

NON-PAPER

Structural and institutional elements for an Electricity Agreement between the EU and Switzerland

I. Introduction

This non-paper lays out a series of elements that may help overcome the deadlock in the discussions about the bilateral contractual relations between Switzerland and the EU.

In July 2010 the two sides agreed to set up a bilateral working group tasked with the search for solutions concerning horizontal institutional provisions allowing for a more structured relation for the future. For the ECom has consistently made such solutions a precondition for further bilateral undertakings. This position is broadly shared by the Council and the EP. However, in December 2011 Switzerland and the ECom had to recognize the failure of the attempt.

In the energy field negotiations on a bilateral electricity agreement between Switzerland and the EU have been on-going since 2007. While progress on the substantive part of such an agreement has been made, the lack of perspective on the key institutional provisions, increasingly affected the ability to conclude the negotiation.

It is against this backdrop that towards the end of last year the ECom tentatively agreed to establish a new bilateral working group with the mandate to identify institutional solutions that would be specifically tailored to the requirements of a bilateral electricity agreement. This move from a top-down to a bottom-up approach, with respect to the institutional aspects, has undoubtedly to do with the greater sense of urgency in view of the conclusion of such an agreement, namely in the light of the post-Fukushima developments in which mutual dependency and increased cross-border electricity flows are of the essence.

This change of paradigm appears to be a worthy window of opportunity. This said one has to be aware that the two sides haven't modified their fundamental positions. Hence there is a need to look for approaches that would allow for a swift conclusion of a "standalone" electricity agreement. At the same time, the institutional provisions of such an instrument would not only have to serve its good functioning, but be broadly in line with what the ECom would like to achieve more generally in relation to Switzerland.

Finally, it is also important to consider externalities, which might impact the negotiations between the ECom and Switzerland. Externalities such as Iceland's possible accession to the EU, Norway's EEA debate and the ECom's own review of the EEA Agreement are elements which cannot be disregarded, because they will inevitably influence the future institutional debate.

II. General Approach and key elements of an Agreement

This non-paper tries to combine two separate but closely connected questions.

The first and principal one relates to a better understanding of the specificity of the electricity sector with respect to the institutional dimension of a bilateral agreement between Switzerland and the EU. One of the specificities of electricity is that it typically requires a functioning and hence properly regulated integrated market. This may not be the case with other sectors. With this in mind, different variants are analysed for the three principal issues at stake, i.e.:

- the incorporation of current and future EU “acquis”,
- the creation of a surveillance mechanism, incl. for State aid, and
- the establishment of a judicial review.

The second question concerns the material and operational link between the specific institutional arrangements envisaged for an electricity agreement and the broader perspective of the future bilateral contractual relations between the two partners. Such a link is twofold:

- On the one hand, the institutional provisions proposed for an electricity agreement should be considered - or become - the building blocks for further agreements between the EU and Switzerland in the energy field and/or beyond.
- On the other hand, the two parties could recognize the legal relevance of such institutional solutions and formalise their commitment for further negotiations of a horizontal undertaking about the institutional underpinning of future Swiss/EU agreements (*clausula de negotiando*).

The institutional solutions could also serve as a basis for a fully-fledged energy agreement (also comprising gas and other related matters). The early conclusion of an electricity agreement would hence constitute either the core of or a first step towards a wider accord while for other “adjacent” fields there would be commitments to negotiate these in the future (“GATS style build-in agenda”).

Thus, the relation between the institutional provisions of an electricity agreement and the broader agenda for further bilateral agreements could become the linchpin of a package comprising both an early conclusion of that agreement and an accord in principle on the future bilateral contractual architecture. The non-paper will however not focus on this last aspect at this point in time.

III. Incorporation of current and future EU Acquis

The situation differs depending on whether one considers a standalone electricity agreement or an electricity pillar as part of a wider energy undertaking, including, gas, environment and other flanking measures (e.g. State aid, Public procurement and further market regulation). In the latter case, i.e. a wider energy undertaking, each “pillar” would constitute an Annex to such a broader agreement and contain the current relevant EU *acquis*. Hence, the Annex on Electricity would list Directive 2009/72/EC (“the third Electricity Directive”), which does, however, not exclude the possible of adaptations as appropriate; whereas the annex on

Environment could list, for example, Directive 2009/28/EC (“the RES Directive”). In the former case, i.e. a standalone electricity agreement, the exact delimitation of the coverage would represent more of a challenge.

As to the present and future EU *acquis* the main part of an agreement would clarify that “legal acts” referred to or contained in the annexes to the agreement are binding upon the Contracting Parties and be made part of their internal legal order. Far-reaching future market harmonisation, which will have a spill-over on the energy sector, will have to be dealt with on an *ad hoc* basis.

In order to ensure a dynamic incorporation of future EU *acquis*, these Annexes would remain “open” and allow for regular up-dating, as appropriate. This would be achieved by amending the respective annexes. These annexes could, in turn, be amended by incorporating references to relevant future EU *acquis* (reference technique).

The incorporation procedure for new EU *acquis* has long been and still is considered as one of the most sensitive areas as it touches upon the very interface between the EU decision making mechanisms and the institutional position of the other contracting party.

Fundamentally, there are two models for tackling the issue.

The first model, which can be considered as a downward delegation procedure, would be to delegate the incorporation procedure to a Joint Committee, composed of representatives from the EU and Switzerland. The Joint Committee would decide (by consensus) on the relevant EU *acquis* to be incorporated into the respective annexes. The Joint Committee would further decide on possible adaptations to the EU *acquis* to take account of specific Swiss circumstances.

Such a procedure would have to respect Swiss constitutional requirements: Even if decisions by the Joint Committee, on amendments to the annexes, constitute agreements of public international law, this would not mean that the Swiss Parliament would not play its part. A provision would need to make sure that a decision in the Joint Committee would be binding on Switzerland only after the fulfilment of the constitutional requirements. In any event, such a decision would only enter into force upon Switzerland’s notification to the EU that those requirements have been fulfilled.

If the partners cannot agree on an amendment to an annex, the Joint Committee would examine all further possibilities to maintain the good functioning of the Agreement and take any decision necessary to this effect, including the possibility to take notice of equivalent legislation. If the Joint Committee has not taken a decision on an amendment to an annex, the affected part thereof would be regarded as provisionally suspended, subject to a decision to the contrary by the Joint Committee.

The second model, rather an upward delegation procedure, would foresee Switzerland’s participation in the EU decision making bodies. This would imply that a Joint Committee be entrusted with the management for the development of future EU *acquis*. However, contrary to the first model, Swiss Ministers would participate in the relevant Council debates and procedures on new EU *acquis*.

In this case, Switzerland would be in a better position in its relation towards the EU, as opposed to Iceland, Liechtenstein and Norway via their EEA membership; a situation that would have to be corrected.

The two models differ from one another to the extent that in the former, Switzerland is expected to take over legislation which has already been adopted on the EU side, while in the latter, Switzerland would be directly exposed to the EU decision making process.

IV. Surveillance

EU-surveillance is entrusted to the ECom. At the same time, operational surveillance is undergoing an incremental transfer of competences to the various EU agencies and authorities. This affects not only EU Member States, but also EFTA States to the EEA Agreement. Thus, one can argue that the so called “two-pillar structure” of the EEA is witnessing an “erosion” due to the multiplication of EU agencies. In a variety of instances EFTA States to the EEA Agreement work directly with the respective EU agencies and, to that extent, no longer fall under the direct competence of the EFTA Surveillance Authority. Such cases in point are the agencies ECHA, EASA, EMSA, as well as others. All of these institutions have different powers, some wider some narrower, and that the degree of participation of EFTA States in these bodies, depend on their specificities and other national political considerations. EFTA States might be more inclined to accept the authority of an EU agency as directly binding for them, if the EU agency concerned deals with technical rather than with more political issues.

It is, for example, ACER - in conjunction with ENTSO-E – that decides on the operational issues regarding market access in the electricity sector. The tasks of ACER can be currently subdivided into the following categories: coordination between ENTSOs and NRAs, other functions regarding terms and conditions for access to and operational security of cross-border infrastructure, monitoring and reporting on the electricity and gas sectors. Some of the reporting may have to be shared with ESMA, namely in the trading field.

As a participant in ACER and ENTSO-E, Switzerland’s surveillance function under a bilateral agreement, for instance in the field of market access, would be carried out by the respective agency. Other and future competencies could equally be handled through Switzerland’s involvement in ACER. In other words, the participation of Switzerland in this EU agency could dispense already a significant part of “surveillance activities”, which otherwise would have required complex negotiations on an accepted surveillance regime. The launch of ACER is an important test for this “new generation” agency, as it will gradually assume more responsibility for the surveillance / oversight of the sector. However, because of the general uncertainties about the political and institutional trends within the EU it is difficult to anticipate the ultimate profile of ACER.

The general market surveillance function by the ECom in the electricity sector at EU-level concerns the following areas:

1. Monitoring and enforcing the application of Competition and State aid provisions.
2. Monitoring national transposition and application of EU law (classical infringement procedures).

Concerning the first function, in the case of Switzerland, the task could be entrusted to one of the existing Swiss agencies. For example, the Swiss Federal Electricity Commission (ElCom) and/or the Swiss Competition Authority (WEKO) could take care of the equivalent application and enforcement of competition provisions. In the area of competition law, WEKO is recognised by the ECom as a partner institution which applies and enforces competition law similar to the ECom. With regard to State aid, the competence of WEKO could be extended to a surveillance function, which would in turn ensure that State aid would not negatively affect the electricity trade between the EU and Switzerland. As Switzerland is member of the WTO, it could make reference to the application of the subsidy concept, which is mentioned in the WTO Subsidy Agreement, with a view to prohibit subsidies which again would affect the electricity trade between the EU and Switzerland. Hence, Switzerland would introduce the subsidy concept, already contained in the WTO Agreement, into the Electricity Agreement (with light modifications which would reflect requirements under the EU *acquis*). This said and as a matter of EU policy, the ECom has so far only admitted national surveillance in the area of State aid by third countries, for a limited period of time.

The second function relates to the monitoring of national transposition and application of EU law. Such a monitoring could either be entrusted directly to the ECom or to an adapted EFTA Surveillance Authority. Hence, Switzerland would inform the ECom (or the EFTA Surveillance Authority) of its implementing measures and application in order to enable it to review Swiss compliance. Sufficient transparency and complaint procedures for private operators would constitute flanking measures to guarantee an effective application of the agreement. If the ECom (or the EFTA Surveillance Authority) were to detect any shortcomings, it could start dispute settlement procedures, which would ultimately find its way to a competent Court.

V. Judicial Review

Disputes and interpretation of a bilateral electricity agreement could be assigned to an *ad hoc* EU-EFTA/Swiss Chamber on Energy/Electricity under the auspices of the EFTA Court. Such an undertaking could rest on existing structures in order to limit the administrative costs of the operation of the agreement. Hence, the (adapted) EFTA Court could have competence to decide, in particular, on disputes arising from the “second surveillance function” (see point IV above).

The EFTA Court was created pursuant to the Surveillance and Court Agreement (SCA) between Iceland, Liechtenstein and Norway. Some modifications and amendments to the SCA (for example an additional Protocol) would be necessary to introduce the competence of the EFTA Court to review and interpret the electricity agreement. A special EU-EFTA/Swiss Chamber on Energy/Electricity would be composed of a representative from the EU and from Switzerland, with the president of the EFTA Court chairing the Chamber. Alternatively, the full EFTA Court could be “complemented” by a representative from the EU and from Switzerland.

VI. Final Remarks

Since the conclusion of the second set of bilateral agreements with the EU, Switzerland's contractual policy, based on a strictly sectorial approach, has reached a watershed. The negotiations on a bilateral electricity agreement, while having made progress as far as the substance is concerned, got tied up in the process and were ultimately held back in the wake of the difficulties to find a compromise on the institutional issues. At the same time the growing need for closer cooperation in the electricity field in a post-Fukushima context, led the two sides, in December 2011, to try to agree on institutional formulae allowing for a swift conclusion of that negotiation.

Two factors seem to characterize the present phase. First, in spite of its readiness to look for institutional provisions that would fit the electricity agreement, the ECom does not seem ready to abandon her above mentioned fundamental principles. Second, the tentative acceptance by the ECom to at least consider an anticipated conclusion of the electricity agreement constitutes a limited window of opportunity.

This non-paper suggests some elements that could help to shape a Swiss position, making the best at this juncture. It seems essential that the Swiss side becomes pro-active with an approach that combines the rapid conclusion of an agreement with the readiness to come to terms with the EU on the modalities for a wider institutional undertaking.

The non-paper covers essentially the conditions for a rapid breakthrough on an electricity agreement. In a next step one would have to focus on the wider bilateral institutional challenges. The non-paper does not try to pass a judgment about the acceptance of the elements presented by either side nor anticipate a different and/or more detailed outcome of the negotiations.