Analyses OSW

CENTRE FOR EASTERN STUDIES 21.02.2019 www.osw.waw.pl

# The gas directive revision: EU law poses problems for Nord Stream 2

Agata Łoskot-Strachota

On 20 February, the Committee of Permanent Representatives of the EU Council (COREPER) endorsed a compromise version of the amendments to the gas directive which had been agreed a week earlier during the tripartite 'trilogue' meeting with the European Parliament & European Commission. This almost certainly guarantees that, after the last few formal steps are completed, the directive will come into force in May or June 2019, i.e. before the finalisation of the construction of the Nord Stream 2 pipeline. Agreement on the directive was made possible by, among others, a change in the position adopted by Germany, which had long opposed the application of the EU's legal rules to the Russian project, as well as the amendments to the directive which had been aimed at guaranteeing that.

The provisional agreement on the amendment is the result of an internal EU compromise, and as a consequence it is less strict than the European Commission (EC)'s original proposal. At the same time, it is the first document which clearly confirms the European Union's jurisdiction in the case of Nord Stream 2; that is, it confirms that EU law applies to the part of the pipeline which will run through German territorial sea. Its detailed provisions should (assuming the likely date when the directive comes into force) *de facto* preclude the granting of exemptions from the application of specific rules (such as the Third Energy Package) to the project. The legal framework for the entire pipeline – including the section running from the end of German territorial sea to the border with Russia – will require a separate clarification which should guarantee the application of EU law in the way foreseen in the directive. This will be established either through bilateral German-Russian talks or an intergovernmental agreement (IGA) between the EU and Russia, negotiated by Germany or the EC. In its current version, the directive guarantees Germany an important role in discussions with Russia on the legal regime of Nord Stream 2, and in enforcing the application of EU regulations to the pipeline. At the same time, it acknowledges that the European Commission will have a decisive role in supervising the compliance with EU law of any bilateral decisions taken by the German side.

The agreed revision of the directive will probably not halt the construction of Nord Stream 2, work on which is already fairly advanced; however, the application of individual provisions of the Third Energy Package will complicate, and probably delay, the pipeline's construction and exploitation.

The revision's final effects on the project will mainly depend on its implementation: the moment when it finally comes into force, and the concrete way and thoroughness with which the individual provisions are implemented. Of key importance here will be both the

policy Germany adopts in this case and its possible bilateral arrangements with Russia, as well as the European Commission's independence, efficiency and resistance to possible lobbying in taking decisions related to Nord Stream 2 and the rules of its operation. In this context, the period from the elections to the European Parliament to the formation of new EU institutions may have an important influence on the form of any possible arrangements relating to the functioning of Nord Stream 2. In this transitional period, when the effectiveness of the existing institutions, including the Commission, will potentially be lower, the role of the political decisions taken by the member states, including Germany, will increase.

## 1. Acceleration of works on the revision

Since the beginning of 2019 and Romania's assumption of the presidency of the EU Council, work on the revision of the EU gas directive has clearly accelerated. Through most of 2018, this work was *de facto* suspended at the EU Council level, largely due to the position of Germany, which opposed any changes to the directive. After January 2019, the Romanian presidency presented two subsequent proposals of amendments. The second of these (from 4 February) was largely accepted at a session of COREPER on 8 February and adopted as the Council's common position on the amendment, after being supplemented with the agreed Franco-German additions. 12 February saw the start – and unexpected finalisation – of the tripartite negotiations in Strasbourg (the so-called 'trilogue') between the ITRE Committee (representing the European Parliament) and the Romanian presidency, in the presence of representatives of the European Commission, on the final version of the revision of the directive. The provisional agreement on the gas directive reached during the trilogue was endorsed on 20 February at the subsequent meeting of COREPER. It should next be put to the vote at the European Parliament's plenary session (probably in April), and approved by the member states' energy ministers (so called energy Council). The revised directive thus adopted should then be published in the EU's Official Journal, and 20 days later it will come into force – which, if everything goes off without any complications, will most likely happen in May or June 2019. From then, the member states will have nine months to transpose the directive into national law.

## 2. The goal of the revision, and the related controversies

The revision of the gas directive was proposed in November 2017 by the European Commission, which explained it was necessary in order to clarify the provisions of European law and ensure its application throughout the territory of the EU – not only to gas pipelines running onshore, but also to the offshore ones running from third countries to EU states, such as Nord Stream 2. The ambiguity of the existing regulations allowed mutually contradictory interpretations to be presented by both opponents and supporters of the pipeline's construction. According to the European Commission's goals, the proposed amendments to the directive were intended to complement the intergovernmental EU-Russia agreement which it had previously proposed, and which was aimed at determining the legal framework for the project and guaranteeing that the key provisions of EU law apply to it.

According to the member states opposing the project, applying the EU's Third Energy Package to Nord Stream 2 – including unbundling, third-party access, and other rules – was supposed to limit the project's privileged status in comparison to other Russian export pipelines to Europe (including those running through Ukraine or Belarus and Poland). Initially it was assumed that the adoption of the amendments and the challenges related to the implementation of the provisions of EU law (for example, the need for an independent from Russian exporter pipeline operator, or to cap the capacity available to Gazprom), would lead to the Nord Stream 2 project being abandoned. However, as the project's construction has progressed, it became clear that at this point the new legal regulations coming into force would mainly result in Nord Stream 2's limited profitability and a possible delay in its completion.

The revision of the directive was also – and perhaps primarily – intended to guarantee that the EU would be able to exert real influence on this project, which has been controversial and inconsistent with the EU's strategic goals (as described in the documents on the Energy Union). Apart from the EC, Denmark (with support from several other member states) also wanted to ensure that the issue of Nord Stream 2 would not be subject just to the decisions of individual member states (by means including the Environmental Impact Assessment [EIA] procedure), but rather also subject to broad, pan-EU debate and jurisdiction.

Since the EC proposal, the revision of the directive has caused controversy within the EU. This was primarily related to the deep divisions between member states related to the Nord Stream 2 project. The amendments proposed by the European Commission were supported from the beginning by those states which opposed the investment (such as Poland, Slovakia and the Baltic states), and/or those which (like Denmark) sought to ensure that the EU would be able to affect the project's implementation. The biggest opponents of to the amendments to the directive were the states supporting Nord Stream 2, mainly Germany and Austria. Negative opinions on the proposal of the amendments were also submitted by the companies involved in the project, as well as the Eurogas association, which brings together European gas companies (including those involved in Nord Stream 2). There were also questions about the impact of specific changes to the directive on other offshore pipelines, as well as about the strengthened role of the EC (at the expense of the member states) in regulating the gas pipelines' operation. Most of these doubts were dispelled by the recent changes to the directive's revision, including the one in February which aimed to guarantee a balance between the roles of the member states and the EC.

Criticism of the proposal for revising the gas directive, coming above all from Germany, not only made it difficult for the EU Council to reach a common position on this matter, but initially also hindered talks within the EU forum on the proposed changes, their objectives and their impact on Nord Stream 2, among others. As a result, work on the directive at the Council level was *de facto* suspended during the Bulgarian and Austrian presidencies. At the same time, calls were made (for example, in December 2018 by the Danish prime minister and the ITRE Committee of the European Parliament) to adopt the amendment as soon as possible, which would have allowed it to come into force during the current term of the European Parliament, and before Nord Stream 2 was completed.

The real acceleration of work on the directive over recent weeks was made possible by the efforts of the Romanian presidency, but it was mostly due to Berlin's change of position.

Germany decided to become involved in drafting compromise provisions (most likely due to international pressure, both from within the EU and the US); this allowed a common position of the EU Council to be agreed, and thus the transition to the final stage of the legislative process.

### 3. Final form of the directive's revision and its implications for Nord Stream 2

The agreed revision of the directive is the result of a political compromise; consequently, its final provisions are less stringent than the EC's original proposal. At the same time, it is the first document which confirms that EU law will apply to the existing and planned offshore pipelines from third countries into the EU, including Nord Stream 2. According to the agreed text, the Third Energy Package will apply in the territorial sea of the member state in which the first entry point of the infrastructure to the EU's network is located – that is, in the case of Nord Stream 2, in the territorial sea of Germany. Thus it would not apply in Danish sea or the exclusive economic zones of the Finland, Sweden, Denmark and Germany, as proposed in the original proposal of the revision. Since the section of the pipeline located outside German territorial sea would not be subject to EU law (in the original proposal too, a much smaller part would have remained beyond its reach), the legal regime for Nord Stream 2 as a whole is not clearly defined. To establish this, German consultations with Russia will be needed, and possibly also the negotiation of an intergovernmental agreement (IGA) between the EU and Russia on this issue. However, the content of the directive does not specify whether the negotiations on such an agreement would be conducted by the Commission on behalf of the EU, or by Germany.

The provisional agreement on the revision clearly strengthens the role of the state in which the first entry point to the EU network is located – which, in the case of Nord Stream 2, is Germany. It is Germany which will be responsible for implementing and enforcing EU law in the case of Nord Stream 2; Germany will conduct the bilateral consultations, and will possibly also negotiate an agreement with Russia (both at the technical level, with the operators, and/or at the political level); it is the German regulatory authority which will consider and decide on the possible exemptions for Nord Stream 2 from the application of various provisions of EU law; finally, it is the German institutions which will be subject in any disputes relating to the operation of the pipeline.

At the same time, within the framework of the trilogue of 12 February, several provisions were added refining the European Commission's role as the institution supervising how EU law will be implemented. The EC should, among other things, authorise any bilateral negotiations of an intergovernmental agreement, and later check its compatibility with EU law (the provisions of the IGA from 2017 were mentioned, including the requirement of *ex ante* consultations on any new IGAs with third countries); it should also be notified about and agree to each exemption decision by member states' regulators (for example, any potential decision by the German BNetzA concerning Nord Stream 2).

Exemptions from the EU law's application to existing (Art. 49) or new (Art. 36) gas infrastructure can be granted only if they are not detrimental to competition, the functioning of markets, or the security of supply to the EU. With regard to the new infrastructure, it was made clear that the exemptions must not negatively impact competition on those markets which are likely to be affected by the investment. In the case of Nord Stream 2, this would

include the markets of Central European countries.

In addition, the directive's final version provides for a role for the other member states whose gas markets will be affected by the investment. The state where the infrastructure's first entry point to the EU network is located is obliged to carry out (non-binding) consultations with them before deciding on any exemptions. At the concerned member states' request, the European Commission can act as an observer to the bilateral consultations with a third country (in the case of Nord Stream 2, German-Russian consultations) on the application of the directive's provisions.

The revision also enhances the transparency of the activities of the state responsible for applying EU law to the gas infrastructure. It is asked to notify and explain its transposition measures of directive into national law instruments to both the European Commission and the other member states; states directly affected by the particular investment should also be notified about the technical agreements concluded with the third-country operator.

Finally, several provisions were introduced aimed at ensuring the smooth implementation of the directive's provisions, including preventing its delay by drawing out the consultations with the third country.

Several issues from the amended version of the directive will require further clarification, including by the EU Commission, which supervises the implementation of the provisions. The procedure for determining the legal framework for the entire pipeline – from its beginning in Russia to its end in Germany – is not clearly defined. Meanwhile, it is not a foregone conclusion as to how the functioning of the segment running from German territorial sea to the Russian border will be regulated, or how a coherent framework for the whole of Nord Stream 2 will be agreed. Among other issues, it is currently unclear whether a given investment will be considered completed at the moment when its construction is finished (such are the prevailing interpretations), when the gas begins to flow, or when the pipeline is filled with gas to its full capacity. This is particularly relevant in the case of Nord Stream 2, whose construction is progressing apace. Clarification is also required as to which countries/markets will be considered as affected by a given gas pipeline – and who it will thus be necessary to consult with regarding certain actions. Finally, it will be important how Nord Stream 2's impact on competition on specific EU states' markets will be assessed; analyses already exist which present mutually contradictory conclusions on this matter.

## 4. The directive's effectiveness

The amendment to the gas directive explicitly confirms that EU law applies in the case of Nord Stream 2 (that is, to the section running through German territorial sea), including the rules on unbundling, third-party access, independent operators et al. However, bringing its provisions into force will probably not stop the construction of the pipeline – over 600 kilometres of the first line and a few tens of kilometres of the second have now been built. The future functioning of Nord Stream 2 would certainly be made more complicated, and the need to establish a legal framework for the whole pipeline and implement the formal changes may contribute to delays in its construction and/or exploitation. At the same time, implementation will be crucial for the effectiveness of the directive and its specific

provisions, which have been agreed after many hardships.

Firstly, the timeframe will be important: both the moment when the directive actually comes into force, and the moment when the construction of Nord Stream 2 is completed, will determine which of the directive's provisions will be applicable in its case. This will define how any possible exemptions for the project could be granted, among other factors. The pace at which Nord Stream 2 is being constructed will in turn be influenced by factors including what kind of decision (if any) is taken by Denmark, which has so far delayed giving permission for the pipeline to be constructed in its territorial sea.

Secondly, the directive's effectiveness will depend on the future European Commission's position on Nord Stream 2, as well as its independence and resilience to any pressure related to how EU law is enforced in the case of the project, or of the effects of any talks with Russia on this issue. This is all the more important as the project is and will remain subject to the strong and often conflicting interests of key political players both inside and outside the EU: Germany, Russia and the United States. In particular, it cannot be ruled out that Russia will put pressure on both the EU and Germany to guarantee some way of exempting Nord Stream 2 from EU law or will propose joint negotiations on the pipeline's legal regime, and the future of the transit of Russian gas via Ukraine to the EU. In this context, the policies and specific actions Germany takes will be important: how Berlin will transpose the revised directive into national law, how it will conduct the talks with Moscow on implementing EU rules to Nord Stream 2, and how willing Germany will be to represent the interests of the EU as a whole, and how much its own interests. The activities of other member states may also play a certain part: after Brexit, the relative importance of France within the EU will increase, as will that of the smaller EU states.

The second half of 2019 and the beginning of 2020 could be a particularly sensitive time for the implementation of the directive's provisions and arrangements concerning Nord Stream 2: this period will see elections to the European Parliament, the election of new presidents of the European Commission and the EU Council, and the formation of a new European Commission. The EU's institutions may function less effectively during this transitional period. Also, the construction of Nord Stream 2 will probably be completed during this time, and the current contracts on the transit of Russian gas to Ukraine and Poland will expire, and it is unclear at present whether, when and what new transit contracts will be signed. The German-Russian talks on regulating the pipeline's operation in accordance with EU law – when conducted in a context where the EU institutions' actions are limited in their effectiveness, and there is no stable framework for the transit of gas from Russia via the current routes – may prove to be an exceptional challenge, and they may bring about arrangements which are contrary not only to the spirit but also to the letter of the amended provisions.