheffield University, 26–28 June 2003, at <<http://www.shef.ac.uk/uni/academic/N-Q/perc/resourcepolicy/papers/johnson.pdf>>.

More general critics of the ECT claim, wrongly, that it runs counter to Russia's overall economic interest because it allows other countries to have easier access to Russia's natural resources. As mentioned above in the discussion on the ECT, it became clear that this treaty seeks to assure a balance of benefits for both consuming and producing nations. It should not be considered as advocating an 'open investment' policy creating a threat to national sovereignty. This being the case, however, it seems that Russia is not willing to enter into a multilateral setting where its power of command in the energy sector would be diminished. In any case, the Commission is clear in emphasising that the energy dialogue should not be considered as a substitute for Russia's ratification of the ECT. They have insisted on such ratification in parallel to the development of the energy dialogue.²³ Although the development of a separate framework for energy cooperation between the EU and Russia is not problematic per se from a legal perspective, (considering that the EU is the main destination for exports of Russian gas), it remains to be seen to what extent the dialogue is not actually replacing those efforts to encourage Russian ratification of the ECT in practice. After all, the dialogue, if developed smoothly and without interruption, will ultimately satisfy the needs of both sides in their energy cooperation, which would render Russia's membership of the ECT obsolete. It is therefore imperative for the Energy Charter Secretariat (ECS) to highlight the added value that the Charter can bring for Russia. They can, for example, emphasise the necessity to diversify Russia's dependence on one destination for its energy exports (ie Europe) to other destinations, such as China and India; they can also refer to the advantages that the ECT can bring to Russia in its competition with other major energy-producing countries of the region that seek to secure the important consuming countries as both export destinations and hosts for Russian investment. This benefit, however, becomes relevant when the ECS secures the membership of all these importing countries in the ECT as well.

Although efforts within these two frameworks are plausible, a Commission communication of 2004 enumerates the difficulties that Russia still faces. It is evident that the energy dialogue is not deemed to rectify all the economic problems that Russia has, and some weaknesses persist. For example, Russia's economy is still not diversified, there has been limited restructuring of many traditional large industrial enterprises, there is a lack of competition as 'market power and wealth is concentrated in a small number of large financial industrial groups with linkages to political power', there is still under-investment, etc.²⁴ Nonetheless, the Commission is correct in mentioning that the efforts in the framework of the energy dialogue should have implications in the long term, and

²³ See the presentation by Cleutin, above n 11.

²⁴ See Communication from the Commission to the Council and the European Parliament on Relations with Russia, COM (2004) 106 Final at 10 [hereinafter Communication on Relations with Russia].

also that 'its leverage should not be overestimated'.²⁵ Therefore, the Community has prioritised its influence in insisting upon Russia's membership of the WTO and enhancing the investment climate as a key factor to sustainable economic growth and economic diversification, the achievement of which will take place in the long term, if cooperation continues at the same pace. It is not too far-fetched to conclude that the details of the cooperation framework herald a rather ambitious and efficient effort, the uniqueness of which will be even more highlighted when compared to other existing cooperation frameworks with other energy-producing countries, discussed in the following sections.

6.1.3. The Common Strategy with Russia

Based on Article 13 of the Treaty on European Union (TEU), 'common strategies' are decided upon by the European Council and are implemented by the Union. As these strategies are undertaken within the policy framework of the Common Foreign and Security of the European Union (CFSP), or the second pillar, they are considered as political tools of the EU, compared to previous measures, such as the PCA, that were adopted based on the TEC or the first pillar.

Article 13 of the TEU provides:

The European Council shall decide on common strategies to be implemented by the Union in areas where the Member States have important interests in common. Common strategies shall set out their objectives, duration and the means to be made available by the Union and the Member States.

Although Article 13 is vague as to what exactly the 'important common interests' are,²⁶ it is clear that great flexibility is given to the European Council to decide the content of such a strategy.

The common strategy was created as the result of a compromise between Member States on extending the use of qualified majority voting (QMV) in the CFSP. A solution had to be found in the Intergovernmental Conference (IGC) 1996 as to the future of the voting mechanism. France proposed the creation of 'common strategies' as a compromise which backed a more powerful role for the European Council which would be decided by QMV and would be specific as to the objectives, interests, conditions and procedures in the field of the CFSP.

²⁵ See the 2004 Communication on Relations with Russia, *ibid*, at 13.

²⁶ The European Council in Lisbon 1992 set out the factors to be used to determine what the common interests are. Although these factors were enumerated for the purposes of joint actions, the definition of which is changed by the Amsterdam Treaty (Art 14) and later in the Nice Treaty, they could be useful for providing an idea of what the relevant factors could be. These factors are: (1) the geographical proximity of a given region or country, (2) the existence of important political interests in the political and economic stability of a region or a country, and 3) the existence of threats to the security of the Union. See D McGoldrick, *International Relations Law of the European Union* (Harlow, Longman, 1997) at 154.

The adoption of common strategies through QMV was not accepted,²⁷ but a compromise was reached that the implementation of these strategies through the adoption of joint actions and common positions would be taken by QMV. Therefore, the existence of this strategy in the framework of the CFSP can be seen as the only way to sneak the QMV into the realm of CFSP where the European Council takes an initiative. The Council shall recommend common strategies to the European Council and shall implement them, but the Council is not given an exclusive right to take the initiative since the European Council can decide on a common strategy in the absence of a Council recommendation. This is so because Article 13 is not described as ‘acting on a recommendation by the Council’.²⁸

In addition, Member States were busy dealing with the voting mechanism as the principal purpose of creating this instrument, and they did not seriously deal with what the substance of such strategies should be. The adoption of common strategies became purely intergovernmental, as it covered the objective interests of Member States.²⁹ Only where there is strong common interest among Member States can a common strategy be adopted—the text of which would be comprised of the smallest common denominator. This common interest, not surprisingly, was dedicated to some of the Community’s immediate neighbours, Russia, Ukraine and the Mediterranean (all are important for our study on energy security).³⁰ This is because the Council underlined that the first common strategies should be adopted with regard to the neighbouring countries, as ‘it is

²⁷ Although Art 23 provides that decisions under Title V are to be taken by the Council acting unanimously, common strategies are adopted by the European Council and there are no rules of procedure prescribed for the European Council to adopt a common strategy. Therefore, it is not clear whether a common strategy is to be decided by unanimity or whether there must be a common accord, because it is doubtful that the intention of the article is to give the Commission a veto over common strategies. For a deeper analysis, see A Dashwood, ‘External Relations Provisions of the Amsterdam Treaty’ in D O’Keeffe and P Twomey (eds), *Legal Issues of the Amsterdam Treaty* (Oxford, Hart Publishing, 1999) at 213 [hereinafter ‘External Relations of the Amsterdam’].

²⁸ A Dashwood rightly observes that it is also not clear whether the Council, in the implementation of common strategies, can use any other instrument apart from joint actions and common positions as Art 13 provides that the ‘Council shall implement common strategies, *in particular* by adopting joint actions and common positions’. He believes, therefore, that Council decisions can also be adopted in the implementation of a common strategy. See A Dashwood, in D O’Keeffe and P Twomey (eds), ‘External Relations of the Amsterdam’, *ibid*, at 212 (In the context of the Common strategy with Russia, the implementing instruments were joint actions and common positions, for example, the 99/878/CFSP Council Joint Action of 17 December 1999, establishing a European Union Cooperation Programme for non-Proliferation and Disarmament in the Russian Federation, [1999] OJ L/331/11.

²⁹ The objectives of the Union in dealing with third countries, however, are not easily determined. See, nevertheless, the text of the Draft Constitution for Europe, Art III-292 where a set of objectives is put in place to demonstrate the goals to be achieved in Union’s external relations, such as democracy, rule of law, universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for principles of UN Charter and international law.

³⁰ There were plans to adopt a common strategy on the Balkan region but the idea was abandoned.

there that the EU has the greatest long term common interest and the greatest need for *coherence and effectiveness*' (emphasis added).³¹

The common strategies already in place do not establish new fields of action in the previously existing relations with third countries or regions. A study of the existing Partnership and Cooperation Agreement with Russia, Ukraine and the Mediterranean Region, reveals that principles and objectives are merely repeated and only '*un léger toilettage*' of some of the already existing issues has taken place in the context of the strategy.³² However, regardless of the repeated objectives, the mere fact that they are mentioned in the context of the CFSP suggests that these objectives could be achieved through a framework, which encompasses both economic and political aspects. Furthermore, in the application of the common strategy, an inter-relation is revealed between the objectives of the Community institutions and those of the Member States in the sphere of external relations, relevant to our discussion on energy security.

In 1998, Russia faced a massive devaluation of the rouble and was falling into an economic crisis. Europe found that there was no real instrument in place to steer an immediate reaction to face this problem. Although it was believed that the Partnership and Cooperation Agreement with Russia (PCA) enjoys a perfect balance of interest, measures with the potential for immediate results were not adequately addressed. For this reason, a strategy was created between the Union and Russia to develop a mutually beneficial partnership with concrete measures.

Taking advantage of Article 13(2), by using a Common Strategy on Russia, was found to be the best way to assist Russia.³³ The Permanent Representatives' Committee or COREPER was asked by the Council of Ministers to prepare a progress report on the development of their policy towards Russia and the report concluded that the '*problems in Russia are multifaceted and an effective EU response required a multidimensional policy which takes into account all the aspects of the Russian reality as well*' (emphasis added).³⁴

³¹ See the Document submitted to the Vienna European Council, 11–12 December 1998, Press Release 13643/98.

³² In the Med Strategy, for example, there is talk of the elimination of poverty, whereas in the Barcelona Declaration there is a reference to the fight against poverty. There is also an added instrument of cooperation with civil society in the Strategy compared to the Declaration, namely cooperation with NGOs. Moreover, 'the promotion of greater understanding between cultures' in Barcelona is turned into 'fight intolerance and the dialogue between cultures'. For this comparison, see S Leonard, 'La Stratégie commune de l'Union européenne à l'égard de la Région Méditerranéenne' in M Dumoulin and G Duchenne (eds), *L'Europe et la Méditerranée: Actes de la VIe Chaire Glaverbel d'études européennes, 2000–2001* (Brussels, Peter Lang, 2001) at 289. More important for the purposes of our study here is energy, where a weak reference is made in the Common Strategy to supporting an interconnected energy infrastructure, whereas in the Barcelona Declaration great emphasis is placed on the various measures to be taken in this field.

³³ See Common Strategy of the European Union of 4 June 1999 on Russia, [1999] OJ L/157/1, (1999/414/CFSP) [hereinafter 'Common Strategy on Russia 1999']. Common Strategy 2003/471/CFSP of the European Council of 20 June 2003 amending Common Strategy 1999/414/CFSP on Russia in order to extend the period of its application [2003] OJ L/157/68.

³⁴ Haukkala and Medvedev (eds), *Common Strategy on Russia*, above n 4.

The drafting of a Common Strategy on Russia was not an easy task, most importantly because the text of Article 13 is vague as to what ‘common interests’ are and how objectives can be set out. However, the Council Working Group took responsibility and drafted the strategy.³⁵

The Common Strategy on Russia was adopted in May 1999. Broad strategic goals were identified as ‘creating a stable, open and pluralistic democracy in Russia governed by the rule of law and further maintenance of European stability, and promotion of global security’. The document also spells out numerous ‘areas of action’ one of which is the energy sector.

The second war in Chechnya in 1999 created a yardstick against which the credibility of the common strategy could be determined. At the General Affairs Council on January 2000, sanctions against Russia for the bombardment of Chechen cities were discussed. They adopted some ‘pseudo sanctions’ as some believe them to be,³⁶ and their loose and inefficient content undermined one of the main objectives of the common strategy, namely support for human rights.³⁷ Member States were not eager to adopt harsh measures against Russia. They supported the policy of the Union and disapproved Russian actions, but they carried on their business with Russia in their bilateral ties,³⁸ especially in their

³⁵ In accepting the draft, Member States found that the problems were outnumbering the advantages of a strategy. Firstly, there was the problem of voting. Art 23(2) states that the Council shall act through QMV when adopting Joint Actions, Common Positions or ‘taking any other decision’ on the basis of a common strategy. Since ‘any other decision’ was not elaborated on, it was feared that the use of QMV would be greater than they wished. Secondly, there was the problem of financial resources and granting loans to Russia through the European Investment Bank. Granting loans to third countries through the European Investment Bank (EIB) is done through unanimity voting through which a representative from every Member State has one vote. However, if one interprets Art 23(2) and the possibility of extending QMV to voting in the EIB (ie *any other decision related to the CS*), it would mean that granting loans to Russia through QMV would substitute unanimity, an outcome that some Member States did not desire. The problem was solved by expressing clearly in the Council Declaration that ‘*any other decision*’ would be taken according to ‘the appropriate decision-making procedures provided by the relevant provisions of the Treaty’ so that QMV could not be extended to the voting system of the EIBA Joint Action adopted based on the Common Strategy with Russia is Joint Action 1999/878/CFSP of December 1999 on establishing an EU cooperation programme for non proliferation and disarmament in Russia, ([1999]OJ L/331/11. Some believe that using the budget of the CFSP for this Action was not necessary, as it could have been done through the TACIS program, and therefore using the budget for this initiative can hardly be seen as an inspiring choice. See S de Speigeleire, ‘The Implementation of the EU’s Common Strategy with Russia’ [hereinafter ‘The Implementation of Common Strategy’] in H Haukkala and S Medvedev (eds), *Common Strategy on Russia*, above n 4, at 98. See also Declaration of the European Council related to the Common Strategy on Russia, annexed to the Common Strategy on Russia.

³⁶ Haukkala and Medvedev (eds), *Common Strategy on Russia*, above n 4, at 56.

³⁷ The sanctions were enumerated as: suspension of the signature of the Science and Technology Agreement with Russia; not using €30m worth of unspent food aid from 1999 to 2000, and taking a hard stance on Russian infringement of the PCA. None of the above appeared significant in Russia’s eyes. The Science Agreement’s non-ratification was insignificant compared to their goal of stopping the separatists in Chechnya; the food aid curtailment was decided at a time when Russia was no longer in serious need of this aid, and it was not clear what ‘hard stand’ would Europe take in the framework of the PCA in order to stop Russia from continuing the war.

³⁸ Haukkala and Medvedev (eds), *Common Strategy on Russia*, above n 4, at 58.

energy relations.³⁹ Since some of the main objectives of the common strategy were undermined in practice, it was difficult to evaluate the role of the strategy and to determine which policy changes at the EU level towards Russia were the result of the existence of this strategy. It is thus unclear what novelty exists in the Common Strategy on Russia that did not already exist in the PCA.

The PCA mentions paving the way for a gradual economic integration of Russia into a wider European Economic area, whereas the strategy emphasises 'a strategic partnership' and 'ever closer cooperation', which could be considered as a more 'integrationist' and political tool. It seems that the common strategy with Russia is an arrow thrown in the darkness of the realm of the CFSP to determine the limits of actions taken in the sphere of this policy by looking at where the arrow finally lands. The arrow of the Common Strategy on Russia did not land too far afield. However, what is important to emphasise is not so much the content of the strategy, which does not add anything new to the overall foreign policy framework with Russia compared to the PCA, but the institutional setting in which this strategy is adopted and its link to discussions on energy security.

The European Union is Russia's main trading partner and Russia itself provides a significant part of the Union's energy supplies. Therefore, the Common Strategy on Russia refers to a common interest in 'developing the energy policies of the Union and Russia in such a way as to improve the exploitation and management of resources and security of supplies in Russia and in Europe'.⁴⁰ In this way, Europe will cooperate with Russia in the field of energy, and consolidate the process of economic reform by exploring the scope for cooperation in areas of established Russian expertise, such as energy,⁴¹ and by helping to make Russian energy sector more competitive.⁴² The EU also agreed to promote Russian ratification of the Energy Charter Treaty⁴³ and to continue consultations on a Multilateral Transit Framework to enhance cooperation over access to the Russian pipeline system.

There are no references to concrete measures in the Common Strategy on Russia and only the objectives that should be pursued are numbered. The strategy, however, mentions that 'all relevant instruments and means available to the Union, the Community and the Member States are to be used in the implementation of the Strategy'.⁴⁴ It is not clear what kind of instruments can be used, and considering that Member States are obliged to take into account their

³⁹ For example, Germany was altogether unwilling to give priority to the Union to manage its external relations in areas where they had a vital economic interest, such as the energy sector. See IG Imhoff, *The New Germany, the New Russia and Energy* (Geneva, Institut Universitaire de Hautes Études Internationales, 2001) at 75.

⁴⁰ See Pt I, Point 4 of the Common Strategy on Russia.

⁴¹ See *ibid* Pt II, Point 2(b)(5).

⁴² See *ibid* Pt II, Point 2(a)(7).

⁴³ See *ibid* Pt II, Point 4(a)(3).

⁴⁴ See Part I, Title on 'Instruments and Means'.

obligations prescribed in this Strategy in their dealings with Russia, it would have been useful to at least refer to some of those instruments that Member States, along with the Community, can utilise.

Nevertheless, it is important that, in abiding by the Common Strategy on Russia, Member States are obliged to develop the ‘coordination, coherence and complementarity of all aspects of their policy towards Russia.’ Coordinating the energy policies of Member States vis-a-vis Russia is not an easy task, especially considering the difficulty that Member States have already faced in coordinating their internal energy policies among themselves. Various Member States have taken different external policies towards Russia for decades, and coordination of these policies requires the establishment of concrete measures and clear-cut mechanisms. The only mechanism in place is that a single questionnaire is established by the Commission and administered by the Council Secretariat, which contains a set of questions to Member States aiming at establishing a system for sharing information on the main features and instruments of relations between the EU Member States and Russia.⁴⁵ After acquiring the results, the aim is to create uniformity or coherence between Member States’ actions in their relations with Russia. Some believe that this questionnaire is of great importance for ‘the establishment of a genuine CFSP’, as no mechanism has ever been put in place to discuss national measures in the field of foreign policy with the aim of coordinating them.⁴⁶ However, true as this may be, one remembers the underlying rationale of the strategy, which is not aimed at Member States informing each other of their policies. The effect that this coherence should have on the EU’s external relations with Russia is the important issue at stake. Of course, one could praise the strategy for having actually developed a mechanism for coordination of Member States’ acts, and claim that an efficient structure for external relations necessitates a coherent internal mechanism. Nonetheless, it is still unclear how the findings of these questionnaires are used in coordinating measures and whether Member States are taking more concrete steps, after submitting these questionnaires, in coordinating their acts. A mechanism should be created to implement these findings and sanction the non-obedient Member State for not implementing them.

If this coherence and coordination is successful among Member States, it seems that the logical result would be a more efficient European policy to cooperate with Russia. However, in the area of investment, cooperation was unsuccessful because Russia made a critical comment concerning the perceived unwillingness of the EU to work out a joint plan to promote foreign investment in the Russian economy.⁴⁷ Russia, hence, adopted ‘A medium term strategy for

⁴⁵ See Speigeleire, ‘The Implementation of Common Strategy’, in Haukkala and Medvedev (eds), above n 4, at 98.

⁴⁶ *Ibid.*

⁴⁷ See Y Borko, ‘The European Union’s Common Strategy on Russia: A Russian View’ in H Haukkala and S Medvedev (eds), *The EU Common Strategy on Russia*, above n 4, at 124 [hereinafter ‘A

Development of Relations between the Russian Federation and the European Union (2000–2010)'. It is believed that the existence of the Common Strategy on Russia prompted its adoption. Through this plan, the Russian government sought to establish its own set of priorities, which was hierarchically different to the common strategy, but they mentioned that what they had in mind is also supporting the EU where their interests coincide. For instance, the reference of the EU's common strategy to energy relations is mainly concerned with energy sector reform and energy efficiency in Russia, and not with the guaranteed flow of Russian energy to Europe. One could make a link between these objectives and the flow of energy to Europe, since reforming the Russian energy sector could eventually lead to better and more efficient ways of exploration, production and export of Russian energy to Europe. Nonetheless, direct reference to this aim would be more consistent with the starting point of the common strategy, which refers to the importance of Russia in supplying energy for Europe. From the Russian perspective, energy revenue from the sale of energy to Europe is referred to in the strategy document. They mention one area where the interests of both parties coincide as the easy flow of fossil fuel supplies to the EU,⁴⁸ which would in turn guarantee income for Russia.

As shown by the examples above, it is difficult to determine the efficiency of the role of the common strategy in achieving the objectives of the PCA with Russia and the strategy itself. Divergent national policies towards Russia prevented the EU from reacting firmly to the situation in Chechnya and, therefore, the strategy turned into a non-strategy. However, one should not harshly react to this strategy, as it is only the starting point, which at least clarifies the European Union's external priorities. Moreover, the obligation adopted in the common strategy, that every presidency must prepare a work plan for its implementation,⁴⁹ will cause even the most disinterested Member States to prepare a list of priorities in their relations with Russia.⁵⁰ It is also emphasised that although Member States can continue their dealings with Russia on a bilateral level, they should nevertheless consider the common strategy.

The analysis of the importance of the tool of common strategies for the purposes of security of energy supply does not end here. Firstly, in order to determine the coherence and consistency of the EU's measures within the framework of the CFSP to initiate relations with energy-supplying countries through a common strategy, and in order to further verify the importance or the

Russian View']. Moreover, there is criticism as to the fact that the PCA framework, if implemented efficiently, is far more useful than the Common Strategy. The PCA needs neither new areas for cooperation, nor new competencies for the EU institutions in external economic relations. Therefore, they believe that the Strategy contains nothing new as far as implementation of the PCA is concerned. See the comments of the Russian delegation, Mr. Medvedkov, that negotiated the PCA between 1992 and 1994, in Borko's article at 127.

⁴⁸ See Borko, 'A Russian View', *ibid*, at 132.

⁴⁹ See the Common Strategy on Russia, Part I, Instruments and Means, point 4.

⁵⁰ Haukkala and Medvedev (eds), *Common Strategy on Russia*, above n 4, at 68.

lack of significance of this measure, we should turn to the Common Strategy with the Mediterranean Region which is discussed in the next section. After examining the existing frameworks of cooperation with energy-supplying countries, the relevance of a political or CFSP tool (such as a common strategy), in parallel with tools for economic cooperation in guaranteeing security of supply, will be revealed.

Putting the institutional aspect of the EU–Russia relations aside, some events in the year 2006 regarding the transit of Russian gas via Ukraine and the harsh stand of the Russian government towards investment of major international oil companies raised doubts regarding the reliability of Russia to guarantee energy flow to Europe and the protection of foreign investors in Russia, which some believed, undermined the overall cooperation framework between the EU and Russia. The first incident was the blockage of the export of gas to Ukraine in the beginning of January 2006. Due to a dispute between Russia and Ukraine over the price of gas and the rejection on the part of Ukraine to agree to a higher price for gas offered by Russia, Gazprom cut off gas supplies to Ukraine on 1 January 2006. The fall in volumes raised concerns in Europe and it once again brought up the question of energy security and reliability of Russia and transit countries in securing energy flow to Western Europe.⁵¹ Although the conflict lasted only four days and the gas delivery was soon resumed, the incident left a bitter taste in the European mouth that prompted the adoption of various measures, such as the speedy submission of the Green Paper on energy security in March 2006 to the Council, dedicating a major part of the G8 discussion to energy security, and emphasising each year on the importance of dealing with energy issues in the Presidency Conclusion of the European Council. This event also raised once more the importance of taking one element of energy security into account more seriously than before, namely diversification of energy sources away from Russia and also diversification away from natural gas.

The second incident was the suspension of Shell’s environmental permit of the Sakhalin II liquid natural gas plant which prompted the anger of the European Union and Japan, and had raised questions about Russia’s good faith and its task to create a secure and predictable investment climate, and has led some to call the incident the ‘gas battle’.⁵² It is argued that the reason for such move were not necessarily the protection of environment by Russia but lies in political decisions

⁵¹ For a detailed analysis of the incident see J Stern, ‘The Russian–Ukrainian Gas Crisis of January 2006’, OIES publication, January 2006, <<http://www.oxfordenergy.org>>. [hereinafter ‘The Gas Crisis of January 2006’]. See also JM Roberts, ‘Mitigating Geopolitical Risks: Eurasian Energy Security in the Wake of the Russia–Ukraine Imbroglio’, Fourth Asia Gas Partnership Summit, 21 February 2006, Delhi.

⁵² See F Roche, ‘La Bataille du Gaz’, Foreign Policy, Edition Francaise, no 1, October/November 2006. See also the Press Release, ‘Energy Commissioner Andris Piebalgs Reacts to Announcement of the Cancellation of an Environmental Permit for the Sakhalin II Project led by Shell’, (19 Sept. 2006) at <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1211andformat=HTMLandaged=0andlanguage=ENandguiLanguage=en>>, and <<http://www.euractiv.com/en/energy/eu-voices-anger-russia-move-halt-sakhalin-project/article-157972>>.

and the desire of Gazprom to dominate the gas sector and finds a strong position in the LNG market and take full control of the exportation channels. Such incidents also raise the concerns of the European Union in heavily relying on Russia, a reliance that cannot easily be circumvented considering the strong dependence of the EU on imports of Russian oil and gas and the difficulty in accelerating new infrastructure projects elsewhere. For this reason some believe that it is not yet wise to cut relations with Gazprom.⁵³ Nevertheless, these incidents call for a strong EU external policy towards major oil-producing and gas-producing countries which guarantees diversification of sources and supplies as a major element. In the following pages the relations of the EU with other major oil-producing and gas-producing countries of the Persian Gulf and the Mediterranean are discussed to explore further the relevance of the element of diversification.

6.2. EU–MEDITERRANEAN ENERGY RELATIONS

The Mediterranean region plays an important role in the design of an EU policy to secure energy supply. The two main obvious reasons for developing close collaboration with the Mediterranean Partners in the energy sector are: (1) geographical proximity to Europe's southern flank as a crucial factor, given the importance of transit of energy sources from other neighbouring regions such as the countries surrounding the Persian Gulf and Caucasus; (2) the cumulative volume of oil and gas reserves in the Mediterranean Partner countries as an important guarantee of supplies to the EU.⁵⁴

The relationship between the European Union and the Mediterranean region, ie the countries bordering the Mediterranean Sea to the East and South,⁵⁵ is multi-dimensional and contains various political, economic and cultural aspects. Within the EU, the discussion on the importance of the region for energy security purposes is approached mainly through the wider framework of the EU–Med Partnership, where the promotion of prosperity, democracy, stability and security in the Mediterranean basin has been considered as a major external relations priority of the European Union. This partnership has become very challenging, not only because a vast number of countries, from Algeria to Jordan and Israel, with their various political and economic characteristics are involved,

⁵³ See Roche, 'La Bataille du Gaz', *ibid.*

⁵⁴ See Communication from the Commission to the Council and to the European Parliament of 7 March 2001, 'Enhancing Euro-Mediterranean Cooperation on Transport and Energy', COM (2001) 126 Final.

⁵⁵ Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey and the Gaza/West Bank. Two of these countries are members of the European Union since May 2004, namely Cyprus and Malta. Turkey is a candidate country and the EU's bilateral relations with this country are covered by the Accession Process.

but also because the region is faced with recurrent conflicts and instabilities, which have proved difficult to deal with.

The Mediterranean region, as mentioned above, is significant for energy security purposes. Four countries in the Southern and Eastern Mediterranean Countries (SEMCs) have energy reserves and are hydrocarbon exporters, namely Algeria, Libya, Syria and Egypt (see tables 6.1 and 6.2). Other countries, such as Morocco and Tunisia, are important transit countries through which Algerian gas is transferred to Italy and Spain.⁵⁶ The executive summary of a report by the Observatoire Méditerranéen de l'Énergie (OME)⁵⁷ on the Development of Energy Supplies to Europe from the Southern and Eastern Mediterranean Countries demonstrated that in 2000 the SEMCs supplied 50 billion cubic meters (bcm) of gas (almost exclusively by Algeria) and 88 Mt of oil (mainly Libya and Algeria) to Europe (EU-15). This corresponds to 27 per cent of European gas imports and 17 per cent of its oil imports.⁵⁸ Egypt and Syria will gradually switch from being oil exporters to oil importers due to 'a shrinking reserve based in Egypt and a strongly growing domestic demand in that country, and depletion of reserves in Syria'.⁵⁹

Table 6.1 Gas Export: Potential Scenarios from the Mediterranean Region to Europe*

Gas Exports (bcm)	2000	2005	2010	2015	2020
Algeria	62	69	85	100	120
Syria	0	1.1	-1.9	-5.6	-10
Libya	0.9	1.0	11	15	27
Egypt	0	12.7	26	31	31
Total	63	84	122	146	178

Source: Observatoire Méditerranéen de l'Énergie, *Med Supply: Development of Energy Supplies to Europe from the Southern and Eastern Mediterranean Countries* (June 2003) at <<http://www.ome.org>>

⁵⁶ Tunisia is a modest oil producer and contributes 0.34% to the EU oil imports. See the Registration of Crude Oil Imports and Deliveries in the Community 2004, at <http://europa.eu.int/comm/energy/oil/crude/index_en.htm>. The country possesses 2.8 tcf (trillion cubic feet) of proven natural gas reserves but produced only 66 bn cf (billion cubic feet) in 2000.

⁵⁷ The Observatoire Méditerranéen de l'Énergie (OME) is a non-profit organisation, whose main objective is to promote co-operation between the major energy companies operating in the Mediterranean basin.

⁵⁸ See also the 2004 Registration of Crude Oil Imports and Deliveries in the Community, above n 56. Libya contributed 9.55% to the European import of crude oil, followed by Algeria 3.67%, Syria 1.66%, Egypt 0.51%, and Tunisia 0.34%.

⁵⁹ See also the EIA Country Analysis Brief: Syria at <<http://www.eia.doe.gov>>. The EIA data predicts that Syria will become a net importer around 2014.

* As the OME provides, in the Executive Summary, Final Report, these tables take into account geological data, technological development, domestic and regional demand for oil and gas, the institutional framework, country and company strategies as well as an assessment of production and export projects and their development. The following tables and figures present the oil and gas export potential for each of these countries as well as major export projects.

Table 6.2 Oil Export: Potential Scenarios from the Mediterranean Region to Europe*

Oil Exports (mtoe)	2000	2005	2010	2015	2020
Algeria	62.3	87.6	104	116	123–143
Syria	16	13	3	-4	-14
Libya	61	92	116	131	150
Egypt	12	1	-12	-25	-36
Total	151	193	223	247	273–293

Source: *Observatoire Méditerranéen de l'Énergie*, Med Supply: Development of Energy Supplies to Europe from the Southern and Eastern Mediterranean Countries (June 2003) at <<http://www.ome.org>>

*As the OME provides, in the Executive Summary, Final Report, these tables take into account geological data, technological development, domestic and regional demand for oil and gas, the institutional framework, country and company strategies as well as an assessment of production and export projects and their development. The following tables and figures present the oil and gas export potential for each of these countries as well as major export projects.

Apart from the broader framework of cooperation with the Med Region, the EU, similar to other Mediterranean countries, has approached Algeria on a bilateral basis as well. In 2002, an association agreement was signed between the EU and Algeria.⁶⁰ Article 61 of this agreement exclusively deals with cooperation in the field of energy and mining. It enumerates the aims of cooperation as upgrading the institutional, legislative and regulatory systems, upgrading the technological system, developing partnership between companies, setting up databases in the mining and energy sectors, and supporting and promoting private investment.

⁶⁰ See Council Decision on the signing, on behalf of the European Community, of the Euro-Mediterranean Agreement establishing an Association between the European Community and its Member States, of the one part, and the People's Democratic Republic of Algeria, of the other part, 6786/02, 12 April 2002.

Libya, on the other hand, is the only country around the Mediterranean Sea with no formal relations with the European Union. Due to the lifting of UN sanctions against Libya in the aftermath of the Lockerbie incident, steps have been recently taken towards a progressive reintegration of Libya into the international community. For that reason, the Euro-Med Partners reached a consensus in 1999 to allow Libya to become a full partner of the Barcelona Process if it accepts the full Barcelona *acquis*. So far, no concrete actions have been taken within this framework by Libya, but the Community is preparing the ground for full integration of this country into the Barcelona Process.

The association agreements with other countries of the Mediterranean, such as Tunisia, Morocco, Jordan, Israel, Palestine, Egypt and Lebanon, also refer to energy.⁶¹ However, the provisions are not as elaborate as those found in the association agreement with Algeria. References are only made to the importance of promoting renewable energies and indigenous energy sources and energy efficiency, as well as modernisation and development of energy networks and their desirable linkage to those of the Community. Considering the importance of Tunisia and Morocco as important transit countries, the modernisation of these networks and the financing of new ones in the region is a desirable goal.

Apart from the association agreements with various countries of the Mediterranean, the Barcelona Declaration also referred to the importance of energy by emphasising the 'pivotal role of the energy sector and the importance of strengthening cooperation and intensifying dialogue in the field of energy policies'.⁶² This reference was made within the framework of the Euro-Mediterranean conference, held in Barcelona in November 1995, which opened a new chapter in relations between the two regions and resulted in the establishment of a list of priorities in the 'Barcelona Declaration'. The aim was not only to create an economic area and to integrate the Mediterranean countries into the wider framework of European free trade, but also to create a zone of political stability and security.

Industrial cooperation was included in the agenda, and the May 1996 meeting in Brussels enumerated priorities for this cooperation, such as the creation of an

⁶¹ See the Association Agreement with Morocco, Art 57, with Tunisia, Art 57, with Egypt, Art 53, with Israel, Art 51, with Jordan, Art 74, with Lebanon, Art 54 and with Palestine, Art 48.

⁶² See Barcelona Declaration, [1995] OJ L/278. The Annex to the Declaration listed the specific actions to be undertaken in the energy sector as the following:

[F]uture cooperation will focus, inter alia on: Fostering the association of Mediterranean countries with the Treaty on the European Energy Charter; Energy planning; Encouraging producer-consumer dialogue; Oil and gas exploration, refining, transportation, distribution, and regional and trans-regional trade; Coal production and handling; Generation and transmission of power and interconnection and development of networks; Energy efficiency; New and renewable sources of energy; Energy-related environmental issues; Development of joint research programs; and Training and information activities in the energy sector.

appropriate legal and administrative framework, improvement of business culture, and modernisation of industrial zones, among other things.⁶³ The success of industrial cooperation was linked to the development of suitable infrastructures and their optimum performance and reliability in areas such as transport, energy, telecommunication and water resources. In this regard, a 'Euro-Mediterranean Energy Forum' was held in June 1996 in Trieste, with the objective of organising and monitoring cooperation in the field of energy between the parties.⁶⁴

In this context, attention was paid to the 'crucial' role that energy can play in achieving the objectives of the Euro-Mediterranean partnership.⁶⁵ In other words, it is not only the development of the energy sector for the economic prosperity of the Mediterranean region itself that was found important. The security of Europe's energy supply, or in other words the economic development of the Community, which is guaranteed through this security, was also found to be essential. It is clear that the important role that the Mediterranean region plays for the importation of energy to Europe, be it as an energy source, such as Algeria, or as a transit country such as Turkey, Tunisia or Morocco, could not be undermined. One can submit that this is an example of a change in the Community policy from 'aid' as a purely demand-driven policy⁶⁶, to 'cooperation and partnership' based on a mutuality of interest in which the energy sector could play an important role. The fact that reference was made to the creation of a framework for 'strategic relations', going beyond traditional areas of trade and assistance cooperation, and the fact that this partnership sought to represent the wish of the EU to work with its partners and 'to get away from the previous situations where the EU made proposals and its Mediterranean partners either accepted or rejected them'⁶⁷ could confirm this change of policy. The question, however, is whether they were successful in achieving these aims.

At the Trieste Conference, the creation of appropriate conditions for investment and increasing trade in energy products were considered as ways to guarantee the development of the energy sector. In order to achieve these objectives, special attention had to be paid to the development of energy

⁶³ See (1996) 6 *EU Bulletin* Point 1.39.5. See also JA McMahon, *The Development Co-operation Policy of the EC* (London, Kluwer Law International, 1998) at 112.

⁶⁴ Conclusions for a Euro-Mediterranean partnership on energy adopted at the Trieste Conference. See also Commission Communication to the Council and the European Parliament concerning the Euro-Mediterranean Partnership in the Energy Sector, COM (96) 149 Final.

⁶⁵ See Conclusion for a Euro-Mediterranean Partnership on Energy adopted at the Trieste Conference <http://europa.eu.int/comm/external_relations/euomed/conf/sect/energy.htm>.

⁶⁶ Demand-driven in the sense that governments of third countries decided their own project priorities and then made requests to European partners for help, operating under what has been called a 'shopping list' approach. See specifically, P Holden, 'The European Community's MEDA Aid Program: A Strategic Instrument of Civilian Power?' (2003) 8 *European Foreign Affairs Review* 347 at 350.

⁶⁷ See Communication from the Commission to the Council and the European Parliament to prepare the fourth meeting of Euro-Mediterranean Foreign Ministers 'Re-invigorating the Barcelona Process', 6 September 2000, COM (2000) 497 Final, at 1 [hereafter 'Re-invigorating Barcelona'].

networks and infrastructure in the Mediterranean countries, including the development of the external dimension of the trans-European Energy networks. Efforts were to be also concentrated on creating a consistent approach to energy policies in the region, and the harmonisation of legal and contractual rules applied to the energy sector in order to encourage investment by foreign companies. Reform of the legislative and regulatory framework, and the restructuring of the Mediterranean Partners' energy industry, were priorities. The existence of a centralised state-controlled monopoly in the energy sector was found to deter inflows of foreign investment, which are crucial to increasing the production capacities needed to satisfy the growing demand for energy, particularly in the electricity sector.⁶⁸

It was also agreed that the Energy Charter Treaty could be considered as a reference instrument. It is not clear what is meant by 'reference instrument', but it was probably intended that the existing principles of that treaty on energy could be incorporated into this cooperation as well.⁶⁹

Nonetheless, the conclusions of the Trieste Conference of June 1996 could only be considered as the starting point for the development of the Euro-Med Partnership in the field of energy. The objectives enumerated in this conference were found difficult to implement, due to general problems in dealing with the Med region. First of all, the establishment of peace and stability, which was considered as the essential component of such a partnership, proved to be a hope flying too high.⁷⁰ Secondly, investment in the energy sector, which was deemed to be an important component of industrial cooperation linked to development cooperation and ultimately the partnership, faced barriers. In order to invest in

⁶⁸ See the EUROMED Report, March 2001 <http://europa.eu.int/comm/external_relations>. See also the 'Euro-Med Partnership: Regional Strategy Paper 2002–2006 and Regional Indicative Program 2002–2004'. It explained that weak service sectors, especially transport, energy, telecommunications and financial intermediaries, account for a significant proportion of high transaction costs in the Mediterranean region. At a broader level, most of the partners 'maintain high barriers to trade in services, impeding access to their markets, making their service providers less competitive and hence lessening their attractiveness to foreign investors and dragging down economic performance generally' (emphasis added).

⁶⁹ Other issues of importance mentioned in the conclusion of this conference were referred to as follows: an effort should be made to identify efficient ways to promote international investment, including methods of providing better cover of investment risks with the participation, where appropriate, of interested companies, to allow the financing of projects aiming at improving the energy situation in countries of the Southern and Eastern Mediterranean; considering the important relations between energy and the environment, environmental objectives should be taken into account in the framework of the energy partnership, being compatible with the improvement of supply security and the interconnection of networks; an effort should be made in order to improve energy efficiency, to develop renewable energy sources, in particular for thermal use and electricity production, and to provide electricity in rural areas.

⁷⁰ On the relationship between the Middle East Peace Process and the Euro-Mediterranean Partnership, see J Hutchence, 'The Middle East Peace Process and the Barcelona Process' in F Attina and S Stavridis (eds), *The Barcelona Process and Euro-Mediterranean Issues from Stuttgart to Marseille* (Milan, Pubblicazioni della Facoltà di Scienza Politiche, 2001) at 171. Art 5 of Part I of the European Council's Common Strategy of the European Union on the Mediterranean Region, approved on 19 June 2000, SN 200/0 ADD 1.

the energy sector, mere reform of the legal system of the energy-producing country is insufficient. Furthermore, there is no outright guarantee that reform is transferred into a quick return on foreign investment. Other factors should exist, such as reform of the fiscal regime, the institutional setting, perceptions of risk and reward, and the local attitude towards foreign investors and the possibility of opening up their reserves to foreign exploration and production. This was all yet to be accomplished in countries of the Mediterranean. Thirdly, the fact that problems existed is evident from the document entitled 'Re-invigorating the Barcelona Process', in which 7 areas of encountered difficulties were enumerated,⁷¹ namely obstacles to the Peace Process, the reluctance of the Mediterranean partners to accelerate the pace of economic transition and to introduce reforms, the low level of investment in the region, and difficulties in implementing the MEDA assistance program⁷² because of complicated procedures in partner countries.⁷³ Nothing very significant, however, derived from this initiative.⁷⁴

More concrete measures in the energy field were introduced in Granada in May 2000. These included the establishment of contacts between energy regulators of the EU and the Med partners, in order to assist in amending the legal framework and laws, the need to train Med partners within the framework of the process of liberalisation of the electricity and gas markets, and increased cooperation between energy companies of the EU and those of the Med.⁷⁵

In 2001, the Commission confirmed its firm position to assist in achieving the objectives of the Barcelona Declaration in the field of energy. They included not only reform of the legal and institutional systems of the Med countries, but also

⁷¹ See 'Re-invigorating Barcelona', above n 67. See also G Luciani, 'Europe and the Mediterranean', Discussion Paper presented at the seminar organised in the framework of the Mediterranean Program of the Robert Schuman Centre for Advanced Studies, European University Institute, February 2003 (on file with the author).

⁷² The MEDA Programme is the European Community's assistance programme, with the objectives of supporting the process of transition, supporting regional integration and helping to maintain social cohesion in the Med region. For the rules on the implementation of the priority objectives of the partnership, see Annex II of Council Reg No 1488/96 on financial and technical measures to accompany the reform of economic and social structures in the framework of the Euro-Mediterranean Partnership, [1996] OJ L/189/1.

⁷³ See 'Re-invigorating Barcelona', above n 67.

⁷⁴ The Euro-Med Energy Forum organised a Euro-Med conference of energy ministers to be held in Brussels in May 1998. This conference was mainly a confirmation of their continuing mutual interest in the development of energy cooperation. See the statement of the European-Mediterranean Energy Ministers on 11 May 1998 at <http://europa.eu.int/comm/external_relations/euromed/conf/sect/energy2.htm>. They adopted the 1998–2002 Action Plan and agreed on the following objectives: (1) security of supply, by the *development and diversification of energy resources* and by close international co-operation, taking account of complementarity and of the mutual interest between consumers and energy suppliers; (2) the *competitiveness of the energy industry*, in particular in view of the implementation of a free trade area by the year 2010 and by means of increased industrial cooperation, taking into account the different economic and social conditions in each country; (3) *environmental protection*, by ensuring production, safe and clean transport and distribution of energy by encouraging energy efficiency and renewable energy.

⁷⁵ See 'Conclusions of the Third Meeting of the Euro-Mediterranean Energy Forum', Granada, May 18–19, 2000.

convergence of their energy policies and the subsequent integration of the energy markets of these countries.⁷⁶ The ways through which concrete actions could be adopted were not elaborated on in this document. Various other documents were provided and fresh emphasis was placed on achieving the objectives mentioned above. For example, the fields to battle against were named as the weakness of the capital markets of the countries in this region, and the lack of an adequate range of available financial instruments (the solution was identified as creating a new facility or a European or international development bank, or re-shaping the existing European Investment Bank to address the problem of the Med region).

The long list of documents provided and the conferences held⁷⁷ between 1995 and 2000 to discuss obstacles to the Euro-Med Partnership in the field of energy are firstly a presentation of the existing political will to create a better framework for partnership, and also shows that no rapid progress, similar to that achieved in the framework of the EU–Russia dialogue, could be achieved.

Recent progress since the beginning of the year 2003, however, shows a significant change in managing this partnership. Ad hoc groups were created to study energy policies, interconnections and undertake economic analysis. They created guidelines and made proposals for concrete actions in projects of regional interest. In the Ministerial Declaration of the Euro-Med Energy Forum (Athens 2003), some useful guidelines for enhancing partnership in the field of energy were proposed. These guidelines could be considered as the first significant step towards efficient energy cooperation between the two regions.⁷⁸

First of all, projects of common interest between the two regions were listed as integration of electricity and gas markets, improving the safety and security of energy infrastructure and reducing the risks of carriage of oil and gas by sea in the Mediterranean basin. For the purposes of security of supply, there is a link between an integrated and interconnected network and diversity of energy links, which would in turn result in enhanced security of supply. However, an interconnected network guarantees security of supply as long as a strong framework is

⁷⁶ See Communication from the Commission to the Council and the European Parliament, *Enhancing Euro-Mediterranean Cooperation on Transport and Energy*, COM (2001) 126 Final at 10.

⁷⁷ See also the meetings of Foreign Ministers in Malta in April 1997 ('Barcelona II'), in Stuttgart in April 1999 ('Barcelona III'), in Marseilles in November 2000 ('Barcelona IV'), and in Valencia in April 2002 ('Barcelona V'). They also held other meetings in Palermo (June 1998), Lisbon (May 2000), Brussels (November 2001), and Crete (June 2003). See also the meetings of the Euro-Med Energy Forum in Trieste in June 1996, in Brussels in May 1998, and in Athens in May 2003. See the objectives to be pursued reflected in the documents of: 'The Euro-Med Partnership Regional Strategy Paper 2002–2006 and Regional Indicative Programme 2002–2004', dealing with the MEDA assistance programme to the 12 Mediterranean Partners; 'The Commission's Work Program for 2002', which presents the list of the 'Commission Priorities for 2002', and the European Parliament resolution on the Commission communication to the Council and the European Parliament to prepare the meeting of Euro-Mediterranean Foreign Ministers, Valencia, 22/23 April 2002, SEC(2002) 159.

⁷⁸ See 'Ministerial Declaration of the Euro-Mediterranean Energy Forum adopted together with its annexes by participants' at the Conference in Athens on 21 May 2003, specifically Annex 2, at <http://europa.eu.int/comm/dgs/energy_transport/international/euromed/doc/conf3/2003_05_21_euromed_3_ministerial_declaration_en.pdf>.

put in place and cooperation among grid operators exists, so that the failure in one connection does not result in the failure of the whole system. Moreover, considering the transit potential of the Mediterranean region to transfer energy from the Caspian, Middle East and Africa to Europe, an efficient interconnected system would facilitate such transit. Moreover, there is the likelihood that a vast part of the Mediterranean region will become a net importer by the year 2020.⁷⁹ Its potential as a transit region therefore becomes more important. From a policy perspective, the creation of common rules for the establishment of a harmonised legal framework in the Med region, the reduction of subsidies, and common rules for transparent energy charging were pointed at.

Another more important step was the repeated emphasis placed on the necessity of enhancing Euro-Med Cooperation with international institutions, such as the Energy Charter Treaty.⁸⁰ It was said that as new ideas are developed in these forums in general, and new solutions for reforming various sectors are introduced and discussed, the Med countries' participation in these discussions (at least as an observer) could assist them in identifying their problems and utilising the proposed solutions. Another noteworthy attempt is to link, finally, the political will of enhancing the Euro-Med partnership with the direct and necessary participation of the energy industry of countries of the Mediterranean. It was not only experts of the industry that were meant to be involved in negotiations at the level of the Energy Forum: there was also an emphasis on the development of close industrial cooperation between the Med region and Europe. Cooperation in transfer of technology, right of establishment of companies, and the use of the Galileo Satellite navigation project—which would enhance supervision of the construction and maintenance of energy infrastructure and monitoring of tankers and trucks, and transporting hazardous products—were named as areas of industrial cooperation.⁸¹

The guidelines provided in this Ministerial Conference are clearly a big step forward in the context of the Euro-Mediterranean energy partnership. Following these recommendations, the Ministerial Conference in Rome, in December 2003, produced the results of some measures taken in this framework, such as the completion of some feasibility studies and the satisfactory progress of the working group in charge of harmonisation of the Maghreb electricity market. They further emphasised that, upon the successful harmonisation of the Maghreb region, the Mashregh region should take steps towards integration as well. Another success has been the progress within the framework of cooperation between Israel and the Palestinian Authority in identifying and promoting energy

⁷⁹ See Annex 2.8 of the Ministerial Declaration of Athens.

⁸⁰ The necessity of linking the Med partnership to the Convention on Climate Change (UNFCCC), the Kyoto flexibility mechanisms, the Coalition of the Willing (Johannesburg); and the International Maritime Organisation (IMO) for issues relating to safety of the carriage of hydrocarbons by sea, especially CDM, where also found appropriate.

⁸¹ See Annex 2.12 of the Ministerial Declaration of Athens.

projects of common interest in the electricity sector, in the context of which an agreement was signed between the two countries in 2003.⁸² Progress was declared in a number of feasibility studies on the network interconnections that have been funded by the Commission, such as the interconnections between Turkey and Greece.⁸³ Moreover, Algeria, Tunisia and Morocco gained observer status at the ECT, in order to ensure wider awareness of this treaty's aims and objectives.⁸⁴ The involvement of the Mediterranean region in the activities of the ECS, of which the European Community is also a member, would create the basis for furthering the aims of the Euro-Med partnership in another institution that aims at energy cooperation among various regions.⁸⁵ However, as the previous chapter demonstrated, it is up to the ECS to evaluate the ways through which membership of these countries could be encouraged.

Another important step was the creation of the Euro-Mediterranean Energy Platform (REMEDI). Its objectives are to facilitate and monitor the implementation of the Euro-Mediterranean energy policy, provide continuous support, and to highlight specific actions of common interest.⁸⁶ The REMEDI was inaugurated on 15 October 2004 and is based in Rome. Each country of this cooperation will nominate representatives and each will cover the cost of their personnel and their participation in the activities of this platform. The contribution of this initiative to enhancing Euro-Med energy cooperation remains to be evaluated in the years to come.

⁸² This agreement identified emergency projects and encouraged the establishment of a Joint Energy Office to conduct joint analysis of common projects and prepare long-term orientation plans. These cooperation agreements were obtained within the framework of the technical working group set up in Athens in 2003 including the two countries and the European Commission.

⁸³ One of the projects within this framework is the extension of the Greek Gas transport system eastwards to the Greek-Turkish border and the parallel extension of the Turkish gas transport up to the Turkish-Greek border. DEPA and BOTAS signed a Memorandum of Cooperation in January 2001 in order to undertake preliminary technical, environmental, commercial, financial and legal studies for the development of a gas pipeline linking the Turkish and Greek gas networks. The first phase of this project purports to build a gas pipeline of 285 kilometers from Turkey to Greece by 2005, the second phase is to increase the capacity of the interconnection so that it does not only serve Greece but can be extended to Bulgaria by 2010, the third phase is to supply Albania and Italy through construction of another line onshore up to the West coast of Greece and another line to the Greek-Albanian border by 2015. The fourth phase is to increase the capacity of the latter pipeline.

⁸⁴ See the *2002 Annual Report of the Energy Charter Secretariat* (Brussels, Energy Charter Secretariat, 2002) at 24, at <<http://www.encharter.org>>.

⁸⁵ See the Communication from the Commission to the Council and the European Parliament, Tenth Anniversary of the Euro-Mediterranean Partnership: A Work Programme to Meet the Challenges of the Next Five Years, COM (2005) 139 Final, at para (h).

⁸⁶ See the Euro-Mediterranean Conference on 'Infrastructure, Investment and Energy Supply Security', Rome, December 2003 at <<http://europa.eu.int>>. See also Rome Euro-Mediterranean Energy Platform 'Establishment and Statute', 15 October 2004 at <<http://ec.europa.eu>>.

6.2.1. The Common Strategy with the Mediterranean

On 19 June 2000, the Feira European Council adopted a Common Strategy of the European Union on the Mediterranean Region (Med Strategy).⁸⁷ This Common Strategy, similar to the one on Russia, is divided into five parts: the vision of the EU for the Mediterranean region, objectives, areas of action, specific initiatives (political and security aspects, democracy, human rights and the rule of law, peace in the Middle East, economic and financial, environment, social and cultural, justice and home affairs), instruments, and duration. The reason for adopting a common strategy on this region was said to be the ‘strategic importance of this region to the EU and the fact that a prosperous, democratic, stable and secure region with an open perspective towards Europe, is in the best interests of the EU and Europe as a whole’. The reference point for this strategy is said to be the Euro-Med Partnership.⁸⁸

Unlike the Common Strategy on Russia, the Med Strategy does not refer to the political and economic transformation of the Med region in describing the vision of the EU.⁸⁹ More attention is paid to the importance of peace and stability in the region. Secondly, although the strategy refers to the Barcelona *Acquis* as its reference document, there is greater emphasis on encouraging the parties to engage in regional cooperation and achieving free trade with the EU.⁹⁰ Lack of reference to the ‘interdependence’ of two regions, unlike the Common Strategy on Russia (Pt I, s 4), demonstrates a perspective of ‘assistance’ to the region rather than cooperation.

The more regrettable aspect of this strategy is that there is no significant emphasis placed on the role that energy plays in the Med region. The only reference to energy is made in Point 16, where it provides that ‘the EU will support the interconnection of infrastructure between Mediterranean partners, and between them and the EU, drawing on the experience of trans-European networks in transport, energy, and telecommunications’. The creation of interconnected networks between the two blocks of the partnership serves the security of energy supply concerns of the European Union and the Med region, but does not necessarily create adequate reform of the overall energy sector of various countries or improve the management of energy resources. Although it could be argued that a common strategy is not aimed at elaborating on specific economic measures, as it is an instrument adopted in the ambit of the CFSP, in comparing

⁸⁷ See 2000/458/CFSP Common Strategy of the European Council of 19 June 2000 on the Mediterranean Region [2000] OJ L/183/5 [hereinafter Med Strategy]. See also Decision 2004/763/CFSP of the European Council of 5 November 2004, Amending Common Strategy 2000/458/CFSP on the Mediterranean Region in order to extend the period of application, [2004] OJ L/337. This decision extended the strategy from its expiration date on 23 July 2004 to 23 January 2006.

⁸⁸ See Med Strategy, Arts 1, 3 and 5.

⁸⁹ See ‘Common Strategy on Russia 1999’, Pt I, para 3.

⁹⁰ Med Strategy, Arts 7 and 9.

this strategy with the one on Russia, significant differences in concrete and efficient measures are found that call for further perusal.

In the Common Strategy on Russia, reference is made to the common interest of the Union and Russia in developing their energy policies in such a way as to improve the exploitation and management of resources and security of supplies in Russia and in Europe.⁹¹ Moreover, it refers to the sustainable use of natural resources, which includes energy reserves, which is not mentioned in the Med Strategy. More importantly, there is a clear reference to Europe's cooperation with Russia in the energy sector and the promotion of Russia's ratification of the Energy Charter Treaty which is absent from the Med Strategy.

There is no clear justification for this underestimation when the importance of this region for the security of Europe's energy supply is evident, as elaborated on in the previous section. Clearly, after security issues, energy is the second fundamental interest of the Community in the region. This is even more so if we link security of energy supply to the broader security framework at the political level. Algeria, after Norway and Russia, is the most important gas producer for the European Union, and the role that Morocco and Tunisia⁹² play as energy transit countries should not be ignored. Even if one accepts the claim that the Med region will become a net energy importer by the year 2020, the potential importance of this region as an extremely important transit region—eg transit of oil and gas from the Persian Gulf—should be highlighted. This omission is all the more unjustifiable considering the Common Strategy on Ukraine,⁹³ where enhancement of the Ukrainian energy sector, by supporting comprehensive energy sector reform, and further development of the TACIS programme (aimed at improving the development of infrastructure networks, especially in the field of energy pipelines), is emphasised.⁹⁴ Ukraine is an important transit country for Russian gas, but so are Morocco and Tunisia for the transport of gas to Spain and Italy.

The adoption of common strategies firstly gives a clearer focus to EU foreign-policy negotiations, and secondly compiles those interests of the Member States that are 'shared among them', as provided for in Article 13 TEU.⁹⁵ Security of energy supply can be considered as a common interest of the Union's Member States, as reflected in the common strategies with Russia and Ukraine. However, it

⁹¹ See 'Common Strategy on Russia 1999', Pt I, S 4, para 2.

⁹² Although Turkey is an important transit country situated in the Mediterranean, it was excluded from the ambit of the Common Strategy because this strategy does not include the EU's bilateral relations with those Mediterranean countries which are candidates for EU membership (Art 6 of the Med Strategy).

⁹³ See European Council's Common Strategy of 11 December 1999 on Ukraine, (1999/877/CFSP). Common Strategy 2003/897/CFSP of the European Council of 12 December 2003 Amending Common Strategy 1999/877/CFSP on Ukraine in order to extend the period of its application, [2003] OJ L/333/96.

⁹⁴ See Common Strategy on Ukraine, *ibid*, arts 37 and 56.

⁹⁵ See in general, S Hix, *The Political System of the European Union* (Basingstoke, Macmillan Press, 1999) at 344.

seems that the peace-keeping objective of the Med Partnership in general, and the ever increasing importance of the Middle East Peace Process in particular, caused a greater focus on this issue than on the energy security aspects of such a partnership. Nonetheless, reference to economic issues in the common strategies with Russia and Ukraine shows that a combination of the two has been possible within the framework of this instrument. We will return, at the end of this chapter, to the potential role of common strategies in the context of a general discussion on the inter-relation between external energy policy and foreign policy.

The above-mentioned undertaking to guarantee cooperation demonstrates that the necessary elements for creating an adequate political and technical basis for energy cooperation are in place. Areas of common interests are clarified and priorities are highlighted. However, the partnership among twelve countries suggests that different countries with differing legal systems, configurations of petroleum resources, industrial structures, financing mechanisms, and political convictions should be approached as one 'region' or one 'group'. This is a difficult task. It is difficult to speak of a 'common Mediterranean problem' in the energy partnership with this region. Although priorities for the EU are established, their implementation cannot be uniform. A few steps should be taken beforehand. For example, the proposals focus on the necessity of integrating the energy sector of the Mediterranean with that of Europe, through connection of their infrastructure, which, although beneficial, needs to be undertaken at a second level. The first step is either promotion of an interconnection with 'some' countries of the Med as the first step, or the promotion of an infrastructure interconnection between the countries of the Mediterranean themselves. This approach would limit the difficult task of interconnecting the two vast regions at once. The idea of integrating interconnections within the Med is said not only to create employment and wealth during the construction phase, but also to enhance overall security of energy supply in the region (considering that the majority of those countries are energy importers) and to enhance the synergy of the economies involved, which would in turn lead to cooperation between these countries. This also enhances the energy security of those countries of the Mediterranean that are dependent on energy, and it is not too far-fetched to say that such security is indirectly relevant for Europe's security of energy supply. Hence, the first step is to achieve South-South cooperation, and as the second step, link that interconnection to that of the European Union (North-South). This objective is a difficult one to achieve. Some might argue that cooperation with the Mediterranean can be limited to those areas where the EU not only enjoys full competence but also has the capability to contribute, and one possible area could be cooperation in the energy field. Nevertheless, some problems still linger. For example, some believe that

one reason why it has proven so difficult to promote regional projects within the Mediterranean Partnership is that relations between Arab neighbours continue to be

difficult, notably in the Maghreb: The fact remains that the attempt to promote greater regional integration has had very little success indeed, and one sees little prospect of an improvement in this respect.⁹⁶

It is also argued that Arab countries of the region (considering that all the countries in the Mediterranean are Arabs except Israel) continue viewing the Mediterranean framework as ‘a deceptive manoeuvre to force cooperation with Israel on them.’⁹⁷

In any case, a collective partnership including all countries in the region is a prerequisite for efficient Euro-Med cooperation in the field of energy. Conflicts and disagreements in the region should gradually disappear in order for the Med Partnership to create an efficient framework for Europe’s security of energy supply. Otherwise, the EU needs to change strategies and approach each country individually. This issue will be elaborated on in greater detail at the end of this section where energy relations between the European Union and the energy-producing countries are compared. Now we turn to the last example of EU relations with energy-producing countries, namely energy relations with the countries surrounding the Persian Gulf.

6.3. EU–PERSIAN GULF COUNTRIES’ ENERGY RELATIONS

The relationship between the countries situated around the Persian Gulf (Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates) and the European Union is the least developed of all of the EU’s relations with energy-producing countries. A historical reference was made to the relationship between the European Community and the Arab countries of the Persian Gulf in the first chapter of this study, where it was emphasised that no efficient cooperation framework could be established with these countries at Community level until 1989 when a cooperation agreement was signed between the Community and the countries of the Gulf Cooperation Council (GCC) (ie Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates). This agreement entered into force on January 1990.⁹⁸ The study highlighted that nothing substantial resulted since the entry into force of that agreement.

Vast reserves of both oil and gas are found in the countries of the Persian Gulf. (Table 6.3 shows the share of each country’s oil and gas in the world.

⁹⁶ G Luciani and F Neugart (eds), *The EU and the GCC: A New Partnership* (Gütersloh, Bertelsmann Stiftung, RSCAS and CAP 2005) at 20 [hereinafter *The EU and the GCC*].

⁹⁷ *Ibid.*

⁹⁸ Council Decision 89/147/EEC of 20 February 1989 concerning the Conclusion of the Cooperation Agreement between the European Economic Community, of the one part, and the Countries Parties to the Charter of the Cooperation Council for the Arab States of the Gulf of the other Part, [1989] OJ L/54/1.

Table 6.3 Oil and Gas Share of the Persian Gulf Countries in the World

Countries	2005 Share of Total Oil Production %	2005 Share of Total Gas Production %
Bahrain	—	0.4
Iran	5.1	3.1
Iraq	2.3	—
Kuwait	3.3	0.4
Oman	1.0	0.6
Qatar	1.3	1.6
Saudi Arabia	13.5	2.5
UAE	3.3	1.7
Total	29.8	10.3

Source: BP 2006 Statistical Review of World Energy

Proven oil reserves in the Persian Gulf countries of Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates reached approximately 61.5 per cent of world total, and proven gas reserves of the major gas-producing countries of the Persian Gulf (Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the UAE) reached around 39.7 per cent in 2004.⁹⁹

Some argue that the evolution of oil exports to the EU from North Africa, the Caspian and Russia, could contribute to decrease reliance on Persian Gulf oil, and this oil will be directed to the Eastern and Southern Asia where demand is on the rise. However, if we accept the claim of the great potential of the Caspian to satisfy the demands of Europe along with Russia and North Africa, 'the question still remains whether this would be at all a sensible approach' considering the importance of the Persian Gulf countries and especially Saudi Arabia in satisfying global demand.¹⁰⁰ The safer approach for the EU is to expand its diversification from Russia, Caspian and North Africa and include the Persian Gulf countries. These issues are further explored below.¹⁰¹

⁹⁹ See the BP (2006) *Statistical Review of World Energy* at <<http://www.bp.com>>.

¹⁰⁰ See G Luciani, background paper for the Third Annual Conference on the Geopolitics of Energy, Florence, July 2004, at 12.

¹⁰¹ Moreover, one unique role of the GCC member countries, especially Saudi Arabia, in guaranteeing the EU's security of energy supply is the existence of spare capacity that can be mobilised quickly when there is a shortage of supply in the world market. This was especially the case in 2003 and 2004, when Saudi Arabia sought to stabilise the market at a time of high oil prices. It provided the market with additional capacity in its possession to compensate for the loss of Iraqi oil in the market. Since then, the message sent by Saudi Arabia is that it will expand its production capacity to meet global demand whenever necessary. This incident could pave the way for stronger EU–GCC cooperation in the field of energy.

6.3.1. The EU–Gulf Cooperation Council

The EU entered into a cooperation agreement with the Gulf Cooperation Council (GCC) in 1989. This agreement was designed to encourage and facilitate diversification of the GCC countries’ economies, promote market research, trade, technology transfer and development, information exchange and training. However, provisions on cooperation in the field of energy could not be phrased in a more general way. Article 6 of the Agreement provides:

In the field of energy, the Contracting Parties shall strive to encourage and facilitate, inter alia: cooperation in the two regions by energy undertakings of the Community and the GCC countries, joint analyses of trade between the two regions in crude oil, gas and petroleum products and its industrial aspects with a view to considering ways and means of improving their trade exchanges, exchanges of views and information on matters relating to energy in general and respective energy policies, without prejudice to the parties’ international obligations, training, studies, notably on new and renewable sources of energy.

As this Article shows, no concrete measures are put in place and no concrete objectives of energy cooperation are stipulated. ‘Exchange of views with respect to energy policies’ cannot be considered as an important undertaking from the perspective of the EU to guarantee security of energy supply. Apart from cooperation in standards and customs, which were linked to the potential creation of a free trade area,¹⁰² and the EU’s assistance to the GCC in drafting protocols for the protection of maritime biodiversity, no other efficient cooperation took place in the following years.

In 2003, a new set of negotiations was initiated within the framework of the EU–GCC Economic Dialogue at the GCC Secretariat in Riyadh, to share further information on fiscal aspects of a single currency, a unified trade policy, and the move from a customs union (which was established in the GCC in January 2003) to a single market.¹⁰³ Although the 2000 Green Paper on Security of Energy Supply signalled that the issue of energy security in the EU is an urgent matter, and diversification of physical sources of energy was considered as part of the response to Europe’s energy security needs and an essential component of its policy, the GCC was not explicitly targeted as one source of satisfying the needs of diversification. In other words, no concrete energy policy was adopted with respect to the GCC. Although the EU and the GCC meet annually and issue a Joint Communiqué, a quick look at these reports shows a repetitive reference,

¹⁰² See Resolution on Economic and Trade Relations between the EEC and the countries of the Gulf Cooperation Council, [1987] OJ C/76/190. See also Resolution on the Significance of the Free Trade Agreement to be concluded between the EEC and the Gulf Cooperation Council (GCC), [1990] OJ C/231/216. The announced development towards a free trade area has yet to be accomplished.

¹⁰³ See the summary of relations between the European Union and the Middle East, especially the GCC, at <http://europa.eu.int/comm/external_relations/us/sum06_04/fact/eu_me.pdf>.

over the years, to the mere fact that the two parties 'welcome cooperation in the energy field, and agree on strengthening work in this field'.¹⁰⁴

In the same year, a project was co-financed by the European Commission and four other institutions, within the framework of the Synergy programme, to analyse in detail the many facets of EU–GCC cooperation in the field of energy.¹⁰⁵ Among other conclusions, the study provided that although the EU has no direct dependence on Persian Gulf oil exports, firstly due to being the preferred destination for oil from Russia, and secondly due to the gradual reliance of the EU on gas and coal instead of oil, the global characteristic of the oil market renders the link between the two regions vital in order to guarantee the orderly functioning of the global oil market. The project also calls for downstream integration, ie involving producer countries in refining and marketing activities in the consuming nations, which is believed to lead to more economic diversification, which could in turn lead to stability and security of supply. Downstream integration was said to ensure better control of market share, better awareness of consumer demands and greater attention to product quality. The study also calls for an analysis of the creation of a possible GCC gas grid. It argues that there is little experience in building and operating gas transportation networks and grids in the GCC, and the EU could help in this respect. This grid could then be linked to the markets of the Near East and Europe. The dialogue between the EU and the GCC could facilitate the development of common gas strategies and the exchange of information between the industry and buyers, which would in turn enhance security of energy supply. With respect to the development of renewable sources of energy in the GCC, the study argues that it is important that refining, petrochemical and other energy intensive activities be concentrated close to the main hydrocarbon fields, and that quality petroleum and petrochemical products be exported rather than crude, which is fully in line with the Kyoto Protocol. However, for this objective to materialise, the EU needs to transfer its knowledge on carbon sequestration and cleaner fuels to the GCC. Overall, a great necessity for cooperation between the two regions was felt in the outcome of the research. The study also analysed the relevance of the Energy Charter Treaty as a cooperation framework between the EU and the GCC, but pointed out that the GCC countries are reluctant to become members of this treaty. The authors of the study attributed this reluctance, firstly, to the fact that the GCC countries argued that they had not participated in the original design of the ECT, and secondly, to the inability of the ECS to establish an efficient cooperation framework at all times. For that reason,

¹⁰⁴ See, eg, the 15th GCC–EU Joint Council and Ministerial Meeting, Joint Communiqué of 5 April 2005, the 14th EU–GCC Communiqué of 17 May 2004, and the 13th Communiqué of 3 March 2003.

¹⁰⁵ The EUROGULF project is a research effort carried out by a consortium comprising the Robert Schuman Centre for Advanced Studies at the European University Institute, the Oxford Institute of Energy Studies, the Energy Policy Unit at the National Technical University of Athens and ECONERGY SAL of Beirut. The Project was finalised in April 2005.

the next important step would be for the GCC and the EU to determine whether cooperation can best be achieved outside the framework of the ECT.¹⁰⁶

The minimal cooperation between the EU and the GCC in the field of energy up to now demonstrates that the focus of the EU is more on the creation of a free trade agreement with the GCC. Although a free trade agreement could ‘warm’ the relationship, spark off some kind of inter-regional cooperation and improve reciprocal exchanges,¹⁰⁷ as some rightly argue, it should not be the sole priority in the EU–GCC dialogue.¹⁰⁸ After all, it is not clear to what extent a ‘free trade agreement’ could by itself guarantee a secure energy supply from this region. An efficient investment and transit protection framework should also be put in place. A free trade agreement would guarantee the uninterrupted flow of energy or energy-related goods and services only, without taking into account other important aspects of security, namely the guarantee of adequate investment in the energy sector and the protection of energy in transit. Moreover, this study also seeks to demonstrate in the next section that the dialogue should also comprise of political aspects of cooperation that will lead to stability in the region. Consequently, the relationship of the GCC countries with other countries bordering the Persian Gulf, such as Iran and Iraq, should also be taken into consideration.¹⁰⁹

¹⁰⁶ See specifically papers by G Luciani, N Abi Aad, and S S Haghighi in the framework of the EuroGulf project at <http://europa.eu.int/comm/energy_transport/doc/2005_04_eurogulf_kuwait.pdf>.

¹⁰⁷ See A Baabood, ‘The Outlook for GCC–EU Relations under the New Commission’ (2005) 1 *EU–GCC Research Bulletin* at 8, at <<http://www.grc.ae>>.

¹⁰⁸ Luciani and Neugart (eds), *The EU and the GCC*, above n 96, at 23.

¹⁰⁹ One recent example of a conflict in this region, which is mentioned in the 15th Joint Council/Ministerial Communiqué of the EU–GCC in April 2005, highlights some issues. This problem is the disagreement between the UAE and Iran over Abu Musa and ‘Big and Small Tunbs Islands’ (or the so-called lesser and greater islands). The Communiqué mentions that: ‘Both sides expressed concern at the lack of progress towards resolution of the territorial conflict between the United Arab Emirates and Iran over Abu Musa and the Tunbs Islands. They reiterated their support for a peaceful solution to the conflict in accordance with international law, either through direct negotiations or by referring the issue to the International Court of Justice’. Reference to the fact that there is a ‘conflict’ has sparked reaction from the Iranian side. They claim that there is no such conflict as the islands legally belong to them. The reaction to this Communiqué was an attack on the European Union for ‘interfering’ with this matter. The petition, which appeared on a website, states that: ‘The GCC was created in response to Saddam’s aggression at the onset of Iran–Iraq war with the aim of coordinating resistance to outside intervention in the Persian Gulf. Considering that Abu Dhabi’s claim on Iranian islands is completely illegal, this latest meddling by the European Union is an outrageous act infringing on Iran’s national dignity and territorial integrity’. They further mention that ‘this type of interference by the EU can only lead to the creation of a legal precedence and international consensus in support of UAE’s baseless claims that must be condemned’. The danger with such a reaction, which has extended to involve the Iranian government as well, is that it creates a loss of confidence in cooperating with the European Union. Their role in the region could be labelled as one of ‘political interferences’ or ‘side-taking’ that results in a greater gap between the countries in the region, something that the EU seeks to overcome. As this approach runs counter to the objective of regional cooperation, it will indirectly affect efforts to create a stable relationship for the purposes of the EU’s security of energy supply. For the complete text of the petition, see http://www.petitiononline.com/EU_UAE/petition.html. For a thorough analysis of the documents related to this issue, see MA Movahhed, *Mobaleghey-e Mostaar: Barrasi madarek Mored-e Estenad-e Shoyoukh*

6.3.2. EU–Iran

The external relations of the European Union with Iran and Iraq have not developed as efficiently as with other energy-producing countries of the region. In October 1998, the Council sought to explore the possibilities for cooperating with Iran through the creation of a Commission–Iran Technical Meeting in December 1998. They agreed to explore a number of possible areas for cooperation, namely energy, environment, transport, agriculture, drugs control, refugees and human rights. The activities, however, were limited to some humanitarian assistance and drugs control. Iran sought engagement in the activities of the Commission and became an observer of the Commission-funded INOGATE programme, which, as mentioned above, is ‘an international cooperation programme that aims to promote regional integration of the pipeline systems and to facilitate the transport of oil and gas both within the greater NIS region and towards the export markets of Europe’.¹¹⁰ Later in December 2002, negotiations on a trade and cooperation agreement were launched by the Commission along with negotiations on political dialogue and the fight against terrorism. The trade and cooperation agreement seeks to: manage trade between Iran and the EU in accordance with the rules of the WTO; to assist Iran in reforming its laws to adjust to WTO rules; to establish closer cooperation in the areas of energy and transport, as well as other areas, and to encourage respect for human rights. Although there is no concrete set of measures in place to advance negotiations on establishing a trade and cooperation agreement, the development of relations was positive and it was only recently affected by claims that Iran possesses the necessary technology to advance nuclear weapons. The Council of Ministers of the European Union has expressly mentioned that maintaining the full suspension of all enrichment-related and reprocessing activities is essential for continuation of the overall cooperation between the EU and Iran.¹¹¹ The effect of this controversy, which has gradually become intense, on EU–Iran relations as whole would have direct implications on the establishment of any cooperation framework in the future.

dar Edea bar jazayer-e Tunb-e Kouchak, Tunb-e Bozorg va Abu Musa (an analysis of the documents referred to by the Sheikhs related to their claim over the Abu Musa and the Tunbs Islands) (Tehran, Nashr-e Karnameh, 2001).

¹¹⁰ There is also the TACIS Programme, which provides grant-financed technical assistance to twelve countries of Eastern Europe and Central Asia (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan), and mainly aims to enhance the transition process in these countries. In addition, Iran is an observer in the TACIS funded *TRACECA-east-west land communication program*. The *TRACECA Programme* was launched at a conference in Brussels in May 1993, where it was agreed to ‘implement a programme of European Union funded technical assistance to develop a transport corridor on a west-east axis from Europe, across the Black Sea, through the Caucasus and the Caspian Sea to Central Asia’.

¹¹¹ Extract from the General Affair and External Relations Council Conclusions of the 13 December 2004 meeting at <http://europa.eu.int/comm/external_relations/iran/intro/gac.htm#iran131003c>.

6.3.3. EU–Iraq

Previously the EU had no special political relations with Iraq and its activities were limited to implementing UN Security Council sanctions or assistance in the humanitarian field. Recently, however, after the collapse of Saddam's regime, a 2004 Communication from the Commission highlighted the interests of the EU in establishing a new cooperation framework with Iraq.¹¹² With respect to energy, the Communication explicitly mentions that

given Iraq's significant contribution to the Union's security of energy supply and the potential for the EU and Iraq to mutually benefit from increased Iraqi production of oil and natural gas, a level playing field for investment and regulatory convergence in the energy sector is of strong interest to both the EU and Iraq.

The Communication further provided that an EU/Iraq working group should be set up to discuss cooperation in the energy sector, and the EU could also support Iraq's participation in other regional energy and transport frameworks. Enriching regional cooperation between Iraq and its neighbours, similar to the cooperation in the Mediterranean, was considered desirable. Concrete measures to attain the objectives of this Communication have yet to be undertaken. The Community also provided the 'Iraq Assistance Program' in 2006 in which references are made to promoting good governance in the field of energy, establishment of working groups in the field of energy, overcoming the shortages of electricity in Iraq, among other things. The practical consequences of this programme are yet to be seen.¹¹³

6.4. CONCLUSION

A study of the relationship between the European Union and the energy-supplying countries of the Mediterranean, the Persian Gulf and Russia reveals that there are some basic elements in place to promote partnership in the energy sector. These elements include the desirability of investment, promoting energy efficiency, development of energy interconnection infrastructure, project financing, and industrial cooperation in third countries. However, these objectives are

¹¹² Communication from the Commission to the Council and the European Parliament of 9 June 2004, the European Union and Iraq, a Framework for Engagement, COM (2004) 417 Final.

¹¹³ See the 'Iraq Assistance Programme' E/2006/470-C/2006/864, 28 March 2006. This programme enumerates the areas of activities as follows: (1) Strengthening the energy sector investment and operational environment; (2) Development of judicial capabilities and energy sector regulatory and legal frameworks to encourage economic activity and international investment as well as to deter corruption, organised crime and criminality; (3) Support to the exploitation of the natural gas reserves, particularly the export of gas to the Mashreq and EU markets; (4) Enhance the reliability of the electricity supply; and (5) Capacity building and training on key environmental issues, including: analysis; water management; pollution management in the production and use of oil and natural gas.

not only inadequate in guaranteeing security, the EU is also faced with a series of challenges in implementing these objectives in its relations with various energy-producing countries.

A comparison of these three sets of cooperation frameworks reveals the discrepancy and differences between them. Clearly, relations established between the EU and Russia have been more detailed and elaborate, and the development of activities in the field of energy is plausible for energy security purposes. A very pale picture of such energy relations can be depicted in the framework of the Mediterranean partnership, but it is totally non-existent in relations with the Persian Gulf countries. Priorities differ and difficulties vary. Although the reasons for such differentiation are clear to some extent—various countries have different economic and political characteristics and have diverging demands, and energy-producing countries bordering the EU are also given priority—the efforts of the EU to guarantee energy security (including the diversification of energy sources) are not undertaken with equal strength in relation to these regions or countries. Either, some insurmountable obstacles existed in relation to some countries with which concrete energy relations are not yet in place, or the EU has not taken a global approach to the issue of energy security seriously into account. However, it is evident that the EU clearly favours an emphasis on some countries and on some elements of energy cooperation (for example with Russia) as opposed to others. The fact that Russia shares a border with the EU, the great mutual interdependence of the two, the eagerness of Russia to cooperate with the EU on various occasions, etc have played a role in creating such a close relationship. The question remains whether this ‘differentiated approach’ is in the long term advantageous for the EU’s security of energy supply. An ideal energy cooperation framework between all consuming and producing countries at the multilateral level is not yet in place (considering the weaknesses of the ECT) and the EU needs to establish bilateral or regional relations with these countries. However, such an approach should embody the mutual needs of these countries at all times. This being said, the energy-producing countries mentioned above share similar basic problems, such as lack of economic diversification, dire need of foreign investment, need to upgrade energy infrastructure, political instability, etc. Satisfying these needs should form part of the EU’s framework of energy security and should be pursued with the same strength in all these countries in order to guarantee an optimum result.¹¹⁴ Another reason for such a balanced approach is the danger of destabilising those countries that cannot satisfy their

¹¹⁴ There is a recent OPEC–EU dialogue, which involves some of the GCC countries members of OPEC. This dialogue, the first session of which took place in June 2005, called for cooperation between the two in the following areas: oil market developments, both short, medium and long term; energy policies (in-depth study of the EU and OPEC policies), energy technologies (communicating the updates on technologies), and energy-related multilateral issues (including the WTO, ECT, MEA, etc.). See the Joint Press Release of the first Ministerial Conference of June 9, 2005, the second Joint Press Release of 2 December 2005, and the third Joint Press Release of 7 June 2006, at <<http://www.opec.org>>.

demands due to a lack of adequate cooperation and relations with industrialised consuming nations. This would in turn destabilise the economy of those countries, along with possible political instability, which would affect the global energy market, including Europe. Moreover, emphasis on one country bears the risk that a sudden decrease in production or other disruptions in that country, due to unexpected causes, would leave the EU with little or no energy security.

In addition to adopting a balanced approach towards all energy-exporting countries, two more elements should be included in the overall analysis of the EU's external energy policy: the encouragement of economic development in these countries through the establishment of an efficient development cooperation policy, and focusing on the creation of a European foreign policy towards these countries. These two aspects are largely absent in the overall cooperation framework of the Community with energy-supplying countries. The next chapter analyses the importance of these missing sides of the triangle of energy security.

The Two Missing Sides: The Development Cooperation Policy and the CFSP

THE ANALYSIS OF the specific relations of the Community with major oil-supplying and gas-supplying countries identified a number of subjects of interest to the Community and their implications for energy security. Unhindered access to resources, investment in capacity expansion, uninterrupted flow of energy and trade of energy products and services, etc were identified as important elements of energy security. These issues are entangled with many broader economic relations, and energy security is bundled with various other issues of cooperation, as specifically demonstrated in relation to the Partnership and Cooperation Agreement with Russia and the Med Partnership. Nevertheless, the approach of the Community to various energy-exporting countries does not include all these aspects uniformly. Although such a differentiated approach is not problematic per se, common characteristic of these countries requires attention in designing the security policy. First of all, these countries are mostly 'Rentier states', ie they depend on one single income of sale of energy and they have struggled for decades to replace this economic structure with a more diverse one. Although it is common knowledge that they need assistance in their struggle to diversify, such assistance is largely undermined in the energy security policy of the Community. Although some may argue that the creation of a trade and cooperation agreement, or financial assistance to these countries, along with paving the way for a better investment climate, would ultimately lead to economic development and diversification, the link is not an outright one. A strong development cooperation policy of the EU should also be pursued in order to guarantee economic development in these countries. The extent to which the Community could or should engage in these aspects of cooperation should be determined. This issue is analysed in the next section.

Moreover, although building efficient interconnected infrastructure or financing various necessary projects in energy-producing countries, among other things, will improve the security of the EU's energy supply, real cooperation demands a political vision. With respect to Russia and the Mediterranean, the

approach of the EU has broader implications. It touches not only upon the commercial and development aspects of energy cooperation but the overall political aspects, through, for example, the establishment of common strategies, as referred to in the previous chapter. The real concern of Europe is security of energy supply. It is not clear whether the mere building of pipelines or necessary infrastructures, without considering the political aspects of this cooperation, would be sufficient to claim that a proper and efficient energy cooperation framework to guarantee security is in place. One important aspect of security of supply is the political stability of the regions where the energy is found. Previous chapters outlined that there may be access to energy that runs through pipelines from major energy-exporting countries to Europe, but its high price may undermine initial efforts to establish infrastructure because political instability in one region in the world is gradually creeping into the picture and is destabilising the market and is increasing volatility. The relationship between energy security and political stability calls for further analysis of the ways through which these two aspects can be bundled together.

Although there are scattered references to these two aspects of security in various energy cooperation frameworks, the study below argues that the most efficient energy policy needs to take the shape of a triangle with three sides: commercial, political and development. Although such a triangle exists with respect to some energy-producing countries, with some emphasis on one side of the triangle more than others, an efficient security framework requires the existence of this triangular approach towards all the major energy-exporting countries, with adequate emphasis on all sides. One side of the EU security triangle, the commercial side, was elaborated on in previous chapters, especially in the framework of the EU's internal market measures with their implications for external relations, and also in the framework of the Energy Charter Treaty, the WTO and bilateral or regional relations (eg the Partnership and Cooperation Agreement (PCA) with Russia or the similar agreements with the Persian Gulf countries and the Mediterranean region). Although these measures could have 'development' implications for the energy-exporting countries, the need for a general 'development policy' approach and its link with energy security necessitates its further elaboration in a separate chapter and their strong inter-relation necessitates its consideration as one, separate, side of the triangle. Brief explanations of measures in the framework of both the CFSP, such as the common strategies with Russia and the Mediterranean were also provided, but the overall implications of this side of the security triangle also necessitates its further elaboration. The analysis of these issues is provided below.

7.1. THE DEVELOPMENT COOPERATION POLICY AND ENERGY SECURITY:
AN INTER-RELATION

The underlying rationale for the Community's adoption of a development cooperation policy with third countries was hinted at in a Commission Memorandum on a Community Policy for Development Cooperation in 1971. It was mentioned that such a policy was 'the systematic pursuit of a more harmonious distribution, and better adapted to modern times, of *well-being throughout the world*, and the *pursuit of better conditions of life and the fulfilment of mankind* (emphasis added).¹ The Community believed that economic integration has proved to be beneficial to all, and therefore there is a particular duty on the Community to help developing countries to integrate economically and to assist them in benefiting from it.² This altruism is found in the early thoughts of the Commission regarding the need for development aid and it continued to exist for a long period. Nevertheless, the transformation of thoughts on 'development cooperation' or 'development aid'³ into concrete policies proved difficult to achieve due to the reluctance of the Member States to provide the Community with a mandate in this field, which was traditionally considered as an aspect of foreign policy.⁴

Gradually the attitude of the Member States changed and they allowed the Community to engage in a development policy that would complement their own. In the Treaty of Maastricht (1992), they created an explicit legal basis for a Community development policy (Title XX EC Treaty). The basic development cooperation policy of the Community, according to the provisions of this Title, is to foster the sustainable economic and social development of developing countries, and more particularly the most disadvantaged among them, the smooth and gradual integration of developing countries into the world economy, the campaign against poverty in developing countries and, more importantly, developing and consolidating democracy and the rule of law. This latter objective

¹ Commission Memorandum on a Community Policy for Development Cooperation [1971] 5 *EC Bulletin Supplement* at 18.

² Commission Memorandum on a Community Policy for Development Cooperation, Programme for Initial Actions [1972] 2 *EC Bulletin Supplement* at 6.

³ The distinction between development aid and development cooperation is significant and their implications differ. The term 'development assistance or aid' connotes a focus on economic development but suggests a 'fundamentally unequal relationship' whereas the term development cooperation indicates 'a joint work between donor and recipient which can work through partnership'. The idea was that the development policy in general could not be limited to unilateral aid. The inclusion of development cooperation in the overall framework of 'development policy' is justified because a successful development policy is generally considered as one created based on the belief that developing another country would in turn result in the development of the 'benevolent'. See also M Breuning, 'Foreign Aid, Development Assistance or Development Cooperation: What's in a Name?' (2002) 39 *International Politics* 369 at 369 [hereinafter 'What's in a Name?'].

⁴ See in general, JA McMahon, *The Development Co-operation Policy of the EC* (London, Kluwer Law International, 1998).

resulted in an effort by the Community to integrate human rights and fundamental freedoms into its development policy (eg efforts to include a human rights clause in the Lomé Convention, which were finally successful in 1990).⁵ These new policies to some extent complemented those on food aid and the environment, and continued to play an important role in the design of a European development policy. The prevailing idea was that *no real peace can exist if the developed countries do not pay more heed to the less favoured nations*⁶ and this was deemed to be guaranteed through efficient cooperation of the Community and the Member States to meet that end. Nevertheless, in some documents, the pure altruism, reflected in the early thoughts of the Community, was limited by referring to the fact that any development policy should also reflect the Community's economic interests in the organisation of their relations with those countries on which the Community depends for the 'security of its supplies and its markets'.⁷

Although the most important relationship of the Community with developing countries was the one with the African countries through the Yaoundé and later Lomé Conventions, the evolution of the relationship between the Community and the countries of the Mediterranean also resulted in calls for a Mediterranean

⁵ It is difficult to include such clauses in the trade agreements with third countries, as they argue that these clauses are a direct interference in their internal affairs. See M Cremona, 'Human Rights and Democracy Clauses in the EC's Trade Agreements' in N Emiliou and D O'Keefe (eds), *The European Union and World Trade Law* (Chichester, Wiley, 1996). See also problems in relation to previously colonised countries in W Zartman, 'Europe and Africa: Decolonization or Dependency?' (1975–76) 54 *Foreign Affairs* 325.

⁶ See Communiqué of the Heads of States and of Government of the Member States in December 1973 [1973] 12 *EC Bulletin* Point 1106, reprinted in McMahon, above n 4, at 6.

⁷ Memorandum on the Community's Development Policy [1982] 5 *EC Bulletin Supplement* 12 at 14. The immediate priority to implement development policies was given to those countries that had associated status or were being offered associated or preferential partnership (eg see the 1975 Lomé Convention). Later on, cooperation with non-associated developing countries entered the policy agenda. There was also a progress within the Community's development policy, where the development cooperation policy complemented the development aid policy, and a relationship based on mutuality of interests was also created. Association Agreements are now concluded based on Art 310, which provides that: 'the Community may conclude with one or more states or international organisations agreements establishing an association involving reciprocal rights and obligations, common action and special procedure'. These association agreements can take three forms: as a form of development assistance (such as the Lomé Convention), in lieu of EU membership (eg Euro-Med Economic Area) and as a prelude to membership (such as the Europe Agreements). See FS Hakura, 'The Euro-Mediterranean Policy: The Implications of the Barcelona Declaration' (1997) 34 *CML Rev* 337 at 350.

policy, which was based mainly on 'development cooperation' rather than development assistance'.⁸ The Euro-Mediterranean partnership⁹ sought to build on the principles identified in the Maastricht Treaty for the Community's development cooperation policy, such as 'guaranteeing peace, stability and prosperity, sustainable and balanced economic and social development, combating poverty, and promotion of understanding between cultures', among other things.¹⁰ In order to achieve the objectives of development cooperation policy, however, the establishment of a free trade area consistent with the rules of the WTO was deemed necessary by 2010. Moreover, the elimination of tariff and non-tariff barriers to trade, and the progressive liberalisation of trade in services were found inevitable in achieving the objectives of the development policy.¹¹ Therefore, a link was made between the principles of free trade and development cooperation policy and it was believed that the success of one depends on the success of the other. These examples reveal that the basic principle of the development cooperation policy is the affirmation of the Community's 'solidarity with developing countries'. In this respect, the Community adopts some strategies to contribute to the strengthening of democracy, consolidating peace, preventing conflict and gradually paving the way for the integration of developing countries into the

⁸ This study focuses mostly on the post-1995 period and after the Barcelona Declaration. However, it should be mentioned that the Community's Mediterranean policy began with the conclusion of an association agreement with Greece in 1961 as a transitional arrangement for eventual membership. This agreement, similar to many other association agreements, comprised of trade liberalisation on a preferential basis and loans from the European Investment Bank to aid the process of industrialisation in Greece. Agreements with the countries of the Med fell into three categories. One set of agreements envisaged eventual membership of the country concerned, or creation of a customs union, such as the agreements with Cyprus, Malta and Turkey. The second group of agreements aimed at promoting economic and social development of the countries of the Maghreb (Western region including Tunisia, Morocco, Libya and Algeria) and Mashregh (Eastern region including Egypt, Lebanon, Israel, Jordan, Turkey, Cyprus, Malta, Syria and Palestinian Territory). The third group, which falls into neither of these categories, such as the agreement with Israel, involved reciprocal trade and the advancement of economic activity between the Community and that country, along with the improvement of living and employment conditions in that country. See McMahon, above n 4, at 96. See also Strengthening the Mediterranean Policy of the European Union: Establishing a Euro-Mediterranean Partnership, COM (94) 427 Final at 14. The specific proposals in implementing the Euro-Med partnership emerged in Strengthening the Mediterranean Policy of the European Union: Proposals for Implementing a Euro-Mediterranean Partnership COM (95) 72 Final.

⁹ The importance of this region for the EU was later described as follows:

The Mediterranean region is of strategic importance to the European Union. A key external relations priority for the EU is thus to promote prosperity, democracy, stability and security in the Mediterranean basin. This is not only because of the political, economic, administrative, ecological and social challenges the basin is faced with, but also in view of the recurrent conflicts/instability in this region on the EU's southern flank. The EU's relations with the countries to the South and East of the Mediterranean are based on a proximity policy guided by the principle of partnership between the EU and its Mediterranean partners to tackle common challenges calling for a coordinated response.

See the 'Euro-Med Partnership: Regional Strategy Paper 2002–2006 and Regional Indicative Program 2002–2004'.

¹⁰ See the Preamble of the Barcelona Declaration, [1995] OJ L/278.

¹¹ See McMahon, above n 4, at 112.

world economy. The inclusion of development cooperation policy into the overall external energy policy of the Community becomes more apparent when one looks at the relationship between economic development and political stability. A number of studies in the sphere of political science argue that the link between economy and security translates into a 'reality'. Where an economy is more developed, the prospects for security and stability are much better.¹² As mentioned in the chapter 1, this is an important element of energy security, since political instability could shake the structure of the security framework. Moreover, the necessity of introducing an efficient development cooperation policy into the overall external energy policy is highlighted through references to doubts that have been raised as to the real efficiency of pure trade relations between consuming and producing countries and their direct effect on economic development. The central debate takes place within the WTO, concerning the role that this organisation has played in the economic development of its developing and least-developed members. The GATT/WTO system has found it necessary to address the specific situation of developing countries through better market access for their goods, lower levels of obligation, imposition of the necessary flexibility to protect the markets of these countries and to pursue policy options that they deem appropriate for development, and to allow them to adopt broad exemptions from various GATT/WTO obligations. However, the main criticism of the system has been that the gains for developing countries were really marginal. As some commentators have observed, the system turned out to be less than it was touted to be at its inception, and it was evident that 'all was not well in the international trade rules governing developing country trade'.¹³ Some, therefore, believe that there is still a need to reform the international trade system so that it can more efficiently reflect the needs of developing countries.

On the other hand, the lack of a direct link between adopting the principles of free trade and economic development called for other means, such as foreign investment, to guarantee access to financial capital, advanced technology, foreign

¹² See SM Lipset, 'Some Social Requisites of Democracy: Economic Development and Political Legitimacy' (1959) 53 *American Political Science Review* 69. See also the lecture of Ambassador Lazar Comanescu, Head of the Mission of Romania to NATO, 'The Link between Economics, Security and Stability: the Case of South-Eastern Europe' at <www.nato.int/docu/colloq/1999/pdf/036-042.pdf>. For an analysis of the link from a historical perspective, see SM Lipset, *Political Man: The Social Bases of Politics* (London, Heinemann, 1969).

¹³ See ch 5.4.6 above on the treatment of developing and least developed countries in the WTO. See also P Low, 'Developing Countries in the Multilateral Trading System: the Insights of Robert E Hudec' (2003) 37 *Journal of World Trade* 801. See also B Hoekman, C Michalopoulos and LA Winters, 'More Favourable and Differential Treatment of Developing Countries: Towards a New Approach in the WTO', World Bank Policy Research Paper 3107, August 2003. See also A Breckenridge, 'Developing an Issues-based Approach to Special and Differential Treatment' Inter-American Development Bank, Regional Policy Dialogue, Trade and Integration Network, Third Meeting, 19-20 March 2002. See also A Mukerji, 'Developing Countries and the WTO: Issues of Implementation' (2000) 34 *Journal of World Trade* 33. See generally, C Michalopoulos, 'Trade and Development in the GATT and the WTO: The Role of Special and Differential Treatment for Developing Countries', (April 19, 2000), available at <http://www.wto.org/english/tratop_e/devel_e/sem01_e/sdt_e.htm>.

sales networks, etc. However, due to the necessity of creating favourable conditions in the host countries to actually attract foreign investment, cooperation also needs to focus on strengthening essential social and physical infrastructures for such investment. Hence, a combination of trade and investment along with social, economic and legal reform of the host country needs to be the basis of a development cooperation policy, which could be included in the overall external energy policy of the EU.¹⁴

Moreover, the fact that the EU has included 'development cooperation policy' rather than 'development aid' in its overall policy makes its discussion more relevant for some important energy-producing countries that are not necessarily in dire need of 'financial aid'. Although foreign aid can be considered as a tool in preparing societies for economic 'take off', especially when their basic foundations of growth and development are not yet adequate,¹⁵ the energy-producing countries have passed the initial 'take off' stage, and are not in as much need of foreign aid as they are in need of economic diversification, which is an aspect of economic growth and development.

The aim of economic diversification is basically the desire to step away from a single economy with strong dependence on one source of income, ie energy sales. In general, there is, however, little guarantee that development aid will achieve this specific objective¹⁶ since development in terms of diversification would only be measured by how much aid the developed countries provide rather than what that aid actually achieves.¹⁷

As any sharp fluctuation of oil prices generates economic instability in the energy-exporting countries, these countries have already acknowledged the necessity of economic diversification in order to achieve greater stability. Sometimes high oil prices have distracted these countries from focusing on this

¹⁴ See also Y Lee, 'Foreign Direct Investment and Regional Trade Liberalization: A Viable Answer for Economic Development' (2005) 30 *Journal of World Trade* 701.

¹⁵ See C Lancaster, *Transforming Foreign Aid: United States Assistance in the 21st Century* (Washington, Institute for International Economics, 2000) cited in Breuning, 'What's in a Name', above n 3, at 371.

¹⁶ For a critic of the EU foreign aid policy see, C Santiso, 'Reforming European Foreign Aid: Development Cooperation as an Element of Foreign Policy' (2002) 7 *European Foreign Affairs Review* 401.

¹⁷ Generally, it is said that development is measured by how much aid the developed countries provide rather than what that aid actually achieves. As one author argues,

depending on the degree to which a donor state wishes to be perceived as meeting the standard of generosity, the incentive is simply to spend money rather than to spend it wisely, and that may be no better than spending aid monies to support a donor state's national interests.

Furthermore, from the perspective of the recipient of development aid, there may be an incentive to create a semblance of compliance with conditions imposed by the donor, without actual monitoring of policy implications. In addition, particularly with respect to energy-producing countries that mostly lack a stable and transparent administrative system, and are not necessarily famous for handling their income or the aid received with care, a framework based on cooperation that strengthens the building blocks of the system could possibly guarantee better economic development. See Breuning, 'What's in a name', above n 3, at 375.

objective as their revenues have increased,¹⁸ but sharp falls in prices have awakened them again. Energy-exporting countries share common economic characteristics that limit their long-term economic growth, such as heavy dependence on oil revenue, small private sector, low degree of self-sufficiency, limited investment in education and training, lack of good governance, etc. It is for this reason that some talk of possessing energy reserves as a 'curse' rather than a 'blessing' and refer to 'oil' as a 'nightmare'¹⁹ or 'devil's excrement'.²⁰ One study argued that it seems that possessing oil promises the opportunity for real choice and for the alteration of a development path, but in countries with a legacy of oil-led development, choice is in fact quite narrow and 'oil booms generate powerful and even overwhelming incentives to sustain existing trajectories but on a grander, more accelerated, and ultimately unmanageable scale' and thus they are the catalyst for future trouble.²¹ This dependence on oil revenues has meant that the majority of energy-exporting countries 'face great obstacles in attempting to exit from old patterns and have low capacities to promote new ones'.²²

¹⁸ See WA Otman and EJ Karlberg, 'Libya: Petroleum Industry and the Economic Diversification' (2005) 3 *Oil, Gas & Energy Law Intelligence*, issue 3 where they argue that there has been a strong correlation between levels of revenue and the price of Brent crude in Libya, which shows an unhealthy dependence on unpredictable oil prices.

¹⁹ See MA Movahhed, *Khab-e Ashofteye Naft: Dr Mossadegh va Nehzat-e Melli-e Iran* (The Nightmare of Oil: Dr Mossadegh and the Iranian Nationalist Movement) (Tehran, Nashr Karnameh, 1999).

²⁰ Interview with Juan Pablo Perez Alfonzo, former oil minister of Venezuela and founder of OPEC, Caracas, 1976, cited in TL Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley, University of California Press, 1997) at 4. The problem with these countries is generally labelled as the 'Dutch disease' or the 'resource curse'. See also the statement of the ex-Saudi Oil Minister, Sheik Ahmed Yamani of when he declared that 'all in all, I wish we had discovered water'. In S Shahnawaz and JB Nugent, 'Is Natural Resource Wealth Compatible with Good Governance?' (2004) 2 *Review of Middle East Economics and Finance* 159, cited in Otman and Karlberg, above n 18.

²¹ See Karl, *ibid*, at 16.

²² *Ibid* at 15. The analysis of one expert who compares the situation in Norway with the Gulf states' ability to diversify economically is worth mentioning here. Noreng believes that Norway's success in managing its energy industry was largely due to efficient government policies, which sought to ensure partnership between foreign and domestic companies, made research programmes mandatory, and encouraged the development of technology that aimed to be among the best of its kind. They compelled oil companies to cooperate in the development of new technology and a wide cooperation venture was launched to establish a national strategy for research and development. He argues that the situation is very different in the Gulf states, as at the time of oil exploration, the Gulf states suffered from under-development. In contrast, Norway was developed and had a highly educated population enjoying full employment and a high standard of living. Therefore, oil became an enormous supplement to the economy of the Gulf states, whereas in Norway it raised the domestic cost level and therefore appeared as a threat to employment due to which 'there has been a constant pressure to diversify for the sake of employment'. Moreover, skilled labour and competent management are lacking in these states and the lack of a representative, transparent and accountable government has contributed to this lack of overall management of the economy and oil revenues. He argues that Gulf states need 'not only to require foreign oil companies to train locals and transfer knowledge but also help to develop some local supply and service industries and even bring them along to markets in other oil provinces' and finally establish a more independent income base. He concludes that in order to diversify, the first step should be within the petroleum industry by developing and expanding local supply industry. The second is to develop competence in relation to petroleum through cooperation with the international oil industry and opening up to foreign

Resource abundance tends to render other export sectors uncompetitive: as a consequence, resource-rich countries never successfully pursue export-led growth.²³

There are references to the necessity of economic development in the agreements between the energy-producing countries and the European Community. For example, in the PCA with Russia, references are made to: the necessity of developing trade and investment, which are essential for the economic restructuring and technological modernisation of the parties; the need to foster sustainable development, and the development of respective industries and transport in all sectors of the economy. The Association Agreement with Algeria, in addition to referring to the objectives previously mentioned in relation to Russia, mentions the necessity to encourage 'diversification of Algerian exports' (Art. 48), 'fostering the development of small and medium-sized enterprises', the 'development of exports of Algerian manufactures' (Art 53), 'fostering an environment with the aim of stimulating and diversifying output for the domestic and export markets', 'developing and diversifying production in the field of agriculture and fisheries' (Art 58), 'smooth and sustainable development of tourism', etc.²⁴ Although some may argue that the EU may not have the expertise to promote economic diversification in other countries, reference to some aspects of this diversification in the framework of the Community's external relations heralds the recognition of the necessity of such diversification in energy-exporting countries. Although this is less evident in the PCA with Russia, it is clear in the association agreement with Algeria. Efforts should be concentrated on realising these objectives in major energy-exporting and transit countries.

It is difficult to determine with certainty the extent of the contribution of the EU's development cooperation policy to these countries' development trajectory and to their diversification. The real demands of these countries need to be analysed, and the possible paths to diversification should be studied by economists. Nevertheless, it is reasonable to call for the EU's involvement in such economic analysis and to highlight its relevance for security of energy supply.

operators. The third is to create a petroleum fund comprised of unexpected income to cushion the domestic economy and promote diversification. See O Noreng, 'Norway: Economic Diversification and the Petroleum Industry', *Middle East Economic Survey* vol LXVII, no 45 (8 November 2004).

²³ See JD Sachs and AM Warner, 'The Curse of Natural Resources' (2001) 45 *European Economic Review* 827. They believe that, almost without exception, the resource-abundant countries have stagnated in economic growth since the early 1970s. They admit that this is difficult to explain by other variables.

²⁴ By looking at EU policy with the Mediterranean countries and studying the 2004 Communication of the EU on its new framework for relations with its Eastern and Southern Neighbours, one can see that the EU has shifted from the logic of 'region building' and shared values with its neighbours to closer cooperation with its neighbours to enable the EU to provide security and welfare to its own citizens as its main objective. See Communication of the Commission on Wider Europe—Neighborhood—A New Framework for Relations with our Eastern and Southern Neighbors, COM (2003) 104 Final at 4. See also R del Sarto and T Schumacher, 'From EMP to ENP: What's at Stake with the European Neighborhood Policy Towards the Southern Mediterranean?' (2005) 10 *European Foreign Affairs Review* 17.

Through the EU's assistance, diverse economic sectors could be supported, such as the development of heavy industry (petrochemicals), basic metal industries, manufacturing industries, agriculture, education, training, services (including financial services), tourism, and privatization, to name a few.²⁵ The mutual interdependence of the EU and these countries suggests that assisting their economic diversification could be a part of a broadly conceived policy of external energy security for the EU.

The Organization of Petroleum Exporting Countries considers all its constituent members to be 'developing countries'. Those members of OPEC that are also members of the WTO have declared their status in that organisation as 'developing' (namely Kuwait, Qatar, UAE, Indonesia, Venezuela, Nigeria and Saudi Arabia).²⁶ Moreover, the 2005 EU Generalised System of Preferences (GSP) includes the most important energy-producing countries in this system, which suggests that they are considered by the EU as developing countries (ie all OPEC countries, Russia, and the countries of the Caspian).²⁷ Normally all imports are subject to duty unless designated as duty-free or given a duty exemption or 'preference', and the GSP provides duty-free treatment 'under certain criteria for an eligible good originating in a specific place for a specific period of time'. Under this system, the EC offers non-reciprocal preferential treatment to products originating in developing countries.²⁸ This programme is unilateral, which means that the EC determines on its own initiative 'which countries receive preferences, to what extent those preferences are granted and when they can be revoked'.²⁹ Nonetheless, the EU provides the rationale for the imposition of such a system as follows:

[D]eveloping countries which, due to a lack of diversification and insufficient integration into the international trading system, are vulnerable while assuming special burdens and

²⁵ See also the Report 'Economic Diversification in the Oil Producing Countries: the Case of the Gulf Cooperation Economies, UN, Economic and Social Commission for Western Asia', E/ESCWA/ED/2001/1, January 2001.

²⁶ There is no definition of 'developing countries' in the WTO. A country that wishes to be treated as a developing country declares its status upon accession. There is also no list available of those countries that are considered as 'developing' in this framework. The fact that the seven countries of OPEC, members of the WTO, are considered as developing countries in that organisation was acknowledged by the WTO staff through email contact. See also the OPEC website, at <<http://www.opec.org>>.

²⁷ See Council Reg (EC) No 980/2005 of June 27, 2005, Applying a Scheme of Generalised Tariff Preferences [2005] OJ L/169/1. See also ch 5.4.6 of this study.

²⁸ The EC reserves the right to demand the satisfaction of some conditions for a country to be accepted in the GSP scheme's 'special arrangements' (such as compliance with international labour rights, or environmental standards, etc).

²⁹ Some countries were previously exempted from the GSP system for a short period of time. For example, Indonesia in fats, oil, waxes, and footwear, and Libya and Saudi Arabia in mineral products, which are defined as products extracted from soil or the seabed. See Council Reg (EC) No 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004—Statement on a Council Regulation applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004, [2001] OJ L/346/1.

responsibilities due to the ratification and effective implementation of core international conventions on human and labor rights, environmental protection and good governance, should benefit from additional tariff preferences. These preferences are designed to promote further economic growth, and, thereby, to respond positively to the need for sustainable development. Under this arrangement *ad valorem* tariffs are therefore suspended for the beneficiary countries, as well as specific duties (unless combined with an *ad valorem* duty).³⁰ (emphasis added)

Moreover, the Community's GSP system could assist the economic diversification objectives of the developing countries to some extent.³¹ The basic idea of providing some preferences for the export of products of developing countries could be linked to that of economic diversification. An energy-producing country, acting in line with its economic diversification policies, seeks to create new industries or advance existing ones and generate income through the sale of the final products to other countries. The GSP scheme of the Community could be considered as an incentive for these countries to do so, which could also be coupled with assistance in upgrading those respective industries.

Although special arrangements, such as the GSP scheme of the Community, are not considered as the only means for economic diversification of these countries, they could be considered as an important incentive for the development of other economic sectors. However, the application of such schemes is limited because not every product would be given such preference if the respective sector of the product were already active in the Community.

The other option in place for the Community to assist energy-producing countries in diversifying economically is the creation of a free trade agreement (FTA), which could be considered as the best incentive to encourage the export of those products that help the developing countries to diversify. As mentioned earlier, no FTA with any energy-producing country is yet in place (apart from one with Norway). There are negotiations to establish an FTA with the countries of

³⁰ The regulation provides that a general arrangement should be granted to all beneficiary countries unless they are classified by the World Bank as a high-income country and where they are not sufficiently diversified in their exports.

³¹ Granting such preferences is also allowed within the framework of the WTO Art XXV(5) of GATT provides:

in exceptional circumstances not elsewhere provided for in this Agreement, the Contracting Parties may waive an obligation imposed upon a contracting party by this Agreement; provided that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties. The Contracting Parties may also by such a vote (i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and (ii) prescribe such criteria as may be necessary for the application of this paragraph.

For an analysis of the law on preferences in the WTO, see JL Stamberger, 'The Legality of Conditional Preferences to Developing Countries under the GATT Enabling Clause' (2003) 4. *Chicago Journal of International Law* 607. For the recent case on the approach of the Community towards developing countries within the framework of the GSP, see the Panel Report European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/R, 1 December 2003 and the Appellate Body Report, WT/DS246/AB/R, 7 April 2004.

the Gulf Cooperation Council since 1989 but it has yet to materialise. Nevertheless, as the argument above demonstrated, a FTA would not necessarily bring economic development without, at the same time, strengthening the social and physical infrastructure of these countries, which would in turn guarantee political stability for the purposes of our study on energy security.

The other alternative is to establish a Partnership and Cooperation Agreement with all energy-producing countries, similar to the PCA with Russia, which includes major elements of development cooperation in its framework that have been functional in practice as well. Such cooperation should take into account the progressive integration of the energy-exporting countries into the world economy. Firstly, it should seek to improve the management and regulation of the energy sector of these countries, in line with the principles of the market economy. Secondly, it should introduce a range of institutional, legal and fiscal reforms to encourage an increase in trade and investment in various existing sectors of the economy to promote economic diversification. In this respect, the PCA with Russia, the details of which were elaborated before, could be used as a model.

It is interesting that in practice the EU has actually shown that the economic diversification of energy-producing countries does not become the first priority in relations with these countries. Two examples can be raised to illustrate this issue. One is the effect of domestic taxation of imported energy on the economic development of energy-producing countries, and the second is the discussion of dual pricing and the attitude of the European Community towards that controversy.

Generally, consuming nations tend to prioritise the use of some energy sources compared to others, 'due to various considerations such as availability, price, technology, environmental impact, etc.', which could alter the competitive relationship between them.³² One method of such prioritisation is the taxation system. They may tax one source of energy differently from another, for various purposes, either to boost consumption of their own domestic production of a particular energy, or to satisfy some environmental demands.

The taxation system of the consuming nations affects the energy demand of a given country. The more one source of energy is taxed, the greater the presumption that that source is consumed less. This system has therefore been scrutinised by the oil-exporting countries because of the simple fact that if higher taxation is applied to the imported oil coming from those countries, the demand for oil will decrease, leading to a reduction in exports from these countries and ultimately lowering their income. Energy-exporting countries have studied the taxation system of consuming nations, including the member countries of the European Community, and have criticised the discrimination between various energy

³² For an analysis of this issue, see also S Zarilli, 'Domestic Taxation of Energy Products and Multilateral Trade Rules: Is this a Case of Unlawful Discrimination?' (2003) 37 *Journal of World Trade* 359.

sources, such as oil, gas and coal. Oil-exporting countries have mainly raised concerns over the high tax on oil, rather than coal or gas, in the OECD countries, including the member countries of the Community. (See ch 5.4.2 above.)

The concern of the energy-exporting countries is not the tax policy of the OECD countries per se, which may be implemented, for example, to protect the environment, but is mostly concerned with discrimination between various sources of energy. The effects of high taxes on oil and the subsidization of coal (which encourages the use of coal and moves consumption away from oil) are significant for the economies of developing oil-exporting countries. For example, Saudi Arabia argues that as its energy exports accounted for almost 40 per cent of its GDP in 1998 (compared to 5 per cent for most OECD energy-exporters such as Australia or Canada), decreases in exports through the taxation system of the OECD countries results in GDP losses of between 3 per cent and 5.1 per cent by 2010. They argue that this decline will significantly affect national development and social welfare aims, which, for the purposes of our study here, will be counterproductive to the Community's development policy goals. Although the Community has not adopted a development policy with Saudi Arabia, references to the overall necessity of 'partnership and cooperation with energy-producing countries' to guarantee energy security, as reflected in various Community documents, will become insignificant. The solution proposed by Saudi Arabia is the abolishment of discriminatory taxation of energy sources and coal subsidies, and taxing those sources only to pursue environmental objectives, which would ultimately minimise the adverse effects on producing countries' economies.³³ The Community could instead specifically encourage the transfer of those technologies, investment and research that promise to improve the efficiency and emissions performance of oil products.³⁴

As it is clear from the Saudi analysis of the taxation system of the OECD countries, there are valid concerns for the effect of such a system on the overall development of a given oil-exporting country. The situation, however, is not limited to oil-exporting countries. The gas-exporting countries (including Algeria, with whom the Community has a development cooperation policy) have raised some concerns with respect to the Community's activities in the field of energy in general.³⁵ Within the context of the 'Gas Exporting Countries Forum'

³³ Council Dir 2003/96/EC of 27 October 2003 on Restructuring the Community Framework for the Taxation of Energy Products and Electricity, [2003] OJ L/283/51, provides that there is a need to harmonise the taxation system of the Member States through the adoption of a minimum level tax on electricity and energy products other than mineral oils. The Directive prescribes that 'it would be advisable in this connection to base the calculation of these minimum levels as far as possible on the energy content of the products', which is an effective measure to determine that product's environmental impact.

³⁴ In the 2003 Council Directive on the Taxation of Energy Products and Electricity, no reference is made to the implications of the EC's taxation system for the economic development of energy-exporting countries. See the 2003 Directive on Taxation of Energy.

³⁵ See 'Algeria Talks Tough as Gas Exporters Explore "Mutual Interests"' in *Gas Matters*, February 2001 at <<http://www.gas-matters.com/>>.

(ie the forum where eleven gas-producing countries exchange their views on how to react towards importing countries' needs), some countries, including Algeria, expressed concern that 'the whole liberalisation of energy markets in Europe could be considered as an attack on non-European exporters'.³⁶ They requested European institutions to consult them when passing regulations and directives to liberalise European energy markets. Their main concern was that the creation of a European energy market would ultimately create gas-to-gas competition, which brings about short-term contracts and spot and future trading, which would place exporting countries in a position where they cannot predict their long-term revenue. This would in turn affect their development goals.³⁷

These concerns are not addressed in any of the documents of the Community that deal either with recommendations to guarantee energy security or development cooperation policy. Would it be too far-fetched to link these concerns to the development cooperation policy of the Community? With respect to the development of the European energy market and the concerns of the gas-exporting countries, although European institutions should keep these concerns in mind, exporting countries should strive for a position where they can take advantage of the gradual development of the European energy market and growth in demand to achieve access to downstream facilities and secure competitive positions.³⁸ This is due to the fact that the liberalisation of energy markets in Europe is a point of no return. Gas-exporting countries would be in a better situation to redefine their position, to engage themselves in this process, and play their role in

³⁶ As Jonathan Stern has correctly pointed out, there are at least three reasons why exporters might believe that liberalization constitutes a form of unfair discrimination against them:

1) it is very clear from the experience of gas markets where liberalization and competition have already developed that the producers are the first group of market players to see their margins eroded. While EU liberalisation policies were in no way targeted against producers—let alone particular groups of producers—the initial impact of gas-to-gas competition could be strongly negative; 2) Liberalization is likely to make the development of new gas projects under long-term take-or-pay contracts more complicated than previously, particularly new multi-billion-dollar green-field projects in non-European countries; 3) The issue of existing long-term contracts which embody 'anti-competitive elements' is currently being addressed by EU competition authorities. The latter are seeking changes in contracts, such as those concluded under the collective negotiation of the Norwegian Gas Sales Organisation (GFU), and clauses in Russian and Algerian contracts which prevent resale of gas to other market players, particularly in other countries. He rightly believes that failure to resolve such issues could jeopardise relationships between producers and the European Commission.

See J Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalization* (London, RIIA, 2002) at 20.

³⁷ For a short reference to this problem, see Draft Strategy Paper, 'A Long-Term Vision of a Fully Operational Single Market for Gas in Europe' Prepared by the Joint Working Group of the European Gas Regulatory Forum, 28 January 2002, at 29. In this draft, reference is made to the importance of 'a reciprocal integration' between gas-importing and gas-exporting countries and opening of upstream and downstream markets. It was found important to give a common strategic external dimension to the EU's gas market liberalisation.

³⁸ Some believe that an energy framework for trade and investment will work best if the interests of countries dependent on energy exports are taken into account. See JV Mitchell, *Renewing Energy Security* (London, RIIA, 2002) at 4.

shaping it. The Community, however, needs to assist them in achieving these goals to better guarantee energy security. This is possible within the context of the existing development cooperation policy, for example with Algeria. There should be a consideration of 'mutual interdependency' in this state of affairs, a factor that is sometimes neglected in the overall design of EU policies.

With respect to those countries with which the Community has yet to establish a development cooperation policy, the situation is different. It was stated that the higher tax on oil will gradually reduce the demand for oil and in turn the income of the oil-exporting countries and affect their economic development. Nevertheless, one can argue that this scenario is actually the best way to encourage these countries to diversify away from full dependence on this income by frustrating their efforts to sell oil, and attract them to other sectors, thus forcing them to diversify. However, if this approach is pursued by the EU, these countries should be assisted in coping with the consequences of such a move. The instability of these countries would have direct effects on Europe's security of energy supply. If EU measures refer to the importance of energy security in the Community and hint at the necessity of cooperation or partnership with energy-producing countries, this cooperation cannot be established when the major concerns of the energy-exporting countries, either a stable income or economic diversification or both, are not addressed.

With respect to economic diversification, interestingly enough, there is not only no Community measure to address this situation, but also some examples show that the concerns of the energy-exporting countries to diversify economically have not been found relevant where the interests of the European industries were 'claimed' to be at stake. In the previous chapter on the Energy Charter Treaty, reference was made to the pricing mechanism of natural gas liquids (NGLs) in Saudi Arabia (the so-called dual pricing system) and its compatibility with WTO law.³⁹ In that context, it was mentioned that Saudi Arabia sells the NGLs more cheaply if the foreign or domestic investor uses it in the domestic petrochemical industry, and sells it more expensively if they are exported without being used in that industry. The reason for this practice is that if they do not adopt such a strategy, there will be no investment in their petrochemical industry. They claim that in order to diversify, they need first to strengthen some of the few industries that they possess.

Interestingly, the Community has actively attacked Saudi Arabia for adopting such a measure.⁴⁰ As mentioned before, the Commission drafted a proposal in August 2005 to impose balancing mechanisms in the form of countervailing and anti-dumping measures on the import of all products in which dually priced raw materials have been used. The proposal provides that this regulation is addressed

³⁹ See ch 5.4.9.3 above.

⁴⁰ See particularly the Proposal by the Commission for a Council Regulation Concerning Balancing Mechanism Applicable to Imports from Certain Countries not Members of the European Community, COM (2005) 398 Final.

to either non-WTO members, or those countries that accept the imposition of such balancing mechanisms on their exports in their WTO Accession Protocol. In other words, they impose a condition on approving the accession of Saudi Arabia to the WTO. Such conditionality suggests that the EU would not agree to Saudi Arabia's membership unless this country eventually abolishes this practice. The EU would therefore frustrate the efforts of that country to join the WTO. Putting aside the legal analysis of such practice and its compatibility with WTO rules, the mere concern of Saudi Arabia to economically diversify has never become a topic of consideration.⁴¹ Although dual pricing may not be considered by some as the most efficient way to attract investment to the petrochemical industry of energy-exporting countries, concentrating on the development of petrochemicals is the natural, immediate, and inevitable choice in the overall economic diversification goals of this country.⁴² More importantly, limiting the accession of Saudi Arabia to the WTO through such defensive mechanisms runs counter to the basic policies of the Union in supporting the efforts of developing countries to better their activities in the fields of trade and investment. The EU explicitly mentions that countries that have integrated into the world economy through trade and investment have enjoyed higher economic growth and an improvement in many key social indicators. For exactly that reason the Union identified trade as one of the six priority areas for development.⁴³ Efforts by developing countries to reform need to be accompanied by 'additional external assistance from developed nations, that complements market access opportunities',⁴⁴ especially in those sectors where these countries enjoy a comparative advantage. Their integration into the world economy, through membership of the WTO, should therefore be encouraged. Nevertheless, in practice it is shown that the extent of the objectives of the EU's development cooperation policy becomes greatly limited in certain circumstances.

How should one approach these differing positions of the Community? Can we conclude that the Community does not take the economic diversification of these countries into account and 'development cooperation policy' of the Community exempts some countries or some issues? Even though the Community does not have such a policy framework with all the energy-producing countries, could we argue that the link between development cooperation policy and policies on energy security would suggest a change in the Community's attitude

⁴¹ See also S Haghghi, 'Dual Pricing of NGLs in Saudi Arabia and the Rules of the World Trade Organisation on Subsidies', *Middle East Economic Survey*, vol XLVIII, no 17 (25 April 2005) and S Haghghi, 'The Relevance of the Energy Charter Treaty for the Countries of the Gulf Cooperation Council' paper submitted within the Framework of the EUROGULF Project, Kuwait City, April 2005, at <http://europa.eu.int/comm/energy_transport/doc/2005_04_eurogulf_kuwait.pdf>.

⁴² For a comprehensive study on this issue, see 'Economic Diversification in the Oil Producing Countries', above n 25.

⁴³ See, eg, Communication from the Commission to the Council and the European Parliament, Trade and Development: Assisting Developing Countries to Benefit from Trade, COM (2002) 513 Final.

⁴⁴ See Communication, *ibid*, at 12.

towards these countries and involve reflecting upon their needs of economic diversification? Or are the measures and proposals already discussed adequate (such as the creation of FTAs or GSPs etc)?

Oil proceeds in the energy-exporting countries are said to be used to modernise infrastructure, create employment, and contribute to overall economic growth. If there is an efficient administrative system in place, this ensures that such income will be used for a good cause. Putting aside the fact that this is not always the case in many energy-exporting countries, where corruption and weak governance weakens this inter-relation, oil revenues could be considered as an important source of economic development. However, non-energy-related economic activities, which are relevant for the economic diversification of these countries, do not develop at a pace that guarantees such structural change. The necessity to use the oil income in various energy-related infrastructural projects reduces the government's spending on non-oil growth. On the other hand, a strong fiscal policy that guarantees adequate finance in the non-oil sector is not always in place, as it is constrained by the government's heavy dependence on volatile oil export income.⁴⁵ There is a need for assistance in eliminating this exact problem in order to pave the way for economic diversification.

The Community could take these concerns into account in establishing its own policies, as well as assisting those countries to overcome their national obstacles. It is strongly arguable that appropriate and efficient economic policies will gradually generate a sense of security, which in turn generates increased incentives for economic activities and thus greater prosperity. This all contributes to energy security. After all the 'European Economic Community' with its strong economic objectives was itself established in order to bring peace and security to Europe and 'to make wars not merely unthinkable but materially impossible'.⁴⁶

As the link between development cooperation policy, political stability and energy security becomes more transparent, it is vital to address these links in designing a cooperation framework between the Community and energy-exporting countries. This will in turn give value to the strongly criticised 'development cooperation policy' of the EU and its so-called 'nothing but symbolic gesture policy that follows the global trends rather than setting them', since it brings a new dimension to this policy based on tangible economic benefits for both sides.⁴⁷ Interestingly, in addition to Article 158 EC's requirement that the Community shall aim at reducing 'disparities between the levels of development of the various regions', the European Community has recently discussed the necessity of creating coherence between development policy and

⁴⁵ See also E Fasano and Z Iqbal, 'GCC Countries: From Oil Dependence to Diversification' (2003) International Monetary Fund Publications, at <<http://www.imf.org/external/pubs/ft/med/2003/eng/fasano>>.

⁴⁶ See Declaration of Robert Schuman on May 9, 1950 in U Kitzinger, *The European Common Market and Community* (London, Routledge and Kegan Paul, 1967) at 37.

⁴⁷ See K Arts and AK Dickson (eds), *EU Development Cooperation: From Model to Symbol* (Manchester, Manchester University Press, 2004) at 149.

other policies. In the 2005 Communication from the Commission on Speeding up Progress towards the Millennium Development Goals and the European Union's Contribution,⁴⁸ there is a call for laying down a 'true European Development Strategy', which embodies 'policy coherence'; that 'non-development policies' should respect development policy objectives, and development cooperation should, where possible, also contribute to achieving the objectives of other EU policies.⁴⁹ Hence, as the Communication calls for the promotion of an 'integrated policy and instrument mix', it seems justifiable to treat energy security and development as complementary agendas. For that purpose, the EU should undertake measures in the framework of this agenda and introduce a range of development policies in these countries. These activities can be extended to cover institutional, legal and fiscal reform in these countries in order to: encourage trade and investment in various sectors of their economy; promote energy saving and energy efficiency in these countries; assist in modernising energy infrastructure; assist in minimising the environmental effects of energy activities, and give full consideration to providing those countries with technical assistance upon request for the development of necessary disciplines of law, such as competition law. Overall cooperation shall therefore focus on the development of respective industries and exploration of new sources of supply and of new markets, and on economic restructuring and technological modernisation in those areas that they deem appropriate to satisfy their needs of economic diversification. This could all be embodied in a Partnership and Cooperation Agreement between the EU and all the major energy-exporting countries, similar to what occurred to some extent in the PCA with Russia, as explained above.

The following section completes the analysis of the necessary tripartite approach to energy security through the discussion of the importance of including a European foreign policy in the overall external energy policy of the EU to guarantee security of energy supply.

7.2. The CFSP and Energy Security: An Inter-relation

European foreign policy has a distinct character in the overall policy making of the Union. This specific character is due to the lesser progress that this policy has witnessed—compared to efforts to create an economic and monetary union—as a result of the exercise of state sovereignty by each Member State, and the reluctance to substitute this reserved domain with European policy-making. For this reason, the external political identity of the EU has become an unsettled issue and there is an ongoing struggle to find a common denominator among various

⁴⁸ See Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Speeding up Progress towards the Millennium Development Goals, European Union's Contribution, COM (2005) 132 Final.

⁴⁹ See Communication from the Commission, Policy Coherence for Development, Accelerating Progress towards Achieving the Millennium Development Goals, COM (2005) 134 Final at 3.

proposals as to how to form this identity. Discussions circle around whether there is a necessity for the various foreign policies of Member States to converge and if yes, whether the possibility exists of assembling compatible interests of Member States at the external level. With regard to the latter point, some believe that assembling compatible interests is a question of mere political will, and some are simply of the opinion that it is not structurally possible to handle such a policy at the European level.

The attentiveness towards a European foreign policy manifested itself in the advent of the European Community in the 1950s through activities that took place in the external field.⁵⁰ The integration effort in the field of foreign policy took place within the intergovernmental system of European Political Cooperation (EPC) in the early 1970s, outside the institutional framework of the European Economic Community,⁵¹ the continued reflection of which can be depicted in the Treaty on European Union.⁵² Later, the Single European Act of 1986 placed the already existing legal instruments under one umbrella, by providing, in its preamble, that the Community 'should speak ever increasingly with one voice and to act with consistency and solidarity', and its Title III dedicated one part to the EPC Article 30 of the treaty introduced a concrete role for the Commission and the Council of Ministers and created the Secretariat under the authority of the Presidency. The intergovernmental character of the EPC became more formal and structured, but was nonetheless based on the principle of consensus. The intergovernmental foundations and mechanisms of EPC were clearly defined, and because of this change, some believed that the foreign behaviour of Member States did change, as it was affected by a spirit of cooperation,⁵³ and thus the SEA was seen as a milestone on the way to a

⁵⁰ Some believe this date could be pushed to 1946 when Churchill stressed the need to establish 'a kind of United States of Europe', or to 7 May 1948 when the so-called 'congress of Europe' called for the establishment of a Political and Economic Union in Europe. See RA Wessel, *The European Union's Foreign and Security Policy: A Legal Institutional Perspective* (The Hague, Kluwer Law International, 1999) at 1 [hereinafter '*The EU Foreign Policy*'].

⁵¹ For an overview of this distinct characteristic of foreign policy as compared to other areas of policy making, see B Soentendorp, *Foreign Policy in the European Union* (London, Longman, 1999).

⁵² The EPC developed a system of its own, which rested on the goodwill of the Member States without creating any binding legal obligations. As the 1970 Luxembourg Report provides, this Cooperation meant to

ensure greater mutual understanding with respect to major issues of international politics, by exchanging information and consulting regularly; to increase their solidarity by working for a harmonization of views, and concentration of attitudes and joint action when it appears feasible and desirable.

Originally, the European Political Cooperation (EPC) was a 'closed' system or a 'private club, operated by diplomats for diplomats', and some of that same ambience still exists today. See the Report by the Foreign Ministers of the Member States on the Problems of Political Unification, Luxembourg, 27 October 1970, in the 1970 *Bulletin of the European Communities* at 6. See S Nutall, *European Political Cooperation* (Oxford, Clarendon Press, 1992) at 11.

⁵³ See M Holland, *European Integration: From Community to Union* (London, Pinter Publishers, 1994).

European foreign policy.⁵⁴ Although there was no formal legal obligation imposed on the Member States in the field of foreign policy, the mere 'soft law' construct of this cooperation influenced the decisions of Member States and made Member States not 'as free as before' in the elaboration and conduct of their foreign policy.⁵⁵ This soft law structure changed into hard law, at least with respect to some provisions, in the Maastricht Treaty, where the notion of a Common Foreign and Security Policy (CFSP) was established.⁵⁶

The most obvious and significant change in the CFSP as compared to the EPC was the change from the language of 'endeavour' in EPC to the language of 'obligations' in the CFSP.⁵⁷ However, nothing was an 'obligation' before a unanimous vote. Moreover, the lack of an 'effective enforcement mechanism' in that field was highlighted as one problem in binding the Member States. No judicial redress exists at this level as the European Court of Justice was deliberately not given jurisdiction to deal with the mere foreign policy provisions of Title III of the Single Act (ie the non-economic dimensions of foreign policy). This lack of jurisdiction was transferred to the Maastricht, Amsterdam and Nice Treaties (Article 46 TEU) as well.⁵⁸

⁵⁴ See S Nutall, 'European Political Cooperation and the Single European Act', (1985) 5 *Yearbook of European Law* 203 at 209.

⁵⁵ See R Dehousse and JHH Weiler, 'EPC and the Single Act: from Soft Law to Hard Law' in M Holland (ed), *The Future of European Political Cooperation: Essays on Theory and Practice* (London, Macmillan 1991) [hereinafter '*The Future of European Political Cooperation*'] at 124.

⁵⁶ On the other hand, other commentators perceived the intergovernmental character of Title III as a move away from integration, as they possessed a 'Community orthodoxy' approach, which regarded the SEA as 'an alibi to conceal internal inaction'. See W Wessels, 'EPC after the Single European Act: Towards a European Foreign Policy via Treaty Obligations' in M Holland, *The Future of European Political Cooperation*, *ibid*. This codification, ie the mere fact that provisions on foreign policy were placed in the treaty for the first time, was found to make the treaty 'progressive', which had the potential to elevate foreign policy issues to a real legal status that will entail the imposition of rights and obligations on the Member States which could hold them accountable at the CFSP level. See Dehousse and Weiler, 'EPC and the Single Act', *ibid*, at 128. Some disagree with Title III having a legal character. See, eg, P Pescatore, 'Observations critiques sur l'Acte unique européen' in J de Ruyt, *L'Acte unique européen: Commentaire* (Brussels, Institut d'Études Européennes, 1987) at 52. See also KE Smith, *European Foreign Policy in a Changing World* (Cambridge, Polity Press, 2003).

⁵⁷ See MR Eaton, 'Common Foreign and Security Policy', in D O'Keefe and PM Twomey (eds), *Legal Issues of the Maastricht Treaty* (London, Chancery Law Pub, 1994) at 215.

⁵⁸ The activities in the second pillar remained in the confines of intergovernmental solutions, and majority voting was limited to 'well defined and limited circumstances'. The rule was that the decision to adopt a position or an action was to be taken by unanimous voting, but its execution could be decided by qualified majority voting. What became important, however, was the creation of features such as common positions, and joint actions, which had binding force on the Member States. They were asked to refrain from any action which is contrary to the interests of the Union or likely to impair its effectiveness as a cohesive force in international relations. In other words, they had to ensure that their national positions conform to the common positions (Art J.2). Through these measures, an improved intergovernmental system was sought, which deemed to facilitate more effective coordination and collective action. Possible contradictions between the Union and national policies were deemed to be removed for those topics agreed as joint actions or common positions. See M Holland, *European Union Common Foreign Policy: From EPC to CFSP Joint Action and South Africa* (London, St. Martin's Press, 1995) at 24 [hereinafter '*From EPC to CFSP*']. The Nice Treaty, which came into force in February 2003, introduced some changes in the sphere of CFSP which are relevant

Irrespective of the differences between various Member States' interests and the institutional shortcomings, some development in some fields of action at the foreign policy level has taken place and the Union has established a political institution capable of making decisions and implementing them.⁵⁹ The Council, based on Article 24 of the TEU, has been given the competence to exercise its international capacity to conclude an agreement with one or more states or international organisations and it has carried out some measures, which led some commentators to conclude that an implied international legal personality exists at this level. It is believed that the long list of various common positions, common decisions, and joint actions are also a manifestation of the steps in creating a European foreign policy,⁶⁰ where partial convergence or the mere pooling of preferences, as the basis for establishing a shared policy regime, can take place.⁶¹

Article 16 TEU stipulates that 'Member States shall inform and consult one another within the Council on any matter of foreign and security policy of *general interest*' (emphasis added). Although there is no further explanation of what those general interests are or what constitutes a 'matter of foreign policy', historically (particularly since the oil crisis of 1973), it has become clear that

for our study. The extension of qualified majority voting for CFSP resolutions did not appear on the agenda, but a new provision for joining international agreements in a CFSP framework was introduced. Art 24 of the Nice Treaty provides that the Council may authorise the Presidency, assisted by the Commission, to open negotiations to conclude an agreement with one or more states or international organisations. This Treaty explicitly provides that these agreements shall be binding on the 'institutions of the Union' (Art 24(6)), which implicates both the Member States and the institutions.

⁵⁹ See also T Tilikainen, 'To Be or Not to Be: An Analysis of the Legal and Political Elements of Statehood in the EU's External Identity' (2001) 6 *European Foreign Affairs Review* 223 at 229.

⁶⁰ See also RA Wessel, 'The International Legal Status of the European Union', (1997) 2 *European Foreign Affairs Review* 109, and J Klabbers, 'Presumptive Personality: The European Union in International Law' in M Koskenniemi (ed), *International Law Aspects of the European Union* (The Hague, Kluwer, 1998) at 231. These activities at the level of the CFSP also suggest that the aim is not necessarily full convergence of foreign policies. In other words, the CFSP is not an end in itself but is the creation of a foreign policy, which proclaims the non-exclusivity of the CFSP and its appearance in areas where the Member States have come to an agreement. See RA Wessel, 'The Multi-level Constitution of European Foreign Relations', EUI Workshop Paper, April 2002, at 9. See also V Constantinesco, R Kovar and D Simon, *Traité sur l'Union européenne: commentaire Article par Article* (Paris, Economica, 1995) at 786.

⁶¹ See H Wallace, 'The Policy Process. A Moving Pendulum' in W Wallace and H Wallace, *Policy-making in the European Union* (Oxford, Oxford University Press, 2000) at 58. She argues that the 'congruence' of policies is defined as 'the compatibility of the policy actors' preferences as the basis for establishing a shared policy regime. 'Congruent preferences imply conditional commitments to collective regimes whereas convergent preferences may produce longer term stability of policy regimes'. As one writer explains,

The European foreign policy is not meant to reflect the aggregation of the foreign policies of each individual Member State but it is a distinct process that combines certain national foreign policy attributes with features and capabilities unique to the EC/EU... [the] trap to be avoided is to expect the EC/EU to behave like a nation-state: it is a foreign policy actor, but one that operates within its own specific constraints.

See M Holland, *From EPC to CFSP*, above n 58, at 2. See also the Conclusions of the General Affairs and External Relations Council of 26 October 1993.

energy security is one important issue in the foreign policy agenda of each Member State (see chapter 1). Although Member States have a shared objective of seeking an assured energy supply, guaranteed energy accessibility does not necessarily mean that Member States are willing to converge their policies to attain this objective.⁶² This provision could suggest that Member States should inform each other about their external energy policies, and it could ultimately be interpreted as encouraging the Member States not to undertake activities that would endanger other Member States' security of energy supply measures. This could also be read in line with the existence of a duty of loyalty imposed on the Member States, as embodied in Article 11 TEU, which necessitates that they 'actively' and 'unreservedly' support the Union's external and security policy in a spirit of 'loyalty and mutual solidarity'.⁶³

This being said, Member States are not obliged to adopt a foreign policy towards energy-producing countries common to all members of the European Union. The question then is whether the development of 'a European foreign policy' results in a better guarantee of security of energy supply and if not, what solutions can be proposed in this respect. In other words, it should be clarified whether a common foreign policy can better guarantee energy security as opposed to unilateral initiatives, which could be, but are not necessarily, in contradiction with or damaging to one another. Thereby, in analysing this area of European policy-making, it should be kept in mind to what extent this common interest necessitates or makes possible a coherent foreign policy towards energy-producing countries or those countries that are important in safeguarding the security objectives (eg transit countries).

Before analysing this issue, it should be mentioned that this analysis cannot be separated from the already existing inter-relation between the CFSP and the EC Measures of the first pillar. The inter-pillar interaction, and the necessity of consistency and coherence between the two, provides some interesting outcomes which renders the two pillars interdependent, and establishes accountability on the part of the Member States that is interesting to highlight in relation to our discussion on energy security. The question arises whether an efficient external commercial and economic policy towards energy-producing countries guarantees adequate security of energy supply, or whether a common foreign policy should also be included in the security framework.⁶⁴

⁶² See also C Musu, 'European Foreign Policy: A Collective Policy or a Policy of Converging Parallels' (2003) 8 *European Foreign Affairs Review* 35 at 44. She is of the opinion that, in addition to specific national interests, unification is being strongly prompted by interests that are shared by all EU Member States, namely: the free flow of oil at a reasonable price to grant energy supplies to Europe; the political stability of the area to avoid an insecurity spill-over and uncontrolled migration flows; and regional prosperity to create a market for European products.

⁶³ The link between Art 11 and Art 10 EC, where Member States shall ensure fulfillment of the obligations arising out of the EC Treaty, will be elaborated on later in this section.

⁶⁴ The TEU uses the two terms of coherence and consistency interchangeably. Nonetheless, coherence, which guarantees positive connections between various fields of external relations, could be considered as a step further than consistency (ie guarantee that the measures at the external level

The relationship between external economic aspects of integration and the political ones became known during negotiations on the Amsterdam Treaty, where the provisions on the CFSP and external economic relations were intended to merge, since the intention was to demonstrate the 'logic of overall approach to external policy'.⁶⁵ However, the insistence of the Member States on keeping the pillar structure and dividing the political and economic dimension of the Union did not allow for fusion of the two in the Amsterdam Treaty. Member States sought to preserve a distinction between the Community method related to economic issues and the intergovernmental CFSP method for foreign policy, even though their eventual overlap was common knowledge. Although, as mentioned earlier, the Commission's role in the field of CFSP, as an indication of the inter-relation between the two aspects of external relations, is increased, it is hardly comparable to the powers it already possesses under the first pillar. The limitation imposed on the activities of the Commission is an example of the motivation of the Member States to create a type of CFSP policy-making, distinct from the first pillar. However, no matter how vigorously they insisted on this distinction, there is strong relationship between the two in practice.⁶⁶ The coordination of these two pillars, therefore, is not a matter of straightforward interpretation in all sectors, but a rather complex one, which has been the subject of intense scholarly comment.

Moreover, there are examples of efforts to coordinate the EC and CFSP measures in the Treaty on the EU, which would lead to the attainment of the objectives of consistency as prescribed by the treaty.⁶⁷ One example of this

are not in conflict). In other words, the objective of 'consistency can be named as one condition for attainment of coherence'. The Treaty on the European Union refers to the necessity of consistency in the external activities of the Union as a whole, in the context of its external relations, security, economic and development policies (Art 3). Although there is no definition of what consistency means and what its implications are, it can be defined as the absence of contradictions between various external policies. Moreover, coherence not only involves positive connections between various external measures, both between the Union and the Member States and between Union measures themselves, but also involves coherence in the activities of the Union institutions, which could directly or indirectly contribute to coherence at the external level. See C Tietje, 'The Concept of Coherence in the Treaty on European Union and the Common Foreign and Security Policy' (1997) 2 *European Foreign Affairs Review* 211 at 212. He believes that the TEU had in mind the principle of coherence, and not consistency, as one objective to be followed by the Union. This is because the TEU, in its other authentic language versions, refers to coherence and not consistency (French *cohérence*, Italian *coerenza* etc.)

⁶⁵ See C Bretherton and J Vogler, *The European Union as a Global Actor* (London, Routledge, 1999) at 191.

⁶⁶ The political practice and scholarly comment points to the growing understanding that the European Union is not a radically different thing from the European Community, and that both organisations have many principles and practices in common, to the extent even that the European Community cannot be considered as a sub-organisation of the European Union.

See B de Witte, 'Simplification and Re-Organisation of the European Treaties' (2002) 39 *CML Rev* 1255 at 1267.

⁶⁷ There is an overlap between the EC and CFSP competences as well and some argue that this overlap becomes more apparent in the European Constitution. The reason is that 'the Union and the

coordination is the link between Article 11 TEU and Article 10 EC. The latter explicitly imposes obligations on Member States (the use of the word 'shall') in prescribing that they should ensure fulfilment of the obligations arising out of this Treaty. On the other hand, as explained earlier, Article 11 TEU talks of an 'unreserved support' for the Union's external policy. This means in practice that Member States shall neither adopt measures which are contrary to the objectives of the CFSP nor undermine their consistency with their obligations under Community law. One ECJ precedent clarifies this coordination. In 1987, the Court held that:

Article 5 (now Article 10 EC) of the Treaty provides that the Member States must take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the Treaty. If, therefore, the application of a provision of community law is liable to be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, *even where the agreement falls outside the field of application of the Treaty*, every Member State is under a duty to facilitate the application of the provision and, to that end, to assist every other member state which is under an obligation under Community law.⁶⁸ (emphasis added)

Hence, if Community law is impeded, no matter whether the activity is within the ambit of Community law or 'beyond', which could be interpreted to cover the domain of CFSP, a breach has occurred, and consequently the ECJ can be engaged.⁶⁹

Community are to be merged into one legal personality', see S Griller, 'External Relations' in B de Witte, (ed) *Ten Reflections on the Constitutional Treaty for Europe* (Florence, RCSAS, 2003) at 136 [hereinafter '*Ten Reflections*']. For an analysis of the distinction between the first and second pillars in the European Constitution, see B de Witte, 'The Constitutional Law of External Relations' in I Pernice and MP Maduro (eds), *A Constitution for the European Union: First Comments on the 2003 Draft of the European Convention* (Baden-Baden, Nomos, 2004) [hereinafter '*The Constitutional Law*'] at 95.

⁶⁸ See Case 235/87, *Annunziata Matteucci v Communauté Française de Belgique et Commissariat Général aux Relations Internationales de Communauté Française de Belgique*, para 19, [1987] ECR 5589.

⁶⁹ Some talk of the 'contamination' of the Community procedures by CFSP procedures. The problem is said not to be the fact that the CFSP measures refer to Community initiatives, but that they do so in the 'operative' part of the decision. This will result in encroachment on Community competences and procedures. For instance, when a common position instructs the Community to act as far as its competences are concerned by saying 'the Council and the Commission acting within the framework of their competences, shall take the measures necessary for the implementation of a Common Position', the CFSP decision affects the content of Community measures. The Council, therefore, has exceeded its competences. See RA Wessel, *The European Union's Foreign and Security Policy: A Legal Institutional Perspective* (The Hague, Kluwer Law International, 1999) at 301 [hereinafter '*The EU Foreign Policy*']. Furthermore, there may be a CFSP decision of the Council and a separate Regulation based on the EC Treaty, which regulates one specific field where national security and common commercial policy are both relevant. A CFSP measure can also have a dual legal basis, one being the already existing Community measure or an EC Treaty provision, and secondly, a TEU provision. See, eg, the measures with respect to 'dual-use goods' in Council Decision of 19 December 1994 on the Joint Action adopted by the Council on the basis of Article J.3 of the Treaty on European Union concerning the Control of Export of Dual-use Goods, 94/942/CFSP and Council Reg No 3381/94, of 19 December 1994 setting up a Community Regime for the Control of Exports of Dual-use Goods, [1994] OJ L/367/1. See the Joint Action 96/688/CFSP, adopted on 22 November 1996

The inter-relation between external measures at the Community and the Union level and the existence of the obligation of consistency are relevant for our discussion on Europe's energy security. Some common positions call for assisting a given country to accede to an international treaty in order to facilitate their gradual integration into the world economy, or paving the way for enhancing political and social stability, or promoting early implementation of an action plan for reform of the energy sector.⁷⁰ As all these objectives, if addressed to an energy-producing country or to a transit country, have implications for energy security, no measure should hamper the achievement of these goals. Hence, it could be argued that consistency between measures at both levels should contribute to the objectives pursued in relation to energy security as prescribed in the CFSP tools.

One clear example of the inter-relation between the EC and CFSP measures is Article 301 of the EC Treaty, which contains the requirement for a prior CFSP decision in order to adopt a Community action to interrupt or to reduce, in part or completely, economic relations with one or more third countries. This requirement suggests that no Community measure, with respect to the imposition of economic sanctions, can be adopted independent of the CFSP measure. As some rightly suggest, this consequence contributes to the consistency of the overall external policy of the Union.⁷¹ The only remaining problem is that the Community measure has to await a unanimous vote in the European Council for the CFSP measure to be adopted.⁷²

by the Council on the basis of Article J.3 and K 3 of the Treaty on European Union concerning Measures Protecting against the Effects of the Extra-Territorial Application of Legislation by a Third Country and Actions based thereon or resulting therefrom (as a reaction to the Cuban, Iran, and Libya Sanctions Acts) [1996] OJ L/309/7. See also RA Wessel, 'The Inside Looking Out: Consistency and Delimitation in EU External Relations' (2000) 37 CML Rev 1135 at 1153 [hereinafter 'The Inside Looking Out']. Some argue that the combination of CFSP and Community procedures should not be allowed, because it would lead to a procedural imbroglio (ie a complicated situation). It is said that it is illegal to combine the cooperation procedure of, for example, Art 179 (on the role of the Council to adopt measures in the field of development cooperation, where the Council acts by qualified majority voting) with then Art J.2 on the adoption of common positions, which necessitates a unanimous vote (comparable to common strategies after Amsterdam). See CWA Timmermans, 'The Uneasy Relationship between the Communities and the Second Pillar: Back to Plan Fouchet?' (1996) 23 *Legal Issues of the European Integration* 61 at 69.

⁷⁰ See 94/779/CFSP Common Position of 28 November 1994 defined by the Council on the basis of Article J.2 of the Treaty on European Union on the Objectives and Priorities of the European Union towards Ukraine, [1994] OJ L/313/1. Ukraine is an important transit country for the security purposes of the EU.

⁷¹ See RA Wessel, 'The Inside Looking Out', above n 69, at 1161. See also Y Buchet de Neuilly, 'European External Relations Fields, the Multi-pillar Issue of Economic Sanctions against Serbia' in M Knodt and S Princen (eds), *Understanding the European Union's External Relations* (London, Routledge, 2003). For the historical background of the practice of economic sanctions in the Community, see also SV Konstadinidis, 'The New Face of the Community's External Relations: Recent Developments on Certain Controversial Issues' in S Konstadinidis (ed), *The Legal Regulation of the European Community's External Relations after the Completion of the Internal Market* (Aldershot, Dartmouth, 1996).

⁷² Nevertheless, some suggest that the problem does not end here. They talk of the danger of the negative effect that the CFSP practice in a specific field may have on the EC measure. This danger

A look at the 2003 Common Position on Iraq, an important energy-producing country, is worthwhile in order to analyse this inter-relation.⁷³ This Common Position, which is accompanied by a Council Regulation (ie an EC measure⁷⁴), was established in the aftermath of the 2003 US and British-led war in Iraq. It prevents the sale or supply to Iraq of arms and related materials, other than those arms and related materials required by the administrative authority to serve the purposes of UN Security Council regulations. Clearly, this CFSP measure touches upon a field of Community activity, namely the Common Commercial Policy (CCP), which is an exclusive competence of the Community. Moreover, the common position provides that all proceeds from all export sales of petroleum, petroleum products and natural gas from Iraq shall be deposited into the Development Fund for Iraq under the conditions set out in the UN resolution, until such time as an internationally recognised representative government of Iraq is properly constituted. These measures are in line with the objectives of the formation of a sovereign Iraqi state, which could in turn create adequate political stability in the country and in the region, and if properly implemented, have implications for energy security. Regardless of whether these measures were successful in practice, a common position among Member States could be created through these measures to establish such stability and achieve these goals.

The other interesting example are the two 1995 common positions on Nigeria, another important energy-producing country for Europe.⁷⁵ Based on these positions, the activities of the Nigerian government in abusing human rights, perpetrated by the military regime, were condemned, and it explicitly mentioned that development cooperation with Nigeria was suspended. Considering that the development cooperation is a field of activity where competence is shared

could be due to the inconsistency of the procedural requirements of the two, which could place an obstacle on the functioning of the EC measure, or the extension of the Council's competence beyond its limits. For a detailed analysis of those CFSP measures that are related to an EC measure, see RA Wessel, 'The Inside Looking out', above n 69.

⁷³ See Council Common Position 2003/495/CFSP of 7 July 2003 on Iraq and Repealing Common Positions 96/741/CFSP and 2002/599/CFSP, [2003] OJ L/169/72. For amendments, see Council Common Position 2004/553/CFSP of 19 July 2004 Amending Common Position 2003/495/CFSP on Iraq, [2004] OJ L/246/32.

⁷⁴ See Council Reg (EC) No 1799/2003 of 13 October 2003 Amending Regulation (EC) No 1210/2003 concerning Certain Specific Restrictions on Economic and Financial Relations with Iraq, [2003] OJ L/264/12.

⁷⁵ See the Common Position of 20 November 1995 defined by the Council on the basis of Article J.2 of the Treaty on the European Union on Nigeria, 95/515/CFSP, [1995] OJ L/298/1. See also the Common Position 95/544/CFSP of 4 December 1995 defined by the Council on the basis of Article J.2 of the Treaty on European Union on Nigeria, [1995] OJ L/309/1. See also Common Position 98/614/CFSP of 30 October 1998 defined by the Council on the basis of Article J.2 of the Treaty on European Union, concerning Nigeria, [1998] OJ L/293/77, and Council Decision 1999/347/CFSP of 17 May 1999 Repealing Common Position 98/614/CFSP concerning Nigeria, [1999] OJ L/133/5. For accompanying EC measures, see the Resolutions of the Parliament on Nigeria, [1998] OJ L/14/204 and [1998] OJ L/292/154 and [1998] OJ L/80/233. They stressed that an international oil embargo would be the most effective way of depriving the military junta of its main source of revenue and forcing the Nigerian authorities to restore democracy.

between the Member States and the Community, the repercussions of this position on overall economic and political relations, with consequent implications for energy security, is clear. Weak economic and political relations with an energy-producing country are related to an overall decrease in the exploitation of the energy reserves and their subsequent export to consuming nations. The existence of such a position limits the activities of both the institutions and the Member States of the Community in guaranteeing security of supply, for the sake of attaining some objectives of the CFSP, namely the protection of human rights (see Arts 6 and 11 TEU).

The other important example of the inter-relation between the EC and CFSP is the common strategy. After the joint actions and common positions that were introduced in the Maastricht Treaty, common strategies are considered as the third instrument available to the Union in the field of Common Foreign and Security Policy, as explained before in the context of the Common Strategies with Russia and the Med. The main characteristic of this instrument is that it is adopted by the European Council, whereas the others are adopted by the Council of Ministers, and they are subject to specific time constraints.⁷⁶ This instrument is believed to re-enforce the power of 'orientation and direction' of the European Council as opposed to pre-Amsterdam, when its role was solely to define principles and general guidelines for the CFSP.⁷⁷ The rationale behind the creation of this instrument was to establish 'a global vision of the Union in the medium or long-term vis-à-vis a geographic area or with regard to a specific theme'.⁷⁸ The idea was to improve the coordination, coherence and efficacy of the external actions of the Union. This was found to be possible if the qualified majority voting could sneak into the realm of the Common Foreign and Security Policy.⁷⁹

The common strategies are the preferred CFSP tool for the purposes of security of energy supply compared to the two other CFSP tools, namely the joint actions and common positions. The shared characteristic of the joint actions and common positions is that they address a 'specific' situation (Art 14 TEU on joint actions) or a particular matter of a geographical or a thematic nature (Art 15 TEU on common positions). The intention here is not to undermine the

⁷⁶ See Art 13.2 para 1, 'Common Strategies shall set out their objectives, duration and the means to be made available by the Union and the Member States'.

⁷⁷ For the provisions on instruments of the CFSP, see Title V of the Treaty on European Union. See also JM Dummond and P Setton (eds), *La Politique étrangère et de sécurité commune* (Paris, la Documentation Française 1999) at 92.

⁷⁸ See S Leonard, 'La Stratégie commune de l'Union européenne à l'égard de la région méditerranéenne' in *L'Europe et la Méditerranée* (Brussels, Peter Lang, 2001) at 282. Common Positions are also adopted in a particular matter of a geographical or thematic nature (Art 15 TEU).

⁷⁹ In this case, a common position or joint action could be adopted based on unanimity [if] a Member State of the Council declares that, for important and stated reasons of national policy, it intends to oppose the adoption of a decision to be taken by qualified majority... [the] Council may, acting by a qualified majority request that the matter be referred to the European Council for decision by unanimity. (Art 23.2.)

importance of joint actions and common positions: they have been of great use in creating consistency among the foreign policies of Member States. Nevertheless, they only cover a specific issue with respect to a country or region, and they do not address the overall foreign policy of the EU towards a country that includes all the relevant economic and political aspects of that policy which Member States need to take into account. For example, they address the issues of settlement of a specific conflict in a country, or combating the spreading of arms, or police mission, or imposition of an armed embargo etc. However, as common strategies are designed to address the EU's overall foreign policy towards a specific country or region, their coverage is broader than joint actions and common positions because they provide a broader EU approach to a given country. This characteristic creates a general European policy towards a country and obliges Member States not to take actions that disregard this policy. Although the content of common strategies have not always been thorough in terms of encompassing all the important political and economic aspects of foreign policy (as mentioned before, especially with respect to our discussion on energy security), they have the 'potential' to act as a useful foreign policy instrument to address the issue of energy security through designing a 'general' approach to a country or region and in converging Member States' approach to that country as well.

The common strategy is not only implemented by either joint actions or common positions in areas related to the CFSP, but also *by other procedural mechanisms provided by the EC Treaty*. The Common Strategy on Russia, for example, states that

[a]cts adopted outside the scope of Title V of the Treaty on European Union shall continue to be adopted according to the appropriate decision-making procedures provided by the relevant provisions of the Treaties, *including the Treaty establishing the European Community and Title VI of the Treaty on European Union*. (emphasis added)

Here there is an interface between various procedural frameworks in the first and second pillars and a blending of intergovernmental authority with Community procedures.⁸⁰ This connection in the energy section of the Common Strategy with Russia will result in the adoption of actions for the development of energy infrastructure in line with the procedural framework of the first pillar, while those for second pillar purposes will be adopted by joint actions and common positions which design the overall political approach. This cross-pillar procedural

⁸⁰ See C Hillion, 'Common Strategies and the Interface between EC External Relations and the CFSP: Lesson of the Partnership between the EU and Russia' [hereinafter 'Common Strategies'] in A Dashwood, and C Hillion (eds), *The General Law of EC External Relations* (London, Sweet and Maxwell, 2000) [hereinafter '*The General Law of EC*']. Some regard this cross-pillar dimension as a disadvantage for the Union as 'L'Union reste prisonnière de ses compétences cloisonnées' See E Decaux, 'Le Processus de décision de la PESC: Vers une politique étrangère européenne?' in E Cannizzaro (ed), *The European Union as an Actor in International Relations* (The Hague, Kluwer Law International, 2002) at 37.

dimension can give effect to the common strategies through the well-established procedural mechanism of the first pillar, and it can strengthen the partnership in achieving political goals through the adoption of common positions or joint actions. Finally, it would allow the 'EU to emerge as an international actor vis-a-vis its partner'⁸¹ based on the second pillar's initiative. The Common Strategy with the Mediterranean was criticised because, compared to the strategy with Russia, it failed to sufficiently elaborate on the issue of energy cooperation. However, the mere reference to the energy sector in general suggests a broader energy cooperation framework, encompassing political aspects beyond purely commercial and economic ones.

The other important component of a common strategy is the aspiration to creating coherence and cooperation among Member States and between the Member States and the Union's policies and activities. If complied with efficiently, this will have positive consequences for security of energy supply. Part I of the Common Strategy on Russia provides that 'the European Union and its Member States will develop the coordination, coherence, and complementarity of all aspects of their policy towards Russia'. Moreover, the strategy calls for consolidation of the coordination between Member States and the Commission, including through regular consultations between their respective representatives in Russia. Member States were asked to make additional efforts to coordinate their actions vis-a-vis Russia (the same obligation exists in the Med Strategy), including in regional and international organisations.⁸² The Med Strategy also emphasises the duty of coordination, providing that Member States participating in other forums, engaging either as their principal objective or as a collateral activity in activities related to the Mediterranean, shall do so *in a way consistent with the objectives of that Common Strategy* (Point 29). The representatives of the Member States and the Commission in the Mediterranean countries shall also take full account of the common strategy when coordinating their activities on the ground. These provisions are not empty words. By using the word 'shall', a firm obligation is created on the part of the Member States.⁸³ They shall support the Union's external and security policy in a spirit of loyalty and mutual

⁸¹ See Hillion, 'Common Strategies', above n 80.

⁸² See Pt I (Instruments and Means), point 3.

⁸³ As mentioned earlier, the CFSP provisions also call for the coordination of Member States activities in the field of foreign policy. The Union's external and security policy should be actively and unreservedly supported by the Member States in a spirit of loyalty and mutual solidarity (Art 11(2)). The Union shall strengthen systematic cooperation between the Member States in the conduct of policy (Art 12). They shall ensure that their national policies conform to the common positions (Art 15). They shall coordinate their actions in international organisations and at national conferences (Art 19). Member States shall defend the common positions adopted under the provisions of Title V (Art 37). Moreover,

even if in adopting a common strategy a member state abstains, it shall not be obliged to apply the decision but shall accept that the decision commits the Union. In a spirit of mutual solidarity, the Member state concerned shall refrain from any action likely to conflict with or impede Union action based on that decision. (Article 23)

solidarity.⁸⁴ They are not forced to make the commitments meaningful by taking effective action, but they cannot adopt measures that run counter to the objectives of the strategy.

More importantly, by adopting a common strategy, the European Council 'mobilises all existing and future EU instruments and institutions to achieve the objectives set out in the strategy'.⁸⁵ This is so because, for example, the Common Strategy on Russia calls on the Council, the Commission and the Member States to 'review', according to their powers and capacities, existing actions, programmes, instruments and policies to 'ensure their consistency with the strategy'.⁸⁶ It would not be too far-fetched to conclude that, as some argue, considering all the obligations imposed on the Member States embodied in both the strategies and the TEU, and the duty of consistency between their policies and the ones established in the strategies, a 'common strategy becomes a vehicle for consistency of the EU's external policy by being established as hierarchically superior to any other instrument adopted in the framework of the EU, EC external relations included'.⁸⁷

Before the entry into force of the Amsterdam Treaty and the creation of common strategies, some joint actions already had considerable political impact.⁸⁸ As Holland describes in his study of the role of the EU in the development and anatomy of EU–South African relations, the policy outcome of the EU's joint action on South Africa⁸⁹ was the more efficient role that the EU could play on the international stage. He refers to the role of the EU in election monitoring, the negotiation of a new bilateral economic framework, and a commitment to long-term involvement in development assistance for South Africa that had direct benefits for the country.⁹⁰ A joint action that is adopted in

⁸⁴ Some believe that the principle of solidarity is an alternative to formalise enhanced cooperation between the Member States as elaborated on in title VII of the Treaty of Nice. See T Jaeger, 'Enhanced Cooperation in the Treaty of Nice and Flexibility in the Common Foreign and Security Policy' (2002) 7 *European Foreign Affairs Review* 297 at 300 [hereinafter 'Enhanced Cooperation']. This set of obligations mentioned above could be initiated when the Union's influence is exerted due to the consultation of Member States within the Council of any matter of foreign and security policy of 'general interest' (Article 16).

⁸⁵ See Hillion, 'Common Strategies', above n 80, at 296.

⁸⁶ See Common Strategy on Russia, Part I, Point II (Instruments and Means).

⁸⁷ See Hillion, 'Common Strategies', above n 80, at 296.

⁸⁸ See D McGoldrick, *International Relations Law of the European Union* (Harlow, Longman, 1997) at 167. See also M Holland, 'Bridging the Capability-Expectations Gap: A Case Study of the CFSP Joint Action on South Africa' (1995) 33 *Journal of Common Market Studies* 555 [hereinafter 'Bridging the Gap'].

⁸⁹ See the 1993 Council Decision on a Joint Action adopted by the Council on the basis of Article J.3 of the Treaty on European Union concerning the Support for the Transition towards a Democratic and Multiracial South Africa, No 10503/93.

⁹⁰ He believes that

[through] the joint action, a comprehensive approach was adopted rather than segregated 'incrementalism'. Coordinating the various policy sectors (development, trade, election etc.) together under a single initiative (the joint action), while difficult and possibly time-consuming, had led, by the end of 1994, to a compatible and comprehensive policy mix that was regionally sensitive as well as of direct benefit to South Africa. The expansive scope of the joint action

the implementation of a common strategy could have a significant impact by efficiently combining the first and second pillar mechanisms and creating a more consistent policy outcome. It would be correct to say that its adoption affects the CFSP action, EC external relations and the Member States' foreign policies altogether. This will in turn enhance coherence among Member States' activities.⁹¹

Although countervailing empirical evidence could be provided to demonstrate the weakness of a CFSP tool in some instances, this does not diminish the important role that a CFSP mechanism could play in creating a European foreign policy in a given field. This could lead us to conclude that if a policy is realistically concluded and pursued, the outcome will be nothing but a step towards coherence in Member States' policies.

The discussion above assumed that Member States comply with their obligations embodied in the common strategies or other second-pillar instruments, and bring their foreign policies towards the Union's partners in line with the provisions of that instrument, which would gradually assist in achieving a 'European foreign policy' towards a specific country or region. The question here is what are the binding forces that would guarantee such coherence and consistency through compliance on the part of Member States? Clearly, in the first pillar, there are restraints on the Member States' activities when the Community is exercising its exclusive power, or when the exercise of a shared power on the part of the Community has pre-empted the Member States from taking action in the same field. Member States, on the other hand, can conclude treaties in areas not

mediated against this unintended consequence and the resulting policy outcome is more efficient and consistent. To that extent, the experimentation of the CFSP using South Africa as a subject, has improved the effectiveness of European policy.

See Holland, 'Bridging the Gap', above n 88, at 568. He builds his approach on the previously published article by C Hill, where he explains the importance that the EU has gained and will further gain in the future in building a European foreign policy. He says that

the EU is regarded as the most likely candidate for replacing the USSR in the global balance of power. Europe exhibits the potential to act as a regional pacifier. The EU will have an intervention role, and could assume a greater responsibility as a mediator of conflicts. The EU has the opportunity to lead and restructure first-third world relations, and lastly, the EU possesses the capacity to become a co-supervisor of the world economy through increasing dominance in the IMF, the WTO and the G7.

See C Hill, 'The Capability-Expectation Gap, or Conceptualizing Europe's International Role' (1993) 31 *Journal of Common Market Studies* 305 [hereinafter 'The Capability-Expectation Gap']. See also R Corbett, *The Treaty of Maastricht: from Conception to Ratification: A Comprehensive Reference Guide* (Exeter, Longman, 1993) at 5. The adoption of a common strategy does not necessarily merge the CFSP and the first pillar, but the coherence among Member States' actions as a result of the efficient application of the strategy, could possibly make the question by third states of 'who is doing what?' unnecessary.

⁹¹ Moreover, because of 'a high profile diplomatic endeavour', future links—in the form of bilateral treaties—will eventually be established. This will reinforce the objectives of the Common Strategy, such as bilateral links with Russia for transfer of energy technology, which would lead to the creation of energy efficiency, an objective pursued in the Strategy with Russia. See McGoldrick, above n 88, at 167.

covered by Community law.⁹² Moreover, there will be a system of supervision of the activities of the Member States in their relations with third countries, and their non-compliance with Community rules will be controlled by the European Court of Justice.⁹³

In the second pillar, the issue takes an even more complicated turn as non-compliance by Member States with their obligations under the instruments of the second pillar cannot be brought before the European Court of Justice. The existence of some restraints on Member States' activities is clear⁹⁴ from the examples given above in relation to the Common Strategy with Russia and the provisions of the TEU. Member States can no longer be autonomous in establishing relations with third countries (those that fall under second pillar measures) since they have to take the provisions of the second pillar instruments and the consistency of their actions with other measures into account. Nevertheless, the main question is what are the consequences of ignoring such a restraint? What happens if a Member State concludes an agreement with a third country in clear violation of the provisions of a common strategy?

Some argue that the intergovernmental structure of the second pillar, and the fact that the Union does not have legal personality to conclude international treaties, suggest that

the same notion of supremacy (ie supremacy of international treaties concluded by the Community over Community law), does not exist in the second pillar, and therefore, this would mean that conflicting obligations would have to be analysed in light of

⁹² It would have been straightforward to follow the reasoning of Jacot Guillarmod when he wrote in 1974: '[L]es accords conclus entre des États membres et des États tiers après 1958 ne doivent rien contenir de contraire au droit communautaire. Cela signifie non seulement qu'ils doivent respecter les compétences internationales expresses ou implicites de la Communauté, mais qu'ils doivent réserver les développements ultérieurs du droit communautaire, autrement dit l'effet utile de ce dernier'. See O Jacot-Guillarmod, *Droit communautaire et droit international public* (Geneva, George & Cie, 1979) at 140.

⁹³ For a brief and concise description of the issue of 'restraint' of Member States, see J Klabber, 'Restraints on the Treaty-Making Powers of Member States Deriving from EU Law: Towards a Framework for Analysis' in E Cannizzaro (ed), *The European Union as an Actor in International Relations*, above n 80, at 160 [hereinafter 'Restraints on the Treaty-Making']. Even where there is exclusive competence of the Community, such as in the Common Commercial Policy, where Member States are pre-empted from acting in the same field, it could be correct to say that 'while it is one thing to say that the Community is exclusively competent in commercial policy, it is quite another thing to delimit this notion itself with some precision'.

⁹⁴ See also M Cremona, 'The Common Foreign and Security Policy of the European Union and the External Relations Powers of the European Community' in D O'Keefe and PM Twomey (eds), *Legal Issues of the Maastricht Treaty* (London, Chancery Law Pub, 1994) at 251. She explains that although the CFSP is the successor of the European Political Cooperation, there are some significant differences between them, the most important of which is the increased level of obligation imposed on the Member States in the implementation of the CFSP.

general international law,⁹⁵ more particularly in light of Article 30 of the 1969 Vienna Convention on the Law of Treaties or its customary counterpart through application of *lex posterior*.⁹⁶

However, the framework in which the Union and the Member States act is different from the way the international law generally functions. 'The Union cannot tolerate the application of the *lex posterior* rule without more.'⁹⁷ In practice, this would mean that the only useful mechanism to guarantee the compliance of Member States with their second pillar obligations is to rely on the duty of 'solidarity' or 'a tacit recognition of the supremacy of obligations arising out of the second pillar over obligations arising under other agreements.'⁹⁸ Member States are not prohibited from taking action in a specific field, and they can continue their diplomatic relations with third states, but that does not mean that they can contradict a common strategy. Therefore, the result is that they cannot change, renegotiate or abolish their commitments as they wish. As Article 11(2) provides, the Council of Ministers shall ensure that the duty of loyalty and mutual solidarity of the Member States in their support of the Union's external and security policy is complied with.

It is exactly in addressing this problem that scholars who speak of 'legalizing EU foreign policy' argue that:

[t]he CFSP officials often acted in a consistent manner as if the rules governing their relations were legal and they believed those rules to be legal ... and as long as the practice of the current CFSP system still follows these principles, it is largely immaterial whether EU governments themselves admit that they consider its rules to be legally binding.... The fact that EU Member States have deliberately acted to restrict the influence of the ECJ in foreign policy certainly demonstrates that they think this issue-area involves legal obligations that must be protected from unwanted judicial intervention.⁹⁹

They argue that EU foreign policy was already legalised in the SEA, the TEU and Amsterdam due to the fact that formal and unanimous commitments by governments existed. Ideas concerning the legalised foreign policy circle around the fact that the more the EC and CFSP measures inter-relate the greater the chance of binding Member States. They believe that intergovernmental bargaining expresses cooperation among Member States, and a powerful sense of 'fairness'

⁹⁵ The European Convention maintains the present system and excludes the ECJ from all provisions concerning the CFSP. Only the legality of restrictive measures against natural or legal persons, adopted by the Council, may in the future be brought to the Court under the general rules governing its jurisdiction.

⁹⁶ See J Klabber, 'Restraints on the Treaty-Making', above n 93, at 168.

⁹⁷ *Ibid* at 169.

⁹⁸ *Ibid*.

⁹⁹ ME Smith, 'Diplomacy by Decree: The Legalization of EU Foreign Policy' (2001) 39 *Journal of Common Market Studies* 79 at 83. He argues that the EPC increasingly functioned as a body of soft law, which materialised in the Single European Act, and the improvised habits of Member States in the CFSP field increasingly became a binding set of rules.

that exists in the European political culture increases legalisation as they seek to protect the interests of others, which would gradually limit their measures that run counter to those interests. This would all lead to more coherence and consistency. Consequently, the fact that the ECJ has no jurisdiction to deal with CFSP issues is not as important as creating a framework where the consistent and coherent approach of Member States in their foreign policy can be guaranteed. Although the ECJ could be described as a strong setting to achieve this goal, this objective can be reached without a jurisdictional exercise through implementation of the duty of cooperation and 'speaking with one voice'.

The above-mentioned argument highlighted the efficiency of the CFSP mechanism in creating consistency between the activities of the Community, the Union and the Member States at the external level. It concluded that if the duties of loyalty and solidarity are abided by, 'a' foreign policy, common to the Member States, could be achieved. For the purposes of our study, the most important role that a CFSP tool can play in creating an external policy for energy security is first, to include this security concern in a political context and justify the inter-relation between security and political relations, and then suggest coherence between divergent policies of various Member States. Although this may not be the exact task of the CFSP instruments, the creation of this coherence is indirectly provided by it.

For the CFSP to function, the Member States' common interests in guaranteeing energy security should collide. The question to answer here is whether there is consultation and cooperation on an energy issue at the CFSP level among Member States? Furthermore, is there an attempt to arrive at a common approach, compared to when most energy issues were looked at independently from the attitude of other Member States, or in other words, without a European dimension? This commonality would indirectly enable the creation of a uniform set of objectives that Member States, along with the Community and the Union, can follow in order to relate to third countries that supply energy.

This issue is made clear by a single example. Prior to the Iraq war of March 2003, we witnessed a split among Member States of the Community in accepting or rejecting a military attack on Iraq. The UK and Spain grouped with the US in supporting such an attack, whereas France and Germany strongly opposed it.¹⁰⁰ Other countries gradually slipped into one of these two groupings, and this division among Member States came to be known as the most obvious example of a lack of a common EU foreign policy. This division creates a good example

¹⁰⁰ See specifically 'the statement on Iraq' issued by the Spanish Prime Minister, Jose Maria Aznar, the UK Prime Minister Tony Blair, and the US President George W Bush in the Azores, March 16, 2003 prior to the war in Iraq <<http://www.acronym.org.uk/docs/0303/doc11.htm>>. France and Germany intensified their cooperation against a US led war in Iraq when they suggested that the issue had to resolve through a UN Security Council resolution, see <<http://news.bbc.co.uk/2/hi/europe/2683409.stm>>.

for analysing its effect on security of supply, considering that Iraq is one of the most important energy-supplying countries in the world.

First, let us assume that this split had taken place in 1973, during the energy crisis that paralysed the European economy. During that crisis, the energy-exporting countries explicitly differentiated between various European countries, based on their support for the state of Israel (see chapter 2 for a discussion of the energy crisis). They imposed sanctions on those countries that supported Israel (such as the Netherlands) and continued exports to those countries that did not (such as France). If a Common Foreign Policy had existed at that time, all the Member States would have 'spoken with one voice' in relation to the Middle East conflict. They would have either supported Israel, and therefore the sanctions by the energy-exporting countries would have been uniformly applied to them, or would have condemned it, which would have considerably lessened the effects of the crisis on the global market.

One could argue that as a common market was established, the existence of some energy in France at that time could have resulted in that energy freely crossing borders and making energy available to all countries of the Community. However, that energy might have been inadequate. Moreover, it is questionable if the energy-exporting countries, being aware of the implications of the existence of a common market, would have continued their exports to that one country. Hence, the existence of a common market would not necessarily have been helpful. This is even more the case considering that energy was exempted in special circumstances from the ambit of the common market (see chapter 4.1 above). On the other hand, the existence of the CFSP would have meant that the Netherlands, the only country that strongly supported Israel, could not have adopted any measure that would have been in conflict with the CFSP when a specific policy towards that region was in place. This could have caused the CFSP to become an efficient 'energy security' measure, which could in turn have led to the accessibility of energy in the Community as a whole. Moreover, the necessity of 'coherence' between the EC and the CFSP measure would have guaranteed that nothing in the EC measures could have undermined this common foreign policy towards the Middle East.

This example can be compared to what happened shortly prior to the military attack on Iraq in 2003. The case of Iraq is a very complex and highly political one, but it highlights the subtle inter-relation between the CFSP and energy security. Although it cannot be said with the utmost certainty that the adoption of a common position on Iraq by all Member States of the Union would have led the US to abandon its attack altogether, a strong unified message from the Member States of the Union could have had consequences for the overall stability of the region prior to the war.¹⁰¹ The acceptance of war by some European countries,

¹⁰¹ It should be emphasised that 'oil' or any other source of energy is no longer used as a 'weapon' (the so-called 'oil weapon') by energy-exporting countries to send their political message, as they did

and the absence of a common position against it, led to the deployment of European troops in Iraq and resulted in an increase in terrorist attacks. This was accompanied by the explosion of many vital oil pipelines, which in turn shook some important pillars of the energy security, namely access to energy and political stability in the country or the region where energy is found. Could the existence of a CFSP tool, for example a common strategy towards Iraq, have changed the picture and contributed to greater security through a uniform stance of the Member States? After all, the Member States would be restricted from taking actions that were contrary to the interests of the Union or likely to impair its effectiveness as a cohesive force in international relations, as prescribed in the common strategy. If a link is made between energy security and the cohesiveness of the Member States' actions, the establishment of such a strategy could be in their common interest.

Although it is clear that an evaluation of the effectiveness of the CFSP should be grounded in fact and experience and not 'built on aspirations and presumed potential',¹⁰² one should not draw ruthless conclusions on the efficacy of this system based on merely one or two failed attempts. As some authors believe, the CFSP is not yet a policy, but only a series of steps towards realising effectiveness and coherence in the Union's external relations, and is an 'evolving entity which has reached no final stasis, nor is likely to do so any time soon but *as a means of making foreign policy decisions* which bind 15 sovereign nation-states (*now* 25), as well as the EU's institutions',¹⁰³ which should be looked at positively. This statement is reinforced by looking at the successful role of the CFSP in crisis management in Macedonia, where tangible evidence showed that the CFSP can be used as a stabilising mechanism to bring security to the EU's near neighbours.¹⁰⁴ Member States uniformly gave authority to the High Representative to find solutions to the crisis in that country. The geographical proximity and the candidacy of the country for future enlargement played an important role, and

in 1973. Although some feared that attacking Iraq might provoke harsh reactions from the neighbouring energy-producing countries with energy security implications similar to those of 1973, these reactions did not materialise. Conversely, some of those countries promised the world to increase production to make energy available if inadequate in the market. However, this undertaking did not drastically improve the situation. In May 2004, Saudi Arabia called on OPEC to raise supply limits by at least 1.5 mb/d, just over 6 per cent, to prevent high crude prices derailing global economic growth. The Saudi Oil Minister, Ali Al-Naimi, said that an increase in output by OPEC was essential to balance global supply and demand after prices spiked to 40\$ a barrel. He said 'We do not want to see prices rise to the level that they negatively affect the growth of the international economy or the demand for oil'. See <<http://www.gasandoil.com/goc/news/ntm42222.htm>>.

¹⁰² Holland, 'Bridging the Gap', above n 88, at 557.

¹⁰³ See J Peterson and E Bomber, *Decision-making in the European Union* (London, Macmillan Press, 1999) at 229.

¹⁰⁴ See C Piana, 'The EU's Decision Making Process in the Common Foreign and Security Policy: The Case of the Former Yugoslav Republic of Macedonia' (2002) 7 *European Foreign Affairs Review* 209. See also, A Björkdahl, 'Norm-Maker and Norm-Taker: Exploring the Normative Influence of the EU in Macedonia' (2005) 10 *European Foreign Affairs Review* 257. See also C Pippin, 'The Rocky Road to Europe: The EU's Stabilization and Association Process for the Western Balkans and the Principle of Conditionality' (2004) 9 *European Foreign Affairs Review* 219.

made the country no longer ‘a contentious area for the EU Member States’, resulting in the appearance of a ‘true’ European foreign policy. Nevertheless, this case shows that as long as interests can be ‘converged’ and pressures exerted on Member States, the EU can draw on its foreign policy tools to exert its influence at the external level.

It is also important to highlight here that if the Member States abide by their obligations that are embodied in the instruments of the CFSP with reference to energy, it reinforces the European identity. The idea is that there will be a single voice personifying European foreign policy, which strengthens the political weight and influence of the European Union, especially with respect to those countries whose energy is vital for the Union. Energy security—as the increase in oil prices since May 2004 demonstrated—has a lot to do with the stability of a region where energy reserves are abundant. The situation in Iraq, and the resulting instability of the region due to the military interference of the US and the UK, was considered as one reason for the increase in the price of oil. A coherent approach by the Union’s Member States towards the situation in Iraq could turn the Union, to use Hill’s wording, into the ‘mediator of a conflict’ and a regional ‘pacifier’¹⁰⁵ or even an organ that ‘shapes events’ rather than ‘reacts’ to them.¹⁰⁶ An energy security problem, through a reactive policy, cannot be as efficient as efforts to prevent a problem from arising in the first place. The CFSP ‘common strategy’ tool embodies pro-active characteristics, as opposed to joint actions or common positions that are designed to address a particular event as it takes place.

As much as the participation of the EU in crisis management or the prevention of a civil war in a neighbouring country is important, exercising power, drawing on existing CFSP tools, and speaking with one voice on matters of energy security, which could also necessitate efforts to stabilise those countries in which energy is found, is vital. The policy-making structure of the EU has been strengthened over time. There is greater coordination and institutionalization of the CFSP; Member States discuss political issues among themselves at the EU level; policy tools from diplomacy and economic tools are at the EU’s disposal, and CFSP decision-making is evolving. The CFSP has the potential to play an important role in pooling Member States together and making them abide by decisions in the form of common strategies, common positions or joint actions, with their link to first pillar decisions.¹⁰⁷ The importance of using this structure must be accentuated, and it must be adapted to the necessities of energy security. Coherence among individual foreign policies towards energy-exporting countries

¹⁰⁵ See Hill, ‘The Capability–Expectation Gap’, above n 88.

¹⁰⁶ See Report on European Political Cooperation, London, 13 October 1981 (The London Report), at 14, cited in Holland *From EPC to CFSP*, above n 58, at 21.

¹⁰⁷ B Tonra, ‘Constructing the Common Foreign and Security Policy: the Utility of a Cognitive Approach’ (2003) 41 *Journal of Common Market Studies* 731.

is important to guarantee energy security.¹⁰⁸ The CFSP should design a framework to ensure that Member States follow similar patterns of energy relations in a consistent and coherent manner. It could shape and direct Member States' dealings with energy-rich countries at a political level. This coherent approach will bring greater stability in international relations, which will in turn contribute to security of energy supply.

¹⁰⁸ There are arguments that common strategies might be abandoned and replaced by other instruments, such as the European Neighbourhood Policy Action Plans which have similar cross-pillar dimension (ENP Action Plan). The main problem with these plans is that there is no legal sanction for failure to implement commitments contained in them and therefore the consequence would be rather political or financial. Nevertheless, if the effects that such plans produce are to bring consistency and coherence among Member States in their activities in the field of foreign policy they can also be considered as useful tools for the purposes of energy security.

Conclusion

THE ASCENT OF oil as a major energy source after the First World War, and its abundance or shortage at various times, shaped political and economic attitudes and policies both domestically and internationally. The use of both oil and natural gas in various economic sectors has since been dramatically expanded throughout the world, especially in the rapidly industrialising Western nations. Satisfying the demands of consumers was placed at the forefront of each nation's policy-making. The shape of energy for the future of a particular nation or region has changed, and considerable efforts were undertaken to speculate on the possible needs for specific sources of energy that may arise in decades to come. Securing energy supply at all times, which suggests access to energy at affordable prices, became the everyday concern of consuming nations.

This study sketched the outline of a possible strategy for the European Union to guarantee energy security. Different objectives pursued in the EU were bundled together with that of energy security in order to advocate efficient strategies to warrant economic growth. What has been important was the inter-relation between various aims, policies and the instruments available to the EU policy-makers to make the attainment of the goals of energy security achievable.

There is no consensus on what exactly constitutes energy security but the majority of experts agree on a few basic elements such as: security of transit, diversification of energy sources, security of facilities, the design of the best model for investment in both upstream and downstream, etc. As the demand for oil and gas in some countries rises, designing the structure of energy cooperation between consuming and energy-exporting and transit countries was found to be a vital task, along with the management of demand through the implementation of regulations on energy efficiency and the use of renewable sources. The energy cooperation framework, which seeks to guarantee energy security at all times, calls for the involvement of various actors, such as the governments of both exporting and importing countries, energy companies, consumers, and investors. Although all these actors have a role in guaranteeing energy security, the energy cooperation framework is still highly influenced by inter-state activities and relations between importing and exporting countries. For that matter, within the

European Community this framework includes cooperation between the Community, its Member States and the governments of both energy-exporting and transit countries. As the consuming nations seek to guarantee access to energy at all times, and exporting countries depend on revenues from the sale of energy along with access to investment and technology from third countries, a mutual interdependency is created. The inclusion of this interdependency in overall policy-making becomes crucial in order to create a balance of interests, allowing these two types of countries to obtain the optimum results within an energy cooperation framework.

The pattern of decision-making at the level of the European Community is highly diffuse and decentralised with respect to energy security. There is a lack of an efficient EU external policy to guarantee an uninterrupted flow of energy into the Union at affordable prices. The long-term significance of energy security, however, necessitates the design of a structure that is based on the doctrine of mutual interdependency, which also reflects upon all necessary elements of energy security. Historically, there have been substantial obstacles in the path of many proposals to adopt new energy policies at the EU level. However, the last decade has witnessed a drastic change where the pooling together of Member States' energy policies and regulating a European energy market has been included in the European policy-making agenda. The main emphasis of the Community was placed on the governments to adjust the patterns of their decisions in order to manage demand efficiently, to guarantee internal security, and make divergent actors establish a common and coherent pattern in using energy. Although this change is a new phenomenon in the overall policy-making of the European Community, it has been relatively successful in creating a European energy market through the efficient implementation of competition law. Nevertheless, the external aspect of this policy, which calls for securing ties with energy-supplying and transit countries and the design of an efficient external energy policy, has remained incoherent and inefficient. The main recurring theme in the most important documents at Community level, such as the Green Papers on security of energy supply, lingers largely on internal security of energy supply, indicating how best to achieve an internal energy system, without adequate emphasis on the increasing dependence on energy that flows from outside the borders of the Community. This study argued that an efficient energy security framework needs to take both these aspects of security into account.

Holding the Community responsible for designing an efficient framework for securing energy at the external level requires an analysis of the Community's external competence in this field. Although there is no specific legal basis for activities in the field of energy in the EC Treaty, the search for an alternative legal basis has not been an insurmountable hurdle. The functional powers of the Community embodied in Article 95 on approximation of laws, or the enabling power embodied in Article 308, along with Article 100 on undertaking activities at the time of the shortage of supply, have been extensively used in relation to

activities in the field of energy. On the other hand, the development of the case law of the ECJ on expanding the competence of the Community becomes relevant in analysing the possibility of linking internal measures adopted in the field of energy to externalities, and in creating an implicit competence for the Community at that level. Although competence to deal with the externalities of energy security remains largely within the hands of the Member States, the study argued that the expansion of internal measures could gradually justify the involvement of the Community at the external level. For example, regulating the transit of energy across borders within the Community could be 'inextricably linked' to transit outside these borders. Therefore, the Community could obtain the necessary competence in that field at the external level. The more dense the secondary legislation becomes, the greater the possibility of expanding the external competence of the Community.

The importance of Europe's energy security suggests that a body accepts the responsibility of designing a framework that can best guarantee security. For that matter, and having in mind the involvement of the Community in the energy sector as a very new phenomenon, it is advisable to restrain the out-of-control expansion of the Community's competence. It should be maintained at a 'general' level, namely the competence to undertake measures that create a better environment for the activities of Member States' private and public actors outside the borders of the Community, and not necessarily substituting these activities through 'creeping exclusivity'. Member States have a more clear-headed vision of their security concerns, and they all seek to manage their dependence on imported fuel. Historically, they have sought to protect their economies from international political disturbances by establishing strong ties with energy-producing countries. Nevertheless, the gradual strengthening of a European energy market would combine these policies and pave the way for a more European approach to energy security. For that matter, establishing cooperation between the Member States and the Community through shared competences is advisable. This should neither call for the demarcation of competences, which creates a rigidity that undermines the everyday development of external relations nor should it prescribe the loose expansion of competences of the Community through a very broad interpretation of the case law. This is especially important considering the absence of efficiency in some of the Commission's proposals to regulate energy security which resulted in Member States correctly restraining the expansion of the Commission's competence, and rejecting those proposals. Furthermore, analysing the necessary measures to guarantee energy security calls for a highly technical investigation of demand and supply forecasts, through close observation of the world energy markets and extensive geological studies of the potentiality for energy exploration in a specific field. Hence, close cooperation with Member States and various other actors, such as energy companies and international institutions, could create the optimal situation for the Community to create the 'best environment' for action.

Creating the optimum playing field for various actors to act does not mean that the Community should not analyse and incorporate all the necessary external elements of energy security in secondary legislation. The link between internal and external security of energy supply suggests the implementation of external aspects in internal measures, in order to guide the Member States in establishing a coherent external security mechanism in their energy policy. This is largely missing at present in the overall internal security framework of the Community. Although the emphasis of the Community on demand management (through regulating energy efficiency) as one component of energy security should be welcomed, the increased demand for imports of energy from outside the borders of the Community necessitates the inclusion of these externalities in the overall security framework. The belief that demand management would ultimately render concern for dependence obsolete is not justified and the energy projections forecast an increase in dependence. Although this increase is not *per se* a threat to security, or, using the wording of Luciani, 'is not a security problem', it should be included in the overall security framework of the Community. The necessary confidence to trust the Community in 'establishing a security framework without more', which suggests control of the expansion of competences where the Community has not possessed the necessary expertise in dealing with security issues, should become a prerequisite for permitting the inclusion of externalities in the internal measures. This in turn suggests the imposition of some limits on the broad interpretation of case law, in expanding the competences of the Community in dealing with externalities of energy security.

Hence, one aspect of Community energy policy for the purposes of our study is the creation of the 'best environment' for action by Member States or their public or private actors. This study argued that, in order to achieve this objective, there is a need for a triangular approach. This policy should include three major inter-related elements: one is the so-called commercial elements where trade, transit and investment in energy should be looked at; the second is the objective of facilitating economic development in these countries through establishing an efficient development cooperation policy, and the third is the creation of a common EU foreign policy towards energy-producing countries.

The Community has already taken some important measures with respect to the first side of the triangle through the establishment of the Energy Charter Treaty (ECT) and membership of the World Trade Organization (WTO). The ECT embodies provisions on trade, transit and investment and seeks to ensure the cooperation of the energy-consuming, transit and producing countries. This treaty guarantees protection of foreign investment, and offers energy-producing countries the essential energy technologies and upgrading of energy exploration and production mechanisms, and eventually guarantees the uninterrupted flow of energy through secure transit routes. One major obstacle in the path of the ECT's development, however, is the lack of adequate membership of major energy-producing countries (only three important countries, namely Turkmenistan, Azerbaijan and Kazakhstan have joined). Hence, the most important task of

the Energy Charter Secretariat (ECS) could reasonably be to encourage all these countries to join, due to the fact that, after all, cooperation to guarantee security necessitates the membership of those countries where energy is found.

The analysis of the investment provisions of the ECT reveals that the treaty represents the best possible multilateral framework for investment in the energy sector. It creates a 'managed' rather than an 'open' investment framework, and seeks to create a balance between the concerns of exporting and importing countries through maintaining sovereignty over natural resources and guaranteeing protection of investment in exploration and production. Nevertheless, guaranteeing foreign investment for energy-producing or transit countries becomes relevant when such investment is demanded by these countries. Hence, a close analysis of the investment needs of these countries should be considered as the yardstick against which the importance of the ECT in providing such investment can be advertised. In other words, the Energy Charter Treaty should not promote itself solely on the basis of its efficient investment provisions 'without more'. As perceptions of the range of possible alternatives to cooperation in the field of energy constantly change, the keystone of the ECT policy should be to take such changes into account and create a framework to incite cooperation beyond a mere insistence on guaranteeing foreign investment. The energy-producing countries' efforts at economic diversification, or their integration into the world economy, have been as much as an 'aim' as attracting foreign investment.

For that matter, the trade provisions of the ECT also become important in order to verify their role in better integrating its members into the world economy. The ECT seeks to create a liberalised energy market across borders, and the adoption of WTO rules by the ECT could create a stable and transparent framework for energy trade. The study argued that the economic, environmental, social and political dimension of energy trade necessitates close cooperation between the two organisations, especially considering that the WTO has not been historically involved in such trade. The strict application of WTO rules to energy trade may not take the peculiarities of energy trade or the specific demands of energy-producing countries for economic development into account. This issue has been highlighted in the clash between the WTO Agreement on subsidies and countervailing measures and the domestic energy pricing of some energy-producing countries, such as Saudi Arabia or Russia. The strict application of those rules may undermine the goals of these countries in strengthening other industries or diversifying economically. For this exact reason, a role can be designed for the ECS to constantly reflect upon the demands of both consuming and producing countries in various multilateral settings.

Moreover, security cannot be guaranteed through mere membership of energy-producing countries in the ECT as transit countries also pay an important role. Hence, cooperation should be achieved between supplier and transit countries to facilitate energy flow. The transit provisions of the ECT address the most important and relevant issues for energy transit across borders. Regardless of the lack of political will of some countries to join the Transit Protocol, in order

for these provisions to become fully operational the membership of all important transit countries between energy-producing nations and Europe's consuming nations should be encouraged. Nevertheless, in order to induce, for example, the Persian Gulf countries to become a member of the ECT, possible transit routes should be verified, for example, taking into account the political as well as the feasibility aspects of such transit. The fact that the transit of natural gas from Qatar via pipeline to Turkey and then to the countries of the European Union is feasible does not mean that such transit can actually take place due to other considerations, such as the political relationship between those countries in the region where Qatar is situated. The mere significance or completeness of the transit provisions is inadequate to attract members and, hence the adequacy of the existing transit routes and the need or the possibility to create new ones should also be analysed.

All of the above suggests that the ECS needs to bring an added value to consumer-producer energy cooperation, which cannot be achieved through bilateralism or regionalism. This body needs to adopt an active role and emerge as an independent institution by reflecting on the real concerns of both sides. The ECS is the only entity that is designed to deal specifically with the energy sector and energy cooperation between various actors. As long as it does not appear eager to act in this way, it will be difficult to attract major energy-exporting countries. Therefore, the fact that the ECT is the most important international treaty to guarantee Europe's security of energy supply will be questionable. Despite the opinion of many commentators, the fact that major energy-exporting countries are not yet members of the ECT is not due to the inefficiency or inadequacy of its provisions but is due to a lack of trust in that system as a framework guaranteeing a balanced approach to the demands of both consuming and producing countries alike. For these reasons, the ECT can be described as a 'potential' instrument of external energy policy to guarantee security of energy supply. Until the ECS takes an active role in designing energy relations between these groups of countries, and as long as such balanced role cannot be fully realised and appreciated, the EU needs to secure its relations with major energy-exporting countries on a regional or bilateral basis.

The Community has established relations with other major energy-exporting countries that are not yet members of the ECT, such as Russia, the energy exporting and transit countries of the Mediterranean region, and the energy-producing countries surrounding the Persian Gulf. The basic principles on which such relations are established are not uniform. EU–Russia relations have been very effective compared to relations with the Persian Gulf countries, which have been stagnant since the establishment of a cooperation agreement in 1989. A similar but incoherent structure applies to relations with the Mediterranean in the framework of the EU–Med Partnership. Clearly, the EU's priorities in establishing relations with these countries differ, due to the varying political characteristics and divergent demands of these countries, along with the geographical proximity of some to the EU as opposed to others. Nevertheless, the

objective of diversifying energy sources, as one aspect of energy security, has not been rigorously pursued and the EU has yet to adopt a 'global' approach to the issue of energy security. The world operates with a mix of different fuels coming from different places. This mix will vary as technologies and environmental or demand management policies change. As long as dependence on sources outside the borders of the EU is growing, and the use of non-fossil fuel energy is not dominant, such dependence needs to be flexible and spread between various sources of fossil fuel energy. This mechanism shelters the EU from instability in one source of supply. Although complete flexibility between different sources of energy is not possible at all times, and it might sometimes be necessary to rely on one source more than another, the formal solution is that a rigid decision to depend on one source should only be taken if the present level of the expected benefits from the decision are great enough to outweigh the present value of the benefits from flexibility. This decision will only have short-term implications as the future of demand and supply and the level of the security of one source cannot always be determined with certainty. Consequently, a well-judged solution demands an open-door policy that does not shut the door on a particular option with potentially irreversible consequences. This solution guarantees security and protection at the time of the failure, shortage, or instability of an individual source. Arranging a reasonably smooth substitution of one source with another necessitates (i) the insertion of the aim of diversification of sources into the overall energy-policy making of the EU and (ii) striving to establish energy relations with all the vital sources of energy. Moreover, this balanced approach diminishes the threat of destabilising those countries where energy is found by way of satisfying their steady income. Otherwise, the ensuing economic instability, followed by political disruption, could affect the global energy market, including the EU.

Establishing commercial relations through trade and investment with energy-producing countries does not fully guarantee security of energy supply. The mutual interdependency of the consuming and producing nations suggests that the latter countries obtain assistance in satisfying their common demands of economic development and diversification. It is here that the second side of the triangle, ie facilitating economic diversification in energy exporting countries, becomes relevant. These countries' dominant perception of abundant energy reserves is not one of possessing 'black gold' but of 'devil's excrement'. They talk of oil as a 'nightmare' because their extreme dependence on one source of income through the sale of energy has frustrated their desire to step away from their single economy and enter the path of diversification.

Although some may argue that the establishing an efficient interconnection infrastructure or financing various necessary projects in these countries and providing necessary investment would contribute to economic development, the significance of the demand of these countries to diversify requires the adoption of an efficient development cooperation policy towards these countries by the Community. Development cannot be defined in general terms—its principal

conditions vary depending on the economic and social characteristics of a given society. For energy-producing countries, development signifies not only the improvement of living conditions but also economic growth through economic diversification and integration into the world economy. In consumer–supplier energy relations, it is therefore important to rethink the economic vision of energy relations beyond the narrow concept of satisfying the needs of consuming nations and to include strong development policies in the Community's overall external energy policy. Not only the financing and transfer of technology for energy investment is necessary, obstacles to handling income or technology in countries where energy is found should be eliminated. General governance conditions should be implemented in these countries in order to strengthen the non-petroleum sectors and related institutions through transparency, suppression of corruption, social and environmental assessments, etc, which would in turn stabilise export earnings and government revenues. After all, improvement of the general conditions for economic activities in these countries contributes to better conditions in the energy sector, which is also relevant for the security of the EU. Moreover, the implementation of a development cooperation policy, the instruments for the implementation of which exists in the Community, is in greater conformity with the doctrine of mutual inter-dependency rather than the mere establishment of the most efficient investment contracts solely to guarantee investment protection without more. Hence, in the consuming-producing relationship, the development aims of both sides should be considered as one element of the overall balancing of interests between the two groups.

This latter aspect has been largely absent in the overall policy-making of the European Community with respect to energy-supplying countries, with the exception of Russia, considering the practical, although not fully satisfactory, improvement of a balanced relationship with that country. The means with which such development cooperation could be facilitated are not financial aid *per se*, but development assistance in terms of promoting industries and cooperation in planning and managing the most important economic sectors. For this objective to be achieved, the potential of developing countries to diversify through verification of their economic conditions should be evaluated. The Community needs to identify the needs of various and often conflicting economic systems, but it should emphasise their common objective of economic diversification. This cooperation could take the form of a free trade agreement that would encourage the export of various products of the energy-exporting countries. Alternatively, it could take the form of a partnership and cooperation agreement, which firstly addresses the management and regulation of the energy sector of these countries, and secondly introduces a wide range of institutional, legal and fiscal reforms in these countries to encourage increased trade and investment in various sectors.

In addition, energy relations are often part of broader economic relations, strongly guided by high-level political associations. The political relations of the Community with third countries, the third side of the triangle, are the topic of

the second pillar, or the Common Foreign and Security Policy (CFSP), a rather distinct aspect of the Union's overall policy-making. However, both the economic and political aspects of policy-making are inter-related and this inter-relation becomes more evident in the discussion on energy security, to the point that a foreign policy independent of an economic policy or vice versa will not guarantee adequate security.

There is hardly another aspect of European policy where Member States pursue such a diverse range of interests as in the CFSP. This is more so in the case of energy where differing views of both national and international energy policies, and the lack of coherence among them, have been most visible. Some believe that the CFSP has not enabled the EU to assume an international role and the major role retained by the Member States in the decision-making system of the CFSP, national egoism, distinctly divergent foreign policy interest, and an inefficient decision-making system in the CFSP has led to a lack of coherence in collective action. The new efforts in the Amsterdam and Nice Treaty aimed at reform of CFSP decision-making, not only by introducing new instruments, but also by 'Brusselizing' the CFSP in the sense that the Member States retain their competences to exercise their sovereignty but allow themselves to be guided by the Union. Nevertheless, the post-Nice era was again plagued with discrepancies and contradictions.

A common foreign policy for the purposes of energy security is a declaratory expression of the lowest common denominator policies of the Member States, which are formulated through the existing potential of the CFSP to transform national foreign policies into a European one to secure security of energy supply, an objective that is shared among them all. Unlike the opinion of pessimists in discarding the efficiency of the CFSP, the study argued that there is significant strength in the policy-making structure of the CFSP as far as pooling Member States' interests in securing energy supply is concerned. Following the trajectory of CFSP, development towards coherence and consistency in the activities of the Member States can be traced not only within the sphere of foreign policy per se, but also through its links with other Community policies. Greater coordination across policy areas, as witnessed by economic cooperation in the framework of the Common Strategy with Russia (ie a CFSP tool) can be invoked as an example of this inter-relation. The adoption of various instruments, such as joint actions, common positions and common strategies, heralds the development of a progressive CFSP, which goes beyond mere intergovernmentalism. Nonetheless, although policy discussions at the CFSP level have expanded considerably and its agenda has been broadened, policy tools have not been adequately drawn upon to address the issues related to security of energy supply. Within the CFSP, policies converge in a specific area of international relations, which makes it clearer where national interests collide or where they have the potential to converge, no matter how minimal. This convergence has been seen in various instances, such as the creation of a common foreign policy towards Macedonia, as opposed to the lack of such commonality prior to the start of the war in Iraq in 2003. Minimal

convergence should neither be seen as necessarily posing a threat to overall national foreign policy interests of the Member States, nor as inadequate to obtain some objectives in relation with third countries. Although some may argue that this minimal design falls short of a true 'common' foreign policy, practicality suggests that efforts could be concentrated on drawing upon the CFSP tools to reach such minimal convergence, at least with respect to the issue of security of energy supply. For that purpose, the study argued for the adoption of a CFSP instrument, similar to common strategies, which embodies a general political approach towards energy-exporting countries. This could contribute to the coherence of Member States' policies in their foreign relations with those countries.

What is still an issue, however, is that state interests can be independently created and pursued outside the interactive framework of the CFSP. Nonetheless, the duties of loyalty and solidarity suggest that nothing in the sphere of 'domestic' policy-making could contradict or adversely affect what has been decided within the sphere of the CFSP. This could in turn shape the domestic policy-making of the Member States. If CFSP policy tools are drawn upon to design a general framework for relations with energy-supplying countries for the purposes of energy security (as can be seen, albeit not comprehensively, in the common strategies with Russia and the Mediterranean), a common approach would be created that acts as a norm, with impacts, no matter how limited, on various actors' behaviour at the political level. However, this suggests that reaching the lowest common denominator should not be created by looking at the existing interests, values, and beliefs of Member States at the political level, but by generating new commitments that have become necessary in the overall framework of cooperation to guarantee energy security at the EU level. If the link between energy security and political stability is adequately revealed in this framework, negotiations over the ways to guarantee energy security at the foreign policy level would lead to consensus. Hence, energy security needs to become a more frequent topic of discussion at this level. Through this mechanism, national priorities with respect to individual energy-exporting countries will be redefined in a new European context. In turn, Member States will commit to a collective policy and thus contribute to security of energy supply. The rule-based mechanism of the CFSP, through respect for the duties of loyalty and solidarity and the link between the obligations of the CFSP with those of the first pillar, will further bind Member States politically and place them in a well-defined policy direction, the rejection of which would cost the rejecting country their respect and support. If the CFSP evolves along this path, and energy security issues become a part of that framework, one could argue that one other side of the triangle of energy security is strongly constructed.

An energy policy to guarantee security needs to be shaped by isolating a number of crucial elements and highlighting their importance in the light of ascertainable facts and justifiable opinions. The triangular 'commercial-development-foreign policy' approach to the issue of energy security sought to

reveal these elements, while designing an external energy policy for the European Union. Energy security is embedded in broader economic, social, and political issues and there will always be compromises and trade-offs. Nevertheless, the lack of an efficient strategy at EU level that embraces all these elements, and reflects upon them in detail, is not justified. Although it would be naive to suppose that an ideal security framework could be created for all times, the three-tiered approach presented in this study identifies the practical basic strategy, the possible policy paths, and the instruments available to the EU to ensure security of energy supply. These three strands of security should be drawn together and taken account of. Hence, the EU needs to rethink the issues thus revealed and examine all the factors in these critical dimensions.

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