

The Trade Amendment (TA) of the Energy Charter Treaty (ECT)

Explained to Decision-makers of ratifying countries

This notice is intended to provide decision-makers of Contracting Parties of the Energy Charter Treaty (ECT) with **key information on the changes** brought about by the Amendment to the trade provisions of the Energy Charter Treaty (Trade Amendment, TA). As is the case for all international legal instruments having a great number of cross-references to other international treaties, reading the Treaty and its TA is a quite complex task for the non-initiated. This notice also aims to explain the **advantages of the ratification** of the TA and to show why its ratification does not entail any risks.

1. What is the Trade Amendment (TA)?

The Trade Amendment (TA) is a supplement to the Energy Charter Treaty (ECT), which was **adopted in 1998** by the Energy Charter Conference, the highest governing and decision-making body for the Energy Charter Process. The TA **entered into force in 2010** after being ratified by 35 Contracting Parties.

Formally the TA **mainly modifies Treaty Annexes**. Some of the Annexes underwent heavy changes in wording. As the body of the Treaty underwent practically no change, some Contracting Parties were able to ratify the TA in a **light procedure**. Those Contracting Parties who have not yet ratified the TA are invited to consider whether they could also ratify it, either by submitting it for decision to their Parliaments, or by applying a simpler procedure used for ratifying amendments to Treaty Annexes by simple decision of their Governments.

Since the entry into force of the TA, the Energy Charter Conference requires that new Contracting Parties **accede to the Energy Charter Treaty only in its amended version**.

2. Principles of the Energy Charter Trade Regime before the Trade Amendment

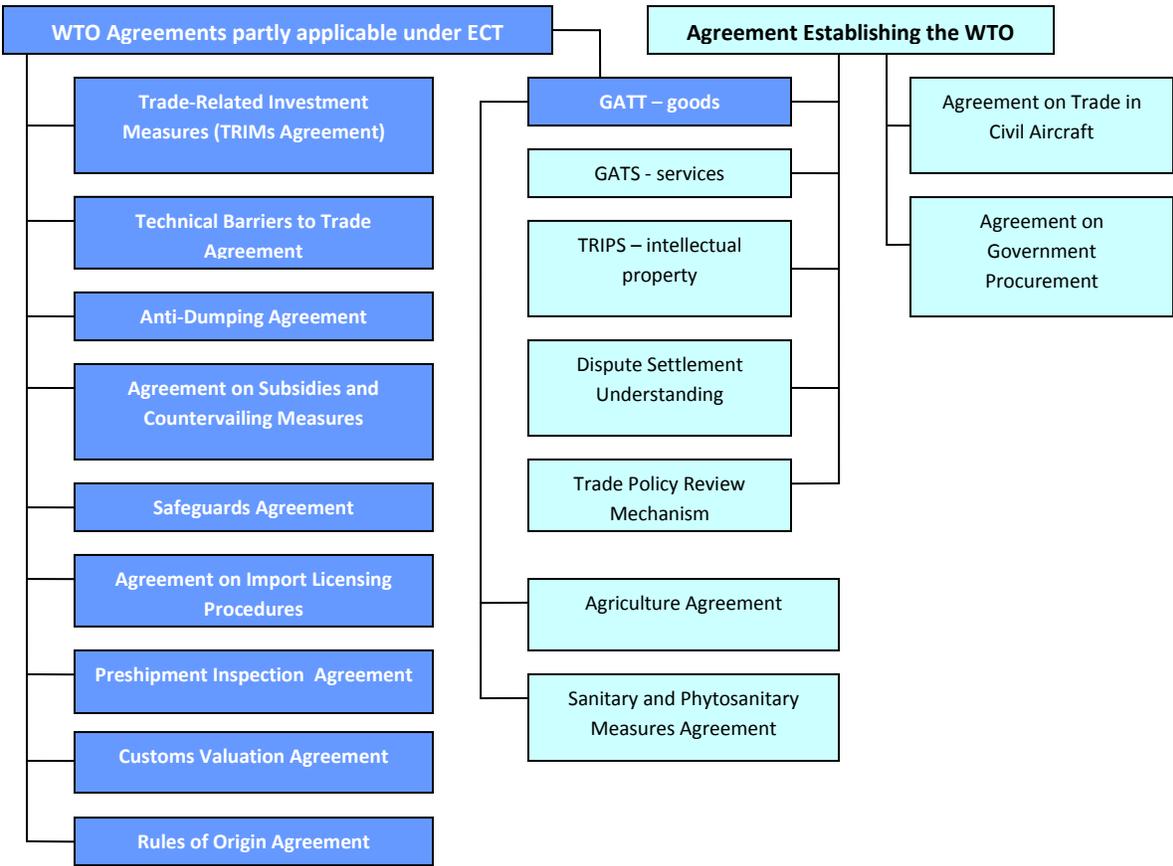
The ECT is a multilateral agreement setting rules for Contracting Parties' regulation of cross-border trade and investment in the energy sector. The **objective of the ECT Trade Regime** is to forge open and non-discriminatory energy markets through the Energy Charter process. The desired outcome of this process is to create a stable, predictable and non-discriminatory regime for all energy-related trade between all ECT Contracting Parties. Such a framework is **based on the rules of the multilateral trading system** as embodied in the General Agreement on Tariffs and Trade of 1947 ("**GATT 1947**") - when the ECT was negotiated between 1991 and 1994 - and now in the Agreements of the World Trade Organization ("**WTO Agreements**").

The **WTO does not have specific rules** for the energy sector. However, the legal framework of the WTO includes a number of rules that are also applicable to the trade in energy-related products and equipments.

The purpose of the ECT Trade regime is to **extend** the benefits, but also the obligations, of **WTO Membership** to the **energy sector of those ECT Contracting Parties, who are not yet in the WTO**. In practice this extension means that trade in the energy sector between WTO and non-WTO Members and among non-WTO Members is treated as if all were Members of the WTO.

To achieve this, the ECT has **incorporated those rules of GATT that are relevant to the energy sector**. The original set of ECT trade rules was drafted before the WTO entered into force; therefore those rules reflect GATT and its related rules of the international trading system applying to trade in goods.

The integration of GATT rules was done using the legal technique known as “incorporation by reference”, i.e. **declaring the applicability of the GATT through an Annex**. Moreover, for reasons of simplicity, the Annex is a “**negative list**” stating the **provisions of GATT that are not applicable in ECT**. This is common legal drafting practice, which ECT negotiators choose because of the complexity of the GATT legal structure. As a result, the ECT does not spell out which rules of GATT and related agreements are applicable. Rather it specifies that all GATT provisions apply under the ECT except those which are quoted in an Annex – because they are not energy-relevant. The only exception where actual incorporation was used is ECT Article 5 on **Trade Related Investment Measures (TRIMS)**, which spells out the provisions of the identical TRIMS agreement of the WTO.



Regarding the scope of the original trade regime, the ECT explicitly defines in its Annex EM I the items to which it applies: “**Energy Materials and Products**”, broadly defined as follows: nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, and other energy (fuel wood and charcoal). However, the EU and six Commonwealth of Independent State (CIS) countries declared that bilateral trade in nuclear materials should for the time being be covered by other agreements referred to in their Declarations in the Final Act of the European Energy Charter Conference of 1994.

As regards the substance of the original ECT trade regime, Contracting Parties are obliged to follow the **principles of non-discrimination** between imported goods (the so-called **Most-favoured Nation Treatment**) as well as between domestic and imported goods after the latter have crossed the border (so-called **National Treatment**). Most-favoured Nation Treatment requires that all foreign products be treated equally with respect to all border measures (e.g. import and export duties, customs formalities, entry points, etc.). National Treatment requires that imports be treated not less favourably than domestic products with respect to all domestic regulations (e.g. taxes, domestic transportation charges, distribution channels, advertisement, etc.). Once imported goods have been cleared through customs, i.e. import duties have been paid, no additional protection against imported goods is allowed. The rationale is to avoid hidden trade barriers, so that legitimate expectations of exporters regarding market access as published in the importing countries' tariff concessions ('tariff bindings') are not diminished through "behind-the-border" discriminatory regulatory practices.

Furthermore, regulation of trade under WTO and ECT requires the **elimination of all quantitative restrictions on trade**, be they in the form of quotas, licensing or any other measures implying a quantitative limit. In principle, this applies also to exports. Exceptions are allowed however e.g. to alleviate shortages in the domestic market.

The WTO or ECT trade regime does not prohibit protection of domestic goods through customs tariffs. The WTO trade regime also provides for a comprehensive system of **ceiling bindings** on customs tariffs, agreed item by item for each good and each country. In contrast to the WTO, the ECT trade regime **does not contain a ceiling binding** on customs tariffs.

Basic Principles of the WTO Incorporated in the ECT

Non-discrimination - Two key principles are involved here:

1) **Most-favoured-nation treatment (MFN)**: Countries cannot normally discriminate between their trading partners. A country granting a special favour regarding its imports or exports to or from any other country has to extend this favour immediately and unconditionally to all other Members. In ordinary language, MFN would translate to: **"I treat your products (goods, services, investments) like I treat those of my best friend"**. The WTO and the ECT however allow exceptions from MFN for Members of customs unions or free trade agreements or for imports from developing countries ("General System of Preferences GSP")

2) **National Treatment**: This is about treating foreign and "like" domestic products equally. This means that imported and locally-produced goods should be treated equally. National treatment only applies once a product has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally produced products are not charged an equivalent tax. In ordinary language, this principle would translate to: **"Once your products are in my house, I treat them like those of my family members"**.

Elimination of Quantitative Restrictions: Governments may not keep any numerical restrictions (e.g. quotas, contingents, rationing) on imports or exports. They may still retain customs duties (as long as they are below the maximum level agreed in their WTO commitments) and qualitative product regulations, also so-called Technical Barriers to Trade (as long as they are least trade distortive and serve a legitimate purpose). In familiar language, this principle can be translated as: **"I will let market actors decide on the quantities they want to import or export"**.

Note that both the WTO and the ECT allow for temporary exceptions in case of emergency situations.

Ceiling bindings

A ceiling binding means the practice in the WTO of binding all, or large sections, of a tariff at a **specified maximum level**, often with a **comfortable cushion above the applied tariff rates**. Ceiling bindings are normally the result of negotiations. Countries that undertake to bind their tariffs are under a legal obligation not to increase applied customs levels above the bound levels, but they may at their discretion apply lower customs tariffs than their ceiling bindings.

Under the ECT, there is only a “**soft law**” or “**best-endeavour**” commitment of Contracting Parties that they will not increase their tariffs beyond a certain level (Article 29 (4)). ECT Contracting Parties, which are also WTO Members, made the “best endeavour” pledge that they would not increase their **import duties** above their **respective WTO bound duty rates**, while those which are not yet WTO Members, undertook a “best endeavour” pledge not to raise their **import and export tariffs** above **their applied levels**. These commitments are called “soft law” because nothing prevents ECT Contracting Parties from increasing their duties above the pledged ceilings provided that they **notify in advance** their tariff increases and hold consultations with interested parties (Article 29 (5)). The only obligation of any ECT Contracting Party with respect to customs duties is, however, to respect the MFN principle for all its import or export tariffs from or to all ECT Contracting Parties. Both, WTO and ECT allow for a general exception of the MFN principle for trade between members of a **Free Trade Agreement** or a **Customs Union**, or for giving preferences to imports from developing countries (**General System of Preferences, GSP**).

3. The three new elements introduced by the Trade Amendment

There are **three new elements** added by the TA to the ECT¹: **(1)** Technical adaptation of the references to incorporated rules in order to reflect the **changes from a GATT to WTO-based trade regime** (ECT Art. 30); **(2)** Inclusion of **Energy-related Equipment** in the list of goods to which the ECT applies (ECT Art. 31), and **(3)** Possibility for the Energy Charter Conference to **progressively replace** the soft law customs tariffs pledges by a binding customs duty standstill regime (ECT Art. 29(6)).

3.1. When the ECT was concluded in December 1994, the Marrakech Agreement establishing the WTO was not yet in force. This explains why it originally incorporated only the pre-WTO rules of the multilateral trading system. Nevertheless, the drafters of the ECT envisaged the need to adapt the Treaty to the new WTO system and mandated negotiations to this effect in Article 30 (“Developments in International Trading Arrangements”). The Trade Amendment, adopted on 24 April 1998, three years after the entry into force of the WTO Agreement, takes account of the relevant **changes in the multilateral trade rules resulting from the Uruguay Round and the creation of the WTO**. The Trade Amendment replaced the GATT provisions of the ECT with those of the WTO. The amendment has used the same legal technique as the original Treaty: it incorporated “by reference” all those WTO rules on trade in goods that are energy relevant. The changes entailed the replacement of the previous negative list referring to non-applicable GATT provisions (Annex G) with a new negative list referring to non-applicable WTO provisions (**Annex W**). This resulted in a much longer list of exceptions simply due to the extended scope of the WTO. **The scope of the ECT did not change** as a result of this technical replacement, because it was decided **not to incorporate provisions to services** (General Agreement on Trade in Services, GATS) **nor provisions on intellectual property** (Trade-Related Aspects of Intellectual Property Rights, TRIPS), even though they are now part of WTO and relevant to energy.

¹ Since the entry into force of the Trade Amendment in 2010, the Trade provisions of the ECT can be found in the following Treaty Articles, Annexes and Decisions: ECT Articles 3 – 9 and 29, - 32 (partly) as well as in Annexes EM I, EM II, EQ I, EQ II, TRM, N, W, TFU, BR, BRQ, D, T (partly), and the Decisions of the Charter Conference in connection with the adoption of the Trade Amendment.

The technical adaptations of the ECT trade regime from GATT to WTO involve detailed changes in wording of Annexes, but **in reality only minimal changes of material scope**. Even the most important adaptation of scope – which in fact is still *de minimis* change – concerns the **dispute settlement system** of the amended ECT (**modified Annex D**). This has only been adapted insignificantly, whereby its **GATT-like diplomatic character**, rather than WTO-like judicial settlement of trade disputes was maintained. As in GATT, a trade dispute is to be adjudicated in the first place by a “panel” before its ruling is considered by the Charter Conference. To put in place the dispute settlement system, the Charter Conference adopted a **roster of panellists** from which, in the event of a trade dispute, three persons are chosen by the Secretary-General to serve on a panel. Individuals on the roster are legal experts nominated by member Governments and persons who **have served as panellists on GATT or WTO** dispute settlement panels. At the First Energy Charter Conference, the Chairman stated – thus reflecting the Members’ consensus – that the roster would be drawn up in accordance with the Trade Amendment.

At the same Conference, consensus was reached regarding the implementation of the ECT trade rules as a whole, that despite the co-existence of two trade regimes, i.e. the original ECT trade regime and that of the TA, there would be **one implementation system based on the regime of the Trade Amendment**.²

For Contracting Parties, who have not yet ratified the TA, there remains a certain degree of **legal uncertainty** in the case of a dispute with the Contracting Party who has ratified it. This uncertainty results from divergences between GATT procedural rules applied on pre-TA basis and the procedural rules applied under the TA. In order to remove this uncertainty, it is greatly desirable that all the Contracting Parties **ratify the TA**.

3.2. Besides making technical changes to reflect the transition of the multilateral trading system from GATT to WTO as explained above, the Trade Amendment introduced an extension of the product coverage of the ECT: it extended the application of the trade rules to **energy-related equipment**. As a result, the ECT trade regime now covers not only “Energy Materials and Products” listed in the re-numbered Annex EM I, but also a large list of items of energy-related equipment, which are **exhaustively described** in the new Annex EQ I based on tariff headings of the Harmonized System (HS) of the World Customs Organization that is also in use in the WTO. Annex EQ I includes a great variety of

Trade Dispute settlement under TA

Under the amended ECT, a dispute settlement panel’s report is subject to adoption by the Charter Conference acting by a **vote of 3/4 of those present and voting**, provided that at least a simple majority of all Contracting Parties supports the decision. This is **different from the WTO** where panel reports are automatically adopted, **unless disapproved by consensus**. Therefore, the TA retains its former element of political decision-making that could serve as an additional incentive for mutually acceptable out-of-court resolutions of trade-related disputes.

In sum, the TA trade dispute resolution mechanism is still lighter, less detailed and simpler than that developed in the WTO. Accepting the Trade Amendment may therefore be an important interim step for non-WTO ECT Contracting Parties towards membership in the WTO.

² Chairman’s Conclusion on the Implementation of Trade-related Rules, at the Energy Charter Conference on 24 April 1998. The Conference agreed without objection to this conclusion

industrial products used in the energy sector. For example, the TA added pipelines, electric cables and towers, drilling platforms, nuclear reactors, central heating boilers, heat pumps, refrigerators, freezers, electrical transformers, accumulators, and even certain types of motor vehicles to the scope of the ECT trade regime. The Twenty-Fourth Energy Charter Conference held in Nicosia in December 2013 **approved a technical change in the wording** of both Annexes EM I and EQ I, adapting them to the wording of the most recent version of the HS system (**HS 2012**) without changing their scope. The Energy Charter Secretariat publishes a transparency document integrating the ECT and the TA, taking also account of these most recent HS changes.

The aim of adding Annex EQ I to the Treaty was to increase the ECT's relevance for investors in the energy sector. Creating a **favourable trading climate for the entire energy sector** requires extending the trade regime to energy equipment used as inputs to energy production. By extending the ECT trade regime to energy equipment, the TA **promotes technology export and technology transfer** from developed countries to energy producing emerging economies needing such technologies. Energy investment is key to satisfying future energy demand. The World Energy Outlook of the International Energy Agency (IEA) quantifies global energy investment needs in the reference scenario until 2030 as being **higher than 1 trillion USD** per year. One **quarter** of these investments is expected to be made in the **ECT constituency**. With the worldwide emergence of policies promoting **low carbon investments**, the investment needs are even higher. Indeed, many of the items included in Annex EQ I are **vital for green energy investments**. Thus the TA facilitates not only **access to commercial energy** in general, but **the transition of developing and emerging countries** towards low carbon economy and sustainable energy production in particular. The export of clean energy equipment and environment-friendly goods by developed countries and their import by developing countries is **also being discussed in other fora**, e.g. the World Energy Council (WEC) and the Asia-Pacific Economic Cooperation (APEC). The ECT equipment list has many items in common with e.g. the **WEC or APEC Lists of Environmental Goods**. The Energy Charter has started cooperating with these organisations.

3.3. Finally, with respect to customs duties, whilst the Trade Amendment has maintained the “best endeavours” system described above (now also applied to energy-related equipment), it has introduced the possibility to **progressively replace the soft law customs tariffs** pledged by a binding customs tariff standstill regime (amended Article 29(6) of the ECT). In the negotiations of the Trade Amendment, efforts to replace the “soft law” tariff provisions generally and immediately by a new legally binding tariff regime were unsuccessful. Instead, a compromise was found that allows moving items gradually, one by one or collectively, from Annexes EM I and EQ I into Annexes EM II and EQ II, respectively, where a **legally binding tariff standstill on applied customs rates** would apply on imports and exports. The Energy Charter Conference is required to examine in annual reviews whether such moving of items is possible. To make a determination for a given item to be moved to Annex EM II or EQ II where legally bound tariffs apply, a **Conference decision by unanimous vote** is necessary. The Energy Charter has started cooperating with WEC and APEC on determining which goods could be moved to Annexes EM II or EQ II, *inter alia*, in view of supporting ECT Contracting Parties' energy or climate targets set, e.g., in the framework of the **Sustainable Energy for All** initiative of the UN Secretary General.

A standstill is an undertaking not to impose new or more restrictive trade measures after a certain date, usually the date on which the undertaking was made.

The Trade Amendment **allows for exceptions** for any Contracting Party not wishing to make commitments at the moment all other ECT Contracting Parties do. For this purpose the Charter Conference may authorise requesting countries to be placed onto Annex BR or BRQ allowing them to apply WTO bindings for their “Energy Materials or Products” or for “Energy Equipments”. Therefore, the wish of a Contracting Party not to make commitments on customs tariffs **is not per se a reason not to ratify the Trade Amendment**. For the same reason, ratifying the TA **does not mean taking an engagement to bind customs tariffs**.

4. Conclusion

The Trade Amendment makes most of the substantive provisions of the WTO Multilateral Agreements on Trade in Goods (Annex 1A to the WTO Agreement) applicable to the ECT constituency. For that purpose it **follows the evolution of the Multilateral Trading System from GATT to WTO** for trade in goods. Therefore, under the Trade Amendment all rules of the WTO Agreements on Trade in Goods apply, except those listed in Annex W of the Trade Amendment

The Trade Amendment has enlarged the scope of the ECT to energy-related equipment. By so doing it becomes a useful tool not only for energy traders, but also for equipment traders. Investors will have access to equipment on a non-discriminatory basis.

The most important change to the ECT brought about by the TA is that it extends the scope of the Energy Charter Treaty to **energy equipment** used in the energy sector. By extending the ECT trade regime to a large number of categories of such

industrial items, the TA favours **technology transfer** from developed countries to developing countries. This facilitates energy sector investments and is an ideal complement to investment protection of the ECT. In sum, with the TA, the Energy Charter Treaty becomes a useful tool for both, the **energy trader and the energy equipment trader**.

Despite the above-mentioned advantages of ratifying the TA, some signatory governments have still not ratified this legal instrument, believing that its **provisional application** will suffice to get all the benefits of the TA.

What is Provisional Application?

In trade policy the term Provisional Application refers to the situation when a Contracting Party to a trade agreement decides to **apply it provisionally within the limits of existing legislation, pending a decision to do so permanently**. ECT Contracting Parties having agreed to the provisional application of the Trade Amendment have extended the basic principles of the ECT trade regime to trade in energy-related equipment between ECT Contracting Parties.

An important advantage of a ratified TA over a provisionally applied one is that ratification provides countries with the **legal certainty** that the benefits of the TA cannot be revoked by other countries having ratified it. Since a country applying the TA provisionally is not definitely bound by that instrument, it does **not have guaranteed entitlement to the rights** provided by the TA. It is therefore in the interest of each Contracting Party to ratify the TA.

Another advantage of ratifying the TA relates to the institutional benefits that might arise from the **dynamic nature of the Energy Charter process**. The TA provides that the Energy Charter Conference may

in the future decide to **progressively replace the soft law customs tariffs** pledges by a binding customs tariff regime on energy materials and products or on energy-related equipment. Full participation of an ECT Contracting Party in this process can **only be ensured** for those countries having ratified the TA.

Finally, it should be mentioned that the ratification of the Trade Amendment **neither entails any risks nor any disadvantages** for the ratifying country.

The substitution of GATT references by WTO references in the ECT corresponds to the reality of global trade and **can not be reversed by abstaining** from ratification.

The inclusion of energy-related equipment adds only the obligation to **respect basic WTO principles** such as non-discriminatory treatment and elimination of quantitative restrictions on these items, **without** any commitment on customs duties. **No ECT Contracting Party** has ever informed the Secretariat that it had problems to respect these basic principles for trade in energy-related equipment.

Countries who have decided to ratify the TA bear neither risks nor disadvantages. Ratification only brings empowerment to decide. It entails no obligation on applied customs tariffs.

The progressive introduction of binding customs tariffs requires **unanimous acceptance** by the Contracting Parties of the Trade Amendment on each item to which such tariffs should apply. Risks or negative effects are mitigated by **two types of exceptions created by the TA**: country by country as well as item by item. Ratification of the TA therefore only brings **empowerment to decide**, but entails no commitment on applied customs tariffs.

Ratification has no effect on **the amount of the budget contribution** of Contracting Parties.