done 14/2 G: RHG (P.1) THANKS. INTERESTING. TO OTHER PL. COPY SEC MEMBERS

Note for the attention of Mr Jones

Note (and some thoughts) on the
ad hoc Group (Energy Charter) Council Meeting,
30-31 January 1992

14/2

1. After a welcome by Mr Vitorio for the Portuguese Council Presidency, Mr Torrent of the Council Legal Service was invited to explain why it had been concluded that there are no major problems between the Basic Agreement (BA) and GATT. A paper was also circulated summarising his arguments, (copy annexed). In this paper, and in his presentation, various combinations of compatible or contradictory obligations under the two regimes are considered, but the general conclusion seems to be that there is no major problem, apart from disputes settlement where it is advised that only one machinery is followed, (as forseen indeed by Article 24).

2. Intuitively I am somewhat sceptical of this conclusion, since if there are two major trading regimes which both embody the principle of equal treatment for third parties, then they should have, as far as possible, compatible rules. The only exception seems to be the recognition of free trade areas under the GATT regime, where the more liberal rules in such areas do not need to be extended to countries outside the free trade area, (as forseen in Article 27). This more reserved view seems to coincide with the analysis in Annex 3 to BA6.

3. There is also another link to GATT, as considered in more detail below, which is that the Charter negotiations themselves should not ~~to~~ duplicate GATT negotiations. One example of this is the desire in the BA6 draft (Article 5) for duties on energy products to be progressively eliminated. However, the removal of duties is a long and complex process, affecting state revenues, trade balances and sometimes employment. Reductions in duties are negotiated between states on a reciprocal basis and often in steps. All this is done within the GATT and could not be carried out in more than one forum. In my view the Charter negotiations could only signal the importance to GATT of negotiations in this and other possible areas, although this would require another condition; that the Eastern countries join GATT, itself a complicated process. The only justification for trying to keep this item in the BA therefore would be that duties could be reduced more easily if only related to energy and that this could be achieved more quickly than through the GATT route. But then the Article would not only have to set the objective of reducing duties, but a machinery would have to be

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established for the complex negotiations - almost unthinkable outside GATT. Perhaps only the countries themselves (i.e. the Conference) are suitably placed to say whether this is feasible and worthwhile, but it seems to me doubtful.

4. This introduces another concept on which I feel there will be increasing emphasis in the future, namely what items are essential for the BA to achieve the essential objectives of the Charter, what items are desirable, and what time and effort would these different items imply. Thus whilst the removal of barriers to trade and commerce in energy is an essential objective of the Charter, the removal of duties is only one aspect of this, and not an essential one. If a country has some duties on imported energy, but is nevertheless interested in importing Russian gas for example, the removal of the duties is not essential. Thus, given the complexity of the task of reducing duties, perhaps para 1 of Article 5 should only refer to attempting to achieve this objective in appropriate international fora.

5. Likewise a very open procurement regime as envisaged by Article 6 of BA6, which calls for procurement contacts to be awarded by open competition, is not an essential condition in order to ensure investment in Eastern Europe. Procurement for key investments in energy is a very sensitive issue, over which countries will usually want to keep close control. The Community has built up sufficient confidence and its member states have sufficient common ground to allow the establishment of an open and competitive bidding system, but this closeness and trust does not extend to between all of the Charter participants. Thus Article 6 may just be too ambitious. It would also require an extensive policing machinery and probably create many disputes (think of US efforts to get building contracts in Japan).

6. In contrast, protection of investments and transit rights for example are clearly essential items to achieve the investment in energy production and the flow of energy trade which are the basic pillars of the Charter exercise. At another level, avoidance of unfair trading conditions, (for example through subsidies), and control of dominant positions are desirable but not essential. It is sufficient for an investor to earn a good return, perhaps a very good return, on his investment for him to invest, but it is not essential for example that a national energy enterprise in the same market does not have certain privileges. Many such companies in the West already do have such privileges; some receive state aids (German coal), some have de facto dominant positions, (electricity and gas companies), some national oil companies get more favourable treatment. Furthermore, if new national companies are competing against multinational oil corporations, for example, with the best expertise and huge resources, is equal treatment necessarily equal to fair competition ? To conclude these ideas then, there may be a need for a critical review of what is essential and achievable for the BA, and what are longer term ideals.

7. Coming now to specific debate on the BA6 text, this began with the Commission representative introducing the Commission's non-paper proposing an alternative structure. Mr Waeterloos also expressed the view that there are two main themes which should feature in the BA : the mechanisms necessary to permit East/West cooperation, and a political/legal framework to allow the West to operate in the East. There was some support for some restructuring, in the interests of clarity, although Mr Fremantle wanted to leave this consideration until later and in any event until after further WG II meetings.

8. The Chairman then took debate on to Article 3. The Commission felt this Article rather odd and overlapping to some extent with the preamble and the declaration of the objectives (Article 2). In Mr Fremantle's defence, he was asked to introduce the Article somewhat "à contre coeur" at the last ad hoc meeting. The DK representative noted that there were some differences in emphasis and content in Article 3 compared to the Charter document : in particular there was not the same balance on the access to resources, markets and technology, and some items, for example on pricing, had lost their qualifying language. In conclusion it was agreed to keep the Article as an "articulation" between the Charter and the BA text, but to look at it again after going through the whole BA.

9. My own view is that the "principles" in Article 3 should be in the preamble (they are in fact more objectives), and that Article 2 should also go in the preamble, since it is saying what the BA intends to do-obviously in both cases taking care to eliminate all repetition. As to the relationship of the BA to the Charter, as I have argued above, the BA we hope to have signed at the end of June should confine itself to legal provisions on essential items. Other more difficult provisions could be evolved over a longer time horizon, (and perhaps in other fora), although there could be "soft" references in the first BA to these items (on the lines of for example "contracting parties will strive to eliminate state aids which distort competition or otherwise impede the achievement of the objectives of the Charter"). Thus the BA, rather like GATT, would be a process as much as a document.

10. On Article 4, the Commission representative argued that the text did not reflect the balance obtained in the Charter and that, in particular, the reference to sovereignty over resources should be matched by a reference to access to resources. In response to a request, he provided a draft text (attached). The UK representative argued that this item was dealt with in specific terms in Part IV on investment promotion and protection. He also recalled the importance and sensitiveness of the references to sovereignty in the Conference discussions on the Charter and asked for a UK reserve.

11. On Part II, the Commission argued that all present articles covering competition should be brought together under one article, and that Part II should begin with a separate article on access to markets (a draft was circulated - copy attached). Several delegations could accept this, but with a reserve on the text for the access to markets.

12. My own view is that access to markets is a rather difficult area and very fuel specific. When gas suppliers for example sell to the Western European market, they will agree a price determined by market factors, i.e. oil and other energy prices, and prices offered by other suppliers. You cannot really legislate for a "commercial" price, but you can try to avoid monopsony buyers, by requiring transit under fair conditions, (which opens up other purchasing countries), and to prevent retail price controls as were found in Eastern Europe, which would feed back to the energy supplier. Moreover,there are arguments against a fortunate investor who finds a low cost source gaining all the economic rent from selling at world energy prices, indeed governments sometimes use special levies or taxes to get round this. Thus again legislating for a "commercial" price may not always be appropriate.

13. Whilst trying to obtain agreement on transit should be possible, (provided that the transiting countries are guaranteed a fair price for the service as well as the option of also buying the fuel, and there are measures or compensation for the disturbance to their own gas or electricity supply systems), complete freedom to export might be more difficult to agree, at least in a transitional period. If a country is trying to reconstruct its economy and is short of foreign exchange, it may wish to require some of the energy produced on its soil to meet domestic needs. In any event, it probably would not allow the freedom to export as a means by the company to try and obtain all the economic rent, (though it could put a levy on production or exports to prevent this).

14. Similar considerations apply to oil and coal, except that the transit requirement is much less, since monopsony buyers can be avoided by selling the fuel elsewhere via trains or ships. For electricity the critical factor for ""access to markets" is the purchase price given to the independent producer, (if such production is allowed), where a formula based on the avoided cost to the main electricity supplier is probably the best formula. Again transit rights (across countries) would be useful, though less critical as electricity is usually best produced relatively close to demand. To conclude then on the question of access to markets, particularly in relation to the effort that would be required, transit seems essential and possible, freedom to export generally desirable but possibly more difficult, and recommendations on prices paid to energy producers (i.e. "commercial" or "fair"), seemingly reasonable but with some difficulties.

15. The difficulties associated with Articles 5 and 6 in general terms have been considered above (paragraphs 3 and 5 on duties and procurement respectively). Specific comments on the procurement Article included DK and DE feeling that it went beyond the EC Directive and the Commission wondering whether it is an appropriate area to extend outside the Community. Reserves were placed by DK, DE, FR, BE, ES and PO.

16. On Article 7, intellectual property, the Commission suggested dropping paragraph 3 which provides for adoption of TRIPS levels of protection, including possibly to non-GATT countries by a special proposal, if and when it is adopted under GATT. It was also suggested to drop paragraph 4 requiring the ability to keep commercial secrets. Personally I see no harm, and some importance, in keeping these provisions.

17. Article 9 on minimising monopolies stimulated the kind of debate raised above, with BE, supported by DE, asking whether it is necessary and whether it is not trying to enter an area which the Community itself has not solved. FR and IR noted that there is nothing on monopolies in the Charter, although the UK noted their tendency to limit competitive markets. HE noted that monopolies are sometimes necessary to supply difficult regions such as islands, whilst ES made a similar observation on the need to ensure security of supply. DE noted that with 50 participating states one should not try to evolve new competition law. Furthermore, dominant positions will be here for a long time, though they should not be allowed to unduly obstruct trade or investment.

18. A similar debate followed on Article 9, which attempts to restrict state aids, and the second paragraph requiring reports on state aids was felt to be impracticable, although NL argued for a "right to information" approach, which seems more reasonable. DE noted that state aids are sometimes necessary !

19. Article 11 on transport and transit precipitated a string of reserves (DK, BE, DE, FR), conditioned partly in my view by the nervousness built up during the Community debate on its transit Directives. DK felt the subject very fuel specific and the Commission felt it should be dealt with mainly in the sectoral protocols. DE and NL had a number of comments on specific words, eg. what does "facilitating" transit mean, should transit costs be "minimised", etc. The UK, NL and IR strongly argued the importance of transit and in my view a text is both essential and achievable. IT proposed a much shorter text of one paragraph (copy attached) to replace paragraphs 3, 4 and 5 which Mr Fremantle accepted, adding that he would seek the Secretariat's agreement to circulate a text based on this to delegations as soon as possible.

20. There were no major problems with Article 12 although DE asked for a caveat to accommodate nuclear non-proliferation treaties, despite Article 27 which covers this. Article 13 on access to capital caused several delegations to note that national export credit guarantee systems are generally only available to companies based in their countries. (In my view this article would need to be reconciled in any case with a future financial protocol, which effectively would put investment/trade guarantees for the East on a common footing). Article 14 on environmental aspects precipitated calls for the carefully balanced wording of the Charter and IR wanting reference to "all aspects of the fuel cycle" i.e. including nuclear waste, decommissioning, etc. Article 15 on transparency caused FR and IR to note that publishing all judicial decisions relating to energy would be very difficult, and NL wanted something on the right to obtain legal information, i.e. a response to a

request, rather than just enquiry point addresses. (I see some difficulties here since the body would have to decide which laws are relevant to an enquiry; would they be legally bound to respond with all relevant laws which might cover investment provisions, tax law, health and safety law, etc. etc.) RL-118

21. Discussion of the BA will continue at the next ad hoc meeting on 13 and 14 February.

22. On the morning of 31 January, Ambassador Rutten and Mr Jones were present by invitation. The timetable of meetings was presented by Ambassador Rutten, who clearly wanted to keep the schedule already prepared, subject to a couple of minor adjustments because of other international meetings on energy. In any event, he noted that the timetable was for discussion in the Bureau meeting that afternoon. On languages, the Commission representative said that the Commission could continue with interpretation as in the past, but not more (i.e. only EN and RU for WG's). Some delegations (notably DE and ES) argued the importance of seeing draft texts in their language, particularly as these are now intended to be legally binding texts.

23. With respect to the relation of the BA to the sectoral protocols (SP's), Ambassador Rutten noted the importance of carrying on with the SP's to allow feedback and cross-fertilisation with the BA. The Chairman had also noted that a certain freedom had been allowed in the evolution of the SP's. There is now however an increasing awareness of the need to ensure that all the SP's and the BA are comparable, consistent and compatible.

24. In this respect, I continue to hold my somewhat heretical view that the BA and SP's should be signed by all, preferably at the same time, and now I believe in the same document. Thus the BA could become the "Charter Agreement" with chapters on oil, nuclear, energy efficiency, etc. This would also allow addition of chapters on other subjects without all the associated machinery of WG's, i.e. chapters on techonology, renewable energies, financing, etc. Such an approach would probably prolong negotiations, perhaps to the end of 1992, but does a BA which does not take account of a financing mechanism, for example, make much sense, (such financing incidentally could easily contradict current provisions on state aids). In addition, by trimming the current BA to essential provisions, as argued above, the work would be reduced, and the work of the sectoral chapters would also be reduced correspondingly. The sectoral chapters would clearly have other material however. For example the electricity and gas chapters would have to give more attention to transit and the effects on transiting systems, electricity would have to consider prices paid to independent electricity producers, etc. There would also be an administrative advantage of a single document, since there would be less working groups, with the work to date of the specific groups merged into the Charter Agreement. Lastly, I do not believe it would be fair for some countries not to sign a sectoral protocol, because this would effectively introduce conditions in another country from which their nationals could benefit, without them adopting the same conditions. Suppose that Australia, Japan or the

US did not want to sign an electricity or even a hydrocarbons protocol, yet their companies would still enjoy rights of access to resources, freedom of disposal etc. etc. in countries courageously entering the free market system. Is that fair ? There is also the danger of a "patchwork" of legislation. Some countries (especially those not wanting reciprocity in all sectors), would probably make a fuss about such a change. But it may nevertheless be worthwhile; we must get this thing right.

25. Lastly, the idea of a seminar for the (ex-Soviet) Republics in March was mentioned in the meeting. The Commission representative noted that his organisation was considering convening this but that early March might not be possible. So far as I recall, the US origin of this proposal, and its content - experts talking on the areas covered by the BA - was not mentioned or discussed. A number of delegations did however stress the importance of this kind of initiative, (DE, NL).

R.H. Greenwood

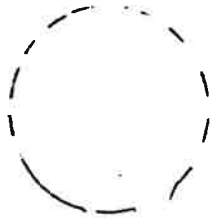
Groups of countries

Group A : Basic Agreement + GATT parties

Group B : Basic Agreement parties only

Group C : GATT parties only.

Obligations



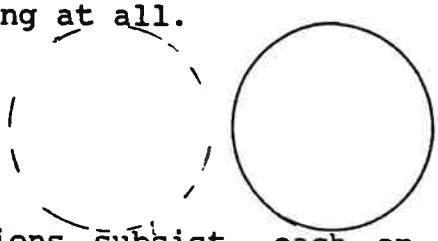
Basic Agreement obligations (A + B concerned)

GATT obligations (A + C concerned)

Substantive obligations : Different Possibilities

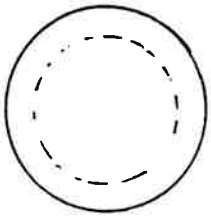
A) Compatible B. Agreement and GATT obligations

1. No overlapping at all.



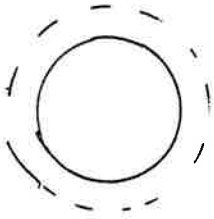
All obligations subsist, each on the basis of the respective Agreement.

2. Obligations of the Basic Agreement are "less" than those of GATT.



GATT parties continue to be tied up by GATT obligations.

3. Obligations of the Basic Agreement are "more" than those of GATT.



"Additional" Basic Agreement rights shall need to be also accorded, if the case arises, to group C. The Basic Agreement is not, as such, "unlawful" ; there is simply a "risk" (which may remain simply hypothetical) for the future.

In any case, the legal situation is absolutely clear.

4. Basic Agreement and GATT obligations are absolutely identical.

A single action fulfils simultaneously both obligations.

B) Incompatible B. Agreement and GATT obligations

5. In all 4 precedent cases there was compatibility (no contradiction) between Basic Agreement and GATT obligations : The situation was in all cases very clear.

Of course, if Basic Agreement obligations were to contradict GATT obligations, then a real problem would arise (affecting only, of course, group A countries).

Procedures for dispute settlement

Concerning substantive obligations, no provision on the relationship between Basic Agreement and GATT was needed because

- if two non-contradictory obligations exist (Basic Agreement obligations and GATT obligations) and they differ - either by their content or by the parties concerned - both must be fulfilled.

- if Basic Agreement obligations and GATT obligations are identical in all respects, a single action may fulfil both obligations simultaneously.

Concerning dispute settlement procedures, on the contrary, it does not make any sense to follow simultaneously two procedures for the same dispute ; so, for group A countries, there must be a choice : some kind of article 24 is needed for disputes falling at the same time under Basic Agreement and GATT.

CONCLUSION :

If there is no contradiction between Basic Agreement and GATT obligations (let be the first "more", "less" or "different" from the second ones), the situation is absolutely clear (provided that for group A countries a choice between the different Basic Agreement and GATT dispute settlement procedures is made).

ARTICLE 4 ~~(or ARTICLE 3)~~

Sovereignty over and access to energy resources

Add a second paragraph as follows :

"The Contracting Parties shall facilitate access to and development of resources by investors. They shall avoid in particular to impose on investors discriminatory rules governing the ownership of resources and shall guarantee the investors that they may dispose of the resources which they are developing, in accordance with the applicable national legislation.

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ARTICLE 8 ~~(or ARTICLE 4)~~

Access to markets

The Contracting Parties shall ensure that access to local and export markets for disposal of energy materials and products can be attained on commercial terms and that investors are not excluded on grounds of nationality or country of origin from entering a market.

In order to promote efficiency in production, distribution and consumption of energy materials and products, Contracting Parties agree to work to alleviate market distortions and barriers to competition in the extraction, production, conversion, treatment, carriage (including transmission and distribution) or supply of energy materials and products in relevant markets. In particular, prices formation shall be based on market principles.

ITALIAN PROPOSAL

Article 11

The following text could replace paragraphs 3 4, 5 and ~~6~~:

"(~~4~~ 3) Each Contracting Party undertakes that its provisions relative to transport of [Energy Materials and Products} by rail, road, inland waterway or sea, including charges, regulations, formalities, providing of services, harbour facilities and use of pipelines or high voltage transmission lines shall not be less favourable, in their direct or indirect effects, than that which would have been accorded to such materials and products wholly or partly originating in or destinated for its own territory or the territory of another Contracting Party."