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## CHAPTER 4:

# EU-RUSSIA RELATIONS THROUGH THE PRISM OF EU LAW

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Relations between the European Union and Russia have been strained in recent years. The reasons for this are many and complex. This article examines the relations between the European Union and Russia from the prism of EU Energy Law only. It discusses in turn: (i) the European Commission's investigation of Gazprom's alleged breaches of competition law; (ii) its actions in respect of the South Stream gas pipeline project; (iii) the legal issues surrounding the OPAL gas pipeline; (iv) the legal proceedings commenced by Russia against the EU before the World Trade Organization (WTO) concerning provisions of EU energy law; and (v) the on-going debate regarding the construction of Nord Stream 2 gas pipeline.

### **European Commission's actions against Gazprom**

There are two investigations of Gazprom underway at the EU level at present. The first one dates back to September 2011 and concerns alleged breaches of Article 101 of the Treaty on the Functioning of the European Union (TFEU). The second one dates back to September 2012 and concerns possible breaches of Article 102 TFEU.

#### *(a) Alleged Breaches of Article 101*

In September 2011 the European Commission (EC) raided the offices of Gazprom and of its major customers in ten EU Member States (MS), including RWE, E.On and OMV.<sup>1</sup> At the time the EC said it suspected that these companies were taking part in the following activities: market partitioning, obstructing network access, obstructing supply diversification and excessive pricing. As at the date of the publication of this article, the EC continues its investigation of these alleged breaches of Article 101 TFEU.

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<sup>1</sup> European Commission. (2011, September 27). *Press Release: Commission confirms unannounced inspections in the natural gas sector*. Retrieved from: [http://europa.eu/rapid/press-release\\_MEMO-11-641\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-11-641_en.htm?locale=en)

*(b) Alleged Breaches of Article 102*

Shortly after the raids in September 2011 Lithuania requested that the EC investigate Gazprom's alleged practice of unfairly pricing gas sold to Lithuania.<sup>2</sup> On 4 September 2012 the EC issued a formal letter of objection to Gazprom alleging that it is abusing its dominant position and is thus, in breach of Article 102 TFEU.<sup>3</sup> In the letter the EC alleged that Gazprom was hindering the free flow of gas in MS by dividing markets, preventing diversification of supply of gas in MS and imposing unfair prices on its customers by linking the price of gas to the price of oil.

In April 2015 the EC issued a much more nuanced statement of objections alleging that Gazprom's overall practices amounted to an abuse of a dominant position.<sup>4</sup> In particular, it claimed that the cumulative effect of the following activities amounted to an abuse of dominant position. First, the EC argued that the imposition of territorial restrictions (including export bans and destination clauses) on wholesalers and industrial customers in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia, the EC argued, enabled Gazprom to pursue an unfair pricing policy in five MS (Bulgaria, Estonia, Latvia, Lithuania and Poland) by charging wholesalers prices that are significantly higher compared to Gazprom's costs or to benchmark prices.<sup>5</sup> Second, the setting of prices using an oil-indexed formula partly, the EC argued, enabled Gazprom to charge unfair prices to its customers. Third, the EC argued Gazprom conditioned its supply of gas to Bulgaria and Poland on obtaining unrelated commitments from wholesalers in those countries regarding gas transport infrastructure.

It is not yet clear that an out-of-court settlement will be reached between the EC and Gazprom. The complete breakdown in relations between the EU and Russia after Russia's annexation of Crimea and the introduction of sanctions against Russia in 2014 have made discussions between them very difficult. If an out-of-court settlement is not reached it is likely that the EC will issue a decision prohibiting infringements it will identify therein pursuant to Article 7 of Regulation 1/2003.<sup>6</sup> In such circumstances Gazprom could potentially face (i) having to pay a fine of up to 10 percent of its annual turnover; and (ii) numerous proceedings in the courts of MS by companies seeking damages for harm they have allegedly suffered as a result of its breaches of EU competition law.

<sup>2</sup> Lithuania steps forward as whistle-blower in Gazprom row. (2011, September 28). *Euractiv*. Retrieved from: <http://www.euractiv.com/energy/lithuania-steps-forward-gazprom-news-514650>

<sup>3</sup> European Commission. (2012, September 4). *Press Release: Antitrust: Commission opens proceedings against Gazprom*. Retrieved from: [http://europa.eu/rapid/press-release\\_IP-12-937\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-12-937_en.htm?locale=en)

<sup>4</sup> European Commission. (2015, April 22). *Press Release: Antitrust: Commission sends Statement of Objections to Gazprom for alleged abuse of dominance on Central and Eastern European gas supply markets*. Retrieved from: [http://europa.eu/rapid/press-release\\_IP-15-4828\\_en.htm](http://europa.eu/rapid/press-release_IP-15-4828_en.htm)

<sup>5</sup> *Ibid.*

<sup>6</sup> Official Journal L 001. (2003, January 4). *Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty*. Retrieved from: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32003R0001>

The most recent meeting between EU Commissioner for Competition Margrethe Vestager and Gazprom took place on 26 October 2016. The possibility of Gazprom making commitments to address EC's competition concerns in a forward looking manner were discussed. In her email statement Vestager said the EC's objectives are (i) to ensure restrictions on cross-border reselling of gas purchased from Gazprom 'are removed once and for all', (ii) 'to facilitate the flow of gas to Central and Eastern European gas markets' and (iii) to ensure that Gazprom 'cannot act on any rights concerning gas infrastructure which it obtained from customers by having leveraged its market position in gas supply'.<sup>7</sup> Based on these discussions Gazprom is expected to prepare its final proposal for out of court settlement in the next few weeks.<sup>8</sup>

### EC actions regarding South Stream

In its original iteration South Stream was a project to construct a 2,380 km gas pipeline project to bring about 63 billion cubic meters (bcm) per annum of Russian gas to South East Europe (SEE). The project was announced on 23 June 2007 with the signing of a memorandum of understanding between Eni, an Italian state-owned company, and Gazprom.<sup>9</sup>

Over the following four years Russia signed Inter-Governmental Agreements (IGAs) with Italy, Bulgaria, Serbia, Slovenia, Croatia, Hungary and Austria regarding the construction and operation of the South Stream pipeline. Gazprom signed agreements with the gas incumbents from these countries to set up joint-venture companies to construct and own the sections of the South Stream pipeline crossing these countries. Under these agreements the joint-venture companies were equally owned between the respective national incumbent and Gazprom.

The project was for a while in 2012 ranked amongst the projects being considered to be nominated as projects of common interest (PCIs) pursuant to Regulation No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) 714/2009 and (EC) No 715/2009 (the 'TEN Regulation').<sup>10</sup> PCIs are projects which are considered essential to completing the EU internal energy market and achieving the EU's energy policy objectives of affordable, secure and sustainable energy. A project which is declared a PCI benefits from accelerated permitting procedure and access to EU financial support *via* the Connection Europe Facility. Importantly, listing as a PCI amounts to political endorsement of the project by the EC and other EU institutions. When the official

<sup>7</sup> Vestager confirms meeting with Gazprom in Brussels. (2016, October 27). Interfax. Retrieved from: <http://interfaxenergy.com/gasdaily/article/22559/vestager-confirms-meetings-with-gazprom-in-brussels>

<sup>8</sup> Gazprom putting 'final touch' to EU antitrust deal. (2016, October 26). Reuters. Retrieved from: <http://www.reuters.com/article/us-russia-gazprom-eu-competition-idUSKCN12Q221>

<sup>9</sup> Gazprom and ENI sign Memorandum of Understanding for South Stream Project. (2007, June 23). *Gazprom News*. Retrieved from: <http://www.gazprom.com/press/news/2007/june/article63839/>

<sup>10</sup> Official Journal of the European Union. (2013, April 25). *OJ L115/39*. Retrieved from: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:115:0039:0075:en:PDF> ('TEN Regulation')

## Map: South Stream



Source: Gazprom<sup>11</sup>

PCI list was adopted on 21 December 2013 pursuant to TEN Regulation South Stream was not listed amongst the PCIs.<sup>12</sup>

In November 2012 the EC was expressly granted the power to review energy-related IGAs entered into by MS with non-EU countries pursuant to Decision 994/2012/EU establishing an information exchange mechanism with regard to inter-governmental agreements between Member States and third countries in the field of energy (the Decision).<sup>13</sup> The Decision required MS to submit existing IGAs to the EC for a review of their compatibility with the EU *acquis* by 17 February 2013.

In compliance with their obligations under the Decision Italy, Bulgaria, Slovenia, Croatia, Hungary and Austria formally submitted the South Stream IGAs to the EC for review. In August 2013 the EC notified these states that their IGAs with Russia were incompatible with the EU *acquis*.<sup>14</sup> In the months that ensued numerous high level meetings were held between the representatives of the MS with and without the EC regarding the alleged incompatibility

<sup>11</sup> Gazprom. *Map* [image]. Retrieved from: <http://www.gazprom.com/f/posts/83/786221/south-stream-map-en.jpg>

<sup>12</sup> Annex VII to TEN Regulation, *Ibid.*; European Commission Unveils Projects of Common Interest, South Stream Excluded. (2013, October 14). *Natural Gas Europe*. Retrieved from: <http://www.naturalgaseurope.com/european-commission-projects-common-interest-budget>

<sup>13</sup> Decision No 994/2012/EU of the European Parliament and of the Council of 25 October 2012 establishing an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy, (2012, October 27). *OJ L 299/13*. Retrieved from: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:299:0013:0017:EN:PDF>

<sup>14</sup> South Stream bilateral deals breach EU law, Commission says. (2013, December 4). *Euractiv*. Retrieved from: <http://www.euractiv.com/section/competition/news/south-stream-bilateral-deals-breach-eu-law-commission-says/>

of the IGAs with the EU *acquis*.

Regulators from a number of countries have maintained that they had obtained the EC's informal clearance of their IGA prior to their conclusion and expressed concerns in private about the EC *volte-face*. For a while Bulgaria took the view that the IGAs and the joint-venture agreements with Gazprom did not breach the terms of Articles 10 and 11 of Directive 2009/73/EC concerning common rules for the internal market in natural gas (the Third Gas Directive)<sup>15</sup> or any other provisions of the EU *acquis* concerning the internal market for natural gas (known as the Third Energy Package). In particular, Bulgartransgaz, the Bulgarian transmission system operator which had entered into a 50-50 joint venture agreement with Gazprom, argued that the requirements of Articles 10 and 11 are only triggered once a pipeline is constructed since a transmission system operator needs to be certified to operate, and not to construct, a pipeline. Since the Bulgarian section of the South Stream pipeline had not been constructed at the time, it therefore maintained that the IGA provisions giving Gazprom a 50% share in the pipeline did not breach the requirements of Articles 10 and 11.

However, the EC took a different view. In its decision granting an exemption from third party access to the Trans-Adriatic Pipeline (TAP) in 2013 the EC interpreted Article 10 as requiring the pipeline to be 'fully certified before the start of the construction of the pipeline'.<sup>16</sup> Since the EC does not quote from the actual wording of the Article or any other provisions of the Third Energy Package in support of its interpretation of the scope of Article 10, it is not possible to comment on the strength of its argument.

In June 2014 the EC started infringement proceedings against Bulgaria pursuant to Article 258 TFEU.<sup>17</sup> No proceedings were brought against the other MS who had similar IGAs with Russia. In its letter of formal notice to Bulgaria the EC alleged that (i) the South Stream IGA breached provisions of the Third Energy Package; and (ii) the tendering procedure for the construction of the Bulgarian section of the pipeline breached EU public procurement rules.<sup>18</sup>

The proceedings were dropped after President Putin announced the cancellation of the project in December 2014.<sup>19</sup> The Bulgarian government alleges that by the time the project was cancelled over 250 million euros had been invested in Bulgaria alone in this project<sup>20</sup>

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<sup>15</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC. (2008, August 14). *OJ L 211/94*. Retrieved from: <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:32009L0073>

<sup>16</sup> Commission Decision of 16.5.2013 on the exemption of the Trans Adriatic Pipeline from the requirements on third party access, tariff regulation and ownership unbundling laid down in Articles 9, 32, 41(6), 41(8) and 41(10) of Directive 2009/73/EC. (2013, May 16). Retrieved from: [https://ec.europa.eu/energy/sites/ener/files/documents/2013\\_tap\\_decision\\_en.pdf](https://ec.europa.eu/energy/sites/ener/files/documents/2013_tap_decision_en.pdf)

<sup>17</sup> EU Commission Triggers Infringement Procedure Against Bulgaria over South Stream Energy Project. (2014, June 2). *Natural Gas Europe*. Retrieved from: <http://www.naturalgaseurope.com/eu-commission-bulgaria-south-stream-infringement>

<sup>18</sup> Does the cancellation of South Stream signal a fundamental reorientation of Russian gas export policy? (2015, January). *The Oxford Institute for Energy Studies*. Retrieved from: <http://www.oxfordenergy.org/wp-content/uploads/2015/01/Does-cancellation-of-South-Stream-signal-a-fundamental-reorientation-of-Russian-gas-export-policy-GPC-5.pdf>

<sup>19</sup> Russia says South Stream Project is over. (2014, December 2). *Euractiv*. Retrieved from: <http://www.euractiv.com/section/global-europe/news/russia-says-south-stream-project-is-over/>

whilst Gazprom alleges that it had invested over Euro 4.3 billion for the development of this project as a whole.<sup>21</sup>

Until recently the South Stream project was considered all but dead. Turk Stream, a Russia-Turkish pipeline project, was announced as its replacement in December 2014. As planned, the offshore part of the pipeline is to cross 910 km of the Black Sea bed and was to surface in Turkey at Kiyıköy, with a gas delivery point at Lüleburgaz for Turkish customers and the border crossing between Turkey and Greece at İpsala serving as delivery point for European customers. The Turkish downing of the Russian military plane in Syria in November 2015 halted discussions on Turk Stream for a while.<sup>22</sup>

Fears that transit of Russian gas *via* Ukraine to the SEE will stop in 2019 has led to a revival

### Map: Turk Stream



Source: Gazprom<sup>23</sup>

of discussions regarding South Stream.<sup>24</sup> Both Naftogaz and Russia have publically discussed the possibility that the transit contract between Gazprom and Ukrtransgaz will not be extended after 31 December 2018, the date its current term expires.<sup>25</sup> With the possibility

<sup>20</sup> Life after South Stream: Accelerated Modernisation of Bulgaria's Gas Sector. (2015, May 12). *Energy World Magazine*. Retrieved from: <https://www.energyworldmag.com/12/05/2015/life-after-south-stream-accelerated-modernisation-of-bulgarias-gas-sector/>

<sup>21</sup> See "Russia says South Stream Project is over," *op. cit.*

<sup>22</sup> Russia shelves Turkish Stream pipeline project. (2015, December 3). *Euractiv*. Retrieved from: <http://www.euractiv.com/section/europe-s-east/news/russia-shelves-turkish-stream-pipeline-project>; Hille K. (2016, August 9). *Financial Times*. Retrieved from: <https://www.ft.com/content/416c57e6-5e4b-11e6-bb77-a121aa8abd95>.

<sup>23</sup> Gazprom. *Map* [image]. Retrieved from: <http://www.gazprom.com/f/posts/55/359415/map-turkish-stream-en.jpg>

<sup>24</sup> Autonomous Non-Profit Organisation (ANO). (2016, February 10). *TV-Novosti: Europe lays out conditions for Russia's South Stream return*. Retrieved from: <https://www.rt.com/business/331995-south-stream-renewal-conditions>

that the transit of Russian gas to SEE *via* Ukraine would be halted, the gas buyers in SEE are in urgent need to secure alternative routes for the delivery of Russian gas.

In February 2016 a memorandum of understanding was signed in Rome between Gazprom, Edison and Depa to 'organize the southern route for supplying Russian natural gas to Europe'.<sup>26</sup> This new version of South Stream is to involve the interconnector between Greece and Italy known as ITGI Poseidon, which is a PCI. Although it is not yet clear, it would seem that Bulgaria would be the point at which Russian gas would land on-shore in Europe as was the plan under the original iteration of the South Stream project.<sup>27</sup>

The viability of the new version of South Stream has been put in question after Russia and Turkey signed the IGA to construct Turk Stream in October 2016.<sup>28</sup> The relations between the two countries thawed after the failed coup against President Erdoğan in July 2016 and the Turkish apology for the downing of the plane in August. The countries have announced that the offshore pipelines will be completed by 2019 – the year the current term of the Ukrainian transit agreement ends.

### Legal issues surrounding the OPAL pipeline

Ostsee-Pipeline-Anbindungsleitung (OPAL) pipeline is a 470 km gas pipeline which runs along the German eastern border with the Czech Republic and connects Nord Stream 1 pipeline to the existing pipeline grid in Central and Western Europe. Nord Stream 1 is a 1225-kilometre twin pipeline system which brings Russian gas to Germany. It crosses the exclusive economic zones (EEZs) of Russia, Finland, Sweden, Denmark and Germany. The combined capacity of the two pipelines is 55 bcm of gas a year. The construction of the first pipeline was completed in June 2011 and the second line in April 2012.

In 2007 Wingas, a joint venture company owned by Gazprom and Wintershall, applied to BundesNetzAgentur (the BNA), the German regulator, for a one hundred percent exemption from third party access (TPA) for the OPAL pipeline pursuant to Article 22 of Directive 2003/55/EC concerning common rules for the internal market in natural gas (the Second Gas Directive).<sup>29</sup> It argued that the pipeline could only be built if all of the capacity on the pipeline was reserved for Gazprom gas.

Under Article 22 an exemption from TPA is granted to construct new pipelines and other

<sup>25</sup> Mazneva E. (2015, April 13). Russia Plans to End Ukraine Gas Transit for New Route After 2019. *Bloomberg*. Retrieved from: <http://www.bloomberg.com/news/articles/2015-04-13/russia-plans-to-end-ukraine-gas-transit-for-new-route-after-2019>

<sup>26</sup> Mustafayeva K. (2016, February 25). Edison, Depa Renew South Stream Vows. *Gazprom*. Retrieved from: <http://www.naturalgaseurope.com/gazprom-proposes-a-third-southern-gas-project-o-eu-28344>

<sup>27</sup> Russia Claims Bulgaria Actively Seeking New South Stream Talks. (2016, March 10). *Sofia News Agency*. Retrieved from: <http://www.novinite.com/articles/173473/Russia+Claims+Bulgaria+Actively+Seeking+New+South+Stream+Talks>

<sup>28</sup> Autonomous Non-Profit Organisation (ANO). (2016, October 10). TV-Novosti: Turkish Stream gas pipeline: Moscow and Ankara sign agreement in Istanbul. Retrieved from: <https://www.rt.com/business/362279-gazprom-turkish-stream-pipeline/>

<sup>29</sup> Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC. (2003, July 15). *OJ L 176*, Retrieved from: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32003L0055>

gas infrastructure when it can be shown that *inter alia* the investment will 'enhance competition in gas supply and enhance security of supply' and 'the level of risk attached to the investment is such that the investment would not take place unless an exemption was granted'. In other words, EU law recognises that large capital intensive projects must be underwritten by long-term supply contracts in order to ensure their bankability.

Before it can grant an exemption under Article 22 the national energy regulator must notify the EC of its draft decision. The EC is in turn able to request amendments to or withdrawal of the decision within two months of such notification.

In February 2009 the BNA granted OPAL a one hundred percent TPA exemption for 23 years from the date of commencement of commercial activity.<sup>30</sup> In June 2009 the EC required the BNA effectively to reduce the TPA exemption to fifty percent. Gazprom's ability to book more than fifty percent of the capacity on the pipeline was, as a co-owner of the pipeline and dominant supplier of gas in the Czech Republic, subject to a gas release programme pursuant to which Gazprom was required to auction of at least three bcm of gas to the market together with related capacity on the pipeline to its competitors.<sup>31</sup>

Since the OPAL pipeline became operational in November 2012 no third party supplier has sought to book capacity on the pipeline.<sup>32</sup> Accordingly, the pipeline has been operating at fifty percent capacity for over 3 years. Eager to supply more gas Gazprom and OPAL Gastransport approached BNA to revise its decisions. At the end of 2013 the BNA proposed to revise its decision by allowing capacity over the 50 per cent to be put up for auction on the European pipeline capacity auctioning platform called PRISMA. Had this proposal been approved by the EC Gazprom would have been able, along with any other interested market player, to have bid for that capacity.<sup>33</sup>

Although Article 22 requires the EC to provide its comments on an exemption within two months of notification by a national regulator of the same, the EC extended, with the consent of Gazprom and OPAL Gastransport, this deadline three times citing 'the need for further clarifications of some technical details' as the reason for the extension.<sup>34</sup> In October 2014 the EC invoked the situation in the Ukraine to seek extra time to issue a decision.<sup>35</sup> In December

<sup>30</sup> Bundesnetzagentur Beschluss Az. BK7-08-009. (2009, February 25). Retrieved from: [http://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK7-GZ/2008/2008\\_0001bis0999/2008\\_001bis099/BK7-08-009\\_BKV/BK7-08-009\\_Beschluss\\_vom\\_25022009\\_bf.pdf?\\_\\_blob=publicationFile&v=6](http://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK7-GZ/2008/2008_0001bis0999/2008_001bis099/BK7-08-009_BKV/BK7-08-009_Beschluss_vom_25022009_bf.pdf?__blob=publicationFile&v=6); and Bundesnetzagentur Beschluss Az. BK7-08-010. (2008, October 2). Retrieved from: [http://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK7-GZ/2008/2008\\_0001bis0999/2008\\_001bis099/BK7-08-010\\_BKV/Beiladung\\_Concord\\_PowerNordalGmbH\\_Id14684pdf\\_bf.pdf?\\_\\_blob=publicationFile&v=5](http://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK7-GZ/2008/2008_0001bis0999/2008_001bis099/BK7-08-010_BKV/Beiladung_Concord_PowerNordalGmbH_Id14684pdf_bf.pdf?__blob=publicationFile&v=5)

<sup>31</sup> European Commission, Decision no. K (2009)4694. (2009, June 12). Retrieved from: [https://ec.europa.eu/energy/sites/ener/files/documents/2009\\_opal\\_decision\\_de.pdf](https://ec.europa.eu/energy/sites/ener/files/documents/2009_opal_decision_de.pdf)

<sup>32</sup> Russian Gas Transit Across Ukraine Post-2019: pipeline scenarios, gas flow consequences, and regulatory Constraints. (2016, February). *The Oxford Institute for Energy Studies*. p. 30. Retrieved from: <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2016/02/Russian-Gas-Transit-Across-Ukraine-Post-2019-NG-105.pdf>

<sup>33</sup> Gazprom cancels request for special access rules on OPAL. (2015, January 28). *Contexte*. Retrieved from: [https://www.contexte.com/article/energie/gazprom-cancels-request-for-special-access-rules-on-opal\\_38649.html](https://www.contexte.com/article/energie/gazprom-cancels-request-for-special-access-rules-on-opal_38649.html)

<sup>34</sup> *Ibid.*



2014 the EC terminated the review procedure after Gazprom refused to agree to a further extension.<sup>36</sup>

The actions of the EC have been criticised by many including leading think tanks as evidence of the increased politicisation of energy. In its recent study regarding transit via Ukraine the Oxford Institute of Energy Studies described the EC's refusal to endorse the BNA's revised decision as 'increasingly illogical, strongly suggesting that it may have been political rather than regulatory' in view of the fact that only 0.17 bcm of the 3.2 bcm of the gas offered and 1.2 bcm of the gas sold at the gas auction organised by Gazprom in September 2015 was sold with delivery via OPAL.<sup>37</sup>

In April 2015 Gazprom filed a new request with the BNA to obtain the right to use one hundred percent of the capacity in the OPAL pipeline.<sup>38</sup> In May 2016 BNA notified the EC of its revised decision to amend the 2009 exemption decision. It proposed to replace the existing fifty per cent booking limitation, which was subject to a gas release programme, with a non-discriminatory access to half of the capacity. On 28 October 2016, two days after the meeting between Vestager and Gazprom regarding EC's competition case against Gazprom (see discussion above), the EC issued a decision revising its exemption decision of June 2009.<sup>39</sup> Pursuant to the decision Gazprom will be able to increase gas exports via the OPAL pipeline by at least 7-10 bcm per annum provided that at least 2.56 bcm of the transmission capacity are auctioned to third parties. Subject to the possibility of Polskie Górnictwo Naftowe i Gazownictwo (PGNiG), Polish energy incumbent, challenging the EC's decision before the Court of Justice of the EU, it would seem that the long-standing issue regarding the use of OPAL will be resolved.

### **Russia's claim against the EU**

In April 2014 Russia commenced proceedings against the EU before the World Trade Organisation (WTO). In its Request for Consultation<sup>40</sup> Russia argued that the EU's certification, unbundling and TPA provisions of the Third Gas Directive, violate: (i) Article II (Most-Favoured-Nation Treatment), Article VI (Domestic Regulation), Article XVI (Market Access) and Article XVII (National Treatment) of the General Agreement on Trade in Services (GATS);<sup>41</sup> (ii) Article I

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<sup>35</sup> EU delays decision on Russian access to Opal gas pipeline. (2014, November 3). *Reuters*. Retrieved from: <http://www.reuters.com/article/us-ukraine-crisis-eu-opal-idUSKBN0IN12S20141103>

<sup>36</sup> See "Russia says South Stream Project is over," *op.cit.*

<sup>37</sup> See "Russian Gas Transit Across Ukraine Post-2019" *op.cit.*

<sup>38</sup> Gazprom requests use of full OPAL capacity. (2015, April 15). *Interfax*. Retrieved from: <http://interfaxenergy.com/gasdaily/article/15835/gazprom-requests-use-of-full-opal-capacity>

<sup>39</sup> Gas markets: Commission reinforces market conditions in revised exemption decision on OPAL pipeline. (2016, October 28) [http://europa.eu/rapid/press-release\\_IP-16-3562\\_en.htm](http://europa.eu/rapid/press-release_IP-16-3562_en.htm)

<sup>40</sup> Request for Consultations by the Russian Federation to the Delegations of the European Union and its Member States. (2014, April 30). Retrieved from: [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-DP.aspx?language=E&CatalogueIdList=124563&CurrentCatalogueIdIndex=0&FullTextHash=](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=124563&CurrentCatalogueIdIndex=0&FullTextHash=)

(General Most-Favoured-Nation Treatment), Article III (National Treatment on Internal Taxation and Regulation), Article X (Publication and Administration of Trade Regulations) and Article XI (General Elimination of Quantitative Restrictions) of the 1994 General Agreement on Tariffs and Trade (GATT);<sup>42</sup> (iii) Article 3 (Prohibition) of the Agreement on Subsidies and Countervailing Measures<sup>43</sup> and (iv) Article 2 (National Treatment and Quantitative Restrictions) of the Agreement on Trade Related Investment Measures.<sup>44</sup> Interestingly it has not claimed that these provisions breach Article V of GATT, which accords freedom of transit to oil and gas via pipelines.<sup>45</sup>

Article 11 is the key provision of the Third Gas Directive challenged by Russia. This Article is known as the 'Gazprom clause' and is said to have been adopted for 'fear that ownership unbundling – the separation of integrated energy firms' production assets from their transmission assets – would lead to the indiscriminate acquisition of EU energy grids by third countries' and, more specifically by Russia.<sup>46</sup>

In September 2007 José Manuel Barroso, the EC President at the time, claimed that Article 11 ensured that 'we all play by the same rules'. However, it is clear from the wording of Article 11 that it imposes different rules regarding the certification of a transmission system operator (TSO) when the TSO is controlled by a non-EU country or a non-EU national compared to those when it is controlled by an EU country or national.<sup>47</sup> In particular, it provides that a request by a TSO or a TSO controlled by a non-EU country or non-EU national must be refused if it has not been demonstrated that (i) the TSO complies with effective unbundling requirements as set out in Article 9; and (ii) the certification will not put at risk the security of energy supply of MS and the EU taking into account: (a) the rights and obligations of the EU arising under international law, including any agreement by the EU which addresses the issue of security of energy supply; (b) the rights and obligations of MS with third countries, in so far as they are in compliance with EU law; and (c) other specific facts and circumstances of the case and the third state in question.

The same rules are not imposed on TSOs owned by an EU national or country. In particular, such TSOs do not have to demonstrate that its certification will not put at risk the security of the energy supply of a MS and the EU as a whole. More importantly, such TSOs are deemed

41 WTO General Agreement on Trade in Services. Retrieved from: [https://www.wto.org/english/docs\\_e/legal\\_e/26-gats.pdf](https://www.wto.org/english/docs_e/legal_e/26-gats.pdf)

42 WTO General Agreement on Tariffs and Trade 1994. Retrieved from: [https://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gatt1994\\_e.htm](https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_e.htm)

43 WTO Agreement on Subsidies and Countervailing Measures. Retrieved from: [https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

44 WTO Agreement on Trade-related Investment Measures. Retrieved from: [https://www.wto.org/english/docs\\_e/legal\\_e/18-trims.pdf](https://www.wto.org/english/docs_e/legal_e/18-trims.pdf)

45 Stanič, A. (2003). A Guide to International Rules for the Transportation of Oil and Gas: a Particular Look at the Caspian Region in Oil and Gas Law of Kazakhstan: National and International Perspectives, *Kluwer International*.

46 'Gazprom clause' issues Russia ultimatum for energy co-operation. (2007, September 20). *Euractiv*. Retrieved from: <http://www.euractiv.com/section/med-south/news/gazprom-clause-issues-russia-ultimatum-for-energy-co-operation/>

47 *Ibid*.

to comply with Article 9 requirements regarding effective unbundling if it is owned by a different public body of a MS to that which owns the company which produces or supplies the gas or electricity. This is because Article 9(6) of the Third Gas Directive deems the requirements for unbundling to have been met even if a MS owns the TSO on the one hand and the gas supplier and/or producer provided two different ministries or public bodies hold the shares in these companies. Without this deeming provision a state's ownership of these companies would make such a company a vertically integrated company and thus would have to be effectively unbundled.

This deeming provision only applies in situations where the shares are owned by a MS and therefore does not apply when shares are owned by a non-EU country. In view of the above, Russia has alleged in its claim against the EU in the WTO that Articles 11 and 9 breach *inter alia* the EU's obligation to accord Russian companies national treatment under GATT and GATS, this being an obligation to accord Russian companies the treatment as favourable as that accorded to EU nationals.

At a meeting of the Dispute Settlement Body (DSB) on 19 June 2015, the EC rejected Russia's request for a panel to be established. It maintained that Russia's panel request manifestly expanded the scope of the dispute, thus changing the essence of the complaint.<sup>48</sup> At the meeting on 20 July 2015 the DSB established the panel in accordance with Article 6 of the Understanding on rules of procedures governing the settlement of disputes (DSU).<sup>49</sup> As no agreement was reached between the EU and Russia on who should be the members of the panel the Director-General of the DSB appointed the members of the panel on 7 March 2016. China, Colombia, India, Japan, the Republic of Korea, the Kingdom of Saudi Arabia, Ukraine and the United States have reserved their rights pursuant to Article 10 of the DSU to participate in the Panel proceedings as third parties.<sup>50</sup> As a general rule Article 12(8) of the DSU requires that the panel issue its final report within six months of the date it was appointed. Given the complexity of this case it is probably more likely that the report will be issued within a year of the panel's appointment. Since the report of the panel can be appealed, the outcome of Russia's challenge is likely not be known before June 2017.

### **On-going discussions regarding Nord Stream 2**

As discussed above, the recent suggestion by both Naftogaz and Gazprom that the transit gas could stop flowing through Ukraine to Europe in early 2019 has re-opened the debate on whether alternative routes for the supply of Russian gas should be considered. Nord Stream 2 is one such project, alongside Turk Stream and the revived South Stream.

Nord Stream 2 is a project to lay a second set of pipelines along the existing Nord Stream

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<sup>48</sup> WTO. (2016, April 12. last update). *European Union and its Member States — Certain Measures Relating to the Energy Sector, Dispute No. DS476*, Retrieved from: [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds476\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds476_e.htm)

<sup>49</sup> Annex 2 to the WTO Agreement. Retrieved from: [https://www.wto.org/english/tratop\\_e/dispu\\_e/dsu\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm).

<sup>50</sup> *Ibid.*

1 pipelines and thereby provide an alternative route to supply Russian gas to Europe. A memorandum of understanding was signed between Gazprom, E.On, Shell and OMV to build Nord Stream 2 on 18 June 2015.<sup>51</sup> A shareholder agreement was signed between Gazprom, BASF, E.ON, Engie, OMV and Shell in September of the same year.<sup>52</sup> The additional 55 bcm per year of gas which would be supplied through the pipeline would cover roughly 75% of the current Russian natural gas export to the EU.<sup>53</sup>

In December 2015 Germany's national competition regulator, the Federal Cartel Office, approved the creation of the consortium (Gazprom, Wintershall, Shell, E.ON, ENGIE, OMV) to construct and operate the Nord Stream 2 pipeline in December 2015, triggering a storm of objections from Poland, the Baltic states and other countries.<sup>54</sup> In August 2016 the Polish competition authority issued a statement of objections arguing that the above mentioned consortium would restrict competition in Poland since 'Gazprom has a dominant position on the market when it comes to supplying gas to Poland, and the deal could strengthen further the company's negotiating position with regard to users in Poland'.<sup>55</sup> Rather than challenge the decision the consortium has withdrawn their application and is now considering other ways to structure their participation in the project.

Objections have been raised by the EU Parliament and by the EC. At the debate in the Parliament on 6 April this year Mr Buzek, a Polish MEP (and former Polish Prime Minister), said that 'Nord Stream 2 and Energy Union cannot co-exist' and stressed that 'the majority of the European Parliament opposes Nord Stream 2'.<sup>56</sup> The EC Vice President for the Energy Union Maroš Šefčovič has also expressed his doubt that Nord Stream 2 is a commercial project which complies with the EU *acquis*. In particular, he said: 'For me it's hard to see the Nord Stream 2 as a purely commercial project. The pipeline's possible construction will drastically change the European gas supply system, with the EU getting 80 percent of Russian gas via one route, in violation of the energy security requirements'.<sup>57</sup> Since there are no legally binding energy security requirements under EU law which would prohibit construction of

51 Press Release: Gazprom, E.ON, Shell, and OMV agree to develop gas transportation capacities for the deliveries of Russian natural gas to Europe. (2015, June 18). *Gazprom*. Retrieved from: <https://www.gazprom-germania.de/en/media/media-centre/press-release/gazprom-eon-shell-and-omv-agreed-to-develop-gas-transportation-capacities-for-the-deliveries-of-t.html>

52 Press Release: Gazprom, BASF, E.ON, ENGIE, OMV and Shell sign Shareholders Agreement on Nord Stream 2 project. (4 September 2015). *Gazprom*. Retrieved from: <http://www.gazprom.com/press/news/2015/september/article245837>

53 *Ibid.*

54 Nord Stream-2 Pipeline Consortium Approved by German Competition Regulator. (2015, December 22). *Sputnik News*. Retrieved from: <http://sputniknews.com/europe/20151222/1032148425/nord-stream-consortium-approved-german-competition-regulator.html#ixzz3zIAowbJB>

55 Nord Stream 2 pipeline hits stumbling block in Poland. (2016, August 16). *Offshore Energy Today*. Retrieved from: <http://www.offshoreenergytoday.com/nord-stream-2-pipeline-hits-stumbling-block-in-poland/>

56 Can Nord Stream 2 be stopped?. (2016, April 14). *Energy Post*. Retrieved from: <http://www.energypost.eu/can-nord-stream-2-stopped>

57 Brussels Pipes Up: 'All Sides Should Rethink Nord Stream 2's Feasibility'. (2016, February 11). *Sputnik News*. Retrieved from: <http://sputniknews.com/europe/20160211/1034561652/european-commission-nord-stream.html#ixzz3zsF6f049>

Nord Stream 2 his objections seem to be political in nature.

Similarly, objections have been voiced by the European Council at its meeting in December 2015. In the conclusions of its meeting in December 2015 the European Council noted that '[a]ny new infrastructure should entirely comply with the Third Energy Package and other applicable EU legislation as well as the objectives of the Energy Union'.<sup>58</sup> The reference to compliance with 'the objectives of the Energy Union' as a requirement for an infrastructure project to go ahead implies that such objectives are legally binding. This is, however, not the case. The Oxford Institute of Energy Studies has noted in its recent report that reference to these objectives has 'introduced a degree of politicisation in the decision process, thus suggesting that in the EU 'political judgements can override regulation'. Clearly the EC understands that such judgements, if acted upon, risk discrediting the EU energy *acquis* among future investors in infrastructure bringing gas (energy) supplies to the EU, especially those from outside the EU (not necessarily from Russia).<sup>59</sup>

There has also been much debate as to whether the unbundling provisions of the Third Gas Directive apply to Nord Stream 2. In 2009 when the construction of Nord Stream 1 was approved the decision was taken that the provisions of the Second Gas Directive (the Third Gas Directive was not in force at the time) did not apply since the pipeline was constructed in the EEZ of a MS. The EEZ is the marine area beyond the territorial sea of a state extending not more than 200 nm from the baseline. It is declared by a state pursuant to Part V of the 1982 Law of the Sea Convention (the Convention). A state does not have sovereignty over the EEZ as it does in respect of its territorial waters but instead has certain sovereign rights as specified in the Convention. Article 79 of the Convention accords states parties to the Convention to lay pipelines within the EEZ of another state. In view of these provisions, it was argued at the time Nord Stream was being approved that there was no basis for applying the provisions of the Second Gas Directive to Nord Stream 1.

The supporters of Nord Stream 2 have invoked the Nord Stream 1 precedent to say that it similarly does not need to comply with the EU *acquis*. From documents leaked to the press, it looks like the EC's legal department agrees with this analysis.<sup>60</sup> However, Professor Riley and other advisors to the European Parliament disagree. They argue that EU law applies to the territorial waters of the relevant member states and to the EEZ and that the Nord Stream 1 precedent cannot be invoked since Article 11 of the Third Gas Directive was not in force at the time Nord Stream 1 was approved.<sup>61</sup> As at the time of the publication of this article the debate continues to rage.

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<sup>58</sup> European Council. (2015, December 18). *17-18 December 2015 – Conclusions*. Retrieved from: [http://www.consilium.europa.eu/en/meetings/european-council/2015/12/201512-EUCO-conclusions\\_pdf/](http://www.consilium.europa.eu/en/meetings/european-council/2015/12/201512-EUCO-conclusions_pdf/)

<sup>59</sup> See "Gazprom cancels request for special access rules on OPAL," *op.cit.*

<sup>60</sup> Legal opinion undermines EU's ability to block Nord Stream pipeline. Politico Pro. (2016, July 2). Retrieved from: <http://www.politico.eu/pro/nord-stream-gazprom-russia-pipelines-gas/>

<sup>61</sup> See "Can Nord Stream 2 be stopped?," *op.cit.*

**Conclusion**

Energy has been and will remain the key element of the interdependency between the EU and Russia. In the short and medium terms, the EU will remain dependent on Russia for its gas and oil supplies and the EU will remain Russia's main destination for such exports. This paper seeks to shed some light on the increasingly complex and fraught relations between Russia and the EU by looking at issues of EU energy law on which they disagree.

The EC's October decision on OPAL the possible settlement of EC's competition investigation against Gazprom may signal that the relations are improving. However, it is early days yet. The EC's OPAL decision may be challenged and the debate on Nord Stream 2 and other pipeline projects continues to rage. How these matters are approached and resolved will be crucial in defining the nature of their relations for many decades to come.