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THE END OF NORD STREAM 2 GERMANY, THE UNITED STATES, AND EU LAW

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TCUP REPORT

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TCUP Report: The End of Nord Stream 2: Germany, the United States, and EU Law

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The End of Nord Stream 2: Germany, the United States, and EU Law

Absent the arrival of Alexei Navalny in the Kremlin, and a future democratically elected Russian government committed to the rule of law, it is difficult to see how Nord Stream 2 can ever be brought into operation. Just before the large-scale Russian invasion of Ukraine on February 24, the German Chancellor Olaf Scholz announced on February 22 that he was suspending the certification process of Nord Stream 2.¹ Subsequently, on February 23 the State Department removed the sanction waivers for Nord Stream 2 AG, the nominal owner of the pipeline, and its principal executives, including Matthias Warnig, the CEO.²

A series of factors make it highly unlikely that the project can easily be revived. First, there's the deliberate throttling of European gas supply. In Winter 2021/2022, Gazprom deliberately reduced supply to the European Union and ran down EU gas storage.³ This decision alone infringes the supply security test under Article 11 of the Gas Directive 2009.⁴ This requires a non-EU owner to be assessed as to whether it poses a risk to the supply security of the relevant Member State (here, Germany) and the Union as a whole.

One also would find it difficult to imagine how it would

be possible to sustain an argument that a Kremlin-controlled Gazprom posed no supply security risk as a non-EU owner of a pipeline while Ukraine is subject to an all-out, large-scale invasion by the Russian Federation. It is now clear that the steps taken to reduce supply to the European spot market in 2021/2022, combined with the decision to refuse to fill European storages, dramatically in the case of Gazprom's EU-based storages, was part of an invasion strategy aimed at maximizing European supply dependence in the run-up to this latest invasion of Ukraine. Consequently, any proposed Russian owner of a pipeline within EU jurisdiction, particularly where the

¹ *Germany Freezes Nord Stream 2 Gas Project as Ukraine Crisis Deepens*, Reuters, February 22, 2022.

² *Sanctioning NS2AG, Matthias Warnig, and NS2AGs Corporate Officers*, Statement of Anthony J. Blinken, Secretary of State, Department of State, Washington, DC, February 23, 2022.

³ Milov, Vladimir. *How Gazprom Manipulated the EU Gas Market*, Martens Centre, Brussels, February 3, 2022.

⁴ Directive 2009/73/EC of the European Parliament and of the Council, July 13, 2009 concerning common rules for the internal market in natural gas, OJ 2009 L211/94.

owner is in fact the Russian state, is extremely unlikely ever to be successfully certified under Article 11.

This paper argues that the regulatory certification process for Gazprom was always fraught with difficulty. Firstly, almost the entire substantive certification process for Nord Stream 2 is governed by EU law. Hence, the European Commission and other EU Member States would be able to seize the EU courts with the issue at an early stage and obtain both interim measures and ultimately judgments from those courts, culminating in the Court of Justice of the European Union (CJEU). There is no closed legal loop under German law available, even if a future German government intended to revive the pipeline.

In addition, EU energy law, principally the Gas Directive 2009, poses significant barriers to Nord Stream 2 in the shape of its ownership unbundling, third-party access, tariff transparency, and supply security rules. Furthermore, the proposed Nord Stream 2 certification solution, which is minimalist in content, seeking to avoid ownership unbundling and limit the application of the provisions of the Directive solely to German territorial waters, is unlikely to survive a legal challenge before the EU courts.

It is also clear that the European Commission, in any future litigation, would likely take a very robust position on Nord Stream 2. In the overlooked Energy Charter

Treaty case *Nord Stream 2 AG v. the European Union*,⁵ the Commission raised a series of legal questions in respect to Nord Stream 2 which throw considerable doubt over the capacity of the pipeline to ultimately be certified.

This paper argues, therefore, that Chancellor Scholz's announcement of a suspension of the Nord Stream 2 certification process, combined with the imposition of full US sanctions on the pipeline company and its key executives, marks the end of the project for the foreseeable future.

This paper is divided into three parts. Part one focuses on the key legal difficulties that Nord Stream 2 would have to face in complying with the principal liberalization obligations of the EU Gas Directive and the scope of the application of the Gas Directive to the entire pipeline. Part two turns to the recent pleadings filed by the European Commission on behalf of the European Union in the Energy Charter Treaty case brought by Nord Stream 2 against the Union. This section argues that the pleadings filed by the European Commission underline the legal difficulties that Nord Stream 2 faces in obtaining full clearance under the Gas Directive. Furthermore, those pleadings also indicate the likely disposition and approach by the European Commission to a BNetzA decision, which did not fully comply with Union law. Part three offers a conclusion.

⁵ Respondents Counter-Memorial on the Merits, filed May 2021, Permanent Court of Arbitration (PCA) the Hague.



PART 1: THE DIFFICULTIES OF THE GAS DIRECTIVE FOR NORD STREAM 2

It is not as if the rules that Nord Stream 2 and its owner Gazprom have objected to over the last seven years are uniquely discriminatory and constitute some form of alien legal regime. All other market participants, European and non-European, in the European energy market work with the EU's energy liberalization rules. These rules flow both from the technical provisions of the EU's electricity and gas directives, as well as from the EU's competition rules. It is not therefore immediately apparent why Nord Stream 2 is objecting so strongly to the application of EU energy liberalization law to the pipeline. After all, the principles of liberalization – built around unbundling, tariff transparency, and third-party access – are hardly unknown and unapplied outside the EU, and they are common across energy markets worldwide. Even in the Russian Federation some elements of the EU's energy liberalization regime can be found in the gas and electricity sectors.⁶

However, on closer examination it becomes clearer as to why Nord Stream 2 and its owner Gazprom are so opposed to the application of the key liberalization provisions of the Gas Directive 2009 to the pipeline. First, as the Commission indicates below, if Nord Stream 2 is not subject to the EU's energy liberalization regime, Gazprom's exclusive right to export gas by pipeline can be used as leverage to assist in obtaining monopoly rents.⁷ Furthermore, without the existence of liberalization rules, it can effectively export its monopoly power directly into the Union market (discussed further below). In addition, it is able to maintain significant pricing leverage via the opacity it can sustain absent the pricing transparency demanded by the EU's energy liberalization regime.

⁶ For example, see Khokhlov, Alexey & Melnikov, Yuriy, "Market liberalization and decarbonization of the Russian electricity industry," *Oxford Energy Studies*, May 2018. Russian electricity was much more fully subject to EU energy liberalization principles than the gas sector. Even in the gas sector, sufficient 'liberalization' principles have been permitted, which have allowed Novatek and Rosneft to thrive and even Novatek to export liquified natural gas (LNG).

⁷ *Nord Stream 2 ECT*, para 11.

This is why in its certification application, Nord Stream 2 seeks to minimize the application of the Gas Directive: First, by seeking certification as an Independent Transmission Operator (ITO); under the ITO model, Gazprom continues to own the pipeline and can supply natural gas through the pipeline. Secondly, by restricting the application of Union law to that part of the pipeline that runs through German territorial waters. This is known as the 'stub' approach. As argued below, this minimalistic approach to the certification process is problematic to say the least.

Now to the key elements of the EU's liberalization regime and the difficulties they cause for Nord Stream 2.

Unbundling

The first major liberalization barrier for Nord Stream 2 is unbundling. Under Article 9 of the Gas Directive, all new infrastructure is subject to ownership unbundling. In other words, Gazprom as Nord Stream 2's owner is unable to both supply natural gas and substantially own or control the pipeline. The original date in the 2009 Gas Directive was set as September 3, 2009; transmission systems that belonged to a vertically integrated undertaking (VIU) on that date were able to opt out of ownership unbundling.⁸ A VIU could choose to either adopt an Independent System Operator (ISO) model or an Independent Transmission System (ITO) model or indeed an ownership unbundling model. The first two options do not require the sale of the transmission system. The principal difference between ISO and ITO is that in an ISO model, the system operator is a third party and the pipeline is essentially leased to the third party. With the ITO model, ownership is retained, and only legal unbundling is required. The ownership and supply operations of the pipeline are separated and subject to regulatory supervision. Although the ISO and ITO models limit anti-competitive activity by the owner of the

⁸ *Gas Directive 2009, op cit*, Recital 14 and Article 9(8)

pipeline, both models are less effective at ensuring competition than full ownership bundling. From Gazprom's perspective, limiting unbundling as far as possible gives it more control over the network and, consequently, the opportunity for greater discrimination between customers.

However, the Amending Directive 2019 (amending the Gas Directive 2009 to formally extend its provisions to import pipelines, hereafter called the Amending Directive),⁹ introduces a new cut-off date of May 23, 2019.¹⁰ If an import pipeline transmission system was part of a VIU on May 23, 2019, it can benefit from the ISO or ITO model. However, Nord Stream 2 lacked all of its licensing permits, was not physically complete, and was not authorized as of May 23, 2019; hence, it cannot benefit from the VIU exemption. As the Commission's Staff Working Paper discussing the original proposed Amending Directive says,

"In order to ensure that pipelines to and from third countries are not treated less favourably than domestic infrastructure, a new reference date is set (*which was subsequently set at 23rd May 2019*) for the application of Article 9(8) and (9) of the Gas Directive. This will allow the use of alternative bundling models in cases where pipelines to and from third countries belonged to VIUs at the date of adoption of this proposal."¹¹

Nord Stream 2 is therefore left with the prospect of full ownership unbundling of the pipeline. For Gazprom, that would mean potentially selling off the pipeline. There are numerous questions here for the company. For instance, who would wish to acquire a politically controversial pipeline that may subsequently be subject once again to sanctions? If the pipeline is sold to a Russian company, not only will that company be subject to Article 11 supply security certification assessment discussed below, but it is likely to be subject to an assessment of whether or not the Russian company is in fact controlled by another arm or emanation of the Russian state. How will Gazprom find a Russian buyer sufficiently independent from the Russian



state and which can be certified in respect to Article 11? Is Gazprom willing to sell the pipeline at a lower price to attract a buyer? If it seeks to do so, will this below-market transaction be considered a connected transaction, triggering a further investigation by the regulatory authorities and litigation in the courts?

One potential loophole open to Gazprom is to try to argue that the Member State exemption in Article 9(6) of the Gas Directive applies to Nord Stream 2. This permits a Member State or another public body to organize the transmission system and supply in a manner that ensures that each function is undertaken by two separate public bodies. There are a number of questions surrounding this potential 'loophole.' Can it apply at all outside a European Economic Area (EEA) or Energy Community context?

¹²Second, even if it can apply in principle, *Rosneft/TNK-BP*¹³ suggests that the Russian energy market structure and political context in which operates will make it difficult for Article 9(6) to be applied. In *Rosneft/TNK-BP*, the Commission undertook its own competitive analysis under a "worst case scenario" where Rosneft and other Russian state-owned enterprises (SOEs) active in the oil and gas sector, namely Gazprom, Zarubezhneft, and Transneft, were deemed to constitute one single economic unit. In sum, it concluded that "*Rosneft cannot be deemed to have an independent power of decision from the Russian Federation within the meaning of Recital*

⁹ Directive (EU) 2019/692 of the European Parliament and the Council of April 17, 2019 amending Directive 2009/72/EC concerning common rules for the internal market in natural gas, OJ 2019 L117/1.

¹⁰ *Amending Directive 2019, op cit*, Article 2(1), amending Article 9(8) of the 2009 Directive.

¹¹ Commission Staffing Working Document, *Assessing the Amendments to Directive 2009/73/EC setting out rules for gas pipelines connecting the European Union with third countries*, SWD (2017) 368 Final, European Commission, Brussels, 4.

¹² The argument here is that the 'public body' criteria can only apply in an EU, EEA, or possibly Energy Community context where the other supportive rules of the *acquis* such as state aid and competition law would also apply. This would clearly not be the case with respect to the Russian Federation.

¹³ DG Comp Case No: COMP/M.6801, March 8, 2013.

22 of the *Merger Regulation*¹⁴ and that their respective market positions should be combined.¹⁵

That analysis in *Rosneft/TNK-BP* was based on the 'decisive influence' definition of control in EU merger law. Critically for the Gas Directive, Recital 10 imports that definition of control into energy liberalization law, directly from EU merger control law. How far would the existing merger decisional practice on the functioning and operation of the Russian energy market undercut any application of Article 9(6)? Furthermore, Gazprom may be state-owned but it is not a public body. To comply with Article 9(6), the Russian state would likely have to substantially restructure Gazprom to provide a public body controlling the pipeline and a public body providing the gas supply.

The discussion above illustrates that the pipeline and its owner Gazprom face potentially serious legal problems related to the application of the key elements of the EU liberalization regime. At every turn, any potential solution ends up always facing the problem of yet more regulatory scrutiny and/or litigation in the national and EU courts. Such litigation risks at least delaying the prospect for the pipeline if it were ever to be certified, and it raises a serious risk of its certification being blocked in the EU courts.

Tariffs & third-party access

These difficulties also persist in respect to tariffs and third-party access. Under the Gas Directive, tariffs and their methodologies must be published in advance. The tariff must reflect the true costs of the infrastructure, including capital costs, and must be applied in a non-discriminatory manner. Tariffs must be approved in advance by the national regulator (here, the Bundesnetzagentur (BNetzA), Germany's Federal Network Agency for electricity, gas, telecommunications, post and railway). It is true that the BNetzA has considerable discretion. However, even with that discretion, an EU tariff regime is problematic for Gazprom. In pursuing Nord Stream 2, Gazprom must cover the costs of an expensive new undersea pipeline. A true cost-reflective tariff would have to cover the whole cost of that pipeline. By contrast, Nord Stream 2's principal competitors are the amortized, land-based, and therefore much cheaper Yamal pipeline and

Ukrainian transit network (even taking into account the cost of maintenance and repair). The difficulty with non-competitive tariff costs is that while Gazprom and the Russian state may be prepared to absorb the costs for geopolitical reasons, any departure from normal parameters in calculating the tariff will open the BNetzA and thereby the German government to legal challenge (under Union law, BNetzA is an arm or emanation of the state, hence any decision of the BNetzA incurs full German state responsibility for any BNetzA decision ultimately before the CJEU).

Equally, third-party access raises a number of problematic issues for the BNetzA. In particular, there is the key question of whether the Russian state can find a truly independent 'third party'. As indicated above, the Commission's merger decisional practice indicated in *Rosneft/TNK-BP* that Rosneft, Gazprom, Zarubezhneft, and Transneft could be deemed to be a single entity. Hence, even if the Kremlin sought to solve the problem of third-party access by leaving Nord Stream 2 with the ownership of the pipeline and arranging for gas flows to be provided by other Russian energy companies, it is difficult to see how Rosneft and potentially other energy companies owned or controlled by the state would be able to count as third parties. At the very least, to seek to become independent third parties, Rosneft and potentially other Russian energy companies would have to be significantly restructured. Again, the problem here for Gazprom, the BNetzA, and the (responsible in Union law) German government is that almost any restructuring could be subject to legal challenge as being insufficient, amounting only to a legally inadequate restructuring or a mere sham operation.

Assessing supply security risk

Aside from the difficulties of navigating ownership unbundling, tariff transparency, and third-party access, there is also the issue of Article 11 of the Gas Directive 2009. This article requires certification by the relevant national energy regulator (here the BNetzA) as to whether a non-EU pipeline owner is a threat to the supply security of the Member State in question (here Germany) or the Union. It is true that the German Economics Ministry indicated that there is no supply security risk in its filing with BNetzA.¹⁶ However, that opinion is not

¹⁴ *ibid*, paras 7-8.

¹⁵ *op cit*, paras 9, 13 and 36.

¹⁶ *Economic Affairs Ministry transmits supply security analysis in Nord Stream 2 certification procedure to Bundesnetzagentur*, Press Release, Federal Ministry for Economic Affairs and Climate Action, Berlin, October 26, 2021.

decisive. As explained above, it has now been withdrawn by the Chancellor and the certification process now remains suspended.¹⁷ Furthermore, as Article 11 is part of EU law, the BNetzA would have to seek the opinion of the European Commission before making a final decision. A further hurdle is the prospect of a negative opinion from the Commission, which for reasons discussed below, would be likely.

The substantive difficulty here for the BNetzA, whatever the eventual (if ever to be delivered) future second opinion of the Economics Ministry, is that there is a very large body of evidence revealing the supply security risk stemming from Nord Stream 2's owner Gazprom. In his seminal work on the subject, Robert Larsson identified over 40 politically motivated instances when Gazprom cut off gas supplies between 1991-2004.¹⁸ Member States in Central and Eastern Europe and the Baltic States have evidence in their own files and those of their state-owned incumbent energy companies of a range of practices over the last three decades, which amount to undermining supply security.¹⁹ Another example is the operation undertaken by Gazprom in 2014-2015 to undermine reverse flows to Ukraine by seeking to reduce supplies to Poland, Hungary, and Slovakia.²⁰ More recently, in Winter 2021/2022, Gazprom reduced gas flows to the European Union so severely that its own gas storages were running at below 25% at the beginning of the winter heating season.²¹ This is despite the fact that gas production has increased by 59bcm over 2020. Gazprom and the Russian state refused to increase historically low gas exports.²²

¹⁷ And that overall certification process itself is in suspension. On November 16, 2021 the BNetzA provisionally suspended the certification process. It had concluded that only a pipeline operator entity organized under German law would be considered for approval. This suspension process would have only delayed the certification process by two to four months.

¹⁸ Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier*, FOI (Swedish Defence Research Agency) Stockholm, 2006.

¹⁹ Author's notes of discussion with energy officials of several EU Member States. The author's understanding is that many EU Member States in the Baltic States and Central and Eastern Europe have copious evidence over at least two decades of cut offs, threat of cut offs and a broader range of threats to gas supply security which have never been reported in the media or via academic research projects.

²⁰ See for example, Loskot-Strachota, *Central European Problems with Russian Gas Supplies*, OSW (Centre for Eastern Studies) Warsaw, September 17, 2014.

²¹ *Only around 18% full: Gazprom Storage Facilities in Germany are Empty than at the Beginning of November*, Teller Report, December 12, 2021.

²² *Gazprom's production increase to cover lion's share of gas consumption growth at traditional markets in 2021*, Gazprom press release, November 23, 2021, and Riley, *Gazprom's Folly: In Seeking to Deliver*

Either Gazprom has not had the gas available or it has chosen not to supply it. In either case, this is evidence of a security of supply issue for Europe.

The twin problem here for Gazprom is, first, any Article 11 decision is a decision under Union law and is reviewable in national and ultimately EU courts. Second, the scale of the evidence available is massive, with numerous Member State parties who can furnish considerable quantities of evidence of prior Gazprom behavior relevant to the question of supply security. Article 11 provides a legal platform to hold what would amount to a 'trial of Gazprom' in the EU courts as to whether it does constitute a threat to supply security. The large-scale Russian invasion of Ukraine also reinforces the argument that any Russian entity should be deemed a supply security risk for the purposes of Article 11. There is a direct link between the invasion and Gazprom's export strategy. It is now clear that, in preparation for war, Gazprom deliberately withheld natural gas supplies to Europe and drained gas storages within the European Union to actively increase European dependence.

In addition, the prospect of such a trial, with Member States tendering evidence on Article 11, would be something no German government would wish to defend. And defend it would have to do, if the BNetzA made a decision certifying Nord Stream 2 with respect to Article 11. The BNetzA is an arm or emanation of the state; hence the German government would have to defend that decision in the EU courts. Berlin would have to argue that Gazprom is not a threat to EU supply security against evidence tendered from numerous Member States and academic, industrial, and policy sources over the last three decades. To avoid having to defend the Russian position on supply security if suspensions are lifted, the BNetzA would have to deny certification and then leave it to Nord Stream 2 to challenge its decision to refuse certification in the German and, ultimately, EU courts.

The 'stub' approach

The principal liberalization obligations in the Gas Directive 2009 arguably can be minimized by only applying those obligations to that part of Nord Stream 2 in German territorial waters. This 'stub' approach would appear to significantly limit the application of Union law to the pipeline as whole. Ownership unbundling would

Nord stream 2, it May Undermine its Own Access to EU Markets, Atlantic Council, Washington DC, July 16, 2021.

be far less of a burden for the small stretch of pipeline in German waters; equally the obligatory cost-reflective tariffs imposed by the BNetzA would be far more bearable. In addition, as the rest of the pipeline outside of German waters would not be subject to Union law, third-party access could only be mandated in the EU part of the pipeline. As a result, the only access point for gas outside EU waters would be controlled by Gazprom, and there would in reality be no third-party access. Nord Stream 2 apparently has chosen to advocate the 'stub approach,' which has now provided the basis for its application to the BNetzA (the application process having now been suspended).

The problem with the 'stub' approach is twofold. First, the 'stub' is wholly artificial. Nord Stream 2 is not two pipeline systems, one in German waters and one in non-German waters, but one single pipeline. Nord Stream 2 was constructed and licensed as a single pipeline system consisting of two continuous pipelines running from the Russian to the German Baltic coast. Second, however clever the 'stub' idea appears to be in attempting to minimize the application of Union law to the pipeline, it will still attract litigation. It is probable that the arguments surrounding the 'stub' will end up being disposed of by the CJEU. This again will create a basis for delay in any future operation of the pipeline and will create a real danger that any certification will be overturned by the EU courts. And, again, from the point of view of the German government, if the BNetzA ever accepted this proposal, it would face the uncomfortable prospect of defending the sham 'stub' arrangement on behalf of Nord Stream 2 and the Russian government before the CJEU and against several Member States and the Commission.

It is true that the Amending Directive refers to the provisions of the Gas Directive 2009 applying in the territorial sea of the Member State where the pipeline lands. However, the Amending Directive as the Commission points out in its Counter-Memorial in the Hague is merely restating the position clear in public international law that Union law applies to the soil of the Member States and their territorial seas.²³

The difficulty here for Nord Stream 2 is the CJEU would be able to justify full application of Union law to the whole of the pipeline on grounds of the territoriality principle in public international law.²⁴ It is clear that conduct 'wholly or substantially in part' within a state falls within a state's

²³ Nord Stream 2 ECT, paras 371 to 382.

²⁴ Scott, *op cit*.

territorial jurisdiction.²⁵ Nord Stream 2 faces here the practical physical problem that there is in reality just one pipeline system consisting of two pipelines running continuously from the Russian to the German Baltic coast. That part of it is outside Union jurisdiction is utterly functionless, purposeless, and without value without that part of it connected to its destination market within the Union. The actual object of the pipeline is directly connected with the Union, i.e. to sell natural gas into the Union's single market (which the CJEU remains the ultimate guardian thereof). The CJEU would therefore be able to argue just on classical territoriality principles alone that the Nord Stream 2 is fully subject to Union law.

That argument is buttressed by considering the Union doctrine of *effet utile*.²⁶ Accepting the 'stub' approach advocated by Nord Stream 2 would permit the objectives of Union law as set out in the Amending Directive to be evaded. There would be no level playing field for supply pipelines external to the Union and internal supply pipelines. The 'stub' approach would allow substantial evasion of the ownership unbundling, tariff, and third-party access rules. And it would also permit Gazprom to bring the negative effects of its export monopoly directly to the entrance of the Union market, reinforcing its market power.

Again, the Nord Stream 2 proposal for certification provides the German government with another major headache. Would Berlin really want to seek to defend a mechanism such as the 'stub,' which will look to most Member States as the German government seeking to find a sham legal structure to evade the application of EU rules? Particularly, does Berlin want to support and advocate for a Russian sham device post-a Russian invasion of Ukraine? The answer is probably not. So even if the suspension and sanctions are lifted at a point in the future, the solution for Berlin is for the BNetzA to rule that that 'stub' proposal is a sham. This will push the BNetzA in the direction of refusing certification and leaving Nord Stream 2 with the option of challenging the BNetzA decision in the national and EU courts.

²⁵ Set out in the *US Restatement of the Law (Third) The Foreign Relations Law of the United States*, (1990) 402(1), and Scott, *op cit* 91-92.

²⁶ For an overview of the *effet utile* doctrine see Mendez-Pinedo, *The Principle of Effectiveness of EU Law: A Difficult Concept in EU Legal Scholarship*, (2021) *Juridical Tribune*, 7 *et seq*.

PART 2: CHALLENGING EU LAW: THE IMPLICATIONS OF NORD STREAM 2 V. THE EUROPEAN UNION

Berlin has been faced with tremendous and fierce lobbying by Nord Stream 2, Gazprom, and the Russian government. Nord Stream 2 has also been willing to reach for every even remotely available legal instrument to challenge the application of EU energy law to the pipeline. This fierce legal response has given the impression that Nord Stream 2 has a compelling legal case that the pipeline will inevitably be brought into full operation shortly. Now that the pipeline has been directly sanctioned and suspended, past lobbying still operates to give the impression that at some point in the not-too-distant future, the pipeline can be unsanctioned and unsuspended and the regulatory process can easily proceed. However, as indicated above, a closer reading of the legal and institutional context in Brussels should provide cause to pause to consider the reality behind all the legal sound and fury from Nord Stream 2 and Gazprom. As argued above, the legal position of the pipeline and the prospect of it being successfully and fully brought into operation anytime soon are weak. The weakness of the Nord Stream 2 position is reinforced by considering the case it has already brought under the Energy Charter Treaty to attack the application of Union law to the pipeline.

This willingness to challenge Union law is certainly underlined by its opposition to the February 2019 Amending Directive amending the 2009 Gas Directive. Nord Stream 2's opposition did not end once the Amending Directive was enacted. It launched a major damages claim under the Energy Charter Treaty against the European Union arguing that the application of the Amending Directive to the pipeline was tantamount to expropriation.

The Commission, acting on behalf of the entire Union, has responded extremely vigorously to Nord Stream 2's claims brought under the Energy Charter Treaty (ECT).

The position taken by the Commission in respect to the ECT Nord Stream 2 litigation is likely to have a significant

impact on the approach of the Commission and EU Member States to the application of Union law and litigation in Union courts in respect to the Nord Stream 2 certification process. It is therefore worth considering some of the key arguments of the Commission in that litigation.

From the start, the pleadings of the European Commission are robust. The Commission commences with the observation that, although in legal form Nord Stream 2 AG is a Swiss based company, it is:

"...fully owned by Gazprom, a Russian company which is in turn owned and controlled by the Russian state. In practice, Gazprom is but a trade and political instrument of the Russian government."²⁷

It goes on to point out that it uses the Swiss corporate legal form (Switzerland being a full member of the ECT, Russia itself having exited the Treaty in 2009) to seek to sue the European Union. However,

"Russia which owns and controls Gazprom, has refused to become bound by the same standards vis-à-vis the European Union and its investors, despite being among the original signatories of the ECT. It would be difficult to conceive of a more egregious instance of double standards and free riding."²⁸

The Commission goes on to argue that Nord Stream 2's primary goal,

"...is not to obtain compensation for any damage allegedly caused by any EU measures. Rather...it is to secure, with regard to the Nord Stream 2 pipeline, immunity from the generally applicable regulatory regime as applied by the European Union within its own territory."²⁹

27 Nord Stream 2 ECT, para 4.

28 Nord Stream 2 ECT, para 4.

29 Nord Stream 2 ECT, para 4.

The Commission's pleadings become ever more robust as it challenges line by line the argument deployed by Nord Stream 2 in its pleadings.

It emphasizes that the legislation had a legitimate objective,

"The Amending Directive makes a material contribution to the legitimate public policy objectives pursued by the Gas Directive, by ensuring that *all* market participants in the EU Single Market for gas- including those with a point of origin outside of EU territory- take part in that market on a level playing field and are *equally* bound by EU public policy on security of supply."³⁰ (author's emphasis in italics)

In some detail, the Commission then proceeds to set out the reasoning underpinning the argument for an amending directive and its legitimate purpose. This reasoning and detail underpins the legitimacy of the legislation.³¹

One of the underlying lines of argument of Nord Stream 2 in this case is that the Amending Directive amounted

30 *Nord Stream 2 ECT*, para 10.

31 *Nord Stream 2 ECT*, paras 10 and 20.

to 'dramatic and radical change,' which it could not have expected to occur and as a result of which it suffered extensive economic damage.

The Commission not only responds in devastating detail to the arguments of Nord Stream 2, but in so doing undermines a significant part of the argument it would seek to make in respect to certification of the pipeline.

The Commission makes two key points on this. First, even before Nord Stream 2 made its final investment decision on September 4, 2015 it was clear that the Union took the view that the Gas Directive could apply to third country pipelines. There was a series of public statements from the European Commission between 2008 and 2015³² as well as decisions of the Commission on the applicability of the Gas Directive to import pipelines.³³ In particular, the Commission was quite explicit on the scope of the application of Union law in respect to a previous Gazprom undersea pipeline scheme the South Stream project.³⁴ This application of Union law not unnaturally followed the view that Union jurisdiction is consistent with EU Member States' territorial jurisdiction in international law, which includes the territorial sea. This would include at least that part of the Nord Stream 2 pipeline in territorial waters.³⁵

Second, the recognition that public international law could apply to import pipelines at least within Member State territorial waters and actual application to prospective import pipelines such as South Stream, and actual pipelines such as the Yamal and the Trans-Adriatic Pipeline, the actual Amending Directive was no more than a clarification. What the legislation did in essence was to enhance legal certainty and ensure a clear uniform legal regime for all pipelines.³⁶ Such mere clarification provides no basis for bringing any claim against the European Union.

This view is reinforced by the fact that the Commission made it clear directly to the Russian government

32 *Nord Stream 2 ECT*, paras 140-144.

33 *Nord Stream 2 ECT*, para 145.

34 *Nord Stream 2 ECT*, para 143.

35 *Nord Stream 2 ECT*, para 365.

36 *Nord Stream 2 ECT*, para 357.



Metal plug on the water pipe to the Nord Stream 2 pipeline

that the Gas Directive could apply to import pipelines well before the final investment decision on September 4, 2015.

“As early as 29th June 2010, the European Commission has informed the Russian government of the correct interpretation of the Gas Directive. In a reply rendered public on 14th August 2012, the European Commission clarified that the gas directive applied to gas pipelines originating from a third country and entering the territory of a Member State. Since (Nord Stream 2) is 100% owned by Gazprom, and Gazprom is effectively the petroleum arm of the Russian government, (Nord Stream 2) must be assumed to have been informed of the EU’s position on the applicability of the Gas Directive and the Gas Regulation (including its rules on unbundling, TPA and tariff regulation) from the date of its incorporation. This alone is determinative of the issue of (Nord Stream 2’s) so-called ‘expectations.’”³⁷

Given the evidence and argument furnished by the Commission, it may seem at first unclear why Nord Stream 2 raced forward with a final investment decision as soon as September 2015. It did not in fact receive the majority of the actual licensing permits until August 2018, and the final licensing permit from Denmark until October 2019. The Commission also published its proposal for new legislation (the initial draft of the Amending Directive) in November 2017, which should surely have caused a pause in the entire construction and permitting process. Yet despite not having all the permits in place and new legislation on the table, it continued at pace with contract ordering and then construction from mid-2016 onward.

The behavior of Nord Stream 2 over the speed of its final investment decision (FID) raises the question as to why the pipeline company made an FID so early? Why let out contracts and commence construction of the pipeline when most of the permitting licences were not in place? This looks to be an even more questionable decision when one considers that legislative proposals were already going through the EU legislative process which would change the regulatory framework under which the pipeline would operate. Given that context, the early FID looks on further reflection very much like an attempt to build a network of allies invested in the project and put facts (and pipeline) on the ground (and in the sea) to seek to stall the application of Union law.

As the Commission says,

37 *Nord Stream 2 ECT*, para 357.

“It is obvious, however, that the regulatory disciplines the EU imposes on participants in the Single Market for gas fail to accord with Gazprom’s preferred business model. Gazprom currently enjoys an exclusive legal right over exports of pipeline gas from Russia. Gazprom and its owner (Russia) are used to extract monopoly rents from that situation. Understandably, Gazprom and Russia would like to prevent the application of the Gas Directive to the NS2 pipeline and import into the EU the preferential status it enjoys in Russia. But the EU’s confirmation that its generally applicable regulatory regime applies equally to all interconnectors, including the NS2 pipeline, cannot possibly constitute a breach of any of the EU’s obligation under the ECT. If Gazprom wishes to sell its gas within the European Union, it is for Gazprom to adapt its business model to the EU’s generally applicable regime, rather than the other way around.”³⁸

The robustness of the Commission’s argument in the ECT litigation raises a number of issues. First, it suggests that, should sanctions and suspension be lifted, the BNetzA and the German government are unlikely to find Brussels suddenly willing to take a significant step back with respect to a legal challenge to certification. Second, even if the Commission were to take a weaker position with respect to the application of the Gas Directive to Nord Stream 2, several Central and Eastern European Member States could use the Commission’s own argumentation in litigation brought against Germany for failing to apply Union law. Third, aside from the scepticism in respect to Nord Stream 2’s motivations and intentions exhibited in the ECT pleadings, some of the argument bears down directly on the direct application of specific provisions of the Gas Directive. The Commission pleadings reinforce the view that Nord Stream 2 is fully subject to Union law, at least within the territorial waters of the Member States; and that Gazprom is a fully owned state entity, ‘the petroleum arm’ of the Russian state (hence the limited ability of any state to obtain third-party access for another state-controlled energy entity). In addition, the tenor of the pleadings is that Union law is to be applied in full in respect to Nord Stream 2, with no special or extraordinary deals for the pipeline.

It is likely therefore that, after the lifting of the suspension of certification, if any cases were to reach Luxembourg based on the Treaty on the Functioning of the European Union (TFEU) Articles 258 (European Commission brings a case against Germany) or Article 259 TFEU (one or

38 *Nord Stream 2 ECT*, para 11.

several Member States bring a case against Germany³⁹), the Commission will take a similar position to that which it took in The Hague. Given the ECT pleadings, it is also likely that the Commission will bring its own infringement proceedings against Germany if the BNetzA subsequently failed to fully apply Union law with respect to the certification process. Hence, faced with the robustness of

³⁹ Every Member State has a right to sue any other Member State in respect of an infringement of Union law before the CJEU by virtue of Article 259 TFEU. There is no standing requirement in any case as before the US Supreme Court.

the Commission's existing ECT pleadings, the prospect of an infringement procedure brought by the Commission, with a number of Member States and Ukraine intervening on the Commission's side, it is again doubtful that the German government would want to be the last remaining defender of Gazprom and Nord Stream 2.

PART 3: THE END OF NORD STREAM 2

Nord Stream 2 is extremely unlikely to be authorized and come into operation for the foreseeable future. This author contends that, absent a democratically elected Russian government committed to the rule of law, the pipeline will not be authorized and brought into operation. In theory, the German suspension could be lifted, and the sanctions waivers in respect to US sanctions could be restored. The argument for Nord Stream 2's eventual revival would be that the European Union requires significant natural gas supplies. Nord Stream 2 could in theory provide 55bcm of supply from Russia. If, as a result of the large-scale invasion of Ukraine, were the Ukrainian transit system severely damaged or eliminated, there would be a superficially compelling argument that Europe really needs Nord Stream 2. This argument, however, overlooks the fact that Europe can obtain natural gas supplies from Norway, Algeria, and from Liquid Natural Gas (LNG) sources, as well as from renewables and other alternative energy sources (and it would also be possible for the Ukrainian pipeline network to be repaired). And it overlooks the huge shift in European perceptions as to the value of Russian gas supplies to Europe after this large-scale attack on Ukraine. There is no need to increase dependence once again on Russian gas. Furthermore, as explained above

in detail, there are significant legal barriers to the use of Nord Stream 2 in a post-invasion environment.

Fundamentally, the obligations of the EU energy liberalization regime, which include ownership unbundling, tariff transparency, and third-party access, are extremely problematic for Nord Stream 2. The liberalization rules undermine the capacity of Gazprom to use the pipeline to leverage its market power across the European continent. That is why Nord Stream 2 filed for a minimalist certification of the pipeline, which itself contravened the provisions of the Gas Directive.

Furthermore, the supply security condition for certification contained in Article 11 of the Gas Directive would be extremely difficult for Nord Stream 2 to comply with. Aside from the at least two decades evidence of Gazprom's operations raising a supply security risk, there are the practices Gazprom engaged in during Winter 2021/2022. In effect, contrary to its commercial practice over the last decade, Gazprom refused to properly supply the European spot market. It compounded this shortage by refusing to fully refill European storages. In particular, its own Gazprom-owned storages were left with very low gas loadings. As Fatih Birol, the Director

of the International Energy Agency, explained in January, Gazprom provides only 10% of European Union gas storage but was responsible for 50% of the gas deficit.⁴⁰ This practice of draining its own storages raises a serious question about Gazprom being a fit and proper entity to own any EU energy infrastructure. However, with the large-scale invasion of Ukraine starting February 24, and with it becoming clear that the planning for such an invasion was in progress as early as Spring 2021, the Winter 2021/2022 gas shortages appear now in a completely different light. The principal purpose of the manipulation of the gas market in 2021/2022 was to increase gas dependency in Europe as part of the overall planned military operation against Ukraine. In essence, the manipulation aimed to increase gas dependency and weaken Europe's resolve in the face of the invasion of Ukraine. The scope and intent of this gas manipulation has the effect of at least broadening the question of Russian ownership of EU infrastructure, whether it's

⁴⁰ Fatih Birol explained that "the current storage deficit in the EU is largely due to Gazprom." He said, "The low levels of storage in the company's EU based (storage) facilities account for half of the EU deficit even though Gazprom storage only accounts for 10% of the EU's total storage capacity," *IEA Chief Accuses Russia of Worsening Europe's Gas Crisis*, The Financial Times, January 12, 2022.

Gazprom or another Russian-state-owned or -controlled entity.

In this context, it is difficult to see how any German government is likely to support either a minimalist interpretation of the certification process to Nord Stream 2, or an interpretation which seeks to fully apply Union law, resulting in certification. Even if a German government were to consider supporting certification, the problem for Berlin is that the BNetzA would have to make the final decision on any future certification, and the German government would have to then defend it in the EU courts against the European Commission and a number of irate Member States, with Ukraine as an intervener and in front of the world's media. Far better for the BNetzA to refuse a certification, perhaps under Article 11, and let Nord Stream 2 make its own case in the German, and ultimately EU, courts.



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