World Trade Review (2019), 1–19
doi:10.1017/S1474745619000260

ORIGINAL ARTICLE

The WTO Panel Report in *EU–Energy Package* and Its Implications for the EU's Gas Market and Energy Security

Vitaliy Pogoretskyy and Kim Talus*

Advisory Centre on WTO Law, Geneve, Switzerland
*Corresponding author. Email: vitaliy.pogoretskyy@acwl.ch

(Received 18 December 2018; revised 20 April 2019; accepted 24 April 2019)

Abstract

This article discusses the decision of the Panel of the World Trade Organization (WTO) in the *EU–Energy Package* dispute between the Russian Federation and the European Union (EU) and certain of its Members. This decision is an important milestone in the history of the WTO. First, it presents a good example of how international economic disputes concerning politically sensitive matters, such as energy security, may be resolved in a pragmatic way, by adhering to multilateral trade rules of the WTO. Second, as the first WTO decision to address a Member's regulatory regime for natural gas, it reminds the WTO community that energy trade is not an alien subject for the WTO. In this article, we discuss some of the Panel's findings that may have significance for other similar cases, and examine the implications of these findings for the EU's internal gas market and energy security. The Panel's decision is currently under appeal with a ruling by the WTO Appellate Body not expected before the end of 2019. Hence, the outcome of this dispute remains uncertain.

Keywords: Third Energy Package; natural gas; energy security; pipeline networks; LNG; security of supply

1. Introduction

On 10 August 2018, a panel of the World Trade Organization (WTO) circulated its almost 400-page report in the *EU–Energy Package* dispute to WTO Members,[1] which had been initiated by the Russian Federation (Russia) against the European Union (EU) and certain of its Member States.[2] At first glance, this decision may seem overly technical as it addresses highly complex factual realities of the natural gas industry. Nevertheless, it is an important milestone in the history of the WTO, for several reasons.

First, it is a good example of how international economic disputes of a politically sensitive nature can be resolved in a spirit of friendly cooperation, by adhering to the rulebook of the WTO. At the heart of this dispute is a clash between two models of energy governance: (i) the 'liberalist' model, currently pursued by the EU, which promotes competition in the entire gas supply chain and encourages diversification among gas suppliers, supply routes, and energy sources; and (ii) the 'statist' model, promoted by Russia, which is based on the vertical integration

Vitaliy Pogoretskyy, Counsel at the Advisory Centre on WTO Law (Geneva), e-mail: vitaliy.pogoretskyy@acwl.ch. Prof. Kim Talus, James McCulloch Chair in Energy Law and Director of the Tulane Center for Energy Law (Tulane Law School); Professor of European Energy Law at UEF Law School (University of Eastern Finland); Professor of Energy Law at Helsinki University. The views expressed in this article are strictly personal and should not be attributed to the organizations with which the authors are affiliated. The authors thank Niall Meagher and the anonymous reviewers for their comments. All errors remain ours alone.

[1]Panel Report, *European Union and Its Member States – Certain Measures Relating to the Energy Sector (EU–Energy Package)*, WR/DS476/R, circulated to Members on 10 August 2018.

[2]These are Croatia, Hungary, and Lithuania.

of strategic energy-supplying companies, such as Russia's Gazprom, and government control over these companies.

The terms 'liberalist' and 'statist' should not be understood in their absolute sense. As explained in section 2 below, the EU's gas market is not entirely free from all forms of government control. On the other hand, in recent decades, some forms of competition between gas suppliers were allowed in Russia's gas market. For example, several gas suppliers independent from the Russian Government, such as Novatek and ITERA, currently compete with Gazprom in Russia's domestic gas market. However, despite these relatively mild liberalization reforms, Russia's gas market remains to be largely dominated by one vertically integrated State-trading enterprise, Gazprom.[3] Gazprom, the majority of whose shares is owned by the Russian Government, enjoys an exclusive right to export natural gas via pipelines from the territory of Russia, which allows it to cross-subsidize its domestic operations, and controls Russia's domestic gas transmission network for long-distance gas transportation (the Unified Gas Supply System or UGSS). Other private gas suppliers rely on third-party access to the UGSS to deliver their gas to consumers in Russia, and have a significantly lower market share than Gazprom in Russia's gas market. Moreover, even though the private companies sell gas in the segments of the Russian gas market where prices are not regulated, their prices are influenced by the level of prices charged by Gazprom, which are regulated by the Government.[4]

The ultimate objective of the EU's model is to create a single competitive gas market in the EU, with integrated pipeline networks. This should, in turn, reduce prices, enhance competition between suppliers, and increase service standards. Another important objective of the EU's gas market is energy security (i.e. security of gas supply), which the EU and its Member States promote through building increasingly connected internal pipeline networks, and diversification of supply sources and routes.[5] It was not disputed by the parties, nor questioned by the Panel, that natural gas 'plays an essential and ever-growing role in the energy balance of many countries, including the [EU]', and that disruptions of energy supply may potentially have 'severe social, economic and, ultimately, political consequences'.[6] With a view to achieving these objectives, for several decades, the EU has developed a comprehensive package of rules, known as the Third Energy Package.[7]

Many of these rules have, however, faced a strong opposition from Russia and Gazprom, whose key interests have been to preserve the security of demand for Russian natural gas and to protect Gazprom's multi-billion-euro assets in the EU. Gazprom is today the largest single exporter of natural gas to the EU.[8] Its ownership of natural gas transmission and distribution pipelines and its control of natural gas storage capacity have been central to its operations in

[3]During its accession negotiations to the WTO, Russia 'confirmed that Gazprom will be notified as [a state-trading enterprise] in accordance with Article XVII of the GATT 1994'. WTO, Working Party on the Accession of the Russian Federation, 'Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization', WT/ACC/RUS/70 (17 November 2011), para. 88.

[4]Gazprom accounts for 12% and 68% of the global and Russia's national gas output respectively. On the role of Gazprom in Russia's gas market, see Gazprom, http://www.gazprom.com (accessed 11 November 2018); and I. Nazarov (2015), 'Overview of the Russian Natural Gas Industry', in A. Vavilov (ed.), *Gazprom: An Energy Giant and Its Challenges in Europe*, Palgrave Macmillan, pp. 15–16, 31, 41–42, 44.

[5]Among the definitions of energy security discussed in the Panel Report is 'the uninterrupted availability of energy sources at an affordable price', *EU–Energy Package*, n. 1 above, para. 7.1150. The need for diversification is emphasized in, *inter alia*, recital 5 and Article 4 of Regulation (EU) No. 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No. 1364/2006/EC and amending Regulations (EC) No. 713/2009, (EC) No. 714/2009, and (EC) No. 715/2009 (OJ L 115, 25.4.2013, p. 39).

[6]*EU–Energy Package*, n. 1 above, paras. 7.1154, 7.1198, footnote 1922.

[7]See section 2.

[8]In 2016, Russian gas accounted for 39.9% of the EU's total imports of gas. EU Commission (2018), 'EU Energy in Figures', Statistical pocketbook, https://www.euneighbours.eu/en/east/stay-informed/publications/eu-energy-figures-statistical-pocketbook-2018 (accessed 11 November 2018), p. 26.

EU markets.[9] As the Third Energy Package has ostensibly put these interests at risk, shortly after its accession to the WTO, Russia challenged the WTO-consistency of the fundamental pillars of this Package.[10]

The differences between the two models of energy governance (i.e. market driven vs. state driven) are not new or unique to the EU or Russia. Instead, the two approaches reflect a common policy difference between upstream energy-producing countries and downstream energy-consuming countries. The former often rely on income flowing from energy sales and prefer to maintain government control over these activities. They also have a traditional preference for long-term sale and purchase agreements to ensure security of demand. Contemporary energy policies of downstream countries typically put emphasis on markets and market mechanisms, short-term trading in particular, to provide the optimal outcome in terms of price and, to a more limited extent, security of supply. These differences in approaches may create political tensions, which are particularly visible in the EU–Russia natural gas trade.

Against this political backdrop of the *EU–Energy Package* dispute, it was essential for the Panel in its legal analysis not to drift too far away from economic considerations into the area of high politics. While one may disagree with certain technical aspects of the Panel's findings and reasoning, the Panel achieved this crucial task with commendable success.[11]

Second, the Panel Report is the first decision involving challenges to a WTO Member's regulatory framework for its domestic energy market, in particular the market for natural gas. As discussed further, the report addresses a number of previously underexplored issues, including the interaction between the General Agreement on Tariffs and Trade 1994 (GATT, 1994) and the General Agreement on Trade in Service (GATS) in the context of network-bound trade; the meaning of certain key terms in the GATS, such as the 'commercial presence' of a foreign service supplier in the importing Member; 'likeness' between natural gas and liquefied natural gas (LNG);[12] and distinction between border restrictions and internal regulations. The Panel Report also provides guidance on the evidence that a complainant must adduce to establish *de facto* discrimination.

Although this report is currently under appeal,[13] given the political significance of this case for the EU's energy market and the many novel issues analyzed by the Panel, it appears useful to draw preliminary conclusions from the Panel's findings already at this stage. In section 2, we provide a general background on the EU's liberalization reforms leading to the adoption of the Third Energy Package. In section 3, we discuss the Panel's findings on the WTO-consistency of certain selected aspects of the Third Energy Package. Section 4 contains our conclusions, including comments on measures that the EU and its Member States may have to take to implement the Panel's findings, if they are not overturned, as well as the potential implications of the Panel's findings for the EU's internal gas market and energy security.

[9]Gazprom, for example, has joint control over Europolgaz (the owner of the Yamal gas pipeline in Poland), and supplies pipeline transport services in several EU Member States through transmission system operators, such as NEL GT, OPAL GT, and GASCADE. See *EU–Energy Package*, n. 1 above, paras. 7.613, 7.1082, 7.1085, and footnote 906.

[10]Russia acceded to the WTO on 22 August 2012. Russia requested WTO consultations with the EU and its Member States regarding the Third Energy Package on 30 April 2014.

[11]For example, in section 3.4, we discuss the significant deference that the Panel gave to the authorities of the EU and its Member States in administering certification requirements for transmission system operators.

[12]LNG is natural gas chilled to the point where it becomes liquid, at an average temperature of −160° C (−260° F). *EU–Energy Package*, n. 1 above, footnote 1414. See also Gas Strategies industry glossary, www.gasstrategies.com (accessed 12 December 2018).

[13]The EU appealed certain findings of the Panel on 21 September 2018, while Russia submitted its other appeal on 26 September 2018. See WTO, Notification of an Appeal by the European Union, WT/DS476/6, 25 September 2018; and WTO, Notice of an Other Appeal by the Russian Federation, WT/DS476/7, 28 September 2018. According to the most optimistic scenario, the Appellate Body will issue its decision not earlier than the beginning of 2020.

2. The EU's Long and Thorny Path towards the Completion of Its Internal Gas Market

In theory, the EU's founding treaties, with their pro-internal market-oriented economic content, have been applicable to the energy sector since the 1950s. In reality, however, energy played such a strategic and political role in respect of national sovereignty that the EU Member States could not and would not transfer significant regulatory powers in this sector to the EU.[14] For this reason, energy was consciously excluded from the process of European integration, and, for a long time, the energy sector and national energy monopolies were protected from the effects of EU law.[15]

As a result, national gas monopolies and national gas markets persisted from the 1950s to the late 1990s and, in practice, beyond. In the late 1980s, the EU's approach to the energy sector began to change. This was largely driven by energy market reforms in the United States (US) and the United Kingdom, and the positive early experiences of these countries. A state-controlled sector started slowly changing into something more market-oriented. However, the path towards competitive markets has been slow, with resistance coming from both the industry and the national governments.

Natural gas market liberalization in the EU has taken place through three consecutive legislative packages. In the 1990s, the various directives constituting the so-called First Energy Package[16] were adopted. These reflected the political realities of the 1990s: their content was not very ambitious. The First Energy Package did, however, establish a regulatory basis for future regulation of this area. Negotiated or regulated third-party access[17] and functional unbundling[18] were among the key issues covered in the directives. However, it was clear that these first steps were not in themselves sufficient to create a competitive energy market.

In 2003, the Second Energy Package[19] followed. Its aim was to speed up the process of creating competitive gas and electricity markets. The Package's new directives and regulations included more detailed sector-specific obligations, which were intended to achieve further liberalization of the European energy markets. The new legislative instruments included provisions on national energy market authorities (NRAs), regulated third-party access, functional and legal unbundling, as well as provisions creating a regulatory framework for cross-border interconnectors (pipelines). The outcome, however, was still insufficient. An energy sector specific inquiry conducted under the competition law competences of the EU Commission in 2007 clearly indicated that, despite the existing regulatory framework, several problems remained: market concentration was still

[14]Even today, certain 'national energy rights' are excluded from the scope of the EU's energy-specific competence under Article 194(2) of the Treaty on the Functioning of the European Union.

[15]The historical development of EU energy law is examined in detail in K. Talus (2013), *EU Energy Law and Policy: A Critical Account*, Oxford University Press.

[16]This Package included: Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas (OJ L 204, 21.7.1998, p. 1); and Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity (OJ L 27, 30.1.1997, p. 20).

[17]Third-party access entails a system where third parties, other than owners and operators of the pipeline, can have non-discriminatory access to pipeline transportation services. Third-party access can be based on negotiated access, where the system operator is required to negotiate access with third parties, or regulated access, where the regulator ensures non-discriminatory access, including tariffs, through regulation.

[18]Unbundling entails a separation of pipeline activities from other gas market activities. There are various unbundling models ranging from account unbundling to legal and ownership unbundling, among other things. Functional unbundling means that the network department is separate from the rest of the vertically integrated company and that behavioral rules are put in place to ensure the independence of this department.

[19]This Package included: Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (OJ L 176, 15.7.2003, p. 57); Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC (OJ L 176, 15.7.2003, p. 37); and Regulation (EC) No. 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity (OJ L 176, 15.7.2003, p. 1).

high, cross-border trade had not developed, vertical market foreclosure remained a problem, and third-party access regimes did not provide the right outcome due to long-term capacity reservations and lack of transparency.[20] Moreover, the system of price formation for natural gas was imperfect as it relied on the price of oil rather than a market price for gas.

In order to resolve these problems, the EU Commission proposed a new sector-specific legislative package: the Third Energy Package. The EU Commission also initiated a campaign directed at the energy industry to address specific competition issues and enhance market functioning, based on the enforcement of competition law.[21]

The Third Energy Package was adopted in 2009.[22] It introduced a raft of new regulations and included internal market directives for electricity and gas with rules on ownership unbundling,[23] new powers for NRAs, more detailed regulations on third-party access to electricity and gas networks, and the establishment of a new, EU-level energy authority, known as the Agency for the Cooperation of Energy Regulators. In addition, the Third Energy Package created a competence for the EU to enact further legislation on specific issues relating to the functioning of energy markets. This legislation included a new type of instrument in EU energy law, known as 'network codes', which regulate details of, among other things, capacity allocation, balancing, and tariffs for transportation.

The EU law also regulates many other aspects of the EU internal gas markets, such as planning and financing of new infrastructure, security of supply-related aspects of energy markets, transparency, gas trading, and other matters.

While the first and second of these packages from the end of 1990s and 2003 may be considered as 'liberalization' or 'deregulation' measures,[24] the Third Energy Package from 2009 and subsequent developments should more appropriately be regarded as a move towards higher regulatory control and increased public sector involvement in the internal energy markets. Essentially, the initial idea of a bottom-up regulatory approach towards energy and energy markets has today been partially replaced by a top-down style of regulation.[25] One example of this public sector influence on market mechanisms consists in regulatory and financial incentives provided to energy infrastructure projects, such as 'projects of common interest' (PCIs), under the

[20]Inquiry pursuant to Article 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors (Final Report) (COM/2006/851 final) 10 January 2007.

[21]For an in-depth analysis of the impact of enforcement of competition law on natural gas markets, see K. Talus (2011), 'Long-term Natural Gas Contracts and Antitrust Law in the European Union and the United States', *Journal of World Energy Law and Business*, 4(3): 1; and K. Talus (2011), 'Just What Is the Scope of the Essential Facilities Doctrine in the Energy Sector: Third Party Access-Friendly Interpretation in the EU v. Contractual Freedom in the US', *Common Market Law Review*, 48(5): 1571.

[22]It consists of the following legal instruments: Regulation (EC) No. 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators (OJ L 211, 14.8.2009, p. 1); Regulation (EC) No. 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No. 1228/2003 (OJ L 211, 14.8.2009, p. 15); Regulation (EC) No. 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005 (OJ L 211, 14.8.2009, p. 36); Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 55); and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (OJ L 211, 14.8.2009, p. 94).

[23]Ownership unbundling entails full separation of network activities from other gas market activities. Vertically integrated companies are, therefore, required to divest their control and rights over either their natural gas production and supply undertakings or their transmission systems and network operators. See section 3.2 below.

[24]'Liberalization' needs to be distinguished from 'privatization'. Many energy companies in the EU are still state-owned. However, with liberalization, these state-owned companies have lost their exclusive or special rights in the EU energy markets and compete today like privately owned companies.

[25]This is discussed in K. Talus (2017), 'Decades of EU Energy Policy: Towards Politically Driven Markets', *Journal of World Energy Law & Business*, 10(4): 380.

EU Regulation on Trans-European Networks for Energy.[26] A PCI status and public sector funding may be, and often are, decisive for an infrastructure project (it is this public funding that either makes or breaks a new cross-border pipeline project). This essentially translates into administrative market creation in the sense that public sector and the EU in particular, instead of market forces, make decisions on pipeline investments, based on the objectives of market creation, diversification of supply source and routes, and security of supply. Thus, even though some pipeline projects may not necessarily make any commercial sense, they may be considered to be instrumental to the achievement of these public policy objectives, and will, therefore, be provided administrative and financial support. Moreover, in some cases, the lack of detailed understanding of energy markets and of the impact of specific pipeline projects on the EU's energy policy objectives may cause investments with limited public policy and commercial rationale.[27]

The transformation of the EU energy markets after the adoption of the Third Energy Package has been remarkable. Cross-border trade and natural gas trading in 'trading hubs' have taken off. Arguably, several factors have led to these changes, including the development of an increasingly dense EU internal pipeline system; an increasing number of pipelines that have reverse flow capabilities; and fundamental changes in the global LNG market. However, these changes may also be attributed to the EU's new regulatory regime, including the regulated third-party access, and ownership unbundling, which are reinforced by antitrust rules.[28]

3 The Panel's Findings on the WTO-Consistency of the Third Energy Package

Russia advanced multiple claims, listed below, against different aspects of the Third Energy Package, including the national laws of Croatia, Hungary, and Lithuania implementing the Package, under different WTO provisions. However, Russia succeeded in only a few of these claims, which are italicized in the list:

- unbundling measure, challenged under Articles II:1, XVI:2(a), XVI:2(e), and XVI:2(f) of the GATS, and Articles I:1 and III:4 of the GATT 1994;
- public body measure, challenged under Article XVII of the GATS;
- LNG measure, challenged under Article I:1 of the GATT 1994;
- *infrastructure exemption measure*, challenged under Articles I:1, X:3(a) and *XI:1 of the GATT 1994*, and Article II:1 of the GATS;
- upstream pipeline networks measure, challenged under Articles I:1 and III:4 of the GATT 1994;
- *third-country certification measure*, challenged under Articles II:1, VI:1, VI:5(a) and *XVII of the GATS*; and
- *the Trans-European Networks for Energy (TEN-E) measure*, challenged under *Articles I:1 and III:4 of the GATT 1994*, and Article II:1 of the GATS.[29]

Our discussion below is limited to Russia's claims against (i) the unbundling measure under Article II:1 of the GATS, (ii) the LNG measure, (iii) the infrastructure exemption measure

[26] Article 4 of Regulation (EU) No. 347/2013, n. 5 above.

[27] An example of such administratively driven projects appears to be the Finnish–Estonian Balticconnector, which was developed within the framework of one of the EU's gas priority corridors (i.e. the Baltic Energy Market Interconnection Plan, covering, *inter alia*, the three Baltic States and Finland). For a more detailed overview of this project and PCI designations more generally, see K. Talus (2016), *Introduction to EU Energy Law*, Oxford University Press; and Enerdata (2015), 'Gasum Cancels Regional LNG Terminal and Finland–Estonia Gas Pipeline', www.enerdata.net/publications/daily-energy-news/gasum-cancels-regional-lng-terminal-and-finland-estonia-gas-pipeline.html (accessed 10 April 2019).

[28] See Talus, 'Just What Is the Scope of the Essential Facilities Doctrine in the Energy Sector', n. 21 above.

[29] Moreover, certain of Russia's claims were found to be outside the Panel's terms of reference (jurisdiction). *EU–Energy Package*, n. 1 above, para. 7.79.

under Article XI:1 of the GATT 1994, (iv) the third-country certification measure under Article XVII of the GATS, and (v) the TEN-E measure under Articles I:1 and III:4 of the GATT 1994. The Panel's assessment of the other measures was facts intensive and does not appear to have raised important systemic issues.[30]

3.1 What are the Energy Services at Issue?

Before addressing Russia's claims, the Panel decided to answer certain threshold questions. As Russia raised many claims under the GATS with respect to most of the challenged measures, the Panel had to identify what types of energy services at issue were affected by these measures.

Russia's Panel Request defined these services as '[n]atural gas pipeline transport services' or 'pipeline transport services' supplied through a commercial presence in the EU. In both its Panel Request and the Panel proceedings, Russia, however, stated that the relevant services covered almost the entire gas supply chain, rather than 'pipeline transport' in its narrow sense – the transmission of natural gas via pipeline systems.[31] The Panel had to analyze, in particular, whether 'pipeline transport services' covered 'supply' of natural gas (or 'supply services') and 'LNG services'. A broad definition of the services at issue would also broaden the scope of the challenged measures and the reach of Russia's claims under the GATS.

As a general matter, the Panel observed that this open-ended definition of the services at issue did not allow it to identify with sufficient clarity the services that were subject to Russia's claims. The Panel recalled that the application of the GATS is premised on the identification of the specific services sectors with respect to which a Member may have taken specific commitments. Thus, if a panel were not able to identify the relevant sector, it would not be able to determine whether the responding Member had taken the relevant specific commitment with respect to that sector, and, consequently, whether it has acted inconsistently with the commitment. The Panel further noted that '[t]he application of other GATS provisions [such as the most most-favoured-nation (MFN) treatment obligation in Article II:1] is also premised on the identification of sectors'.[32]

With respect to Russia's specific allegation that the services at issue encompassed *supply services*, the Panel stated that the supply of natural gas, including its production and direct sale to consumers, was not 'a service' subject to the GATS. In the Panel's view, the supply of natural gas, which is 'unquestionably a "good"', involves trade in goods, subject to the GATT 1994.[33]

With respect to *LNG services*, Russia contended that, without access to these services, the transportation of re-gasified LNG via pipeline networks would not be feasible. For the Panel, however, the mere fact that the two services are complementary did not 'necessarily and automatically' mean that *they constituted the same service*.[34] In this respect, the Panel noted distinctions between 'essential or core activities' performed in relation to LNG services (i.e. liquefaction of natural gas for purposes of its maritime transportation by LNG tankers overseas, and offloading and re-gasifying LNG at LNG terminals), on the one hand, and the transmission of natural gas via pipeline infrastructure, on the other.[35] Moreover, the Panel observed that Russia's argument that the two services constituted the same service was contradicted by the fact that some other auxiliary services that also enable transmission of natural gas (e.g. '[b]ulk storage services of liquids or gases (CPC 7422)') were inscribed in separate headings of the GATS Schedules of Croatia, Hungary, and Lithuania (i.e. the EU Member States whose measures Russia challenged

[30]However, see the Panel's interpretation of Articles XVI:2(e) and XVI:2(f) of the GATS, as well as its analysis of 'likeness' between LNG services and pipeline transport services in ibid., paras. 7.627–7.651, 7.709–7.719, and 7.1398–7.1416.

[31]Ibid., paras. 7.251–7.252, 7.254–7.255, 7.278; WTO, Request for the Establishment of a Panel by the Russian Federation, WT/DS476/2, 28 May 2015, footnote 3.

[32]*EU–Energy Package*, n. 1 above, paras. 7.272–7.274, 7.280.

[33]Ibid., para. 7.269, footnote 604.

[34]Ibid., para. 7.282.

[35]Ibid., para. 7.281.

in some of its claims).[36] Thus, the only service that the Panel found to be relevant to Russia's GATS claims was the transmission of natural gas via pipeline systems, excluding supply and LNG services.[37]

The Panel's analysis of the services at issue warrants two comments. First, while the Panel's conclusion on the meaning of 'pipeline transport services' is sound, the Panel's reasoning has its weaknesses. In particular, the Panel found it unnecessary to address the EU's argument that LNG services and pipeline transport services are classified explicitly as two different services in a newer version of the United Nations Central Product Classification (CPC 2.1). This document replaced the original version of the CPC, which was used by many GATT Contracting Parties as a basis for scheduling their GATS specific commitments (the UN Provisional CPC).[38] The Panel may have been reluctant to rely on this direct evidentiary source to avoid a novel question raised by the EU of whether it constitutes 'supplementary means of interpretation' under Article 32 of the 1969 Vienna Convention on the Law of Treaties, and, therefore, could be used to interpret the GATS.[39]

However, a reference to the CPC 2.1 could arguably have strengthened the Panel's conclusion, which otherwise does not address all of the important questions raised by Russia. For example, had the Panel identified the specific services sector, other than 'pipeline transport services', to which LNG services properly belong, this could have strengthened its view that two complementary services do not 'necessarily and automatically' constitute the same service.[40] Had the Panel identified that other sector by relying on the CPC 2.1, according to the principle of 'mutual exclusivity' of services sectors in the CPC,[41] this would mean that LNG services could not also fall under the 'pipeline transport services' sector.[42] Hence, the two services would have to be considered as different, mutually exclusive services. The Panel, however, declined to address this issue.[43]

The GATS does not, in principle, exclude the possibility that two complementary services may fall within the same services sector. In *China–Electronic Payment Services*, the panel recognized that a service, which is made up of several services, may be considered to be an 'integrated service', if all of the elements of this service, taken together, are necessary for the relevant transaction to take place.[44] Similarly, one could argue that, in the context of gas trade, a long-distance supply of natural gas overseas could not take place without involving both LNG services and pipeline transport services.[45] The Panel did not explain sufficiently why the notion of 'integrated' services would not apply to the relationship between LNG services and pipeline transport services.

Second, the Panel's distinction between WTO rules applicable to energy services, such as the GATS, and those applicable to energy goods, including the GATT 1994, has significance for other disputes involving trade in energy, as well as network-bound trade more generally. In these areas, in many jurisdictions, one and the same entity, frequently with monopoly rights, may be both the

[36]Ibid., paras. 7.330–7.333.

[37]Ibid., para. 7.338.

[38]Ibid., para. 7.279, footnote 692. GATT Contracting Parties and the newly acceded WTO Members have inscribed specific commitments in their GATS Schedules, based on the document 'W/120', prepared originally by the GATT Secretariat during the Uruguay Round of negotiations. This document had, in turn, been drawn up based on the UN Provisional CPC.

[39]Curiously, the Panel referred to the CPC 2.1 in its substantive analysis of Russia's claim against the TEN-E measure under Article II:1 of the GATS, i.e. its assessment of 'likeness' between LNG services and pipeline transport services – although without explaining the legal basis upon which this version of the CPC was used. The Panel found that these services were not 'like'. Ibid., footnote 692, paras. 7.1412–7.1413, 7.1416.

[40]Ibid., para. 7.282, footnote omitted.

[41]Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted 20 April 2005, para. 172.

[42]Note that the CPC is exhaustive and covers all goods and services. Ibid.

[43]*EU–Energy Package*, n. 1 above, para. 7.333.

[44]Panel Report, *China – Certain Measures Affecting Electronic Payment Services*, WT/DS413/R and Add.1, adopted 31 August 2012, paras. 7.55–7.62.

[45]The Panel acknowledged this fact in *EU–Energy Package*, n. 1 above, paras. 7.282, 7.311.

supplier of goods (e.g. natural gas) and related services (e.g. LNG services, pipeline transport services, and bulk storage of gases). It may, therefore, be difficult to draw a clear demarcation line between the two separate legal regimes for goods and services applicable to different business operations of such entities.[46]

3.2 Russia's Claims against the Unbundling Measure

The unbundling measure addresses the conflict of interests between vertically integrated undertakings/companies (VIU) owning their pipeline networks and other third-party users of these networks. In a nutshell, this measure requires the separation ('unbundling') of entities performing any of the functions of production or supply, on the one hand, and transmission system operators (TSOs) or transmission systems (e.g. pipelines), on the other hand. There are three models of unbundling under the EU Gas Market Directive:

- **the ownership unbundling (OU) model**, according to which a pipeline transport service supplier must be structurally separated from entities engaged in the production or supply of natural gas in order for it to supply pipeline transport services in the EU;
- **the independent system operator (ISO) model**, according to which a VIU may own the transmission system, but the TSO is required to be separate from the VIU by complying with the OU rules; and
- **the independent transmission operator (ITO) model**, under which the owner and operator of a transmission system, the TSO, belongs to a VIU, but certain behavioral and organizational requirements apply to the relationship between the two entities.

EU Member States must implement the OU model. The ISO and ITO models are optional and may be implemented only with respect to transmission systems that belonged to VIUs on 3 September 2009 (i.e. the date of entry of the Gas Market Directive into force).[47]

Russia claimed that the unbundling measure in the EU Gas Market Directive resulted in *de facto* violation of the MFN obligation in Article II:1 of the GATS, which provides that: '[w]ith respect to any measure covered by [the GATS], each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country'. To establish that the measure at issue was inconsistent with Article II:1, Russia had to prove that (a) it fell within the scope of the GATS; (b) the relevant services and service suppliers (i.e. pipeline transport services and suppliers) were 'like'; and (c) the measure accorded less-favorable treatment to Russian services and service suppliers than that accorded to like services and service suppliers of any other country.[48] Although Russia succeeded, in part, in establishing the first two elements, it ultimately failed to demonstrate the third element.

For Russia, the less-favorable treatment stemmed from the fact that the unbundling measure allowed EU Member States to choose between implementing only the OU model or implementing the ISO and/or the ITO models in addition to the OU model. Russia argued that its service

[46]The Panel noted in this respect that it 'encountered [Russia's] claims against various aspects of the challenged measures under both the GATS and the GATT 1994, accompanied by some argumentation seemingly blurring fundamental distinctions between the GATS and the GATT 1994'. Ibid., para. 7.14, footnote omitted. See this issue discussed in greater detail in V. Pogoretskyy (2017), *Freedom of Transit and Access to Gas Pipeline Networks under WTO Law*, Cambridge University Press, pp. 123–124. On different types of services related to trade in natural gas, see V. Pogoretskyy and S. Melnyk (2016), 'Energy Security, Climate Change and Trade: Does the World Trade Organization Provide for a Viable Framework for Sustainable Energy Security?', in P. Delimatsis (ed.), *Research Handbook on Climate Change and Trade Law*, Edward Elgar, p. 254.

[47]*EU–Energy Package*, n. 1 above, paras. 2.10–2.28, 7.409, 7.426. Articles 9–23 of 2009/73/EC Directive n. 22 above.

[48]*EU–Energy Package*, n. 1 above, para. 7.404.

suppliers were prevented from supplying their pipeline transport services to the EU through a commercial presence under the OU model implemented in some EU Member States, whereas certain VIUs of other countries were able to continue supplying these services under the ISO and ITO models, which were implemented in addition to the OU model in some other EU Member States. The italicized parts of table 1 below illustrate Russia's method of comparing the treatment accorded to its service suppliers with that accorded to the service suppliers of other countries in order to prove the existence of *de facto* discrimination.[49] Russia's comparison, however, ignored situations where Gazprom was treated more favorably than the service suppliers of other countries, for example, situations in which it continued to supply pipeline transport services under the ITO model implemented in Germany.

Table 1. Russia's method of establishing *de facto* discrimination[50]

	Treatment of Russia's Gazprom	Treatment of the suppliers of pipeline transport services from other countries
Under the OU model, a gas supplier was separated from a pipeline operator	*Gazprom was required to divest its shares in the TSO Amber Grid in Lithuania, which has implemented only the OU model.*	The US VIU Conoco Phillips divested its shares in a TSO, pursuant to the OU model.
Under the ITO model, a gas supplier continues to supply pipeline transport services in the EU	Gazprom continues to supply pipeline transport services through a commercial presence in the ITO GASCADE and the ITO NEL GT under the ITO model, implemented in Germany.	*Norwegian Statoil and Azeri SOCAR continue to have shares in various ITOs in Germany, Greece, and Italy, which have implemented both the OU and ITO models.*

The Panel found that Russia's approach to compare the treatment accorded to different 'subsets' of Russian service suppliers and those of other countries was insufficient to show *de facto* discrimination as it could 'skew[] the proper comparison for purposes of determining [less-favorable treatment]'.[51] In the Panel's view, the real reason why the unbundling measure may have had a greater impact on Gazprom than the service suppliers of other countries was that Gazprom had a greater commercial presence on EU gas markets than the other suppliers when the Directive entered into force.[52]

Moreover, the Panel rejected certain of Russia's examples of TSOs that were claimed to be Russian, and where Gazprom was required to sell its shares pursuant to the OU model. Based on the definition of the terms 'commercial presence', 'ownership', and 'control' in the GATS, the Panel found that these companies were not, in fact, Russian service suppliers for purposes of the GATS. In particular, the Panel determined that Gazprom did not have a commercial presence in the EU through service suppliers where it owned less than 50% of shares or where it had no power to name the majority of directors.[53] These examples were, therefore, excluded from the comparison of treatment accorded to Russian and non-Russian service suppliers in the EU.

Given that the Panel's findings that the unbundling measure is WTO-consistent were to a large extent based on its factual assessments, it is unlikely that the Appellate Body will disturb them.

[49]Ibid., paras. 7.373, 7.451, 7.482.

[50]The facts in the table are discussed in ibid., paras. 7.484, 7.494, 7.509, footnotes 885, 906.

[51]See ibid., paras. 7.486–7.492 (and, in particular, para. 7.488, citing Appellate Body Report, *US–Tuna II (Mexico) (Article 21.5–Mexico)*, para. 7.71). The Panel took issue with Russia's use of the same approach in the context of certain other claims as well, in particular Russia's claims against the infrastructure exemption measure and the third-country certification measure. Ibid., footnote 1529, para. 7.1081.

[52]Ibid., para. 7.510.

[53]See the Panel's interpretation of Articles XXVIII(d), XXVIII(m)(ii), and XXVIII(n) of the GATS in ibid., paras. 7.432–7.444, 7.477, 7.498.

The Appellate Body may review such assessments only in the limited circumstances where concerns are raised regarding the Panel's objectivity under Article 11 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).[54] However, as the standard of proof for substantiating these claims is very high,[55] in most cases the Appellate Body has rejected them. On its face, the Panel's reasoning with respect to this measure seems to be well grounded and does not appear to have exceeded the bounds of the Panel's discretion as 'the trier of facts'.[56]

3.3 Claims against Measures that Russia Perceived to be 'Exemptions' from Unbundling

Russia also made several claims with respect to measures that it perceived to be 'exemptions' from the unbundling measure: in particular the public body measure, the upstream pipeline networks measure, LNG measure, and the infrastructure exemption measure.[57] Russia did not succeed in proving any of these claims, except one instance of the application of the infrastructure exemption measure, i.e. the 2009 Infrastructure Decision for the OPAL Pipeline (OPAL Decision). Below, we discuss the Panel's findings with respect to the LNG measure and the OPAL Decision.

3.3.1 LNG Measure

Russia claimed that LNG imported into the EU via LNG facilities, such as LNG terminals, is excluded from the application of the unbundling measure and in this way receives an advantage within the meaning of Article I:1 of the GATT 1994, which is not accorded to Russian natural gas imported into the EU via pipelines.[58] Article I:1 of the GATT 1994 is a provision analogous to Article II:1 of the GATS, establishing the MFN obligation in the context of trade in goods. To prove its claim, Russia had to demonstrate that (a) the LNG measure fell within the scope of Article I:1; (b) the relevant imported products were 'like'; (c) the LNG measure conferred an advantage on a product originating in the territory of any country; and (d) that advantage was not extended immediately and unconditionally to the like products of Russian origin.[59]

The key difficulty that Russia faced in this claim was establishing 'likeness' between LNG and natural gas in its gaseous state (pipeline gas). It is well settled in WTO law that 'likeness' must be demonstrated by analyzing criteria such as: '(a) the properties, nature and quality of the products; (b) the end-uses of the products; (c) consumers' tastes and habits in respect of the products; and (d) the tariff classification of the products'.[60] In the Panel's view, each of these criteria, except the third one on which neither party provided evidence, led to the conclusion that LNG and pipeline gas *were not 'like'*. The Panel, for example, found that they do not share the same physical properties, nature and quality (i.e. LNG is liquid while pipeline gas is gaseous).[61] While *re-gasified LNG* and pipeline gas have identical end-uses (e.g. both are used for heating), *LNG in its liquid form*, unlike pipeline gas, may also be used as a transport fuel, including for vessels.[62] The Panel

[54]Russia appealed the Panel's findings with respect to the unbundling measure under Article 11 of the DSU. See WTO, Notice of an Other Appeal by the Russian Federation, n. 13 above.

[55]Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 133.

[56]Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 162.

[57]Note that the Panel disagreed with Russia that some of these measures, in particular the public body measure, could properly be characterized as 'exemptions' from unbundling, as, in the Panel's view, they contained separate regimes, functionally equivalent to unbundling. *EU–Energy Package*, n. 1 above, paras. 7.776, 7.786.

[58]LNG system operators are not subject to the unbundling measure as a consequence of how LNG facilities and LNG system operators are defined in the EU Gas Market Directive. Ibid., paras. 7.825, 7.831. See also Articles 9–23 of 2009/73/EC Directive, n. 22 above.

[59]*EU–Energy Package*, n. 1 above, para. 7.827.

[60]Ibid., para. 7.837 (citing Appellate Body Report, *EC–Asbestos*, paras. 99 and 101–102).

[61]Ibid., para. 7.847.

[62]Ibid., paras. 7.842, 7.848, footnote 1407.

also noted that LNG and pipeline gas are classified under different headings of the World Customs Organization Harmonized Commodity Description and Coding System, which is used by WTO Members to schedule their GATT tariff commitments (i.e. HS Codes 2711.11 and 2711.21 respectively).[63] Given that Russia's claim did not pass the 'likeness' test, the Panel rejected it.[64]

The accuracy of some of the Panel's factual conclusions may be questioned. With regard to the physical properties of pipeline gas and LNG, natural gas, in both its liquid and gaseous states, has the same molecular structure – both liquids and gases are classified as fluids. Put simply, as opposed to solids in which there is a rigid atomic structure, atoms in liquids and gases can flow. The main difference between the two is their compressibility.[65] Moreover, LNG is only a method of transportation and will always be re-gasified before use (e.g. as a fuel for heating or transport). Thus, at the time of their consumption, pipeline gas and LNG are identical products: simply natural gas.[66] Finally, the use of natural gas as a maritime transport fuel is currently a small-scale activity. One report suggests, that out of more than 60,000 commercial vessels in operation globally, fewer than 125 vessels operate on natural gas.[67] This segment will undoubtedly grow in the future, but is a long way from being a natural gas market with real significance.

The Panel's factual assessment of the elements of 'likeness' was certainly informed by the evidence supplied by the disputing parties. That said, given the technical nature of this assessment, the Panel could have sought information from a scientific expert or international agencies specializing in the field of energy trade, such as the Energy Charter Conference.[68] This would have allowed the Panel to base its factual conclusions on more solid scientific grounds and to arrive at a better-informed understanding of how different segments of energy markets work.[69]

3.2.2 OPAL Decision

Under the infrastructure exemption measure, certain energy infrastructure projects may be exempted from unbundling and other requirements of the Third Energy Package, such as third-party access and regulated tariffs, if they, *inter alia*, qualify as a '[m]ajor new gas infrastructure, i.e. interconnectors' – a project connecting energy markets of several EU Member States.[70] Russia's claim concerned a specific instance of the application of this measure, as reflected in the OPAL Decision. In particular, it concerned certain conditions that were imposed by virtue of this decision on the operator of the OPAL pipeline, OPAL GT,[71] for granting the exemption.[72] The first, and the most relevant, of these conditions was the '50% capacity cap', which limited the ability of OPAL GT, to allocate, in any given year, more than 50% of capacities in the pipeline to dominant undertakings on one of the Czech gas markets, including Gazprom.[73]

[63]Ibid., para. 7.850.

[64]Ibid., para. 7.855.

[65]M. Wüstenberg, K. Talus, and R. D. Ripple (October 2018), 'A False Dichotomy Between LNG and Natural Gas? A Comment on Recent Practises at the World Trade Organization', *OGEL*, www.ogel.org, p. 2; J. M. Smith, H. C. Van Ness, and M. M. Abott (2005), *Introduction to Chemical Engineering Thermodynamics*, 7th edn, McGraw-Hill, chapters 3 and 6.

[66]Burning a liquid with an average temperature of –160° C (–260° F) would be technically impossible.

[67]Wüstenberg *et al.*, n. 65 above, p. 2; 'New Fuel Rules Push Shipowners to Go Green with LNG', www.reuters.com/article/us-shipping-fuel-lng-analysis/new-fuel-rules-push-shipowners-to-go-greenwith-lng-idUSKBN1L01I8 (accessed 12 December 2018). The Panel also acknowledged this in *EU–Energy Package*, n. 1 above, footnote 1407.

[68]Panels have these powers under Article 13 of the DSU.

[69]As the Panel itself recognized, 'this dispute occurs in the context of certain highly complex factual realities of the natural gas industry, including particularities of the markets for natural gas and its transport'. *EU–Energy Package*, n. 1 above, para. 7.15.

[70]Ibid., paras. 7.924, 7.926; Article 36(1) of 2009/73/EC Directive n. 22 above.

[71]OPAL GT is owned jointly by German Wintershall and Gazprom through another company, WIGA Transport. See OPAL, www.opal-gastransport.de/en/company/ (accessed 11 November 2018).

[72]*EU–Energy Package*, n. 1 above, para. 7.976.

[73]The second condition, 'gas release programme', served to reinforce the first one by discouraging the exceeding by Gazprom of 'the 50% capacity cap'. Ibid., paras. 7.983, 7.1000.

The OPAL pipeline was built as an inland transportation route to deliver Russian gas to Western Europe, in particular the German/Czech border, through an entry point in German Greifswald. Russian gas reaches that point via the offshore pipeline Nord Stream, which was built by Russia to ease its reliance on the transit routes via Ukraine and Belarus. Hence, this project has a strong political background.[74]

Russia claimed that the conditions imposed on OPAL GT constituted a *de facto* quantitative import restriction on Russian natural gas that was inconsistent with Article XI:1 of the GATT 1994, which provides, in relevant part, that '[n]o prohibitions or restrictions other than duties, taxes or other charges … shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party'.[75] Given that the OPAL Decision 'described the capacity cap as an annual 50% cap on the "exit capacity" of OPAL *at the Czech border*',[76] the first question that the Panel had to address was whether the OPAL Decision is an internal EU regulation, or a border measure.

This question was of a threshold nature determining the applicability of Article XI:1 to the measure at issue. The GATT 1994 draws a fundamental distinction between border measures in the form of quantitative prohibitions or restrictions, which are addressed in Article XI:1, and internal regulations, which are subject to the national treatment obligation in Article III:4 of the GATT 1994. The purpose of this distinction is to limit the reach of Article XI:1, which could otherwise capture a wide array of internal regulations, most of which would have some restrictive effect on imports.[77] While *different aspects* of the same measure may fall under these two provisions,[78] *one and the same aspect* of the measure cannot be considered as both an internal regulation and a border measure. In this respect, Ad note to Article III states that 'any law, regulation or requirement … *which applies to an imported product and to the like domestic product* and is … enforced in the case of the imported product at the time or point of importation, *is nevertheless to be regarded as an internal … regulation or requirement …, and is accordingly subject to the provisions of Article III*' (emphasis added). Thus, a measure that, by its very design and structure, is an internal regulation applicable to both domestic and imported like products cannot fall within the scope of, and, consequently, violate, Article XI:1.

In light of this guidance, to determine the applicability of Article XI:1, a panel would normally assess whether the challenged measure applies *to both imported and domestic like products*. As clarified by the panel in *Indonesia–Chicken*, 'this does not mean that the *"identical"* measure must apply to like domestic products; rather, that there is *an equivalent measure* for like domestic products'.[79] In the present case, for example, the Panel could have examined whether an infrastructure exemption with conditions similar to those imposed on OPAL GT could be granted, or were granted, to pipeline networks carrying natural gas of domestic origin. In some disputes,

[74]The development of the Nord Stream–OPAL pipeline route has faced political opposition from opponents both within and outside the EU. For example, Poland – the host country of a competing pipeline project Yamal – and its State company PGNiG, as well as Ukraine's national oil and gas company, Naftogaz, challenged the 2016 OPAL Exemption Decision (revising the original 2009 Decision) before the Court of Justice of the EU and a German national court. See Case T-849/16, *PGNiG Supply & Trading* v. *Commission* (ECLI:EU:T:2017:924); Case T-849/16 R (ECLI:EU:T:2017:544) and the appeal C-117/18, *PGNiG Supply & Trading* v. *Commission*; and T-196/17, *Naftogaz of Ukraine* v. *Commission* (ECLI:EU:T:2018:140). At the time of writing, the proceedings before the Court of Justice of the EU initiated by Poland and PGNiG were still pending. However, the action of Naftogaz was dismissed as inadmissible.

[75]*EU–Energy Package*, n. 1 above, para. 7.976.

[76]Ibid., para. 7.995.

[77]GATT Panel Report, *Canada – Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, BISD 30S/140, para. 5.14. Unlike the prohibition on import restrictions in Article XI:1, the national treatment obligation in Article III:4 does not prevent Members from applying regulatory measures that have some restrictive effect on imports, as long as they do not discriminate between imported and domestic like products.

[78]Panel Report, *Indonesia — Measures Concerning the Importation of Chicken Meat and Chicken Products*, WT/DS484/R and Add.1, adopted 22 November 2017, para. 7.185.

[79]Ibid., para. 7.192, emphasis added.

the distinction between border and internal measures was also drawn by assessing whether the application of the challenged measure was triggered by internal factors, which occurred after the product had already been imported.[80] In the present case, the application of the EU's competition rules could arguably have been such a factor.

The Panel chose a different approach, however, focusing its inquiry on the restrictive effect of the measure on Gazprom's ability to import its natural gas via the Nord Stream–OPAL pipeline route. The Panel noted that due to 'the fixed nature of pipeline infrastructure and the necessity for natural gas transported by pipeline to flow along predetermined paths and to be imported through a limited number of fixed entry points', the exit conditions imposed on OPAL GT at the Czech border could have an effect on the entry conditions and, consequently, on the importation of Russian gas through this route.[81] For the Panel, this was sufficient to establish the applicability of Article XI:1 to the OPAL Decision.

After addressing the threshold question, the Panel analyzed whether the OPAL Decision constituted a quantitative restriction inconsistent with Article XI:1. The Panel upheld Russia's claim based on the following considerations: (i) the OPAL pipeline transports natural gas exclusively of Russian origin, exported by Gazprom; (ii) the '50% capacity cap' applies to Gazprom; and (iii) Gazprom can, therefore, utilize only 50% (as opposed to 100%) of the OPAL pipeline's capacity.[82] At the same time, the Panel found it irrelevant that: (i) the OPAL Decision does not extend to Russian gas suppliers other than Gazprom, such as Novatek, which do not export natural gas to the EU, because of Gazprom's export monopoly on natural gas under Russia's domestic law; and (ii) other opportunities for the importation of natural gas by Gazprom exist in the EU market, such as using other pipeline routes, including through Belarus or Ukraine, or selling gas at Greifswald's entry point.[83] Thus, the Panel's finding of inconsistency of the OPAL Decision with Article XI:1 was based on what the Panel considered to be a limiting effect of this measure on imports of Russian natural gas supplied by a major importer of this commodity to the EU.

The Panel's analysis raises an important systemic question of how a distinction between border and internal measures must be drawn in the context of network-bound trade. The Panel's approach may have been driven by the particular features of natural gas as a commodity that must necessarily be transported through fixed infrastructure. While, for most goods, conditions imposed after importation would be considered internal measures and would thus fall outside the scope of Article XI:1, the Panel considered that, in the case of natural gas, a broader view has to be taken.[84]

The Panel's overall analysis of the WTO-consistency of the OPAL Decision may also have been informed by the Panel's apparent understanding that this measure was largely a political tool to limit artificially the dominant position of Gazprom in the EU's gas market, and to force Gazprom to utilize the existing gas transit routes through Belarus–Poland and Ukraine. Given that, due to the geographic location of the OPAL pipeline, no third parties could effectively utilize the remaining 50% of its capacity, the measure objectively did not have a strong economic rationale.[85] The political nature of this measure is further confirmed by the fact that the more recent 2016 OPAL Exemption Decision, which revised the 2009 OPAL Decision, lifted the '50% capacity

[80]Appellate Body Reports, *China – Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R / WT/DS340/AB/R / WT/DS342/AB/R, adopted 12 January 2009, paras. 158, 162.

[81]*EU–Energy Package*, n. 1 above, paras. 7.994–7.996.

[82]Ibid., para. 7.997.

[83]The Panel stated, albeit without much elaboration, that 'Russian natural gas imported via other pipelines goes to other EU destinations and cannot be substituted for natural gas that could have been transported through the additional capacity on the OPAL pipeline'. Ibid., paras. 7.998–7.999, footnotes 1693–1694.

[84]See ibid., paras. 7.15, 7.994. The network dependence of gas trade is discussed in greater detail in Pogoretskyy (2017), n. 46 above, pp. 46–48.

[85]*EU–Energy Package*, n. 1 above, footnote 1687. See also n. 74 above; and K. Yafimava (January 2017), 'The OPAL Exemption Decision: Past, Present, and Future', OIES PAPER: NG 117.

cap'.[86] If the EU had wished to defend the OPAL Decision based on public policy grounds, such as compliance with its antitrust rules, it could have invoked Article XX(d) of the GATT 1994 as a defense. This provision allows Members to adopt measures that are necessary to secure compliance with laws or regulations which are not themselves GATT-inconsistent. However, the EU did not do so.

3.4 Russia's Claim against the Third-Country Certification Measure

Russia also challenged the third-country certification measure in the domestic laws of Croatia, Hungary, and Lithuania implementing the EU Gas Market Directive, which establishes procedures for the certification of TSOs by the EU Member States' NRAs and the EU Commission. When a TSO is controlled by a person from a third country, the certification procedures must include the assessment of whether the certification 'will not put at risk the security of energy supply' in the relevant EU Member State or in the EU at large. In contrast, in the case of domestic TSOs, the 'security of supply' assessment is not required.[87] Given that this measure applies only to TSOs controlled by foreign entities, Russia claimed that it is inconsistent with the national treatment obligation in Article XVII:1 of the GATS. Pursuant to this provision, 'each Member … [must] accord to services and service suppliers of any other Member … treatment no less favourable than that it accords to its own like services and service suppliers'.[88]

While the EU did not dispute the existence of discrimination under Article XVII:1,[89] it maintained that the third-country certification measure was necessary to ensure the EU's security of energy supply and hence to maintain public order within the meaning of a general exception in Article XIV(a) of the GATS. To substantiate its defense, the EU had to prove, first, that the measure was provisionally justified under the sub-paragraph (a) of Article XIV, and, second, that it fulfilled the requirements of the *chapeau* of Article XIV.[90] The EU's defense under the sub-paragraph (a) was based on the following main considerations, with which the Panel agreed:

- Security of energy supply is a 'fundamental interest of society' in the EU to which foreign control of TSOs may pose a 'genuine and sufficiently serious threat' within the meaning of footnote 5 to Article XIV(a).[91] This is because foreign governments have the means to require or induce foreign-controlled TSOs to undermine the EU's energy security, which may, in turn, have 'severe social, economic and, ultimately, political consequences' for the EU.
- The measure was designed to ensure the EU's security of energy supply and 'is manifestly apt' to contribute to this objective as it, *inter alia*, 'involves [an *ex ante*] "screening mechanism which allows the competent authorities to detect and assess in advance the potential risks to [energy security]"'.

[86]Commission Decision of 28.10.2016 on Review of the Exemption of the Ostseepipeline-Anbindungsleitung from the requirements on third party access and tariff regulation granted under Directive 2003/55/EC, Brussels, 28.10.2016 C (2016) 6950 final.

[87]At the time of the adoption of the Third Energy Package, the third-country certification measure under Article 11 of the EU Gas Market Directive was also called 'Lex Gazprom', as, in some analysts' view, it was clearly intended to target primarily Gazprom to restrict its presence in the EU gas markets. A. R. Willems, J. Sul, and Y. Benizri (2009), 'Unbundling As a Defence Mechanism Against Russia: Is the EU Missing the Point? ', *OGEL* 2, www.ogel.org.

[88]*EU–Energy Package*, n. 1 above, para. 7.1079. Article XVII:1 applies only to services and the modes of supply with respect to which the WTO Member concerned undertook specific commitments on national treatment in its GATS Schedule. The Panel found that Croatia, Hungary, and Lithuania took such commitments with respect to the supply of pipeline transport services via a commercial presence. Ibid., paras. 7.362, 7.365, 7.370.

[89]Ibid., para. paras. 7.1117, 7.1121.

[90]Ibid., para. 7.1138.

[91]Footnote 5 states: 'The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.'

- The measure's trade restrictiveness is limited as in reality 'all applications for third-country certification have so far been granted'.
- Russia did not demonstrate that a reasonably available less-trade-restrictive alternative measure existed, which would achieve an equivalent level of protection of the EU's objective.[92]

The Panel, however, found that the measure did not pass the legal test of the *chapeau* of Article XIV, which requires that 'measures [be] not applied in a manner which would constitute a means of *arbitrary or unjustifiable discrimination* between countries where like conditions prevail' (emphasis added). In particular, the Panel considered that similar threats to the security of gas supply were posed by both foreign and domestic TSOs. In particular, the Panel saw 'no reason to conclude that there is no risk of domestic persons having commercial interests and/or personal and family links in foreign countries, which would render them vulnerable to requirements and inducements emanating from foreign governments'.[93] On this basis, the Panel found it unconvincing that the 'security of supply' assessment was required only with respect to foreign-controlled entities, while domestic TSOs were certified without any such assessment.[94]

One drawback in the Panel's examination of the EU's defense is that, in determining the 'necessity' of the 'security of supply' assessment for the fulfillment of the EU's objective under sub-paragraph (a), the Panel did not examine sufficiently the *content* of the measure, i.e. *how precisely it operates in practice*. While it is clear that the measure involves an *ex ante* 'screening mechanism', the Panel did not assess *the specific criteria* on the basis of which the screening is conducted by the EU Commission and the relevant NRAs. For example, are these criteria of a purely political, discretionary, or technical nature? Without answering this question, it would appear difficult to assess properly the alleged contribution of the measure to its stated objective or its trade restrictiveness.

The Panel's cursory analysis of these issues may be explained by its reluctance to interfere with the EU's discretion as to which measures it considered were 'necessary' to fulfill the objective of energy security, which is 'a fundamental interest of society' in the EU and may be threatened by politically motivated measures of energy-exporting Members. That said, the amount of deference the Panel gave to the EU in its assessment of the consistency of the third-country certification measure with sub-paragraph (a) is unusual. In such assessments, panels have traditionally been lenient only with respect to the first element of their analysis – whether the challenged measure was designed to protect one of the objectives listed in general exceptions, such as the protection of public order in Article XIV(a). The analysis of the other elements, such as the alleged contribution of the challenged measure to its stated objective and its trade-restrictiveness, has so far been more rigid.

3.5 Russia's Claims against the TEN-E Measure

The last challenged measure, the TEN-E measure, consists of certain provisions of the EU Regulation on Trans-European Networks for Energy, which (i) set forth the criteria for the PCI designation of energy infrastructure projects; and (ii) established regulatory and financial incentives to facilitate the implementation of such projects. In order to be designated as a PCI project, the infrastructure must meet certain specific criteria that relate to market integration, sustainability, and/or security of supply, including contribution to diversification of gas supply sources.[95] Russia claimed that the criterion of 'diversification' discriminated *de facto* against

[92] *EU–Energy Package*, n. 1 above, paras. 7.1148–7.1156, 7.1171–7.1202, 7.1207, 7.1213–7.1224, 7.1226, 7.1228, 7.1239.
[93] Ibid., para. 7.1250.
[94] Ibid., paras. 7.1241–7.1254.
[95] Ibid., paras. 2.52–2.60, 7.1267–7.1269; Article 4 of Regulation (EU) No. 347/2013, n. 5 above.

natural gas of Russian origin within the meaning of Articles I:1 (MFM) and III:4 (national treatment) of the GATT 1994.[96] Thus, to resolve Russia's claims, the Panel had to interpret the meaning of this criterion, in particular whether it required the diversification from Russia as a source of natural gas supply.

The Panel acknowledged that the TEN-E measure itself did not define the concept of 'diversification of gas supply',[97] nor did the measure refer to Russia in any way. The Panel, however, observed that in the context of certain priority gas corridors of the EU in which the TEN-E measure incentivized the development of additional infrastructure (such as the Baltic Energy Market Interconnection Plan), the measure referred to diversification away from '*a single supplier*'.[98] The Panel then read these references in the context of a blueprint prepared by the EU Commission, identifying *Russia* as that supplier.[99] On this basis, the Panel found that the measure operates 'to bring within the scope of [certain gas] corridors projects developing infrastructure aimed at connecting a number of EU member States with sources of natural gas supply *other than Russia*', by providing these projects with financial and regulatory incentives.[100] The Panel stated that 'by this means, the TEN-E measure provides more favourable conditions for the transportation of natural gas of any origin other than Russian', and, therefore, discriminates against natural gas of Russian origin in a manner inconsistent with Articles I:1 and III:4 of the GATT 1994.[101]

The EU's defense was based on a general exception in Article XX(j), which allows Members to take measures 'essential to the acquisition or distribution of products in general or local short supply'. The EU argued that natural gas *may become* such a product in the event of the disruption of the gas supply, since 'the transmission of gas requires especially dedicated fixed infrastructure that is costly and time-consuming to build'.[102] However, the Panel found that Article XX(j) concerns only situations where a product is '*presently in short supply*', but not situations where a product is being at risk of becoming in short supply in the future. The Panel thus rejected the EU's defense.[103]

The Panel's analysis raises two systemic questions for WTO Members at large. The first question is whether a measure may be considered to have a detrimental impact on the competitive opportunities of products of a certain origin within the meaning of Articles I:1 or III:4 (e.g. Russian gas) when it in fact aims to correct the inequality of competition between these products and products of other origins, due to the underdeveloped infrastructure between consumers and the alternative sources of supply. This question is particularly pertinent in the context of network-bound trade, where there is no market without a sufficiently developed infrastructure, such as gas pipelines and LNG terminals, the construction of which normally costs billions of euros in investments and takes many years.[104] The lack of adequate energy interconnectors in the EU led to a situation in which, in 2013, Russia was a single or predominant gas supplier in many of its Member States, with the following market shares: 'Austria (63%), Bulgaria (100%), Czech Republic (100%), Estonia (100%), Finland (100%), Greece (67%), Hungary (95%), Latvia (100%), Lithuania (100%), Poland (77%), Romania (92%), Slovenia (58%) and Slovakia (100%)'.[105] In these circumstances, one can hardly argue that, at the time of the adoption of

[96] *EU–Energy Package*, n. 1 above, paras. 7.1262–7.1263, 7.1265–7.1266, footnote 2054.

[97] Ibid., para. 7.1269.

[98] Ibid., para. 7.1275 (referring to Annex I.2(8) of Regulation (EU) No. 347/2013) and para. 7.1277.

[99] Ibid., paras. 7.1275–7.1278 (referring to the European Commission's communication 'Energy Infrastructure Priorities for 2020 and Beyond — A Blueprint for an Integrated European Energy Network' (COM(2010) 677 final of 17 November 2010), p. 34).

[100] Ibid., para. 7.1281, emphasis added (and paras. 7.1282–7.1285, 7.1298–7.1286, 7.1298–7.1300).

[101] Ibid., para. 7.1312 (and paras. 7.1300–7.1301, 7.1313).

[102] Ibid., para. 7.1336.

[103] Ibid., paras. 7.1348–7.1350 (referring to Appellate Body Report, *India–Solar Cells*, para. 5.90; and Panel Report, *India–Solar Cells*, para. 7.250).

[104] Pogoretskyy (2017), n. 46 above, pp. 44–48.

[105] *EU–Energy Package*, n. 1 above, footnote 2089.

the TEN-E measure, there was a completed gas market at an EU-wide level with the effective gas-to-gas competition, where consumers could choose freely between different sources of gas supply.[106] Hence, the TEN-E measure has aimed to correct this problem by, *inter alia*, incentivizing the development of infrastructure carrying gas from sources other than Russia and interconnections between fragmented EU gas markets. This does not necessarily mean that the competitive opportunities of Russian gas are diminished. Russian gas is already a predominant or a single source of supply in many markets of the EU, and is delivered to those markets via numerous existing pipeline networks, many of which were built decades ago during the Soviet era. Thus, one may argue that the TEN-E measure does not discriminate against Russian gas and does not place it at a disadvantage *vis-à-vis* natural gas of other origins. Rather, by breaking Gazprom's monopoly in certain of the EU Member States, the TEN-E measure forces all market participants to compete on an equal footing.[107]

But, even if measures correcting the inequality of competitive opportunities between goods of different origins would violate Articles I:1 or III:4,[108] the second question is whether such measures may be justified under GATT general exceptions, other than Article XX(j). The main implication of the Panel's findings is that measures that, through regulatory or financial incentives, aim to diversify away from a monopolistic supplier, or to promote infrastructure connections between an importing WTO Member and other Members with which the importing Member would otherwise not trade, will likely be inconsistent with Articles I:1 or III:4. One exception that Members could try to use to justify such measures is Article XX(d) of the GATT 1994, which, as noted, allows Members to adopt measures that are necessary to secure compliance with laws or regulations but that are not themselves GATT-inconsistent, including laws and regulations governing competition and energy security.

4. Concluding Remarks on the Implications of the Panel Report for the EU's Internal Gas Market and Energy Security

Although Russia advanced multiple claims against the Third Energy Package, the Panel found only limited inconsistencies with WTO law, while largely recognizing the EU's freedom to pursue its regulatory reforms in the natural gas market. In particular, the Panel did not find the EU's long-standing policy of unbundling the VIUs' pipeline activities from their other gas market activities, such as production or supply, to violate WTO rules. Similarly, the Panel did not take issue with the EU's approach to regulate differently the activities of the operators of pipeline networks and LNG facilities.

A key message of the Panel's adverse findings against the EU is that measures to diversify away from Russian gas – either through restrictions on a pipeline capacity that may be used by Gazprom to transport its gas or the advantageous treatment of natural gas of non-Russian origin in the promotion of pipeline infrastructure projects – will likely be found to violate WTO law.

[106]This is confirmed in the TEN-E measure itself. See recital 5 of Regulation (EU) No. 347/2013, n. 5 above. See also the European Commission's communication, n. 99 above, p. 7 ('[d]eveloping our energy infrastructure will not only enable the EU to deliver a properly functioning internal energy market, it will also enhance security of supply'). Although, with the passage of time, the EU's gas networks continue to expand and this problem is becoming less acute, the existence of infrastructure bottlenecks in the EU's internal gas market, preventing free gas flows, underinvestment in energy facilities, and the overreliance on a single supplier, such as Russia, are not completely in the past.

[107]The Appellate Body has, for example, clarified that 'Article III:4 … seeks to preserve *equality* of competitive opportunities for imported products as compared to like domestic products'. Appellate Body Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, adopted 19 January 2010, para. 305, emphasis added. This suggests that measures that seek to correct an inequality of competitive opportunities between products of different origins, which was created due to a market failure (such as the lack of adequate infrastructure), should not fall afoul of this provision, as well as the MFN obligation in Article I:1.

[108]This appears to be the Panel's position in *EU–Energy Package*, n. 1 above, paras. 7.1319–7.1321.

The Panel's findings were appealed by both the EU and Russia and the precise outcome of the dispute is, therefore, still uncertain. However, assuming for the sake of argument that the Appellate Body were to uphold the Panel's findings, the EU and its Member States may have to take the following implementing measures to bring themselves into conformity with their WTO obligations. These measures would require changes in the EU's regulation of its internal gas market and may potentially have an impact on the EU's energy security.

The Panel's finding regarding the WTO-inconsistency of the OPAL Decision suggests that any regulatory restriction on a pipeline capacity that Gazprom requires for the transportation of its natural gas via pipelines may be seen as inconsistent with Article XI:1, unless justified under a general exception of the GATT 1994. On 28 October 2016, the OPAL Decision was modified. Under the new regime (the 2016 OPAL Exemption Decision), Gazprom may now use up to 80% of the OPAL pipeline's transmission capacity, and, with no third-party demand for capacity, Gazprom could potentially use the full capacity of the pipeline.[109] It remains to be seen whether the new OPAL Decision has resolved the EU–Russia dispute over this measure. Unlike the previous regime for the OPAL pipeline that could only be explained by politically driven decision-making, the new regime represents a move towards a more market-driven approach.

To implement the Panel's finding on the WTO-inconsistency of the third-country certification measure, Croatia, Hungary, and Lithuania may have to create a certification regime for domestic TSOs. The EU may also have to extend PCI designations to projects that would transport Russian gas. The essential drawback of such an amendment to the TEN-E measure is that the EU would have to allocate its budget for PCI projects that do not contribute to, but rather undermine, the EU's objective of diversification and that increase even more the EU's reliance on Russia as its major supplier of natural gas. Alternatively, the EU and its Member States could repeal these two measures. This would, however, limit the ability of the EU authorities to detect potential risks for the EU's energy supply security during the certification of foreign TSOs and to promote the development of energy infrastructure of strategic and economic significance for the EU.

As in the case of the Panel's finding on the OPAL Decision, the Panel's findings on the TEN-E measure essentially suggest that the EU should rely more on market signals to achieve the completion of its internal gas market and the objectives of diversification and security of supply. Due to the recent increase in cross-border interconnectors with reverse flow capabilities, LNG, and storage facilities, the EU's gas market is now very different from how it looked at the time of the adoption of the Third Energy Package and the TEN-E measure. It is more diverse in terms of both suppliers and supply routes and less vulnerable to security of supply risks.[110] In light of these recent developments, easing its reliance on the 'administrative market creation' model may not be a bad idea for the EU.

The EU–Russia gas relations are complex. While it is clear that, from a commercial perspective, both parties are mutually dependent and locked into each other, it is equally clear that strong tensions exist between their political objectives. As noted earlier, these tensions are not unique to EU–Russia energy relations, but are common for upstream – downstream country relations in general. The existence of a neutral dispute resolution mechanism, such as that in the WTO, to defuse some of the tensions is a necessary and important component of international energy trade.

[109]Commission Decision n. 86 above.

[110]ACER, CEER (2018), 'ACER Market Monitoring Report 2017 – Gas Wholesale Markets Volume', www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202017%20-%20Gas%20Wholesale%20Markets%20Volume.pdf (11 April 2019).

Cite this article: Pogoretskyy V, Talus K (2019). The WTO Panel Report in *EU–Energy Package* and Its Implications for the EU's Gas Market and Energy Security. *World Trade Review* 1–19. https://doi.org/10.1017/S1474745619000260