

Global Challenges at the Intersection of Trade, Energy and the Environment

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Energy Transport and Transit in the WTO¹

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I. INTRODUCTION

After a long period underground, energy has become increasingly visible in the WTO. Reforms in the energy sector and technological developments have created room for private operators, which has allowed energy services to be identified as a negotiating topic in the Doha Development Agenda (DDA) negotiations. Several important energy-exporting or transit countries have recently acceded to the WTO (Saudi Arabia, Oman, Ukraine) and others (Algeria, Iran, Iraq, Kazakhstan, Libya, Russia, etc.) are currently negotiating their accession, bringing with them a substantial part of energy trade. Furthermore, the interaction between trade and climate change, biofuels and concerns surrounding energy security have also contributed to raise the profile of energy-related issues in the WTO.

Existing WTO rules provide a basic framework for trade in energy goods and services, including for transport and transit. However, it is an incomplete puzzle. One should first recall some key characteristics of the WTO system which have important consequences in the energy sector.

- WTO has different rules for trade in goods and trade in services. The distinction between trade in goods and trade in services is not always easy to apply in the energy sector and may lead to artificial determinations. It is at odds with everyday business reality (especially in the upstream hydrocarbon segment). This dichotomy between goods and services has consequences in the field of investment, for instance. While trade in service benefits from basic investment disciplines contained in the GATS, the TRIMS Agreement, which applies to trade in goods, does not protect investment *per se*. And, as we shall see, transport and transit are very much on this "dividing line".
- The WTO system is largely based on "don't", while "do" would be necessary for regulating some aspects of the energy industry. In other words, WTO disciplines primarily aim at preventing governments from discriminating among trading partners (MFN) or between foreign and national products (national treatment), from imposing import restrictions, or market access restrictions on services, etc. While these disciplines are necessary, "positive" obligations, in particular with respect to access to and use of transport facilities, should be elaborated for the energy sector.
- A third important characteristic of the WTO in relation to energy is that the WTO has more detailed rules for imports than for exports. In the energy sector, countries are more often concerned with the fact that export restrictions (export prohibitions or export taxes) may prevent them from buying energy resources.

II. TRANSPORT OF GOODS

There are no particular WTO disciplines for the transport and transit of energy. Rules for the transport of energy goods are the same as for the transport of any other good in international trade.

Generally speaking, WTO rules do not contain detailed rules regarding goods transport. Article III of the GATT (National treatment) stipulates that internal taxation and regulation affecting, among others, distribution and transportation of goods cannot discriminate against imported products.

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Differential internal transportation charges are allowed if they are based exclusively on the economic operation of the means of transport and not on the nationality of the product (Art. III:4).

The main transport-related obligation in the GATT is Article V on "Freedom of Transit", which is based on the 1921 Barcelona Convention and Statute on Freedom of Transit. According to Article V, goods are in transit when the passage across a country "is a portion of a journey beginning and terminating beyond the frontier" of the country across whose territory the traffic passes (Art. V:1). This provision further establishes that "there shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, or vessels or of other means of transport" (Art. V:2). Countries must not subject transit traffic to "unnecessary delays or restrictions" and are not allowed to levy custom or transit duties; charges reflecting administrative expenses or services rendered may be levied. Charges and regulations imposed on traffic in transit must be "reasonable" having regard to the conditions of traffic. Transit countries cannot discriminate among WTO Members regarding traffic in transit (MFN obligation).

Several comments should be made with respect to GATT Article V:

- GATT Article V applies to energy goods, such as oil and gas, but also electricity (the majority view seems to consider that electricity is a good).
- There is a controversy as to whether Article V applies to fixed infrastructures, such as electricity grids and pipelines. Some argue that this provision applies to "moving" modes of transport only. However, nothing in the text of Article V seems to support such a reading. This provision does not enumerate all possible means of transport, but refers generally to "vessels and other means of transport". In fact, the only exception (aircraft in transit) is explicitly mentioned in paragraph 7 of Art. V.
- Article V:5 contains an MFN obligation with respect to charges, regulations and formalities imposed on transit goods. It might be argued that Article V:2 entails a limited national treatment obligation, i.e. requirements not to discriminate between foreign and national goods in transit. However, there is no requirement to treat goods in transit like goods destined for or originating in the domestic market.
- Article V is an inter-state obligation. It may be difficult to argue that governments can be required to oblige energy companies to comply with GATT transit disciplines.

There has been little "practical" experience with GATT Article V so far. Some disputes arose, in GATT and in WTO, concerning the scope of this obligation, but they were settled between the parties concerned. This provision has only recently been applied by a panel in the dispute *Colombia – Indicative Prices and Restrictions on Ports of Entry*.

Transit issues have been discussed in some recent accession negotiations. In this context, several Members have committed, in their Accession Report, that they "would apply [their] laws and regulations governing transit operations and would act in full conformity with the provisions of the WTO Agreement, in particular Article V of GATT 1994".⁴ Ukraine's Working Party Report is more specific and contains a specific reference to energy: "Ukraine would apply all its laws, regulations and other measures governing transit of goods (including energy), such as those governing charges for transportation of goods in transit, in conformity with the provisions of Article V of the GATT 1994 and other relevant provisions of the WTO Agreement". These commitments should not impose additional substantive transit obligations to the Members concerned, though.

⁴ *Technical Note on the Accession Process*, Note by the Secretariat, WT/ACC/10/Rev.3, 28 November 2005.

Under the "trade facilitation" agenda of the DDA negotiations, Members have been discussing possible improvements and clarifications to the transit obligation contained in GATT Article V. Some of the proposals directly concern transit of energy goods. For instance, it has been proposed: (i) to spell out that Article V applies to fixed infrastructures, such as pipelines and electricity grids; (ii) to clarify that Members should undertake that enterprises with special privileges should act in a manner consistent with Article V; and (iii) to introduce a full national treatment obligation for goods in transit.

III. ENERGY TRANSPORT SERVICES UNDER THE GATS

Since 1995, the General Agreement on Trade in Service (GATS) has applied basic GATT principles to international services transactions. The GATS has also had to "invent" new concepts and disciplines in order to take into account the different nature of services trade. This agreement covers all services, including energy services, provided through four different modes of supply. With the commercial presence mode of supply, the GATS provides basic protection to investments by energy services providers. The broad scope of the GATS is compensated by a high degree of flexibility, in the sense that its market-opening provisions, the market access and national treatment obligations, apply only in sectors where Members have undertaken commitments in their national schedules. Market access concerns essentially the absence of quota-type limitations; national treatment obliges to grant foreign services and services suppliers conditions of competition no less favourable than those offered to national services and service suppliers. In the absence of specific commitments, GATS obligations are limited: the main obligation that Members have to apply in all sectors is the MFN obligation.

Energy services were not addressed as a distinct topic during the Uruguay Round. This is explained by the fact that, at the time, private operators had a limited role in the energy sector which was still largely in public hands. However, progressive unbundling of state-owned utilities and technological developments have created room for private operators, which, in turn, has raised the profile of energy services in WTO negotiations.

The nomenclatures most commonly used by WTO Members under the GATS⁵ do not contain a separate chapter for energy services. Nevertheless, energy-related activities are covered, either explicitly or subsumed in other sectors. Two important activities relating to energy transportation are:

- Services incidental to energy distribution, which concerns in particular the transmission and distribution of gas and electricity;
- Pipeline transportation of fuels, which includes transport of oil and gas by pipelines.

Other means of transport (road, rail, maritime) which are relevant for energy products are also listed, as well as bulk storage of oil and gas, which is a necessary complement of transport. Construction services of energy transport infrastructure (long distance and local pipelines, power lines) are classified under different headings.

Few Members have undertaken specific commitments regarding transport services of energy: 19 schedules record commitments on services incidental to energy distribution and 12 on pipelines transportation of fuels. Moreover, most of the Members which have undertaken specific commitments in these two sectors have acceded to the WTO during the last 10 years or so. Two possible reasons why recently acceded Members are overrepresented when it comes to commitments in these two sectors: (i) the dynamic of accession negotiations, where countries must "pay" their entry ticket to the WTO and undertake a much higher level of obligations than WTO Members; and (ii) the

⁵ This includes the Services Sectoral Classification List (MTN.GNS/W/120) and the 1991 UN Central Product Classification (CPC prov.). Note that these nomenclatures are voluntary tools that Members can use to establish their schedules of commitments. They do not determine the scope of the GATS.

increasing interest that energy-related issues are attracting in the WTO and the fact that some countries which acceded recently to the WTO are important energy players.

What kind of benefits can GATS specific commitments bring to the industry? Commitments on cross-border trade (mode 1) have gained commercial importance as technological developments increasingly allow services to be supplied electronically (e.g. remote control of pipelines). Commitments on commercial presence (mode 3) can address measures affecting energy services providers, such as nationality and residency requirements, or restrictions on foreign investments (limitations to foreign capital participation) and on the legal forms of doing business. Mode 3 commitments could also be undertaken when there is a monopoly, for instance in gas and electricity transmission and distribution services; in such cases, they could, for instance, grant the right to invest in an existing monopoly. Commitments on the temporary movement of natural persons (mode 4) could, for instance, contribute to easing the intra-corporate transfers of technicians and managers working for energy services companies.

An interesting question is: what is a supplier of energy transport services under the GATS? In practice, firms may transport their own fuels or may transport energy goods owned by third parties. As a service is by definition provided to a third party, which is not the case when a company transports its own fuel or electricity, GATS would seem to cover only the latter category.

Moreover, GATS specific commitments on energy transport services raise several interesting and complex questions concerning, for instance, the scope of the activities covered (e.g. what is a pipeline transport service? What kind of activities are covered? Same types of questions for electricity), treatment of rights of ways for the construction of pipelines and electricity lines, whether a right to build new facilities is implied, issues related to concessions, government procurement, etc.

The GATS also contains basic disciplines regarding monopolies and business practices (Articles VIII and IX). Members must, *inter alia*, ensure that monopoly suppliers – whether privately- or publicly-owned – act, in the supply of the monopoly service, in a manner consistent with the MFN obligation and that Member's specific commitments. Moreover, monopoly suppliers acting outside the scope of their monopoly in a sector where a Member has undertaken GATS commitments must respect those commitments. However, these disciplines do not allow to address the main anti-competitive practices affecting energy transport networks, which concern access to and use of energy transport facilities by third parties.

Even assuming that a large number of WTO Members undertakes liberal GATS commitments, evidence from the telecom sector suggests that this is not sufficient to guarantee effective conditions of competition for suppliers seeking to provide transportation services over energy networks. There are several important similarities between telecom and energy network industries: both are characterized by large incumbents which traditionally dominated a market and which often retain a dominant position after liberalization, in particular over key infrastructure. In the GATS telecom negotiations, it was considered that, while specific commitments and relevant GATS disciplines represented an important step in establishing a level-playing field for service suppliers, they needed to be complemented by additional disciplines. A so-called Reference Paper was negotiated, which contains disciplines regarding interconnection, anti-competitive safeguards, independent regulator, transparency, etc. These disciplines were adopted on a voluntary basis by WTO Members, but apply on a MFN basis. Another precedent which can be mentioned in this context is the model schedule for maritime transport, which contains additional disciplines regarding use of basic port services. At the beginning of the services negotiations, in 2000, some Members proposed to negotiate additional disciplines for energy services, modelled on the telecom Reference Paper, and which would address regulatory transparency, non-discriminatory third-party access to networks and grids, the need for an independent regulator, and requirements preventing certain anti-competitive practices. However, this negotiation has never really taken off and such disciplines are not likely to materialize during the DDA.

Nevertheless, with or without a Reference Paper, Members still have the possibility to undertake additional commitments on energy services. For the time being, there is one case of additional commitments undertaken with respect to pipeline transportation. Ukraine, which has acceded recently to the WTO, "... commits itself to provide full transparency in the formulation, adoption and application of measures affecting access to and trade in services of pipeline transportation." It further "... undertakes to ensure adherence to the principles of non-discriminatory treatment in access to and use of pipeline networks under its jurisdiction, within the technical capacities of these networks, with regard to the origin, destination or ownership of product transported, without imposing any unjustified delays, restrictions or charges, as well as without discriminatory pricing based on the differences in origin, destination or ownership."

The first part of Ukraine's additional commitment goes quite further than the GATS transparency disciplines contained in Art. III. The latter part of the second sentence seems to be borrowed from GATT Article V, while the references to "non-discriminatory treatment in access to and use of pipeline networks under its jurisdiction, within the technical capacities of these networks" may be inspired by the Draft ECT Protocol on Transit.⁶ We are here on the dividing line between trade in goods and trade in services: obligations are included in a services schedule, but their primary purpose seems to be to provide some minimum access guarantees for the goods transported, rather than for the suppliers of pipeline transportation services.

Energy services are an important theme in the DDA services negotiations. In the initial stage of the discussions, a great deal of work was put into identifying and defining services along the energy chain. When it comes to the market access negotiations, several elements indicate that energy transportation services remain a touchy topic for WTO Members. In fact, services incidental to energy distribution and pipelines transportation of fuels are on the sidelines which indicates that most Members are not ready to undertake GATS commitments in these two sectors. Negotiations focus instead on upstream energy activities (exploration and mining), various professional (engineering) and business services (consulting), construction and distribution/commercialization services.

It is interesting to note that, in the context of preferential trade agreements, a number of WTO Members have undertaken obligations on energy transport services which go (much) further than their GATS commitments and even, in most cases, their DDA offers.⁷ This may indicate that they have scope for more ambitious commitments under the GATS.

IV. CONCLUSION

WTO rules provide some basic disciplines for energy transport and transit. These disciplines have been little tested in practice.

The importance of GATT Article V in international trade is inversely proportional to the interest that this provision has attracted so far among WTO Members and scholars. Article V establishes the principle of the freedom of transit for all goods and contains a number of substantive legal obligations which have been little tested in practice. The scope of Article V is not devoid of controversies, in particular when it comes to transit of energy through fixed infrastructures, though. Moreover, this provision is less detailed than the corresponding provision of the Energy Charter Treaty. For instance,

⁶ Th. Wälde proposed to develop an "Energy Transit Reference Paper" modelled on the WTO telecom Reference Paper to complement the disciplines contained in GATT Article V, thus already blurring the line between goods and services. See Th. Wälde and A. Gunst, *International Energy Trade and Access to Energy Networks*, Journal of World Trade 36(2): 191-218, 2002.

⁷ See M. Cossy, *The Liberalization of Energy Services: Are PTAs More Energetic Than the GATS?*, in "Opening Markets for Trade in Services – Countries and Sectors in Bilateral and WTO Negotiations", J. Marchetti and M. Roy (eds.), WTO/Cambridge, 2008

it does not contain a full national treatment obligation and does not entail obligations with respect to construction of new facilities, which are some of the important elements included in Article 7 of the Energy Charter Treaty. However, the importance of GATT Article V for the transit of energy goods has contributed to triggering a renewed interest among WTO Members. The DDA negotiations offer a good opportunity to clarify and strengthen these disciplines.

The GATS offers a legal framework to energy transport services. All Members must grant MFN treatment to energy transport services and service suppliers. Specific commitments under the GATS can provide at a minimum transparency and predictability to services suppliers. Mode 3 commitments on market access and national treatment offer basic guarantees to investors and can help to attract investment (10 years ago, the need to attract foreign investment prompted a number of Members to undertake specific commitments in the telecom sector). However, pro-competitive disciplines, in particular non-discriminatory third-party access, are necessary to complement specific commitments on network-based industries.

The fact that WTO rules are different for goods and services is a source of ambiguity for their application because it obliges to categorise a given activity as trade in goods or trade in services, which may prove uneasy in the energy sector. Also, investment protection is rudimentary in the WTO system. While basic investment rules apply to trade in services, investments in the goods sector are not protected *per se*. The WTO does not contain rules regarding expropriation and only governments can have access to the WTO's sophisticated dispute settlement system. In this regard, WTO rules go less far than the Energy Charter Treaty, bilateral investment treaties, or even some preferential trade agreements.

With 153 Members, WTO offers a forum to discuss energy issues. The WTO is not a forum for framing energy policies, but it is a place where trade-related energy issues can be raised, negotiated and, if necessary, litigated. While there is no sign that a WTO agreement on energy will emerge in a near future, WTO rules will likely develop incrementally through negotiations in order to address energy trade more comprehensively. Case-law may also contribute to the clarification of existing disciplines. In short, it is to be expected that energy will stay on the WTO agenda for the years to come.

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