

COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION

THE EUROPEAN ENERGY CHARTER:
FRESH IMPETUS FROM THE EUROPEAN COMMUNITY

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Introduction

1. *The successful exploitation of the energy resources of the Republics of the former Soviet Union and the Central and Eastern European countries is vitally important to their ongoing efforts to rebuild their economies and would also contribute to a more stable political environment. Production and/or consumption of oil and gas in these countries has fallen dramatically. They have been engaged in difficult discussions about pricing and transit arrangements. Some of these countries are also discussing how much access foreign investors should be allowed to their raw materials, and the outcome of that debate is difficult to predict. Internationally guaranteed rules would therefore be a way of convincing economic operators in the OECD countries of the need to help in renewing and developing infrastructures for the whole energy cycle. Clear standards of conduct should also help to limit potential conflict and improve the security of energy supply to the Community.*

It should be underlined that from a political point of view the successful conclusion of the Basic Agreement and subsequently of an agreement on the national treatment in the pre-investment phase, would play a major role in the relations between the Community and the CIS.

At the same time such a development would favourably influence the political relations between the CIS republics themselves and with the PECO's. The latter are, at present, importing nearly the totality of their energy supplies from some of the CIS republics and notably Russia.

2. *In the light of these considerations and at the prompting of the European Community, the European Energy Charter was adopted on 17 December 1991. It now has 50 signatories, including the European Community, all the other OECD countries (except New Zealand), the countries of Central and Eastern Europe and the Republics of the former USSR (except Turkmenistan).*

The signatories have begun to negotiate an international convention, known as the Basic Agreement, designed to ensure the mandatory implementation of the political principles set out in the Charter.

Progress of the Basic Agreement negotiations

3. *Negotiations on the Basic Agreement have been going on for two years and are now entering the final stage.*

Negotiation takes place during the plenary sessions of the Conference, which are held at regular intervals (roughly every six weeks) and are hosted and funded by the Commission. The last meeting was held from 6 to 8 October 1993 and the next is scheduled for 14 to 18 December. The technical aspects of the Basic Agreement are discussed at expert level in working parties meeting in parallel with the Conference. The Community's position is prepared in an ad hoc working party set up by the Committee of Permanent Representatives and in on-the-spot coordination sessions.

The Community's aims in the negotiations.

4. Since the beginning of the negotiations the Community has pursued the following objectives:
- to set the highest possible levels of protection for investors;
 - to maximise access to investments;
 - to lay down strict provisions governing freedom of transit;
 - to reaffirm the traditional position of the Community in favour of opening up access to trade in energy materials and products as set out in the existing trade and cooperation agreements and in line with the partnership and cooperation agreements currently being negotiated;
 - to ensure that the other parties to the negotiations demonstrate the same openness in respect of trade and investment.

Specific issues related to the situation in Russia

5. At the negotiating session of 6 to 8 October 1993 in Brussels the Russian delegation reaffirmed its attachment to the principle of national treatment for investments, but requested a three-year period of adjustment after the signature of the Basic Agreement in order to frame the legislation needed for the orderly implementation of the market economy system and, where necessary, to prepare a list of exceptions to that principle in the light of the legislation adopted.

Outline of a Community response to the difficulties mentioned by Russia

6. The conclusion reached in discussions at Community expert level was that a two-stage approach enshrined in the treaty to be concluded might overcome the problems encountered by Russia, while protecting the legitimate interests of Community industry and investors.

The first stage would entail the conclusion of a Basic Agreement containing all the elements agreed as at the date of signature, including principles on trade, transit, access to international arbitration and national treatment for investments. The aim of the negotiations would be to conclude a final agreement on all outstanding issues, except for the detailed procedures for implementing national treatment during the pre-investment stage. On this particular issue the most-favoured nation (MFN) principle would apply for a period not exceeding three years.

The second stage of negotiations, to be carried out during that three-year period, would be aimed at full implementation of national treatment to the pre-investment stage. A suitable procedure for negotiating the content of clauses setting out exceptions to that principle and deciding on the full implementation of the Basic Agreement would have to be agreed.

The Russian delegation welcomed this idea. It undertook to study the implications and give its opinion at the next meeting. This solution also found favour with the other countries of Eastern Europe and most of the Western countries. Only the United States and Japan have reserved their position at this juncture.

7. The approach suggested by the Community assumes that an acceptable balance between rights and obligations can be achieved as early as the first stage, even though this would mean a less ambitious agreement, at least initially. As far as the countries of the CIS are concerned, this approach presupposes that the main incentive to implement the principle of national treatment prior to investment will be the realization by these countries that it is in their interest to do so, rather than the hypothetical threat of reprisals if they do not.

The approach also takes the following points into account:

- The general issue of access to natural resources is an extremely sensitive one in the countries of the CIS. This is unlikely to change, whatever the economic philosophy adopted. An agreement which is over-ambitious in this area would encounter ratification problems. The West has similar concerns; indeed, some member countries of the OECD are also unwilling to grant unrestricted access to foreign investors in the energy sector.
- The undertakings written into the draft partnership and cooperation agreement with Russia as it stands are that the MFN principle should apply, moving on to national treatment at the pre-investment stage and MFN or national treatment, whichever is the better, in the post-investment stage.
- Russia has requested that the provisions of GATT should be incorporated in the Basic Agreement. The Community should therefore take steps to ensure that its response to this request is consistent with the partnership agreement with Russia, which is still being negotiated, and with the position that the Community takes in the discussions on the possible accession of other countries (e.g. China) to GATT.
- Despite years of discussions, the OECD countries have not yet managed to convert the national treatment instrument into a binding agreement. It would be inadvisable to risk the success of the Charter negotiation process over the single issue of access to investment.
- Provisions more favourable to investors, which might be included in bilateral treaties concluded by the Member States or the Community, would continue to take precedence over the provisions of the Basic Agreement.
- In some Member States economic operators consider that provisions in the Basic Agreement to protect existing investments are intrinsically useful.

8. *It follows that the first stage of the Basic Agreement must be structured as follows:*

The countries of the CIS would accept:

- a transitional period of clearly defined scope and duration for the provisions on the protection of investments plus articles on expropriation, compensation, transfer of payments, subrogation, taxation and settlement of disputes;*
- national treatment in the post-investment phase;*
- the EC position on coal, uranium (see point 11d) and the Community exception clause (known as the REIO clause - see point 11a). This last point will have to be examined with the United States and Japan once the final proposal on investments has been drawn up;*
- no less than MFN treatment for investors in the pre-investment stage and acceptance of the principle of national treatment not later than three years following the signing of the Basic Agreement.*

In return, the CIS countries should see an increase in investments made in the energy sector by the industries of the OECD countries.

Where trade is concerned, the Community should take steps to ensure that its response to the Russian request for GATT treatment is consistent with the position adopted during the negotiation of the partnership agreement and in the GATT accession negotiations.

The Basic Agreement would be formally concluded and ratified in this first stage. The same procedure will apply to phase 2.

9. *In view of the broadly favourable reaction to this Community approach, the US delegation put forward the idea of adding a 'positive list' which would enable any Contracting Parties who so wished to accept national treatment in certain specified sectors even before the beginning of the second stage.*

This positive list could take the form of an annex specifying the economic activities in the energy sector. Contracting Parties prepared to offer national treatment in the pre-investment phase, for particular activities, would inform the Secretariat. Those having accepted this obligation would automatically grant each other national treatment in this area. The positive list could continue to apply until the necessary procedures for implementing the second stage had been completed.

This is an interesting option which could be chosen provided that it does not delay the conclusion of the Basic Agreement. The list could, for example, be established after signature of the Basic Agreement.

Other outstanding problems

10. Some other difficulties were identified in Commission staff working paper SEC(93) 1313 of 27 August 1993.

They relate to the scope of the Basic Agreement (i.e. whether or not equipment and services are to be included), the applicability of the rules of transit to the continental shelf, temporary suspension of access to convertible currencies and exceptions to national treatment for investments.

Suggestions to resolve these difficulties are put forward in points 11 and 12 below.

Problems concerning Community Integration

11. As far as the Community, in particular, is concerned, the observance of certain key principles still has to be established. The main ones are non-extension of Community treatment to third countries, the principle of disconnection, preservation of the autonomy of the Community's legal system and protection of specific aspects arising from the ECSC and Euratom Treaties.

a. The REIO (Regional Economic Integration Organization) clause

The Community has proposed that a clause protecting the *acquis communautaire* and any developments thereof from being extended to the other Contracting Parties should be inserted in the list of general exceptions to the rules of the Basic Agreement.

Any extension to all the other Contracting Parties of the Community's own rules on freedom of establishment and provision of services would be tantamount to bringing them into the Community integration process. This would be unprecedented, with the exception of the European Economic Area Treaty and the Europe Agreements with the countries of Central and Eastern Europe which are part of the moves towards European integration.

The REIO clause therefore also aims to cover the preferential agreements concluded by the Community in these areas and, more especially, the EEA or Europe agreements. It may be of interest to the CIS or other free trade areas yet to be established.

The United States and Japan are resolutely opposed to the proposed clause, as presently worded, but they are alone in this.

To accommodate some of their concerns about the scope of the REIO clause (and presumably also about the creation of other REIOs) the Community could propose a clarification of the clause, explaining that:

- the purpose is not to erect new barriers to trade or investment;

- and that it is a question of protecting Community integration which contributes towards the development of trade and investment and, through agreements concluded by the Community with third countries, enables the latter to participate in a European integration process.

With regard to trade, provisions on the subject already exist within GATT and also apply to the Basic Agreement.

b. Disconnection clause

In order to dispel any ambiguity about the primacy of Community law, the Community proposed the inclusion, among the general exceptions to the Agreement, of the following clause separating the internal functioning of the Community from its external obligations under the Basic Agreement:

"In their mutual relations, Contracting Parties which are Members of the European Communities shall apply Community rules and shall not therefore apply the rules arising from this Agreement except insofar as there is no Community rule governing the particular subject concerned".

At the moment this clause appears in a ministerial declaration. It ought to be included in the actual text of the Basic Agreement.

c. The exclusion of 'forum shopping'

The draft Basic Agreement does not, in principle, rule out the possibility of an investor in dispute with a contracting party bringing the matter to international arbitration after having exhausted all possibilities of appeal before the defendant's national courts.

In the case of the Community this comprehensive right runs counter to the guiding principles of the precedence of Community law and the autonomy of its legal system, which are clearly spelled out by the Court in its rulings 1/91 and 2/91.

The Community has therefore asked to be included among those Contracting Parties which do not unconditionally accept 're-submission'.

This position could be substantiated as follows:

"The Treaties establishing the European Community have created an autonomous legal order in which the Court of Justice exclusively ensures that, in the interpretation and application of these Treaties, the law is observed".

d. Exceptions for the ECSC and Euratom

These are intended to cover two types of situation resulting from specific features of the ECSC and Euratom Treaties which are not contested in GATT, in order to rule out the possibility of Contracting Parties which are not yet members of GATT calling these situations into question under the terms of the Basic Agreement.

In the case of the ECSC this refers to measures to enable Community coal to be produced and sold in accordance with Community rules relating to the restructuring of the coal industry.

In the case of Euratom it means leaving intact the role of the Euratom Supply Agency and, in particular, its acknowledged right to determine the geographical origin of materials purchased outside the Community.

In both cases the Community should ensure that the conclusion of the Agreement does not affect the existing practices under the two abovementioned Treaties. These practices could be listed in an appropriate annex. Other Contracting Parties could also add their own traditional exceptions to that annex.

Wider Issues

12. The other outstanding problems in the negotiations are as follows:

a. Definitions

Some definitions are very comprehensive and have to be brought into line with the partnership agreement being negotiated with Russia (on economic activity in the energy sector) or simply defined more clearly so as to avoid introducing liberalization which may not be reciprocated, in particular the definition of beneficiary companies and the control thereof.

For the Community the benefits of Community treatment ('national treatment') under Article 58 of the EEC Treaty apply only to companies or firms which are formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Community, or have an effective and continuous link with the economy of a Member State.

b. Territorial scope

The territory covered by the Basic Agreement is the subject of much discussion; Norway wants the continental shelf to be excluded. The scope of the Agreement would be defined instead by reference to the territory under the sovereignty of a Contracting Party and, in accordance with the law of the sea, to the sea, the sea-bed and the subsoil over which that Contracting Party exercises sovereign rights.

c. Transit

The definition of transit in this article is a source of ambiguity as it duplicates Article V of GATT. This definition should therefore be deleted.

d. Free movement of capital

This form of liberalization, even though it is sectoral and relies on the application of national treatment for access to sources of credit and the freedom to transfer payments related to investments, must leave intact the relevant safeguard clauses which the Community is allowed to apply under the Treaty on European Union (Articles 109h, 109i and 73f to protect the future EMS).

e. Exceptions to national treatment for investors

A broad definition of the coverage provided by the Basic Agreement and the existence of reciprocity clauses in some Community directives (on public procurement and banking, for example) might necessitate the inclusion of Community exceptions to national treatment in the pre-establishment phase.

Relationship with other agreements

- 13. As stated above, the horizontal nature of the provisions in the Basic Agreement inevitably gives rise to overlapping with similar provisions in other multilateral or bilateral agreements being negotiated (e.g. Uruguay Round - GATT membership - partnership and cooperation agreements - Euratom nuclear cooperation). It is important to ensure, as the negotiations progress, that full compatibility is maintained between the respective provisions covering a particular area, and that the clause which is most favourable to the investor/operator applies in every case.*

Future timetable of the negotiations

- 14. The next plenary session of the Conference is scheduled for the 14 to 18 December 1993. This session is likely to be decisive in terms of concluding the Basic Agreement, if the lines of thinking set out at the beginning of October can be confirmed as a basis for discussion which is both acceptable to the main players in the negotiations and credible to industrialists/investors.*

Informal bilateral contacts between the Community, the United States and Russia are due to take place in November. These could contribute to a fruitful outcome to the Conference in December.

By outlining a possible compromise the Community has regained the initiative in these negotiations. It would be most valuable if it could hold on to that initiative. Hence, the Community institutions must make very plain their approval of and support for the individual components of the proposed compromise.

Conclusion

15. The Commission therefore proposes that the Community should reaffirm its desire to conclude the Basic Agreement as soon as possible.

To that end the Council should formally endorse the two-stage approach described in points 9 to 11 of this paper and, in accordance with the procedures laid down in the negotiating directives which it adopted, should instruct the Presidency and the Commission to prepare the necessary draft texts. These texts should be examined and approved in the ad hoc Working Party on the Charter set up by the Committee of Permanent Representatives.

In this way the Community could continue to negotiate the Basic Agreement on the basis set out at the beginning of October 1993 and arrive at the text of a substantial treaty which satisfies the following criteria:

- It should form a balanced set of mandatory provisions on trade and investment;
- It should contain the exception clauses which the Community needs (as described in point 11);
- It should include transitional measures which are of clearly defined duration and scope;
- It should ensure that, at the end of the initial three-year period, the principle of national treatment in the pre-investment phase is actually put into practice;
- It should enable that principle to be implemented, on a voluntary basis, as from the signature of the Agreement.

In order to prepare the December plenary conference, the Council should confirm the mandate given to the Presidency and the Commission to make the necessary contacts on behalf of the Community.

An assessment of the outcome of the December 1993 plenary conference will be drawn up for the Community institutions. They will be invited to express an opinion in principle on the acceptability of the draft Basic Agreement which will be produced by that plenary session.

The Commission will then put the necessary procedures in hand to enable the draft Treaty to be concluded by the Community.

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