A Pipeline Too Far? EU Law Obstacles to Nordstream 2


1.0. Introduction

It is doubtful that Russian President Putin could have imagined the legal and political controversy occasioned by the announcement of the Nordstream 2 pipeline proposal at the St Petersburg Forum in June 2015. It is likely that the Russian government, Gazprom and its Western commercial allies assumed that though there would be some controversy but after some debate and concessions the pipeline would smoothly sail through EU and Member State regulatory processes. This at first sight would have not seemed an unreasonable view to take as Nordstream 1 after some technical and political debate at EU and Member State level sailed relatively serenely through EU and Member State regulatory regimes.

In fact Nordstream 2 was faced almost immediately with wide ranging political opposition from across the Union’s Member States. There has been extensive legal debate within and outwith the EU institutions on the application of Union law to import pipelines and in particular Nordstream 2. The European Commission has sought in co-operation with the Member States to develop mechanisms to provide a comprehensive legal regime for the pipeline by proposing a mandate by which it would seek to negotiate a single legal regime with the Russian government on the operation of the pipeline. More recently the Commission proposed an amendment

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1 In the interests of full disclosure it should be noted that Dr Riley is an adviser to PGNiG and Naftogaz.
2 EU leaders sign letter objecting to Nordstream 2 gas link, Reuters, 16th March 2016,
3 For instance the opinion of the Legal Service of the Council of the European Union on the applicability of the Gas Directive 2009 to the Nordstream 2 pipeline. The can be found linked to the article, EU lawyers give Russia a free pass, EU Observer, 2nd October 2017. For a critique of that opinion see Riley, EU opinion on Russia pipeline lacks credibility, EU Observer, 5th October 2017.
4 Commission seeks a Mandate from Member States to Negotiate with Russia on Agreement on Nordstream 2, European Commission, Brussels 9th June 2017, IP/17/1571.
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to the Gas Directive 2009 under which import pipelines will be expressly subject to the application of the directive\textsuperscript{5}.

This controversy should not have in fact come as too much of a surprise to the Russian government or the Gazprom board. In the first place the political context had changed radically since 2006 and the launch of the first Nordstream pipeline. By the time of the St Petersburg Forum in the summer of 2015, the Russian Federation had annexed Crimea, and had occupying forces in eastern Ukraine\textsuperscript{6}. In addition, the EU and the US had imposed sanctions on the Russian Federation for the aforesaid annexation and occupation\textsuperscript{7}. The political resistance to any new Russian pipeline project such as Nordstream 2 was therefore likely to be much more significant than that in respect of Nordstream 1.

Nordstream 2 also raised additional supply security concerns compared with Nordstream 1. At least initially these were overlooked by Gazprom and its corporate partners. In 2006 Gazprom could genuinely argue that Nordstream 1 improved at least the route diversity of the exporters to the Union. In addition to the Yamal and Brotherhood pipelines Nordstream 1 provided a third route for gas supply into the Union. By however, building Nordstream 2 alongside the same route as Nordstream 1\textsuperscript{8}, with the prospect that most of the Brotherhood pipeline would no longer be used, Gazprom was in fact advocating a concentration rather than a diversity of routes\textsuperscript{9}. This route concentration as explained below raises a plethora of supply

\textsuperscript{6} Crimea was formally annexed by the Russian Federation in March 2014. There is substantial evidence of Russian control, funding and direction of the occupying forces in eastern Ukraine, see for instance, \textit{Hiding in Plain Sight: Putin’s War in eastern Ukraine}, (2015) Atlantic Council, Washington, DC.
\textsuperscript{7} An overview of EU sanctions against Russia since March 2014 can be found on the Council of the European Union’s website here: \url{http://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/}. An overview of US sanctions on Russia can be found on the website of the US Department of State here: \url{https://www.state.gov/e/eb/tfs/spi/ukrainerussia/}.
\textsuperscript{8} The proposed route for Nordstream 2 is substantially the same as Nordstream 1, save that this later Nordstream route commences from the southern rather than the northern shore of the Gulf of Finland.
\textsuperscript{9} This supply security concern is reinforced by the choke issue: This is the concern that as Nordstream 2 follows for most of its route the route of Nordstream 1. As a result approximately 70% of Russian
security issues which create a significant range of additional legal problems for the pipeline. These concerns over supply security were compounded by the adoption of the Energy Union strategy by the European Union in 2014 which emphasised the importance of supply and route diversity.\(^\text{10}\)

The other major and perhaps ultimately most significant question that was underestimated by Gazprom in planning the project was the impact of the EU’s third energy package, and particularly the gas directive 2009. The third energy package was in the process of adoption and implementation when Nordstream 1 was being planned, financed, subject to regulatory processes and construction. The third energy package it is argued in this paper poses far greater difficulties for Gazprom than the second energy package regime, notably with the requirement for ownership unbundling and the supply security analysis required by Article 11 of the gas directive 2009. Furthermore, as indicated above, the route concentration created by Nordstream 2 being placed next to Nordstream 1 makes an already problematic prospect of an exemption under Article 36 of the 2009 directive that much more difficult to achieve.

This paper in part two considers why the third energy package and the 2009 directive in particular is such an obstacle to Nordstream 2. In part three, it turns to the vexed and controversial question as to whether the 2009 directive applies to import pipelines. Part four examines the extent to which EU energy law and in particular the third energy package has been applied to import pipelines in practice. Part five offers a conclusion in which it argues that the best way forward is for the natural gas imports to the European Union will flow through a narrow two kilometre channel in the shallow Baltic sea at certain points the waters are only 30 metres deep. The argument here is that by laying Nordstream 2 alongside Nordstream 1 Gazprom is proposing to create an artificial choke point which undermines European supply security. It is not difficult to see how the pipelines could face, accident, engineering failure or terrorist attack. This concern is compounded by the fact that once Nordstream 2 is operational the Brotherhood pipeline which currently transits Russian gas via Ukraine and Slovakia will cease to function as natural gas flows are diverted to Nordstream 2. The EU will be heavily dependent on one vulnerable single channel of gas supply from its principal supplier with no significant alternative route available.\(^\text{10}\)

Council and Parliament to adopt the amendment proposed on November 8th 2017 which would formally extend the 2009 directive to import pipelines.

2.0. Why is the Third Energy Package such an Obstacle to Nordstream 2?

It is clear from the controversy over the Nordstream 2 pipeline that the Russian Federation, Gazprom and the 100% Gazprom owned subsidiary Nordstream 2 all oppose the application of EU’s Third Energy Package, and particularly the EU’s 2009 Gas Directive\(^\text{11}\) to the pipeline. Much of the legal dispute surrounding the pipeline has focussed on whether or not a pipeline importing gas into the EU is capable of being subject to the 2009 Gas Directive and other third energy package legislation\(^\text{12}\). That issue is discussed extensively in the next section. However, what is not so frequently discussed is why the Russian state and Gazprom so object to the application of the third energy package legislation to import pipelines in the first place. Identifying these objections can help us understand why they are viewed as more intolerable than in the past and where there may or may not be scope for compromise.

The third energy package and particularly the 2009 Gas Directive includes a much more onerous liberalisation regime than either the second or first energy packages\(^\text{13}\). The current regime has three key provisions.

First, under Article 32(1) of the 2009 Directive all Member States are required to provide third party access to all transmission and distribution pipelines. Furthermore, this access has to be implemented by periodic capacity auctions as provided for in the EU’s network code regulation\(^\text{14}\).

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\(^{11}\) Gas Directive 2009, *op cit.*

\(^{12}\) The most substantial contribution to the argument that Nordstream 2 is not subject to EU energy law has been provided by Professor Kim Talus. See Talus, *Application of EU Energy and Certain National Laws of Baltic Sea Countries to the Nordstream 2 Pipeline*, JWELB (2017) 30 et seq.

\(^{13}\) see in particular, the first and second gas directives, respectively directive 98/30/EC OJ 1998 L204/12 and directive 03/55/EC, OJ 2003 L176/57

The immediate difficulty here is that in respect of pipeline gas Gazprom has a state export monopoly. As there is only one entry point in respect of Nordstream 2 on Russian territory the export monopoly restricts any other competitor from seeking access to the pipeline. There are other major gas producers in Russia such as Novatek and Rosneft, their production has been growing in recent years. Gazprom’s competitors are leaner and more efficient and domestically offer lower prices than Gazprom. However, the export monopoly remains in place restricting competitors and conflicting with the requirements of the Gas Directive.

Second, Article 32(1) also provides for regulated tariffs, published in advance, applicable to all eligible customers and applied objectively and without discrimination between system users. Such tariffs must be approved by the relevant national regulatory authorities prior to their entry into force. Given that the pipeline passes at least through Danish and German territorial waters co-operation would be required between German and Danish national energy regulators in supervising the tariff regime under the directive.

The third major concern flows from Article 9(1) of the Directive. This provision requires full ownership unbundling for new infrastructure such as Nordstream 2. The effect of this requirement is that the pipeline infrastructure has to be owned by the transmission system operator (TSO). Furthermore such an owner cannot at the same time be active in the production and supply of natural gas (for a natural gas pipeline). Clearly, as Nordstream 2 is a wholly owned subsidiary of Gazprom, and Gazprom intends to both own the pipeline and provide all of the natural gas by

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15 The Gazprom export monopoly is currently contained in Federal Act of the Russian Federation No.117-FZ of 18th July 2006. Note however, the export monopoly only applies to pipeline gas and not exports of liquid natural gas. See below for a more extensive discussion of the extra-territorial issue.

16 For a discussion of the state of Rosneft’s gas operations see Russia’s Rosneft goes Big into Natural Gas, Platts, 9th October 2017 and for a broader and more detailed discussion of the competitive impact of Rosneft and Novatek on Gazprom in the Russian domestic market see Karadas, At Crossroads: Current Problems of Russia’s Gas Sector, (2017), OSW, Warsaw.

17 Given that the landing point in EU territory is Germany the likelihood is that the German national energy regulator would be the lead regulator in undertaking the certification process under the directive.
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virtue of its export monopoly into the pipeline Article 9(1) presents a significant problem for Gazprom.

If the 2009 directive applies to Nordstream 2 one potential way to escape its provisions would be to seek an exemption under Article 36. This exemption clause recognises the need to provide incentives for new investors to be willing to invest in new infrastructure. To that end it provides for fixed period exemptions from the liberalisation rules contained in such provisions as Articles 9(1) and 32(1) of the directive.

In theory an Article 36 exemption would provide a means to avoid the liberalisation requirements of the directive and provide a mechanism for compromise between EU and Russian interests. EU law could be applied but only limited obligations would actually be applied to Nordstream 2. Unfortunately the criteria set out in Article 36 make it difficult to see how an exemption could be granted and such a compromise arrived at within the framework of the legislation.

There are two relevant criteria contained in Article 36. The first is contained in Article 36(1)(a). This provides that ‘the investment must enhance competition in gas supply and enhance the security of supply’. The second is contained in Article 36(1)(e) that, ‘the exemption must not be detrimental to competition or the effective functioning of the internal market in natural gas’.  

These criteria are difficult for Nordstream 2 to meet. In respect of the enhancement of the competition in gas supply and security of supply the pipeline undermines competition and security of supply. The pipeline will bring a further 55bcm of natural gas into Germany. That gas will flow into Nordstream 2’s connecting pipeline EUGAL into Central and Eastern Europe. Combined with the existing OPAL pipeline19 (EUGAL

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18 The list of Commission decisions under Article 36, its predecessor and the electricity equivalents can be found at: https://ec.europa.eu/energy/en/topics/markets-and-consumers/wholesale-market/access-infrastructure-and-exemptions

19 The OPAL pipeline is a connecting pipeline for Nordstream 1. OPAL received an exemption under the then equivalent of Article 36 under the 2003 Gas Directive which is legally identical to Article 36. It
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follows the same route as OPAL) which has 36bcm of capacity and brings gas flows into Europe from Nordstream 1 the total gas flows could reach approximately 90bcm. The flow of natural gas, with all the capacity already booked by Gazprom on EUGAL into the 2030s will make it difficult for any other natural gas source to obtain access to interconnectors in the region and enter the market. Furthermore the size of the investment and consequent capacity it provides will make it difficult to fund other new infrastructures that could provide a basis for competition to Nordstream sourced gas. In essence Nordstream 2 will crowd out other valuable and strategic infrastructure which would have brought more competition and supply diversity into the market.

What also makes it difficult to apply these exemption criteria to Nordstream 2 is that the pipeline is a diversionary pipeline. In other words it does not actually provide any new gas. It will merely, just as Nordstream 1 did, divert gas flows from the Brotherhood pipeline running through Russia, Ukraine and Slovakia into Nordstream 2. As a consequence it is difficult to see how the pipeline enhances competition in gas supply or adds to supply security if it does not in fact result in an increase in the supply of gas into the European Union.

is questionable how safe that exemption is from legal challenge. It was replaced in October 2016 with a new exemption which significantly expanded Gazprom’s ability to use that pipeline. That exemption is now subject to a challenge from PGNIG and the Polish government before the EU General Court. For a further discussion on the OPAL pipeline see Riley, The OPAL Pipeline Extension: The Implications of a Questionable Decision, Statecraft, London, 24th February 2017.


Despite an initial argument that Nordstream 1 would result in new natural gas supplies entering the European market once in operation Nordstream 1 operated solely as a diversionary pipeline, with gas flows dropping in the Brotherhood pipeline (which runs through Ukraine and on into the EU via Slovakia) and rising in Nordstream 1. Equally, once Nordstream 2 is constructed and brought into operation the gas that currently flows through the Brotherhood pipeline which runs through Ukraine and Slovakia will be diverted into Nordstream 2. One of the major reasons for Gazprom and its Western corporate allies seeking to move at speed, building for instance both of the two Nordstream 2 pipelines at once (whereas for Nordstream 1 the pipelines were built sequentially) is to ensure that Gazprom does not find itself in the position of having to agree a further supply contract with Ukraine in 2019.

Questions of competition and supply security are discussed further extensively below.
It could be argued by supporters of Gazprom that Nordstream 2 is required and justified for an exemption under Article 36 because the Brotherhood pipeline flows are unreliable. This argument relies on the 2006 and 2009 cut offs, the latter of which saw gas flows cut to the European Union for a period of two weeks. Aside from a lack of clarity as to who was exactly responsible for those flows a number of salient facts undermine this argument. The first is that since 2009 there has been no disruption in flows via Ukraine. This is despite Ukraine facing revolution, annexation, occupation and significant economic problems. Furthermore, in 2011 Ukraine joined the Energy Community and is pledged by treaty and supervision of the Energy Community institutions to comply with EU energy liberalisation rules, and flanking measures in the energy sector in respect of EU antitrust, state aid and environmental law\(^\text{24}\). It is also the case that in the last decade there has been only one state that has both threatened to disrupt gas flows and has actually done so, and that is the Russian Federation via Gazprom, as explained below, which sought to do so to close down reverse flows of gas to Ukraine\(^\text{25}\).

In addition, the need for any additional gas import capacity particularly from an already major importer into the Union is difficult to justify given the scale of Union import capacity. The Union has the capacity to import 700bcm per year (490bcm from pipelines and 197bcm from LNG terminals). By contrast actual total gas imports in 2015 amounted to 300bcm\(^\text{26}\). Even if there was a degree of unreliability in transiting gas via Ukraine it is difficult to see the justification for building another pipeline of 55bcm when the Union has approximately 400bcm of spare capacity.

It is also difficult to see how Nordstream 2 will enhance security of supply. The effect of the pipeline is to remove transit security from the states of Central and Eastern Europe. Currently gas flows along the Brotherhood and Yamal pipelines from East to


\(^{25}\) Ukraine has been able to obtain significant gas imports by buying gas from Gazprom’s customers in Central and Eastern Europe and then either physically reversing flowing the gas back into Ukraine or via arranging swaps. Gazprom sought to stop this practice by targeted reductions of gas flows to some of its customers aimed at reducing their capacity into enter such reverse flow deals.

\(^{26}\) Nordstream 2-Divide et Impera Again? op cit, 5.
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West providing Russian gas to the large Western European gas markets such as Germany. This East to West Russian gas transit provides the CEE states with a degree of security that they cannot be cut off without threatening transit gas supplied to countries in Western Europe. Nordstream 2 removes that transit security. Russian natural gas can now flow directly from Russia to Western Europe, bypassing Ukraine and the states of Central and Eastern Europe, undermining their supply security and as a consequence making them more vulnerable to supply shocks and leverage than before.

It is true that Russian gas can flow from Nordstream 2 and via its main connecting pipeline EUGAL into the CEE states. However, from a CEE perspective such a flow of Russian gas creates a number of serious difficulties for states in the region. The principal difficulty is that flow cannot be guaranteed. In essence, the CEE states become much more dependent on Russian goodwill. Gas flows into Nordstream 2 can be reduced leaving sufficient gas for Germany but insufficient gas for CEE states. This is not a theoretical risk. In 2014 and 2015 seeking to stop flows of Russian gas contracted to Poland, Hungary and Slovakia being dispatched on reverse flow to Ukraine, Gazprom sought to reduce the gas flows to those countries.

Nordstream 2 also hardly assists the functioning of the internal market in gas. The impact of the pipeline on the integrity of the European single market in gas is negative. In Western Europe there will be a well supplied and diverse market of LNG, Russian, Algerian and European suppliers in an deeply interconnected market. By contrast as still much of the interconnection in Central and Eastern Europe has not yet been completed and there are far fewer alternatives to Russian natural gas supplies these markets will become increasingly isolated and subject to Gazprom’s

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market leverage\(^{29}\). That lack of connection and supply alternatives combined with huge gas volumes moving eastward from EUGAL and OPAL, will as explained above, make it much more difficult for alternative sources of natural gas to reach CEE states\(^{30}\). As a consequence, Nordstream 2 is likely to operate to divide rather than complete the single market. The probable result is a European gas market in which Western Europe enjoys the benefits of a liberalised and competitive market, whereas Central and Eastern Europe will face less supply diversity and higher gas prices\(^{31}\).

As a consequence it does appear that Nordstream 2 would have significant difficulty in sustaining a case that it satisfies the criteria for the application of an Article 36 exemption.

An additional question in respect of Nordstream 2 flows from Article 11 of the Gas Directive. Article 11 requires certification of a transmission system operator where that operator is controlled by a person from a third country or third countries. As Nordstream 2 is a wholly owned subsidiary of Gazprom it would be subject to Article 11 certification. The relevant national regulatory authority must consider whether granting certification will put at risk the security of energy supply of the Member State and the Community (now Union). Given the discussion above regarding transit security and the past behaviour of Gazprom in threatening the supply security of CEE and Baltic states any national regulatory authority granting certification on the basis that Article 11 was satisfied and that there was no threat to the Union’s supply security would be likely to face a powerful legal challenge by several Member States, ultimately before the EU courts\(^{32}\).

\(^{29}\) For an illustration of the lack of interconnection in CEE states compared with North-Western Europe see: Entsog, Central Eastern Europe-Gas Regional Investment Plan, 2017, Brussels, 2017.

\(^{30}\) Nordstream 2-Divide et Impera Again? op cit, 7.


\(^{32}\) This would most likely to occur via a challenge to an Article 11 decision made by a Member State regulatory authority which was first be seized by a national administrative court and then would almost certainly be subject to an Article 267 TFEU reference for a preliminary ruling to the European Court of Justice in Luxembourg.
This initial analysis does underscore why Gazprom is so opposed to the application of the rules of the third energy package. The prospect of not just third party access rules and tariff regulation being applied to the pipeline but full ownership unbundling and the prospect of seeking to obtain certification as a transmission system operator when that certification includes a supply security assessment creates a formidable barrier to the execution of the project compared to the terms on which Gazprom would prefer to operate. Equally, seeking an exemption provides no obvious route out of the application of the liberalisation rules because of the criteria contained in Article 36(1)(a) and Article 36(1)(e). Again it is difficult to see how the competition, internal market and supply security criteria of Article 36 can easily be met by Nordstream 2. Furthermore, even in the unlikely event an exemption were obtained by Nordstream 2, it would still face certification as a transmission system operator where an assessment under Article 11 would be required as to whether the pipeline threatened the supply security of a Member State or the Union as a whole.

This analysis also underlines the extent to which the third energy package is a much more formidable threat to Gazprom’s ambitions than earlier EU liberalisation measures. Ultimately it may have been possible to live with third party access and tariff regulation rules stemming from the second energy package. However, the third energy package with its rules on ownership unbundling and Article 11 supply security assessment makes it much more difficult for Gazprom to contemplate any compromise with the European Union.

3.0. Does EU Law Apply to the Nordstream 2 Pipeline?

The core legal question is whether EU law and particularly the Gas Directive 2009 applies to Nordstream 2. The pipeline crosses Russian territorial waters, its exclusive economic zone (EEZ) as well as the EEZ of four Member States (Finland, Sweden,
Denmark and Germany) and the territorial waters of two Member States (Denmark and Germany), plus German inland waters and soil. It is difficult therefore to see how EU law does not apply—at least to that part of the pipeline which falls within the territorial waters, inland sea, and soil of the Member States. There is no special legal regime in the Gas Directive 2009 limiting the application of Union law on its territory. The specific Treaty articles (article 52 TEU and article 355 TFEU) setting out the territorial application of Union law apply in full to the 2009 directive as any other piece of EU legislation.

Furthermore the Directive itself makes no distinction in respect of import pipelines bringing natural gas into the Union. The relevant reference is found in the definitions section of the 2009 Directive in Article 2(3) when defining transmission. There the directive simply refers to high pressure transmission pipelines delivering gas for supply through a network, which are distinguished from upstream or distribution pipelines.\(^{33}\)

In principle therefore it would appear that import pipelines entering the territory of the Member States are fully subject to Union law and particularly the gas directive 2009.

The main technical argument against the 2009 directive applying to import pipelines relies on the exemption provision contained in article 36. An exemption can only be granted to ‘major new gas infrastructures’ which are classified as interconnectors, LNG terminals and storage facilities. In respect of Nordstream 2 the key question is whether that pipeline can constitute an interconnector for the purposes of article 36. Interconnector is defined in article 2(17) of the directive. It refers to,

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\(^{33}\) Clearly Nordstream 2 would be viewed as a high pressure transmission line and not an upstream or distribution pipeline. For a discussion of the applicable rules under the gas directive 2009 to different types of pipelines see Riley, *Nordstream 2: A Legal and Policy Analysis* (2016) CEPS, Brussels, November 2016.
‘a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States’

The clear difficulty here is that Nordstream 2 does not cross or span a border between Member States. It crosses a number of borders, including the soil, inland waters and territorial sea of a non-EU Member State and then the EEZ of several Member States, before entering the territorial waters, of two Member States and the internal waters and soil of a Member State. Despite the number of jurisdictions it crosses the pipeline does not cross or span a border between Member States.

The argument therefore runs that if import pipelines cannot benefit from an article 36 exemption the Union legislature cannot have intended to apply the directive to such pipelines. Otherwise the inequitable situation would arise that import pipelines would be subject to all the burden of liberalisation without being able to obtain relief via Article 36. It would also result in discrimination between import and non-import pipelines, which again it can be argued cannot have been the intention of the legislature.

That argument can be contested. It does not necessarily follow that an exemption from the obligations of the EU’s gas liberalisation regime should be provided to all forms of investment into the gas supply network. The Union legislature may well have taken the view that only a limited class of investments should be able to benefit from an exemption. The general principle is clearly set out in the directive is that the liberalisation provisions will apply across the entire European gas supply and distribution network. The Article 36 exemption regime can be viewed as being a relatively limited derogation from that general rule.

However, the probably better view is to argue that the Union legislature intended for import pipelines to be included in the class of infrastructure that is capable of obtaining an exemption. This is supported by some language versions of the directive that suggest that the classes of infrastructure is not exhaustively listed in
article 36 and other classes of infrastructure can be included. It is also supported by recital 35. It envisages,

‘the possibility of temporary derogations should apply, for security of supply reasons, in particular to new pipelines within the Community transporting new gas from third countries into the Community’

Recital 35 suggests that there has been a drafting failure by the Union legislature and the intention of the legislature was in fact to include import pipelines as capable of obtaining exemptions under article 36. Drawing upon recital 35 and language versions which indicate that the classes of infrastructure capable of being subject to an exemption under article 36 are not exhaustive, it can be compellingly argued that the Commission could apply the directive to import pipelines.

This argument is further underpinned by the Commission Regulation 2017/459 which provides the operating framework for the capacity allocation mechanisms network codes. The regulation makes it possible for entry and exit points from a third country to be regulated by a Member State national regulatory authority. Article 2 (1) provides that,

‘This regulation shall apply to interconnection points. It may also apply to entry points from and exit points to third countries, subject to the decision of the relevant national regulatory authority.’

Accordingly therefore Nordstream 2 could be subject to the regulation at its exit point, subject to the decision of the relevant (presumably German, as Germany is the exit point) national regulatory authority.

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34 For example, the Czech and Bulgarian versions of Article 36 indicate that the list of permitted infrastructure capable of benefiting from an exemption is indicative and not exhaustive.
35 For a discussion of the different types of pipelines and the application of the Gas Directive 2009 see Riley, Nordstream A Legal and Policy Analysis, op cit.
36 This view is reinforced by Recital 4 of the regulation. It indicates that the objective of the regulation is ‘bringing about effective competition between suppliers from inside and outside the Union requires that they are able to flexibly use the existing transmission systems to ship their gas
It is perhaps therefore not surprising that the European Commission when questioned by Parliamentarians on the applicability of article 36 to Nordstream 1 and Southstream indicated that the Commission was open to receiving an exemption request.

‘No exemption has been granted or requested for the Nord Stream pipeline project. Should South Stream promoters decide to apply for an exemption under the third energy package, the Commission stands ready to review the national regulators decision on such requests’.38

Taken together these arguments suggest that the intent of the Union legislature was that exemptions are possible for import pipelines. Article 36 is not as limited in its application as some commentators have claimed.39

This view is reinforced by a compelling effet utile argument. If the 2009 directive cannot apply to import pipelines, then the operation and effectiveness of the European Union’s single market in gas can be substantially undermined. If energy firms and their third state supporters wish to avoid the application of the liberalisation provisions of the 2009 directive import pipelines provide an effective device to do so. A firm can seek to build two pipelines one an ‘import pipeline’ to the borders of the Union, and a second ‘connecting pipeline’ flowing solely through

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37 For a contrary view on the application of the CAM Regulation 2013 (and as the text is the same the CAM Regulation 2017), see Talus, op cit. Part of the argument made by Talus revolves around the fact that Article 2(1) provides the CAM regulation ‘may’ apply to import pipelines. The argument here however, is that it is the fact that the network codes can be applied to entry and exit points from third countries that provides support for the broader case that EU law applies to import pipelines.

38 Response to Parliamentary Question, E-001009/2014, 31 March 2014. See also response to Parliamentary Question E-010819/2013, 14 November 2013, in which the Commission specifically refers to Article 36(1) and goes to indicate that no exemption request had yet been submitted by Southstream.

39 The best contrary argument is by Talus, op cit. The legal opinion of the Council’s Legal Service appears to echo in large part Talus’s argument. The fundamental difficulty with both papers is that they involve (aside from ignoring the actual reality that EU law has been applied to import pipelines discussed below) and that they takea much more formalistic approach to the application of Union legislation than that of the ECJ.
Union territory which is subject to Union law. In essence, this two stage approach permits commercial actors to avoid the application of Union law, gain a competitive advantage over other actors and avoid a supply security assessment under Article 11. In essence, the regulatory structure adopted by the Union legislature becomes optional under an interpretation of the directive which takes import pipelines out of its scope. The likely consequence is regulatory fragmentation and a significant distortion of the competitive conditions within the EU market.

This effect can be demonstrated by Nordstream 1 and the OPAL pipeline which is a connector pipeline for Nordstream 1. In essence, not applying the 2009 directive or its predecessors to Nordstream 1 results in the importation of the Gazprom export monopoly directly into the single market. There is only one exit gate at Greifswald where Nordstream 1 lands. Because of the Gazprom export monopoly the only gas that can flow through into OPAL is Gazprom gas. No matter how the auctions are constructed the only party capable of effectively bidding for the auctions for the gas entering OPAL is Gazprom.

The argument therefore is that for at least the 140 kilometres of the pipelines route through the German landside, German internal waters, German and Danish territorial waters, the 2009 directive applies in full to the pipeline. Most of the remaining 950 kilometres runs through the EEZ of EU Member States, Germany, Denmark, Sweden and Finland before entering Russian waters. It is arguable that EU law does apply. It is true that Article 79 of the United Nations Convention on the Law of the Sea (UNCLOS) gives third states rights to lay cables and pipes through the EEZ of other states subject to a licensing regime. However, Article 79 is silent on whether

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41 Riley, OPAL, op cit.
42 It is true that after Greifswald entry point through eastern Germany and to the Czech border there are a couple of entry points to OPAL. However, for those to be used to compete with Gazprom it would require the German corporate allies of Gazprom to do more than make token bids for capacity. Given that they substantially rely on Gazprom for supplies and a number have upstream relationships with Gazprom in Russia this is unlikely.
the EEZ states can seek to regulate the operation of the pipeline and cables. Application of the 2009 directive would in no way stop any state laying its pipelines in the EEZ; it would merely control the way they operated. It is submitted that the EU Courts are likely to give significant weight to the argument made above in terms of the danger of regulatory fragmentation and the potential for a significant distortion of the conditions of competition on the EU market as a justification for applying the 2009 Directive in the EEZ.

Whether the 2009 directive applies or not in the EEZ, as argued above, the directive will apply on the soil, inland waters and territorial sea of the Member States through which Nordstream 2 passes. That however, leaves a further question even if the directive does apply in the EEZ or not there remains a ‘conflict of laws’ question—as EU law clearly does not apply to Nordstream 2 pipeline on Russian territory on its soil, inland waters, territorial sea or EEZ.

From the Russian perspective an argument can be made that the application of EU law to Nordstream 2, even in clearly what is EU territory undermines the operation of the pipeline. While Russian law grants a pipeline export monopoly to Gazprom, the application of EU law to Nordstream 2, particularly the requirement of third party access, would effectively terminate that monopoly. Equally, EU law requires transparent tariff regulation and ownership unbundling, neither of which are required to the same extent in Russian law. Applying the 2009 directive to just the 140 kilometres of the pipeline clearly in EU territory still has this substantial knock on effect on Nordstream 2, despite the fact that it runs from Russian territory. The Russian argument is therefore that even though EU only seeks to apply its law in EU territory there is a substantial extra-territorial effect on Russia and Russian interests which are being undermined.

One solution would be simply for Russia to agree to the application of EU law to the whole pipeline. This ‘extension practice’ is a common practice for the EU in relation

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43 Talus relies on an academic paper to support his contention. There is however, no legislative instrument or international treaty which supports his position, Talus, op cit.
to third states. The EU contains the world’s largest market (Brexit or no Brexit) and other states want to trade within it. That price is usually conformity to EU rules. The EU deploys the single market as a mechanism to ensure its rules are fully applied and extended to third states who wish to deal with it. There is no reason why this practice should not be extended to natural gas. This is particularly the case when the EU already has 400 bcm of spare import capacity. Furthermore, as explained above, not applying EU law to the import pipelines has the effect of bringing Russian market practices into the EU and consequently disrupting the proper functioning of the Union’s otherwise increasingly liberalised gas market. In other words Russian legislation and market practices have an extra-territorial effect on the EU market if EU law is not applied to Russian import pipelines.

Assuming however, that Russia does not wish to agree to at least an extension of the application of Union law to the whole route of the pipeline, the EU it is contended here is still able to apply its law, at least to that part of the pipeline which passes through its territory.

4.0. The Actual Application of EU Law to Import Pipelines

One of the difficulties with the argument that the gas directive 2009 does not apply to import pipelines is that it has in fact been applied to two such pipelines already. For example, the Yamal pipeline which brings gas from Russian gas fields in Siberia, across Belarus and into Poland. That pipeline is clearly an import pipeline, it brings natural gas from a third country (Russia) into the European Union. It however, not an interconnector for the purposes of Article 2(17) of the directive as the pipeline does not cross the border of two Member States.

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44 For a discussion of the EU in its role as a regulatory superpower, see Bignami and Zaring, Comparative Law and Regulation: Understanding the Global Regulatory Process (2016) Edward Elgar, 86 et seq.
Various attempts have been made to distinguish the Yamal pipeline from other import pipelines by Nordstream advocates. For example, it is argued that the Yamal pipeline continues 680 kilometres into Poland. This is correct but legally irrelevant. The length of an import pipeline’s route within Union territory provides no basis for distinguishing it from any other import pipeline under the provisions of the gas directive. Furthermore, that argument highlights another major difficulty for the case that import pipelines are not subject to the directive. If import pipelines are not subject to the directive then one can have an import pipeline stretching deep into Union territory not subject to any application of Union law or jurisdiction.

An additional argument that has been deployed to distinguish Yamal is to point to the fact that Yamal crosses a third state which is neither the supplier third state (Russia) nor a European Union state, Belarus. It is true that in this respect Yamal can be distinguished from Nordstream 2. Again however this distinction has no legal relevance. There is no reference in the directive to non-supplier third states in respect of the territorial scope of the directive. The fact that Yamal passes through Belarus does not impact on the underlying argument made above that import pipelines at least on Union territory whether the soil of a Member State, its inland waters or territorial seas are subject to the full application of the directive.

It has also been argued that Yamal is distinguishable from Nordstream 2 because it is connected to other pipelines which take gas on into Poland and Germany. The difficulty with that argument if taken up it could also be applied to Nordstream 1 and Nordstream 2. Both pipelines have or will have connecting pipelines (NEL, OPAL...
and EUGAL) which will take gas on further into other parts of the Union. In any event, it is clear from the Commission’s Opinions on the Yamal pipeline, that the third energy package was applied to and supervised by the Commission solely by reference to the Yamal pipeline qua the Yamal pipeline and no other pipeline.\footnote{Commission Opinion Pursuant to Article 3(1) of Regulation EC 715/2009 and Article 10(6) and Directive 2009/73/EC –Poland Certification of Gaz-System as the operator of the Polish Section of the Yamal Pipeline (2014) European Commission, Brussels.}

A final argument that has been deployed is to distinguish between onshore and offshore pipelines. This has the advantage that Yamal can be distinguished from Nordstream 2. The problem however, is that there is no basis in the gas directive or any other EU third energy package legislation for a distinction between onshore and offshore pipelines. Pipelines are not distinguished in the directive on the basis that they are part of a transmission network, as interconnectors or upstream pipelines. The only reference to pipelines from third countries in the directive is contained in Recital 35. Recital 35 treats such pipelines as a single class. That is equally the case in Recital 4 and Article 2(1) of the Capacity Allocation Mechanism Network Regulation. It is difficult to see therefore legally and on a policy basis\footnote{The policy basis for distinguishing only on the basis of import pipelines is that to do otherwise would be to create incentives to prefer offshore over onshore import pipelines. This give a competitive advantage to one class of pipelines over another; encourage distortions of competition and incentivize avoidance of Union liberalization law.} how if pipelines are going to be distinguished in the directive, that they can be distinguished other than as a class as import pipelines. There is no basis in policy or legally to distinguish on the basis that a pipeline is an onshore or offshore pipeline.

It is also noticeable that the proposed amendment to the 2009 gas directive which would formally extend EU law to pipelines coming from third states, extends the directive to all import pipelines not just those that are offshore.\footnote{Proposal for a Directive of the European Parliament and of the Council amending directive 2009/73/EC concerning common rules for the internal market in gas, 8th November 2017, see article 1(1) and 2(b) (hereafter Import Pipeline Amendment Proposal).}

There is a similar problem for Nordstream advocates with the Southstream pipeline that was cancelled by the Russian Federation in 2014. Southstream like Yamal is an
import pipeline. The ostensible reason for cancellation of the pipeline was the insistence of the European Commission that the third energy package applied to the pipeline\textsuperscript{52}. The Commission went as far to institute infringement proceedings against Bulgaria for non-compliance of EU law (specifically the third energy package and EU public procurement law) in respect of the development of the pipeline\textsuperscript{53}.

The principal argument deployed to distinguish Southstream from Nordstream 2 is to argue that the infringement procedure was targeted only at the onshore part of the pipeline and not at the offshore part of the pipeline. This is factually correct. However, a tactical consideration by the Commission\textsuperscript{54} as to which part of the pipeline to challenge does not assist the argument of Nordstream advocates. As explained above as EU law, and specifically the gas directive does not distinguish between onshore and offshore pipelines. The only basis that any line can be drawn between different types of pipelines is to distinguish the whole class, that is import pipelines.

A further argument that is deployed and which does descend into shades of legal whataboutism is the reference to a series of other import pipelines to which EU energy law has not been applied. These include the Magreb Pipeline, Transmed, Greenstream, the Medgaz Pipeline, and Galsi Pipeline.

The difficulty with raising the application of EU law to these import pipelines is that most of these pipelines came on stream long ago, well before even the first energy package came into force. For example, the Magreb Pipeline, was under construction

\textsuperscript{52} Behrens, The Declared End of Southstream and Why Nobody Seems to Care, (2014) CEPS, Brussels.


\textsuperscript{54} The Commission had a number of reasons for not bringing infringement proceedings in respect of the offshore. One consideration was that whilst it was clear that EU law applied in territorial waters it was and remains unclear whether EU law applies in the EEZ in respect of the gas directive 2009. For tactical reasons therefore the Commission’s brought infringement proceedings in respect of the onshore only. Noticeably however, in response to a parliamentary question the Commission’s services took the view that EU law applied in the offshore.
well before the first energy package was enacted\textsuperscript{55}, as equally was Transmed\textsuperscript{56}. Greenstream\textsuperscript{57} and Medgaz\textsuperscript{58}, were all underway before the second energy package came into force. Even Galsi, the most recent in that list had its Intergovernmental agreement in place before the third energy package came into force\textsuperscript{59}.

EU energy law, no matter how light the burden in its earlier iterations should have been applied to the earlier pipelines. This did not occur for various reasons. Most of the pipelines were built before any of the modern regime post-1998 was in place so the liberalisation regime was thought not to apply. The burdens involved, until the third energy package, were light and therefore from the perspective of both sides were not considered an issue of great concern\textsuperscript{60}. The Commission was largely focussed on the development of the liberalisation programme in respect of electricity and gas. In particular, it was focused on ensuring the Member States implemented and applied the rules and the potential role of dominant European players to undermine liberalisation was forestalled rather than that of suppliers bringing fossil fuels into the Union market.

Given, however, the actual practice of the Commission and the Member States in not applying EU law investors in those pipelines had legitimate expectations in respect of the then regulatory regime which was in place at that time. If one were to argue that despite their legitimate expectations that they should be required to comply with current EU energy law standards, it would not be unreasonable to make

\textsuperscript{55} The Maghreb-Europe Pipeline final investment decision took place in 1993 before even the coming into force of the first energy package. See: http://www.prensa.gasnaturalfenosa.com/en/20th-anniversary-maghreb-europe-gas-pipeline/
\textsuperscript{56} Transmed was built in two phases in the late 1970s and late 1980s both well before the first energy package came into force. See Trans-Mediterranean Natural Gas Pipeline (Project Overview) https://www.hydrocarbons-technology.com/projects/trans-med-pipeline/
\textsuperscript{57} The final investment decision for Greenstream was made before even the second energy package came into force. http://www.greenstreambv.com/en/pages/company/history/history.shtml
\textsuperscript{58} Medgaz, the pipelines were constructed and in place by the end of 2008. This was well before the enactment of the Gas Directive in July 2009. http://www.medgaz.com/medgaz/pages/historia_cronologia-eng.htm
\textsuperscript{59} The IGA for the project was agreed in November 2007. The third energy package, including the Gas Directive 2009 was not enacted until July 2009. http://www.galsi.it/en/about-us/history
\textsuperscript{60} There was also practical force in the recognition that obligations such as third party access would have no effect on the ground because neither in Libya or Algeria were there any alternative suppliers in the local markets who could access any of the pipelines providing gas into the European Union.
the case for a long period of adaptation. This is particularly so, as explained above, that because the obligations under the third energy package are so much more significant than under the first or second energy package.

It is noticeable in the proposal to amend the gas directive 2009 to formally extend its scope to import pipelines that the Commission proposes derogations for existing import pipelines in recognition of the legitimate expectations of investors in the pre-third energy package era pipelines.61

The fact that EU energy law has not been applied to some projects where it should have been applied or has been applied to some projects but not others only provides an argument that EU law has so far been not fully applied. It does not provide a credible legal argument that EU law should not be applied.62

In terms of how the EU brings those pipelines into regulatory compliance with Union law, the argument here is that adaptation of existing pipelines should follow the Union’s own priorities and needs. Hence the Russian import pipelines, which raise far greater supply security issues and concerns regarding the effective functioning of the single market in gas need to be prioritised over other import pipelines.

5.0. Conclusions: A Pipeline Too Far Given the Development of Union Law

The European Commission has now proposed a draft directive which will formally amend and extend the gas directive 2009 to all new import pipelines. It will at the same time provide for a derogation regime to all existing pipelines. Existing import pipelines will be able to apply for a derogation from the application of the key

61 *Import Pipeline Amendment Proposal, op cit.*
62 This point also applies to Nordstream 1. The fact that EU law was not applied to Nordstream 1, in respect of where the pipeline ran through the territory of the Member States, does not provide any form of immunity or justification for the non-application of Union law to Nordstream 2. It can in fact be argued on similar grounds to the Yamal pipeline, that pressing concerns of supply security and integrity of the Union’s single market in fact require the full application of Union law to Nordstream 1.
liberalisation features of the 2009 directive. Adopting such an amendment to the 2009 directive will provide clarity in respect of new pipelines and legal security for older pipelines. However, given the analysis above it is clear that if the Council and the Parliament adopt this amendment then Gazprom will have a formidable difficulty in developing its Nordstream 2 project.

Given the analysis above it has also to be asked whether given the development of the legislation, decisional practice and case law over the last decade whether the traditional pipeline strategy adopted by Gazprom has run out of legal road: That Nordstream 2 is a pipeline too far. That view is underpinned by the observation that even if the amendment is not adopted on the legal analysis above any attempt to develop Nordstream 2 is fraught with legal risk. The danger for the pipeline is that as the project is developed its certification is challenged before national administrative courts and ultimately a reference for a preliminary ruling is sought from the European Court of Justice (ECJ). At that point the pipeline would face an existential legal risk in Luxembourg to its operation on anything like the terms that Gazprom would favour.

It is unlikely therefore that even if the amendment is not adopted that Nordstream 2 will not be subject to a substantive legal challenge. Whereas if the amendment is adopted then at least existing import pipelines will have a route to obtaining legal security via the proposed derogation procedure. The great danger with any legal challenge to Nordstream 2 is that the ECJ rules not only that Nordstream 2 is subject to Union within the territorial limits of Union jurisdiction but also that such a ruling will cast doubt on the legal regimes of all other existing import pipelines. In other words, the effect of such a ruling would be to significantly weaken Gazprom’s remaining leverage in respect of Nordstream 1.63 The conclusionary argument here therefore is that Gazprom should recognise that its traditional pipeline strategy has had its day and should recognise that the game is up.

63 Nordstream 1 would have an argument in respect of a period of adaptation, this however would merely delay the onset of full application of the EU liberalization rules.
It is also worth asking the question from a Russian perspective is whether the battle over Nordstream 2 is in fact truly in Russia’s interests. The argument is that by refusing to accept the liberalisation rules which govern the transit and supply of gas across modern Europe, Russian energy companies are isolating themselves and undermining their own market. While currently Gazprom may have some allies amongst Western European energy companies, the Nordstream 2 debate is enhancing the Gazprom fear premium for Russian gas across Europe. This ‘fear premium’ has significant commercial consequences, as states and companies, particularly but not exclusively in the CEE and Baltic States seek to diversify away from Russian gas supplies to LNG, renewables, nuclear or even coal.

In effect Gazprom is shrinking its own market by pushing forward with Nordstream 2. It would better for Gazprom, and for Europe, if it accepted the legitimacy of all the three principal east to west Eurasian pipeline routes of Nordstream 1, Yamal and Brotherhood. Gazprom should seek to become one of the main champions of a single European gas market. It should be the great advocate of a single open trading market, operating by common rules and in favour of diverse routes of market entry. Gazprom is it traditionally the lowest cost producer at scale\textsuperscript{64}. It should have a huge incentive to promote the single market and be unworried about routes to market as long as there are a number of routes. It should seek to reduce the Gazprom fear premium by abandoning Nordstream 2 and embracing the single market. Then it can prepare to face the real market competition from the large flows of liquid natural gas which will enter global and European markets in the early 2020s.

\textsuperscript{64} For a contrary argument see Umbach, who argues that the new Yamal fields will significantly increase the costs of Russian gas production. See Umbach, \textit{The Myth of Cheap Russian Gas}, Geopolitical Intelligence Services (2017). Even on Umbach’s analysis Russian pipeline gas would be able to obtain a significant slice of the European gas market, even if it had less of a price advantage than currently against LNG.