WEAPONIZING ENERGY: ENERGY, TRADE, AND INVESTMENT LAW IN THE NEW GEOPOLITICAL REALITY

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ABSTRACT

Concerns over the weaponization of energy during the war in Ukraine have revived state anxieties about overreliance on certain foreign energy sources. This Essay argues that instruments of energy trade and investment protection have helped to lock states into dangerous dependencies. Trade and investment law can inhibit energy security strategies designed to diversify away from unreliable sources and to block suspicious investors. With energy used as a weapon, reform of the liberal energy regime is needed to allow states to prevent the creation of dependencies and protect their energy security in the new geopolitical reality.

I. INTRODUCTION

The Russian invasion of Ukraine in February 2022 triggered a fundamental rethink of states’ reliance on Russian energy and energy infrastructure. The European Union (EU) has agreed to “phase out its dependency on Russian gas, oil and coal imports as soon as possible.”1 Banning the import of Russian energy aims both to undermine Russia’s ability to finance its military operations in Ukraine, and to impose a cost on Russia for its invasion.2 At the same time, ending reliance on Russian energy is now seen as a strategic priority to protect the EU against the use of energy “as an economic and political weapon,”3 because Russia has disrupted gas supplies to Europe and threatened the secure operation of critical energy infrastructure.4

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4 See, e.g., David Sheppard, Tom Wilson, Guy Chazan & Roman Olearchyk, Russia Reduces Gas Exports to Germany and Italy in “Political” Move, FIN. TIMES (June 15, 2022), at https://www.ft.com/content/1e972cf5-f42b-4cd8-b81b-6969dd91ccfd; Marek Strzelecki, Tsvetelia Tsonova & Pavel Polityuk, Russia Halt Gas Supplies to Poland and Bulgaria, REUTERS (Apr. 28, 2022), at https://www.reuters.com/world/poland-bulgaria-
Reducing dependence on Russian energy is a radical departure from the principles that govern the liberal energy regime, as embodied in the International Energy Charter and the Energy Charter Treaty (ECT) (which the EU helped to establish). In the liberal view, cooperation, liberalization of energy trade, and the promotion and protection of energy investments are necessary to achieve energy security. By contrast, geopolitical analysis emphasizes how certain states can seek control over critical energy infrastructures abroad—usually through state-owned enterprises (SOEs)—to influence foreign policy decisions by the host state and retaliate against unfriendly acts. Russian control over the gas pipelines in the former Soviet Union and Europe is often presented as a textbook example of the “weaponization” of energy infrastructure dependencies, with the Russian SOE Gazprom acting as the “arm of the Kremlin” in pursuit of foreign policy goals. The Russian invasion of Ukraine, and the subsequent disruption of gas supplies to Europe, requires a searching analysis of how the liberal energy regime has helped to create undesirable dependencies, and how states can avoid running similar geopolitical risks in the future.

With a focus on foreign-controlled gas pipeline infrastructure, this Essay argues that instruments of liberal energy trade and investment policy have contributed to locking states into dangerous dependencies that are now at the center of energy security concerns. International trade and investment law can also constrain future strategies aimed at reducing these dependencies through diversification, energy security reviews, and nationalization. There is now an increasing awareness that foreign control over energy infrastructures, and thus energy flows, has an important strategic dimension that has long been overlooked or downplayed. In this new geopolitical reality, international energy, trade, and investment law must be reformed to allow states adequately to respond to the weaponization of energy, without neutralizing the contribution of the liberal trade and investment instruments to cost-efficient energy supply. This Essay first considers the threat posed by infrastructure and supply dependencies. Then, it analyzes the trade and investment law implications of state measures designed to counter strategic threats of this kind. The Essay concludes with proposals for reforming international energy, trade, and investment law to allow states greater discretion to protect their energy security.
II. THE WEAPONIZATION OF ENERGY

A. Energy Dependence and Geopolitical Influence

The Russian invasion of Ukraine has revived concerns that overdependence on a single energy supplier, and its control over critical energy infrastructure, can be used much in the same way as military coercion for an adversary to achieve strategic objectives.9 In EU–Energy Sector, a World Trade Organization (WTO) panel recognized that there was a risk that foreign-controlled gas pipeline system operators could interrupt gas transmission in extreme periods of cold, disclose confidential information to foreign governments, fail to invest in and maintain the pipeline network, and refuse to provide access to competing gas sources.10 Foreign governments might have both the means and the incentives to require their energy companies to engage in such actions.11 For instance, a gas-exporting state might try to prevent importing states from diversifying their sources of supply so as to maximize gas exports.12 A foreign government might also seek to gain leverage on unrelated political issues or retaliate in response to perceived threats to national interests. Given the economic and social importance of energy, disruptions to energy supply could threaten public order.13

In the EU, views of the Nord Stream 1 and Nord Stream 2 pipelines, which directly connect Russia to Germany via the Baltic Sea, illustrate how attitudes toward Russian energy and Gazprom’s control over gas infrastructures have changed. The Nord Stream 1 pipelines began operation in 2011 and 2012; they benefited from EU support because they diversified gas import routes. By contrast, Nord Stream 2, due to come into operation in 2022, has recently been repudiated by the West. The Nord Stream 2 pipelines would have allowed Russia to “achieve aggressive political ends by using energy as a weapon.”14 For the United States, the project is a central aspect of Russia’s strategy to use “energy as a tool of coercion and political leverage” and “make European countries dependent on Russia for energy supplies, so as to increase this political leverage.”15 Following Russia’s invasion of Ukraine, the EU has decided that the security risks associated with increased dependence on Russian gas are unacceptable.16 Germany has halted its certification of the investment, effectively preventing the pipelines from coming into operation.

11 Id., paras. 7.1186, 7.1182.
12 Id., para. 7.1174.
13 Id., para. 7.1197; see also DANAE AZARIA, TREATIES ON TRANSIT OF ENERGY VIA PIPELINES AND COUNTERMEASURES 232 (2015).
16 European Parliament Resolution of 7 April 2022 on the Conclusions of the European Council Meeting of 24–25 March 2022, Including the Latest Developments of the War Against Ukraine and the EU Sanctions
In the former Soviet space, Gazprom’s investments and subsidized gas supplies are commonly understood to be part of Russia’s strategy to maintain control over its sphere of influence and exclude foreign influence. As documented in the literature on Russian external energy relations, promises of discounted gas, combined with the threat of price increases and interruption of supply, have been used to pressure Russia’s energy-poor neighbors into surrendering control over their gas infrastructure. Belarus, Armenia, and Kyrgyzstan sold their gas infrastructure to Russia thereby accepting far-reaching constraints on their energy sovereignty. However, the Ukrainian Parliament has denounced the possibility of selling the Ukrainian gas transit system to Gazprom as a “betrayal of national sovereignty.”

B. The Role of Energy Agreements

According to liberal investment theory, the international protection of energy investments contributes to energy security and to the cost-efficient supply of energy by addressing the political and regulatory risks investors face in the energy industry. For instance, the EU proposed the ECT in 1994, arguing that ambitious investment protection standards would facilitate the development of the energy resources of the former Soviet states and contribute to EU energy security. However, given increasing concern about the strategic use of energy investments, a critical reassessment of the role of international investment agreements in establishing energy dependencies is needed. The literature on the imperialist origins of international investment law provides a useful theoretical basis for this analysis, by conceptualizing investment law as an instrument of control to protect the exporting state’s interests abroad and to keep host states in relations of dependency. Unlike imperial powers, which used state-controlled entities (e.g., the Anglo-Iranian Oil Company) to control the resources of energy-rich host states, Russia—through Gazprom—uses its natural gas wealth to secure influence over energy-poor states.

Russia has concluded a number of bilateral investment agreements that both protect Gazprom’s foreign investments and monopolize its gas supply activities in the host states, with serious energy security implications. For instance, Russia’s agreements with Belarus, Armenia, and Kyrgyzstan established the right of Gazprom’s subsidiary in the host state to


18 Balmaceda, supra note 8; Margaret M. Balmaceda, Russian Energy Chains: The Remaking of Technopolitics from Siberia to Ukraine to the European Union (2021); Domitilla Sagramoso, Russian Imperialism Revisited: From Disengagement to Hegemony (2020).

19 Thane Gustafson, The Bridge: Natural Gas in a Redivided Europe 325 (2020).


continue to operate as a vertically integrated entity. That right means that these entities can combine the activities of production, supply, and transportation, ensuring the domination of the SOE over all segments of the gas industry in the host states. The Kyrgyz agreement has also guaranteed exclusive import rights to Gazprom, thereby preventing the host state from diversifying its gas imports and thus surrendering its security of gas supply to the Russian SOE. In addition, the prohibition of re-exports of Russian gas, through so-called “export bans” or “destination clauses,” has reinforced bilateral dependencies on Russia. Given the limited availability of alternatives sources of gas supplies in the region, prohibiting the re-export of Russian gas prevents the creation of a competitive market at the regional level, blocking the market liberalization policy promoted by the EU and United States to counter Russia’s energy influence in Eurasia. Russia’s agreements contain stringent investment protection provisions, including stabilization and nationalization clauses, and a dispute resolution clause that allows Gazprom to challenge in arbitration any breach of the agreement. Thus, Russia, through Gazprom, may use arbitration to enforce in its sphere of influence the dependencies secured through its investment agreements.

III. NEUTRALIZING THE ENERGY WEAPON

To neutralize the threats posed by infrastructure and supply dependencies, states can nationalize energy assets, unbundle pipeline from supply activities, screen investments for security risks, and diversify import routes. International energy, trade, and investment law constrain the implementation of each of these neutralization paths and would need to be reformed to rebalance the liberalization agenda with strategies to ensure energy security.

A. Nationalization

Nationalization is the most radical response to the perceived security threat posed by foreign control over critical energy infrastructure. Following Russia’s invasion of Ukraine, the German government placed Gazprom Germania GmbH under its administration, to ensure the secure operation of the critical gas infrastructure controlled by Gazprom’s subsidiary in


Europe. In parallel, the UK government announced its intention to nationalize Gazprom Marketing & Trading Retail Ltd., Gazprom’s retail arm in the UK. Russia has criticized these measures as serious violations of international law and simultaneously announced the nationalization of property belonging to entities registered in “unfriendly states.”

As confirmed by arbitral practice, states have the right to nationalize foreign investments on grounds of public security, provided they act in a non-discriminatory way and pay appropriate compensation. Measures that target energy investments from unfriendly states are “directed specifically against a certain investor by reason of his, her or its nationality” and may thus be difficult to justify under the non-discrimination test, particularly if the measure was taken by way of retaliation during a foreign policy dispute with the home state government. The German-Russian investment treaty clarifies that “measures undertaken in the interests of . . . security . . . shall not be regarded as ‘discriminatory measures.’” However, this clarification applies only to the most-favored-nation treatment clause of the treaty, and thus not to nationalization.

The options for overcoming the requirement that any nationalization not discriminate on the basis of nationality are limited. Although an essential security interests clause may exempt the host state from an obligation to pay compensation for measures to protect national security, many investment treaties, including Russia’s energy agreements with the former Soviet states and many of Russia’s bilateral investment treaties (e.g., with Germany and the UK), do not contain such a clause. Further, some agreements, such as the ECT, explicitly exclude expropriation from its essential security exception. In addition, recent investment arbitration decisions have limited security interests to military questions. This restrictive interpretation has been criticized for ignoring the complexity of security challenges springing from

31 See Noble Ventures, Inc. v. Romania, ICSID Case ARB/01/11, Award, para. 180 (Oct. 12, 2005).
34 The Protocol of the German-Russian investment treaty explicitly limits the clarification on security interests to Article 3, paragraph 4 of the treaty, according to which “each Contracting Party undertakes not to take discriminatory measures against joint ventures in which investors of the other Contracting Party are participants . . . .”
35 The ECT Exceptions clause (Article 24) explicitly provides that it does not apply to expropriation (Article 13).
foreign control over critical infrastructure, and fails to recognize the possibility to use the energy weapon in the absence of direct military confrontation.

Given how hard it is to reconcile measures targeting investors of a certain nationality with the non-discrimination principle, arbitral panels may well find unlawful the nationalization of energy investments from jurisdictions that are perceived as unfriendly, thus exposing the host state to high damages.

B. Unbundling

A state determined to address the security risks associated with vertically integrated energy companies like Gazprom might require the separation (or unbundling) of gas supply and production from the transportation of gas. The U.S. 2019 Protecting Europe’s Energy Security Act, for example, subjected the Nord Stream 2 pipeline to sanctions unless safeguards were put in place “to minimize the ability of Russia to use the pipeline as a tool of coercion and political leverage, including by requiring unbundling of energy production and transmission.”

There are different unbundling options, diverging in their degree of interference with investors’ rights and effectiveness in addressing security risks. EU law requires “ownership unbundling,” imposing on the owner and operator of a gas transmission pipeline system the obligation to be fully independent from any production or supply interests. Under certain conditions, EU member states can opt for the less intrusive “independent transmission operator” alternative, allowing vertically integrated entities to own transportation assets, provided that the operation of their transmission system is transferred to an independent company.

Russia and Gazprom have challenged the EU unbundling arrangements before the WTO and investment arbitration as a “political weapon” aimed at “ousting Gazprom from the EU gas market.” The WTO claim was unsuccessful. In EU–Energy Sector, the WTO panel agreed that requiring companies to choose between production/supply and pipeline transport treated companies less favorably than allowing an independent transmission operator alternative. However, this did not amount to de facto discrimination against Russian companies, because Gazprom also benefited from the independent transmission operator option in states where it was allowed. Other foreign companies also had to divest their shares in transmission systems in states where ownership unbundling was required. The panel also rejected the alleged bias of ownership unbundling against Russian gas, by ruling that this regime did not confer an advantage upon gas imports from other producers.

2017). See, however, Continental Casualty Company v. Argentina, ICSID Case No. ARB/03/9, Award, para. 180 (Sept. 5, 2008).


H.R. 3206, supra note 15.

Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas, Art. 9, 2009 OJ L211 94.

Id. Arts. 14–22.


Id., paras. 7.448, 7.584
Under investment law, ownership unbundling might raise potential tensions with the substantive standards of investment protection, including indirect expropriation, as the prohibition to jointly control production/supply and pipeline assets could force investors to divest one of these vertically integrated interests.\(^{45}\) By contrast, the independent transmission operator option is less likely to amount to a breach of investors’ rights as it allows for the continued ownership of both production and transmission infrastructure. However, by tolerating the ownership of pipelines by energy producers, this alternative is also less effective in addressing the threat posed by vertically integrated foreign conglomerates over strategic gas transmission assets.\(^{46}\) As only more intrusive corporate restructuring reforms can neutralize the weaponization of pipelines, states’ right to protect their energy security by requiring ownership unbundling should be recognized as part of states’ right to regulate under international investment agreements.

C. Energy Security Reviews

An increasing number of states now require investments in critical infrastructure to be certified after being screened for security risks. In the EU, an energy-specific screening mechanism, commonly known as the “Gazprom clause,” requires member states to evaluate the energy security risks posed by non-EU investors in transmission systems.\(^{47}\) On this basis, Germany halted the certification of the Nord Stream 2 pipeline in February 2022, pending a new security assessment in light of Russia’s invasion of Ukraine. The war in Ukraine also prompted the European Commission to call “for greater vigilance towards Russian and Belarusian direct investments,” given the “strong incentive [of these governments] to interfere with critical activities in the EU and to use their ability to control . . . investors in the EU for that purpose.”\(^{48}\)

Security reviews can block the commissioning of completed projects or expose existing investments to renewed scrutiny, so they might give rise to investment arbitration claims even if the host state did not undertake any pre-establishment commitment. As with nationalization, the difference in treatment of investors based on the perceived risk posed by their home state government might be in tension with the non-discrimination principle.\(^{49}\)

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\(^{46}\) For instance, in February 2022, the European Court of Justice decided that the transfer of Gazprom’s pipelines in Poland to an independent operator did not by itself provide sufficient proof that the Russian SOE did not engage in abusive infrastructure dealings at the demand of the Russian government. See Polskie Górnictwo Naftowe i Gazownictwo S.A. v. European Commission, Case T-399/19, Judgment of the General Court, paras. 39–98 (Feb. 2, 2022), at https://curia.europa.eu/juris/document/document.jsf?text=&docid=253224&pageIndex=0&doclang=EN&mode=list&dir=&occ=first&part=1&cid=13208601.

\(^{47}\) Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas, Art. 11, 2009 OJ L211 94.

\(^{48}\) Communication from the European Commission: Guidance to the Member States Concerning Foreign Direct Investment from Russia and Belarus in View of the Military Aggression Against Ukraine and the Restrictive Measures Laid Down in Recent Council Regulations on Sanctions, at 1, 2022/C 151 I/01, OJ 2022 C 151I (Apr. 6, 2022).

Energy security reviews can also conflict with WTO law. In EU–Energy Sector, the panel rejected Russia’s characterization of the Gazprom clause as de facto discrimination against Russian pipeline companies. However, it found that, for EU member states that committed to liberalizing pipeline services, the mechanism breached the national treatment obligation of the General Agreement on Trade in Services (GATS) by treating foreign companies less favorably than EU companies (which are not subject to review). In its assessment under the public order exception (GATS Article XIV(a)), the panel ruled that security of energy supply was a fundamental interest of society, to which foreign control of transmission systems can pose a genuine and sufficiently serious threat. The panel also agreed that national security reviews were “manifestly apt to address ex ante the threat to the European Union’s security of energy supply posed by foreign control over TSOs, [transmission system operators]” and were thus necessary to maintain public order. Still, the panel determined that the mechanism constituted an arbitrary and unjustifiable discrimination, since it failed to address the possible security risks associated with domestic investors in gas transmission systems, in particular those with commercial and personal interests abroad.

The panel’s decision, if upheld, can have major implications for states’ right to control foreign investments in strategic energy assets. As all major energy companies are active in overseas investment and trade, requiring security reviews for domestic investors with foreign commercial interests essentially amounts to assessing most existing investments in the EU energy sector. EU companies with investments in countries found to pose security risks might be required to either divest their interests abroad (a decision that many international energy companies active in Russia have taken in 2022 following the invasion of Ukraine) or in the EU, with potentially significant consequences for energy markets.

Compared to the public order exception, the WTO security exceptions (e.g., GATS Article XIVbis) afford states greater discretion to protect their essential security interests based on their “particular situation and perceptions.” However, this right has been interpreted to be limited to situations of “armed conflict, or of latent armed conflict, or of heightened tension or crisis, or of general instability engulfing or surrounding a state,” giving rise to “defence or military interests, or maintenance of law and public order interests.” “[P]olitical or economic differences” between states do not of themselves constitute an emergency in international relations.

While the security exception is likely to cover the investment measures taken in response to Russia’s aggression in Ukraine, it cannot provide exemptions from

53 Id., paras. 7.1249-51, 7.1253.
55 Panel Report, Russia, supra note 54, para. 7.76.
56 Id., para. 7.75; see also Tatiana Lacerda Prazeres, Trade and National Security: Rising Risks for the WTO, 19 WORLD TRADE REV. 137, 144 (2020).
restrictions imposed in times of peace to prevent foreign-controlled pipeline companies from establishing dangerous dependencies.

Given the constraints that WTO law imposes on energy security reviews (as seen in EU–Energy Sector), reform is needed to recognize energy as an essential security interest, and allow states under the public order exception to control foreign energy investments that security reviews identify as unfriendly.

D. Diversification

Where states are dependent on a single or predominant supplier, diversifying their sources of supply requires the development of pipeline or liquified natural gas infrastructure projects that connect the domestic system to alternative suppliers.57 Under EU law, new infrastructure projects that significantly contribute to the diversification of energy supply sources can benefit from regulatory exemptions and financial assistance.58 This policy, introduced in the mid-1990s, has successfully enabled certain member states to end their dependency “on a single supplier,” i.e., Russia.59 Diversification of supplies, and thus infrastructure routes, is now at the heart of the EU’s determination to phase out dependence on Russian fossil fuels in response to Russia’s invasion of Ukraine.60

WTO law can be an obstacle to the preventive implementation of infrastructure diversification strategies. In EU–Energy Sector, the panel found that, by increasing transport capacity for non-Russian gas and decreasing capacity for Russian gas, the EU infrastructure policy reduced the competitive opportunities for Russian gas vis-à-vis other sources, including domestic gas, in breach of the General Agreement on Tariffs and Trade (GATT) (Article I:1 and Article III:4).61 The panel also rejected the defense that infrastructure diversification was “essential to the acquisition or distribution of products in general or local short supply,” within the meaning of the GATT’s general exceptions regime (Article XX, para. j). The EU failed to demonstrate that gas was currently in short supply.62 Even if a shortage was proven, a demonstration that diversification of import routes would contribute to energy security would not by itself establish that diversification also contributes to the “acquisition or distribution” of gas.63

This finding, if upheld, creates an unreasonable obstacle to infrastructure diversification. Excluding the diversification of supply routes from measures “essential to the acquisition or distribution” of gas ignores the risk that energy exporters will block the sale and transportation of gas for geopolitical reasons, as illustrated by the disruption of Russian gas exports in 2022. Simultaneously, the limitation of the security exception, not invoked in EU–Energy Sector, to situations of armed conflict or heightened tension does not allow states to respond sufficiently early to the geopolitical threat posed by certain exporters. Given the long lead times required

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60 Communication, supra note 3, at 12.
62 Id. Similarily, see India–Solar Cells Report, supra note 51, para. 5.45.
for energy infrastructure projects, reform of international trade law is necessary to recognize the right of states to diversify away from certain sources and adjust their infrastructure to current geopolitical realities.

IV. ENERGY SECURITY REFORMS TO NEUTRALIZE THE ENERGY WEAPON

The Russian invasion of Ukraine has brought energy security back at the center of global energy politics, and placed the spotlight firmly on the weaponization of Russian fossil fuels and gas pipelines. Russia’s energy agreements illustrate how investment protection and investor-state arbitration, as well as trade arrangements, can be used to lock importing states into dependence on Russian energy. Similar concerns have been expressed regarding the energy infrastructure diplomacy of other major emerging powers and the creation of new import and infrastructure dependencies in the clean energy transition. The liberal energy model exacerbates these concerns by constraining energy security measures aimed at reducing dependencies on energy supply or investment from countries that are perceived to be unfriendly and have the ability to harm the energy security of others.

Reform of international energy, trade, and investment law is needed to enable states to protect their energy security and neutralize the weaponization of energy in the new geopolitical reality. The difficulty is in recognizing a sufficient degree of discretion for states to protect their energy security interests, while avoiding overly protectionist policies that put at risk the foundations of trade and investment law and undermine the contributions of these instruments to cost-efficient energy supply. On the one hand, security exceptions might trigger a return to “power-oriented techniques” at the expense of judicial dispute settlement procedures, and might increase the cost of energy supply if states are allowed to interfere with energy trade and investments without judicial control. On the other hand, there is a risk of a backlash if states are prevented from addressing their genuine energy security concerns, beyond narrow military and defense settings.

To help rebalance the liberal trade and investment instruments with greater discretion for states to mitigate the threat posed by foreign energy dependencies, energy security considerations have a role to play in the assessment of energy measures under the substantive trade and investment standards and security exceptions. First, energy security interests, and in particular states’ perception of threats to energy security, should be taken into account in the justification of differences in trade and investment restrictions. As “security is . . . a matter of perception rather than hard fact,” states are best placed to determine the nature of a threat to their security, and how to protect their energy security against this threat. Strategic alliances play a role in this assessment. Fears that a foreign-controlled energy company might exploit energy vulnerabilities might not exist if that company came from an allied state. Second, as energy dependencies are being used as alternative or additional weapons of war, security interests can

65 See, e.g., Daria Boklan & Amrita Bahri, The First WTO’s Ruling on National Security Exception: Balancing Interests or Opening Pandora’s Box, 19 World Trade Rev. 123, 135 (2020).
67 UNCTAD, supra note 49, at 17–18.
no longer be limited to military risks and tensions, but must also encompass the vulnerabili-
ities of critical infrastructures and resources. Energy security strategies require long-lead
adjustments to energy systems, and the right of states to diversify away from existing vulner-
abilities by building alternative import routes should therefore not be limited to periods of
heightened crisis. The imperative of energy security reforms is vital both for upholding the
demands of national security and assuring the continuing acceptability of international
energy, trade, and investment law.