



## Negotiations between the European Commission and Russia on Nord Stream 2

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*The European Commission has proposed that the legal status of the Nord Stream 2 pipeline be settled with an agreement between Russia and the European Union, negotiated by the EC on behalf of the Member States. Support for the proposal should be conditional on the agreement confirming, without exception, the application of EU energy law to the entire pipeline. The consequence of such a position may also entail the opening of discussions on the status of Nord Stream 1.*

In March this year, the European Commission has proposed to negotiate with Russia on the Nord Stream 2 gas pipeline. This came as a response to the energy ministers from Denmark and Sweden who asked the EC to take a position on the application of EU law to the pipeline. The reply of the Commissioners—Maroš Šefčovič and Miguel Arias Cañete—indicates that the Commission considers the legal situation of Nord Stream 2 to be unclear and believes that it should be clarified by intergovernmental agreement. The proposal has been made at a time when preparations for investment in the project are accelerating. Gazprom has submitted applications for construction permits in Sweden, Finland, Denmark, Germany and Russia. In Germany, public consultations have begun. At the same time, Western European companies Engie, OMV, Shell, Uniper and Wintershall have committed themselves to co-financing the project, scheduled for completion in 2019.<sup>1</sup>

**EC Motivations.** The Commission proposed that it would negotiate with Russia on the Nord Stream 2 project for legal and political reasons. The main reason is the uncertainty surrounding the application of EU energy law to Nord Stream 2 as an offshore gas pipeline originating outside the EU. The doubt derives from the interpretation of the provisions of the Gas Directive, which relate to interconnections defined as transmission lines which connect the national transmission systems of the Member States. The legal situation, unregulated in the Commission's view, has two consequences. First, EU energy law (relating to transparent tariffs, third-party access and the unbundling of transmission and gas supply) does not apply to Nord Stream 2. Second, there is a risk that the gas pipeline will operate in a legal vacuum or under the laws of a third country.

Politically, Nord Stream 2 has been evaluated by the EU institutions differently than Nord Stream 1, which was considered a common interest project and was promoted as enhancing EU security. Nord Stream 2 not only fails to meet this requirement (as it does not diversify sources or gas delivery routes), it is also against the energy union strategy. In the 2015 energy union concept, the Commission argued that the EU needs to diversify gas supplies and increase resistance to disruption by limiting dependence on dominant suppliers and finding alternative sources. In addition, the EC had stated in the previous year's energy security

<sup>1</sup> Z. Nowak, "Gas Interests in Nord Stream 2," *PISM Bulletin*, no. 91 (823), 15 October 2016.

strategy that the biggest problem was dependence on Russia. This should set for the EC the political framework for assessing Nord Stream 2.

**Status of Other Gas Pipelines.** The EC's opinion that the legal status of Nord Stream 2 is unclear clearly differs from the Commission's position in similar cases in recent years. In 2014, the EC opposed Bulgaria's plans to exempt part of the South Stream gas pipeline, planned to run from Russia to Bulgaria along the bed of the Black Sea, from the Third Energy Package. According to the Commission, the fact that only about 20 km of a pipe exceeding 900 km in length would run through EU territory (i.e. Bulgarian waters and land near Varna) had no bearing on the need to comply with EU regulations. Under threat of legal action by the European Commission, Bulgaria suspended work, which led to Russia abandoning the project.

In the case of the Trans Adriatic Pipeline (TAP), work on which is already underway to link EU states Italy and Greece via the Adriatic Sea and non-EU state Albania, the authorities of the three countries decided to apply the Third Energy Package to the whole project on their own. In 2013, the Commission accepted their decision, introducing only minor modifications.

Some less rigorous obligations are applied with respect to upstream pipeline networks, built specifically to convey natural gas directly from its fields. These are, among others, the Green Stream, which runs from Libya to Italy (2004), and Medgas, running from Algeria to Spain (2011). Nord Stream 2 is, however, a typical interconnection between two gas systems and does not fit the definition of an upstream pipeline network. It should therefore be subject to the rules of the Third Energy Package. In this regard, the situation of the existing Nord Stream 1 pipeline is not unique.

**Conclusions and Recommendations.** Although the Commission claims that the legal situation of the Nord Stream 2 pipeline is unclear, its earlier actions indicate that the provisions of the Third Energy Package do apply to offshore pipelines running through or from third countries to the EU. This is consistent with the IGA decision,<sup>2</sup> which states that the proper functioning of the internal energy market requires that energy imported into the Union be fully governed by the rules establishing that market. This was also the Commission's position in the case of the South Stream. This is justified because the application of Third Energy Package provisions (such as the free choice of a gas supplier) to gas pipelines between EU Member States becomes unworkable if EU legislation is not respected at the time that gas is transported to the Union. Therefore, even without an agreement regarding a gas pipeline running through its territory, a Member State should adopt measures to ensure that the operation of the pipeline complies with EU law. Only such a solution can prevent a race to the bottom, reducing regulatory requirements to the lowest common denominator imposed by third countries, which would be detrimental to competition and security of supply. At the same time, for technical reasons, it is not possible to apply various regulatory regimes to parts of the pipeline that do not have their own entry or exit points. It is therefore necessary to apply EU legislation to an entire section between the two nearest points. In the case of Nord Stream 2, this means between the German and Russian coasts.

The Commission's initiative to negotiate with Russia to clarify the Nord Stream 2 regime is positive. It refutes the German argument that the pipeline is a purely commercial venture, which excludes any interstate interference. It also acts to direct further discussions with Russia and Gazprom, by preventing any questions as to the need for Nord Stream 2 operation to respect EU law. However, the consent of all EU countries will be required for the negotiation mandate, and the chances of such unanimity will be limited. The Commission's proposal responds to Danish and Swedish expectations, but undermines Germany's argument that it has exclusive jurisdiction over the gas pipeline. Moreover, any agreement, that brings the gas pipeline under EU law and question Gazprom's export monopoly will face resistance from Russia. Re-opening discussions of the status of Nord Stream 1 can be expected because of this.

An agreement between the EC and Russia could be beneficial to the EU and Poland if it includes clear confirmation that existing EU law is unconditionally applicable to the entire Nord Stream 2 pipeline, in particular to unbundling, third-party access and tariff regulation. It would also allow settlement of some other aspects of the pipeline operation, such as access and trade conditions, environmental issues and even security matters. In such a form, an agreement would make it possible to exert pressure on the Member States' regulatory authorities to enforce EU law with regard to Nord Stream 2. Such a framework would enable Poland's support for EC attempts to negotiate an intergovernmental agreement with Russia. That may lead to Poland gaining increased influence on the status of Nord Stream 2.

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<sup>2</sup> A. Gawlikowska-Fyk, W. Gruszczyński, Z. Nowak, "EU Winter Gas Package: The Next Phase of the Struggle to Strengthen Energy Resilience," *PISM Bulletin*, no. 9 (859), 3 February 2016.