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DISPUTES OVER THE PIPELINES IMPORTING RUSSIAN GAS TO THE EU: HOW TO ENSURE CONSISTENCY IN EU ENERGY LAW AND POLICY?

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ABSTRACT

Europe is divided on how to construct and exploit pipelines importing Russian gas to the EU. The division evinces two opposing models, which I label (1) the Overcapacity and Exemption-Based Model and (2) the Optimal Capacity and Regulatory-Based Model. As those labels suggest, these models are premised on different assumptions as to the number and capacity of such pipelines that the EU requires, and as to how far those pipelines should be subject to EU energy law. The struggle between these models is not merely a legal one. More fundamentally, it is an economic and geopolitical one involving a wide range of stakeholders: public and private. This article evaluates the two models. By describing the legal disputes concerning OPAL and Nord Stream 2 and analysing their wider legal, economic and geopolitical implications, it argues that the second model (Optimal Capacity and Regulatory-Based) is clearly superior in today's context. It is fully aligned with the objectives and

provisions of EU energy law. In particular, it is consistent with that law's aim of diversifying the external suppliers, sources and routes of gas supplies available to the EU. This article concludes that this latter model must win in the OPAL and Nord Stream 2 disputes, and, moreover, that it must be implemented with respect to all eastern import pipelines and connected pipelines before any further pro-competitive or pro-integrative reforms to the EU's energy law and policy.

KEYWORDS

EU energy policy; energy security; gas markets; diversification of gas supplies

INTRODUCTION

In recent years, one of the greatest challenges facing the EU's energy policy has been presented by the existing and planned pipelines importing Russian gas to the EU. This includes in particular the 'eastern import pipelines' (Nord Stream, Nord Stream 2, South Stream and Turkish Stream) and the 'connected pipelines' (the infrastructural and functional extensions of the eastern import pipelines: OPAL, NEL and EUGAL).¹ Member States, EU institutions and other stakeholders are sharply divided over not only the geopolitical and economic importance of these pipelines in ensuring the security of gas supplies to the EU Member States, but also how far they should be subject to EU energy law. On one side are Germany and other Western European countries; on the other, the Central and Eastern European countries ('the CEE countries').²

This division recently came to the surface through two heated disputes concerning Nord Stream 2 (a planned natural gas pipeline that will connect Russia and Germany, running through the Baltic Sea, almost in parallel to the already existing Nord Stream pipeline) and OPAL (a pipeline which extends the Nord Stream pipeline by running along the eastern border of Germany to the Czech Republic). The first dispute concerns whether the EU's Third Energy Package ('the TEP')³ applies to Nord Stream 2, and particularly to its underwater section. The second dispute concerns the lawfulness of the regulatory exemption applied to OPAL in 2016, under Article 36 of Directive 2009/73/EC.

The present article argues that these legal disputes concerning Nord Stream 2 and OPAL starkly demonstrate the nature of the division noted above. They embody the struggle between two opposing models of building and using both the eastern

¹ A detailed map of all of the already existing and planned gas pipelines in Europe can be found at: https://www.entsog.eu/public/uploads/files/publications/Maps/2017/ENTSOG_CAP_2017_A0_1189x841_FULL_064.pdf.

² See, e.g., Rafael Leal-Arcas, Costantino Grasso, and Juan Alemany Rios, *Energy Security, Trade and the EU: Regional and International Perspectives* (Cheltenham: Edward Elgar, 2016), 344; Andreas Prontera, *The New Politics of Energy Security in the European Union and Beyond: States, Markets, Institutions* (London: Routledge, 2017), 109; Slawomir Raszewski, "Russian energy projects and the global climate, geopolitics and development conundrum": 215, 225; in: Rafael Leal-Arcas and Jan Wouters, eds., *Research Handbook on EU Energy Law and Policy* (Cheltenham: Edward Elgar, 2017); Kai-Olaf Lang and Kirsten Westphal, "Nord Stream 2 – A Political and Economic Contextualisation," *Stiftung Wissenschaft und Politik, Research Paper* 3/2017 // <http://www.ssoar.info/ssoar/handle/document/51318>; Samuel Schubert, Johannes Pollak, and Maren Kreutler, *Energy Policy of the European Union* (Basingstoke: Palgrave Macmillan, 2016), 225.

³ The TEP comprises the following legal acts: *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*, OJ L 211, 14.8.2009, p. 94; *Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005*, OJ L 211, 14.8.2009, p. 36; *Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators*, OJ L 211, 14.8.2009, p. 1.

import pipelines and the connected pipelines, a conflict that – as we shall see – is also visible within EU decision-making processes; in Member State policy; in multiple judicial and administrative proceedings in Member States; in the investment decisions of gas undertakings; and in public debate and scientific discussions. I label these two models (1) the Overcapacity and Exemption-Based Model and (2) the Optimal Capacity and Regulatory-Based Model.

Sections V and VI analyse these two models, building on the conclusions drawn from the analysis of the Nord Stream 2 and OPAL legal disputes in sections II and III. Section V contends that continued implementation of the first model (Overcapacity and Exemption-Based) in the eastern import pipelines and the connected pipelines would lead to a number of undesirable consequences in the EU, notably: a deepening of axiological inconsistencies in EU energy policy; an undermining of the gains made by EU energy law; and the weakening of energy solidarity. By contrast, Section VI shows that the second model (Optimal Capacity and Regulatory-Based) is fully aligned with the objectives and provisions of EU energy law. In particular, it furthers that law's aim of diversifying the external suppliers, sources and routes of gas supplies available to the EU, which is, in turn, a key pillar of the EU's energy security strategy. This article concludes that this second model must win in the OPAL and Nord Stream 2 disputes, and that it must be implemented with respect to the eastern import pipelines and the connected pipelines before any further pro-competitive and pro-integrative reforms to the EU's energy law and policy.

Before considering these broader points, we must begin by looking more closely at the Nord Stream 2 and OPAL legal disputes and the way they illustrate the tensions between the two models.

1. THE LEGAL DISPUTE OVER THE APPLICABILITY OF THE TEP TO NORD STREAM 2 AND SIMILAR IMPORT PIPELINES

A fierce legal dispute is currently underway in the EU as to whether Nord Stream 2, when built, will be subject to the TEP; this legal dispute should be distinguished from the broader controversy over the economic and geopolitical justification for Nord Stream 2 being built in the first place (see Section IV).

Those who oppose the TEP's application to Nord Stream 2 claim that their position is supported by the provisions of the TEP, the intention of the EU legislature and the current administrative practices at EU and Member States level.⁴

⁴ Kim Talus, "Application of certain EU energy and national laws of the Baltic Sea countries to the Nord Stream pipeline project 2," *Journal of World Energy Law & Business* 10(1) (2017): 30.

In particular, since regulatory exemption in Article 36 of Directive 2009/73/EC cannot apply to import pipelines like Nord Stream 2, that is, pipelines that import natural gas from a third country to the EU, those pipelines would be subject to the Directive's obligations without the counterbalance of the regulatory exemption from which intra-EU pipelines benefit. Because such discrimination between intra-EU and import pipelines would, they say, be arbitrary and impossible to justify, it follows that the EU legislature simply cannot have intended for Directive 2009/73/EC to apply to import pipelines, including offshore pipelines.⁵ This is underlined by practice: the TEP is currently de facto not applied to existing offshore import pipelines (e.g. Nord Stream, Green Stream,⁶ Medgaz⁷) by the European Commission ('EC') or by the EU Member States through whose land or maritime territories those pipelines run.⁸

According to this position, Nord Stream 2 simply falls outside of the TEP. It is therefore immune from all of the TEP's pro-competitive regulatory arrangements, including the rules on unbundling (i.e. the requirement to separate transmission activities from other activities in the gas sector⁹), on the designation and certification of transmission system operators,¹⁰ on the access of third parties to the transmission networks¹¹, and on the fixing and approval of tariffs.¹²

This article contends that the above position is not merely surprising, it is wrong. As it stands, the TEP applies in full to Nord Stream 2 and to similar import pipelines, including the existing Nord Stream. This follows from three points.

First, the TEP treats and regulates all gas transmission pipelines within the EU equally. It is irrelevant whether they are solely, or only partly, located on EU territory. The provisions of the TEP show that the EU legislator was fully aware of the fact that in the EU there are currently, and may be in the future, import pipelines partly situated outside of EU territory.¹³ Despite that manifest awareness,

⁵ See *The Opinion of the legal services of the Council of the EU of 27 September 2017 on the operation of the Nord Stream 2 pipeline*, pp. 10-11, paras. 40-44 // <http://www.politico.eu/wp-content/uploads/2017/09/SPOLITICO-17092812480.pdf>.

⁶ Running from Libya to Italy.

⁷ Running from Algeria to Spain.

⁸ Kim Talus, *supra* note 4: 30; Philipp Offenberg, "The European Neighbourhood and the EU's Security of Supply With Natural Gas," *Jacques Delors Institut, Berlin, Policy Paper* 156/2016 // <http://www.delorsinstitut.eu/011-22328-The-European-neighbourhood-and-the-EU-s-security-of-supply-with-natural-gas.html>.

⁹ Articles 9, 14 and 17-23 of Directive 2009/73/EC.

¹⁰ Articles 10-11 of Directive 2009/73/EC.

¹¹ Article 32 of Directive 2009/73/EC and Articles 14, 16, 18 and 20-22 of Regulation (EC) No 715/2009.

¹² Article 41(1)(a) and (6) of Directive 2009/73/EC and Article 13 of Regulation (EC) No 715/2009. As regards all those regulatory instruments see for more Angus Johnston and Guy Block, *EU Energy Law* (Oxford: Oxford University Press, 2012), Part II; Kim Talus, *Introduction to EU Energy Law* (Oxford: Oxford University Press, 2016), Chapter 2; Christopher Jones, ed., *EU Energy Law. Volume I. The Internal Energy Market* (Leuven: Claey's & Casteels, 2016), *passim*.

¹³ See Article 11 Directive 2009/73/EC and paras. 22 and 37 of the preamble to Directive 2009/73/EC.

the EU legislature declined expressly to exempt from the TEP the parts of these pipelines that do fall within the EU's territory, and therefore jurisdiction.

Second, import pipelines are perfectly capable of benefitting from the regulatory exemption provided for in Article 36 of Directive 2009/73/EC, so long as they fulfil that provision's requirements – notably that the pipeline connects two Member States' national transmission systems. Nothing in Article 36 excludes import pipelines.¹⁴ This is supported by the EC's practice. In 2013, the EC granted an Article 36 exemption to the pipeline importing gas to the EU from Turkey, a pipeline which also passed through another third country (Albania). The EC expressly recognised then that the fact the pipeline was partly located outside of EU territory did not prevent Article 36 from applying.¹⁵ It follows that Nord Stream 2 is ineligible not because it is an import pipeline, but because it does not connect two Member States' national transmission systems.

The third point is the ordinary rules of jurisdiction. Nord Stream 2 will pass through the EU's territory, and therefore through its jurisdiction. In particular, Nord Stream 2 will be located in the territorial seas, in the exclusive economic zones and/or on the continental shelves belonging to Finland, Sweden, Denmark and Germany.

All three of those maritime areas form an integral part of those Member States' territorial jurisdiction as a matter of international maritime law, a field primarily regulated by the United Nations Convention on the Law of the Sea ('the UNCLOS').¹⁶ As a consequence, those areas also fall within the EU's territorial jurisdiction for the purposes of the competences that the Member States have conferred on the EU, including the competences in the energy and internal gas market.¹⁷

This is certainly true with respect to the territorial seas of the EU Member States which form an integral part of these States.¹⁸ This analysis is also confirmed by the case-law of the Court of Justice of the EU ('ECJ') with respect to exclusive economic zones and continental shelves (although the legal regime of these latter maritime areas differs from that of territorial seas). According to the ECJ's case-

¹⁴ Article 36(1) in principio read with Article 2(17) of Directive 2009/73/EC.

¹⁵ *The EC Decision of 16 May 2013 on the exemption of the Trans Adriatic Pipeline from the requirements of Directive 2009/73/EC*, C (2013) 2949 final, para. 55.

¹⁶ On States' jurisdiction in those maritime areas see John Noyes, "The Territorial Sea and Contiguous Zone": 91; in: Donald Rothwell, Alex Oude Elferink, Karen Scott, and Tim Stephens, eds., *The Oxford Handbook of the Law of the Sea* (Oxford: Oxford University Press, 2015); Gemma Andreone, "The Exclusive Economic Zone": 159; in: *ibid.*; Ted McDorman, "The Continental Shelf": 181; in: *ibid.*

¹⁷ On these competences see Article 4(2)(a) and (i) of the Treaty on Functioning of the EU ('TFEU'); see for more Kim Talus, *supra* note 12, 7.

¹⁸ *Cornelis Kramer and others*, Cases 3, 4 and 6/76, ECLI:EU:C:1976:114, pp. 1295-1296; *Commission v. Greece*, C-331/94, ECLI:EU:C:1996:211, para. 10; *Aktiebolaget NN v. Skatteverket*, C-111/05, ECLI:EU:C:2007:195, paras. 55-58.

law, insofar as EU Member States exercise in those maritime zones sovereign rights vested in them under the UNCLOS – even if those rights are merely functional and limited – both those actions and the actions of those against whom such sovereign rights are exercised (e.g. other States or individuals) take place within those Member States' territory within the meaning of Article 52 TEU and Article 355 TFEU. It follows inexorably that relevant EU secondary law – i.e. law that regulates the Member States' exercise of their sovereign rights in such maritime areas, or regulates the actions of other states or individuals against whom those sovereign rights are exercised – also applies.¹⁹

It is worth pausing here to recall that in 2013, the EC had no doubts that the South Stream pipeline was subject to the TEP. South Stream was planned as a transmission system importing Russian gas to the EU, and was to run under the Black Sea to Bulgaria (including through the Bulgarian exclusive economic zone and its continental shelf) and then on to other Member States. The EC required the Member States which had concluded the bilateral agreements with Russia for the construction of South Stream (namely Bulgaria, Hungary, Greece, Slovenia, Croatia and Austria) to renegotiate these agreements so they would comply with the TEP.²⁰

In order to dispel any existing doubts as to the above, on 8 November 2017 the EC submitted a proposal to amend Directive 2009/73/EC. The proposed amendment would clarify that that Directive applies in full to the sections of gas pipelines to and from third countries that fall within EU jurisdiction, including the territorial sea and exclusive economic zones of Member States. The Directive's definition of 'interconnector' would be amended to explicitly include a transmission line which crosses or spans a border between a Member States and a third country (again, only up to the border of the EU's jurisdiction). Such import pipelines would be eligible for regulatory exemptions under Article 36 of the Directive. Moreover, Member State would be permitted to derogate from even the basic regulatory arrangements of Directive 2009/73/EC for the sections of import pipelines between the border of the EU's jurisdiction and the first interconnection point with an EU pipeline, provided that the derogation is not detrimental to competition, the

¹⁹ *Herbert Weber v. Universal Ogden Services Ltd*, Cases C-37/00, ECLI:EU:C:2002:122, paras. 31-36; *Commission v. The United Kingdom of Great Britain and Northern Ireland*, C-6/04, ECLI:EU:C:2005:626, paras. 115-121; *A. Salemink v. Raad van Bestuur van het Uitvoeringsinstituut Werknemersverzekeringen*, C-347/10, ECLI:EU:C:2012:17, paras. 33-37; *L. Kik v. Staatssecretaris van Financiën*, C-266/13, ECLI:EU:C:2015:188, paras. 40-42; *Aktiebolaget NN v. Skatteverket*, *supra* note 18, paras. 59-61.

²⁰ "South Stream bilateral deals breach EU law, Commission says", *EURACTIV* (4 December 2013) // <http://www.euractiv.com/section/competition/news/south-stream-bilateral-deals-breach-eu-law-commission-says>.

effective functioning of the internal gas market, or the security of gas supply to the EU.²¹ We will return to this amendment below, in section VI.

2. THE LEGAL DISPUTE OVER THE REGULATORY EXEMPTION GRANTED TO OPAL

This dispute concerns the extent of the regulatory exemption granted to the OPAL pipeline. As will be shown below, the current exemption (granted in 2016) contradicts previous regulatory practice and undermines the EU's interests and policy.

The OPAL pipeline transports Russian gas through the territory of Germany to its border with the Czech Republic. Russian gas flows through the Nord Stream pipeline to Greifswald, in northern Germany, OPAL's entry point. It then flows through OPAL until that pipeline's exit point in Brandov, on the German-Czech border. From Brandov, the gas is transmitted within the Czech Republic by the Gazelle pipeline, which is, in turn, connected to both the Czech transmission system and the MEGAL pipeline. The latter further transports the Russian gas through southern Germany to France. The OPAL pipeline is co-owned by two companies, one of which is (indirectly) controlled by Gazprom. The pipeline's operator is also a company which is dependent on Gazprom.²²

In 2009 the operator of OPAL was granted a regulatory exemption under the precursor of Article 36 of Directive 2009/73/EC ('the 2009 OPAL Exemption').²³ This exempted OPAL from the basic requirements of EU energy law, such as unbundling, third party access and price regulation, and was granted by the German Federal Network Agency ('BNetzA')²⁴ and accepted by the EC.²⁵ The 2009 OPAL Exemption was subject to a 'capacity cap': a maximum of 50% of OPAL's exit capacity at Brandov could be booked by undertakings with a dominant position in the Czech Republic. There were three such companies: Gazprom, Gazprom Export and RWE Transgas (now RWE Supply & Trading CZ).

²¹ See the *Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/73/EC concerning common rules for the internal market in natural gas*, COM(2017) 660 final.

²² See information available at: <https://www.opal-gastransport.de/en/company/portrait> and <http://www.wiga-transport.de/home.html>.

²³ The 2009 OPAL Exemption was granted on the basis of Article 22 of *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*, OJ L 176, 15.7.2003, p. 57. After the repeal of Directive 2003/55/EC, the 2009 OPAL Exemption became a regulatory exemption within the meaning of Article 36 of Directive 2009/73/EC.

²⁴ *Decision of BNetzA of 25 February 2009, amended by decision of BNetzA of 7 July 2009*, Case BK7-08-009.

²⁵ *The EC Decision of 12 June 2009 on regulatory exemption for OPAL pipeline*, COM(2009) 4694 final (hereinafter – 'the 2009 EC OPAL Decision').

The practical effect of the 2009 OPAL Exemption was that the remaining 50% of OPAL's capacity remained unused. This was because there were no other undertakings that had non-Gazprom gas at the entry point in Greifswald at their disposal and were able to supply this gas to Brandov by using OPAL's interconnection capacity. This underutilisation of OPAL in turn forced Gazprom and Gazprom Export to reduce commensurately the use of the Nord Stream pipeline to transport Russian gas to Germany.²⁶

In 2016, the 2009 OPAL Exemption was reviewed and changed by a public-law agreement between BNetzA, OGT (OPAL's operator), Gazprom and Gazprom Export,²⁷ accepted with certain modifications by the EC²⁸ ('the 2016 OPAL Exemption'). The 2016 OPAL Exemption maintains the exemption from the provisions of the TEP for 50% of OPAL's interconnection capacity: this 50% is still reserved for Gazprom, its subsidiaries or close contractual partners. But in contrast to the 2009 OPAL Exemption, the 2016 OPAL Exemption releases the remaining 50% of OPAL's capacity that, before 2016, were not used at all. This remaining capacity must be allocated by transparent and non-discriminatory auctions. The 2016 OPAL Exemption expressly provides that Gazprom, Gazprom Export and affiliated undertakings can participate in those capacity auctions and purchase and use interconnection capacity on equal terms with third parties. In practice, there are negligible prospects that any third party undertakings will use this 50% released interconnection capacity.

The 2016 EC OPAL Decision concludes that the 2016 OPAL Exemption will neither negatively affect competition in the Czech and German wholesale gas supply markets, nor be detrimental to the internal gas market. Instead, it will increase the security of gas supply to the EU.²⁹ Commission underlines there that the scope of the exemption, as compared to the 2009 OPAL Exemption, is reduced and therefore no negative effects on competition result from changes to the scope of the exemption. Commission also emphasizes the attractiveness of newly released OPAL's interconnection capacities for third parties and their positive role for

²⁶ Katja Yafimava, "The OPAL Exemption Decision: past, present, and future," *Oxford Institute for Energy Studies* (January 2017): 7–8 // <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2017/01/The-OPAL-Exemption-Decision-past-present-and-future-NG-117.pdf>.

²⁷ The final version of this public-law agreement is available at:

https://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/Beschlusskammer7/BK7_96_Freistellung_Regulierung/BK7_Freistellung_Regulierung_node.html.

²⁸ *The EC Decision of 28 October 2016 on review of regulatory exemption for OPAL pipeline*, C (2016) 6950 final (hereinafter – 'the 2016 EC OPAL Decision'). The 2016 EC OPAL Decision has been appealed to the General Court – see the pending cases *PGNiG Supply & Trading GmbH v. Commission*, T-849/16; *Poland v. Commission*, T-883/16.

²⁹ The 2016 EC OPAL Decision, paras. 48-53 and 62-161 of the preamble.

competition. However, more detailed analysis reveals that these conclusions are unfounded.³⁰

Starting with the 2016 OPAL Exemption's effect on competition, the following objections must be raised. First, undertakings others than Gazprom and Gazprom Export will be *de facto* excluded from access to OPAL's interconnection capacity at the Brandov exit point, and therefore newly released OPAL's capacities are of no relevance for third parties, except for Gazprom. Second, the 2016 OPAL Exemption enables Gazprom and Gazprom Export to deliver to the Czech Republic almost double the volume of gas than that delivered under the 2009 OPAL Exemption. This will significantly strengthen these companies' dominant position on the upstream wholesale gas supply market in the Czech Republic. The EC clearly underestimates the dominance of the aforementioned undertakings and the potential for foreclosure of relevant markets. Further, the 2016 EC OPAL Decision departs from the EC's settled past practice that, as a rule, no regulatory exemption can be granted to a pipeline likely to have a significant amount of its capacity allocated to any dominant player in one of the markets affected. According to that practice, where an exemption is exceptionally granted in such a situation, all relevant dominant gas undertakings must be subject to regulatory caps.³¹ Yet the 2016 OPAL Exemption effectively removes the 2009 OPAL Exemption's capacity cap.

Third, the 2016 EC OPAL Decision fails to consider the impact of the 2016 OPAL Exemption on competition in the Polish and Slovak gas markets. The 2016 OPAL Exemption will significantly worsen the competitive position of the operators of pipelines which provide alternative routes of transporting Russian gas to the EU. This will be especially so for the operators of the Yamal-Europe pipeline (which runs from Russia, through Poland, to Germany) and the Brotherhood pipeline (which runs from Russia, through Ukraine, to Slovakia; and then onward via two further streams, one to Hungary and Austria, and the other to the Czech Republic and Germany). Increasing quantities of Russian gas transported via Nord Stream and OPAL entail decreasing quantities transported through the Yamal-Europe and

³⁰ See, e.g., Michał Krzykowski and Karolina Krzykowska, "Will the European Commission's policy hinder gas supplies to Central and Eastern European countries? OPAL case decision," *Energy Policy* 110(11) (2017); Agata Łoskot-Strachota, "The OPAL pipeline: controversies about the rules for its use and the question of supply security," *Centre for Eastern Studies, Commentary* No. 229 (January 2017) // <https://www.osw.waw.pl/en/publikacje/osw-commentary/2017-01-17/opal-pipeline-controversies-about-rules-its-use-and-question>. As regards the view supporting the 2016 OPAL Exemption, see Katja Yafimava, *supra* note 26: 29–30.

³¹ The EC decision of 8 February 2008 on regulatory exemption for the Austrian section of the Nabucco pipeline, CAB D(2008) 142, paras. 31 and 39; The EC decision on 20 April 2009 on regulatory exemption for the Bulgarian section of the Nabucco pipeline, C (2009) 3037, paras. 33 and 62; Commission staff working document on Article 22 of Directive 2003/55/EC concerning common rules for the internal market in natural gas and Article 7 of Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity – New Infrastructure Exemptions, SEC(2009) 642 final, para. 34.

Brotherhood pipelines, and therefore decreasing revenues of their operators from transmission fees.³² The 2016 OPAL Exemption will also have very negative effects on the market position of gas suppliers in Poland and Slovakia. This will be caused by a significant rise in their operating costs.

The fourth answer is that the 2016 OPAL Exemption will erode the market position of gas suppliers importing gas from Western Europe to Poland and Slovakia. As the volume of Russian gas transported westward through the Yamal-Europe and Brotherhood pipelines decreases, Poland and Slovakia will need more gas via other routes to compensate. This will trigger the need for an increased use of the physical reverse flow capacities of the Yamal-Europe and Brotherhood pipelines, so as to supply larger volumes of gas from Germany to Poland (via Yamal-Europe) and from the Czech Republic and Austria to Slovakia (via Brotherhood). The result will be a huge increase of transmission tariffs rates for physical transportation of gas to Poland and Slovakia from the west,³³ as well as a decrease of physical reverse flow capacities available at the western entry points to the Yamal-Europe and the Slovak section of the Brotherhood pipelines. Both of these occurrences will greatly increase the operating costs of gas suppliers importing gas from the west to Poland and Slovakia using the physical reverse flow capacities, in turn gradually but inevitably eroding their market position.

In the long run, all three of these market developments will greatly benefit Gazprom and Gazprom Export. Their dominant position in gas supply markets in Poland and Slovakia will be strengthened,³⁴ as will their ability to abuse this market power.

³² That this scenario is a realistic one can be demonstrated by the fact that exactly such changes in the proportion of use of particular pipelines occurred in late December 2016 and early January 2017, i.e. when the operator of OPAL and Gazprom Export started to effectively implement the 2016 OPAL Exemption (eliminating the regulatory cap with regard to OPAL) and before those undertakings complied with the order of the General Court (issued on 23 December 2016) temporarily suspending the 2016 EC OPAL Decision. During this period, the volume of Russian gas transported via the Nord Stream-OPAL route increased (from about 600,000 MWh/d to nearly 1,100,000 MWh/d, measured in Greifswald). Relevant gas flows through the Brotherhood pipeline decreased (from about 1,700,000 MWh/d to 1,200,000 MWh/d, measured in Veľké Kapušany in Slovakia). This suggests that, if there is no regulatory cap with regard to OPAL, Gazprom and Gazprom Export will prefer to export their gas through Nord Stream and OPAL rather than through the Brotherhood pipeline: see Katja Yafimava, *supra* note 26: 25–26.

³³ Such an increase of transmission tariff rates for reverse flow capacities in fact occurred during the period October 2014 to March 2015, when Gazprom decided to decrease its gas supplies to Poland. During this period, the Polish wholesale gas suppliers were forced to buy additional volumes of gas from Germany, using the physical reverse flow capacities of Yamal-Europe pipeline. As a result, the tariff rates for physical reverse flow capacities at the entry point in Malinow increased: in November 2014 they increased over 230% as compared to the standard tariff rates, in December 2014 the increase stood at over 240%, and in the first quarter of 2015 those tariff rates remained at about 80% over standard rates – see the data available at: <https://transparency.entsog.eu/#/points/data?points=DE-TSO-0001ITP-00096exit%2CPL-TSO-0001ITP-00096entry> and at: <https://aukcje.gaz-system.pl/auctions?tab=A>.

³⁴ As the EC admits, Gazprom is still a dominant player on the Polish and Slovak upstream wholesale gas markets, as well as on upstream wholesale gas markets in other CEE countries – see the data available at: http://ec.europa.eu/competition/elojade/iseef/case_details.cfm?proc_code=1_39816.

In addition to its negative effects on competition, the 2016 OPAL Exemption will also diminish the security of gas supplies to the EU – in particular to Poland and Slovakia. True, the 2016 OPAL Exemption will result in an increased flow of Russian gas via OPAL, and thus in a greater supply of gas to the Czech Republic and to Western Europe. However, these increased supplies are in fact neither needed to cover any rising demand for gas in the EU (to the contrary: since 2010, gas consumption in the EU has fallen about 15%),³⁵ nor likely to stimulate demand in previously untapped markets or consumers in the EU. Furthermore, increased gas supply via OPAL will not give the EU access to the new sources of gas from new suppliers. On the contrary, this gas comes from traditional suppliers to the EU (Gazprom and its affiliate Gazprom Export), and originates in long-exploited gas deposits in Russia. The increased supplies of Russian gas through OPAL caused by the 2016 OPAL Exemption do not constitute an overall increase in the EU's gas supply, as is evident from the constantly decreasing flows of Russian gas through the Ukrainian and Slovak sections of the Brotherhood pipeline.³⁶ This reveals the actual reason why Gazprom and Gazprom Export sought to increase the proportion of OPAL's interconnection capacity open to them to use: to gradually replace the transit routes for Russian gas to Western Europe, which until now ran through Poland, Ukraine and Slovakia, with the northern route consisting of the Nord Stream and OPAL pipelines.³⁷

This gradual replacement of the Yamal-Europe and Brotherhood pipelines, until now the main transit routes for Russian gas to Western Europe, will significantly threaten the security of gas supplies to Poland and Slovakia (as well to other CEE countries).

To summarise, then, the 2016 OPAL Exemption contradicts the EC's previous regulatory exemption practice, and underestimates its serious threats to

³⁵ See the data of Eurostat available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Gross_inland_consumption_of_natural_gas_in_EU-28.png. As for the forecasts of future EU gas demand see, e.g., Anouk Honoré, "What Outlook for European Gas Demand? An Overview of Possible Scenarios": 49; in: Manfred Hafner and Simone Tagliapietra, eds., *The European Gas Markets: Challenges and Opportunities* (Basingstoke: Palgrave Macmillan, 2017); Phillip Offenberger, *supra* note 8: 4–5; Graham Duxbury, *A Guide to Energy Forecasting: ...part exercise in smoke and mirrors* (Kibworth Beauchamp: Matador Publishing, 2017), 194.

³⁶ Between 2011 and 2017 there was a decrease from 74 (bcm) to 60.6 in 2016 and 64.2 in 2017: see the data presented by Eustream a.s., i.e. the operator of the Slovak section of Brotherhood pipeline, in its Annual Report 2017, at page 9, available at http://www.eustream.sk/en_company-eustream/en_annual-reports. Those decreases are accompanied by even more significant decreases in the volume of Russian gas transited through Ukraine: from 137.1 (bcm) in 2004 and 104.2 in 2011 to 67.1 in 2015, 82.2 in 2016 and 93.5 in 2017: see the data of Naftogaz, the Ukrainian transmission system operator, available at: <http://naftogaz-europe.com/article/en/naturalgas transit via ukraine 2017>.

³⁷ Russian officials have declared that once the new eastern pipeline or pipelines become operational, the role of Ukraine as a transit country will be reduced to zero: Karel Beckman, "Gazprom CEO Alexei Miller: 'This is the beginning of the end of Gazprom's business model in Europe'", *Energypost* (December 8, 2014) // <http://energypost.eu/gazprom-ceo-alexei-miller-beginning-end-gazproms-model>.

competition, gas supply security and the internal gas market, especially in neighbouring countries.

3. THE LEGAL DISPUTES CONCERNING NORD STREAM 2 AND OPAL AS A CLASH OF MODELS

Having described and analysed the legal disputes concerning TEP's application to Nord Stream 2 and the regulatory exemptions granted to OPAL, I now turn to what underlies them. Here, I will show that both legal disputes are in fact manifestations of a much deeper phenomenon. That phenomenon is the struggle between two opposing models of building and using both the eastern import pipelines and the connected pipelines, a struggle that is also visible within EU decision-making processes; in Member State policy; in multiple judicial and administrative proceedings in Member States; in the investment decisions of gas undertakings; and in public debate and scientific discussions.

The first model is the 'Overcapacity and Exemption-Based Model'. Russia, Gazprom and Gazprom's affiliates have actively pursued this model for many years, and it also finds support in Germany and some large gas undertakings in the EU. This model posits the following. First, in every region of Central and Eastern Europe lying between Russia and the Western Europe (i.e. the Baltic Sea; Poland and Belarus; Ukraine, Slovakia and the Czech Republic; the Black Sea and the Balkans) there should be at least one pipeline importing Russian gas to the EU. Secondly, the total nominal annual capacity of these pipelines should significantly exceed the volume of gas actually imported annually from Russia to the EU. Thirdly, each eastern import pipeline and its operator should be controlled, directly or indirectly, by the Russian undertaking Gazprom. Fourthly, none should be subject to EU energy law, or at least not to any significant degree. Fifthly, the eastern import pipelines should be connected to other transmission pipelines, especially in Germany, transporting the Russian gas onward to Western Europe. Finally, those connected pipelines should also be controlled – at least indirectly – by Gazprom and should benefit from regulatory exemptions under Article 36 of Directive 2009/73/EC, giving them immunity from the basic pro-competitive requirements of the TEP, such as unbundling, third party access and price regulation. The European promoters of this model argue that it ensures these pipelines' economic viability in terms of both construction and exploitation, and so guarantees the security of

supplies of Russian gas to the EU.³⁸ In turn, for Russia this model is advantageous for both economic and geopolitical reasons. In particular, it gives Russia the ability to prefer particular transit routes for Russian gas (i.e. particular eastern import pipelines) over others for geopolitical purposes, and it strengthens Russia's bargaining power in gas negotiations and disputes with Ukraine, the other CEE countries and China.³⁹

The second model is the 'Optimal Capacity and Regulatory-Based Model'. This is primarily advanced by the CEE countries, and posits the following: first, that the existing eastern import pipelines (Nord Stream, Yamal-Europe and Brotherhood) are, in combination with other external and internal sources of gas to the EU, fully capable of guaranteeing the EU's gas supply security. This is so in terms of not only the volume of gas they supply, but also the number of pipelines and diversity of routes supplying Russian gas to the EU. Secondly and as a corollary, no new eastern import pipelines need be built: these would simply add to the already adequate number and capacity of existing routes, rendering some of them superfluous. Thirdly, all eastern import pipelines and connected pipelines should be fully subject to the provisions of the TEP. This is because only the full application of these regulatory arrangements (including unbundling, third party access and price regulation) to those pipelines is capable of ensuring sufficient competition (including price competition) in the EU energy markets, the security of the EU's gas supply, the proper functioning of the internal gas market, and greater choice and lower gas prices for EU consumers. Two important aims underlie this model: to reduce the risk of the EU becoming totally dependent, in geopolitical and economic terms, on

³⁸ Harald Hecking, Simon Schulte, Adnan Vatansever, and Slawomir Raszewski, "Options for Gas Supply Diversification for the EU and Germany in the next Two Decades," *Ewi Energy Research & Scenarios gGmbH, European Centre for Energy and Resource Security* (October 2016): 55 // <http://www.ewi.research-scenarios.de/cms/wp-content/uploads/2016/10/Options-for-Gas-Supply-Diversification.pdf>; Hannes Adomeit, "Germany, the EU, and Russia: The Conflict over Nord Stream 2," *Centre for European Studies, CES Policy Brief* (April 2016): 6-8 // <https://carleton.ca/ces/wp-content/uploads/Adomeit-policy-brief.pdf>; Konrad Popławski, "German energy companies lobby for Nord Stream 2," *Centre for Eastern Studies, Analyses* (September 2016) // <https://www.osw.waw.pl/en/publikacje/analyses/2016-09-21/german-energy-companies-lobby-nord-stream-2>.

³⁹ Adnan Vatansever, "Is Russia building too many pipelines? Explaining Russia's oil and gas export strategy," *Energy Policy* 108(1) (2017); George Niculescu, "The Geopolitics of Energy in the South Caucasus and the Prospects for Regional Energy Security Cooperation": 51, 54; in: Jurate Novogrockiene and Eva Siaulyte, eds., *Addressing Emerging Security Risks for Energy Networks in South Caucasus* (Amsterdam: IOS Press, 2017); Agnia Grigas, *The New Geopolitics of Natural Gas* (Harvard: Harvard University Press, 2017), 108; Tatiana Mitrova, "The New Russian Gas Export Strategy After the Ukraine Crisis": 195, 220; in: Manfred Hafner and Simone Tagliapietra, eds., *supra* note 35; Andrey Vavilov, Galina Kovalishina, and Georgy Trofimov, "The New Export Routes and Gazprom's Strategic Opportunities in Europe": 180; in: Andrey Vavilov, ed., *Gazprom: An Energy Giant and Its Challenges in Europe* (Basingstoke: Palgrave Macmillan, 2015).

Russia, already the dominant external source of the EU's gas; and to reduce the risk of discrimination by Russian gas suppliers against certain EEC countries.⁴⁰

Before considering the substance of this dispute, we should pause to consider the relationship between economic and geopolitical arguments on the one hand, and legal arguments on the other. The critical point here is that the former dominate. Both models express specific economic and geopolitical approaches, and are often justified in those terms. Where legal arguments are invoked by the proponents of either side, they play a primarily instrumental role: they are invoked and used as tools to promote a given model and demonstrate its supremacy over another, especially in a given legal dispute or proceedings.

Ideally it would be possible to separate these two sorts of arguments with regard to the eastern import and connected pipelines. It should be possible to consider economic and geopolitical arguments in isolation – i.e. whether each model, including the legal regime that applies under it, furthers certain strategic interests of the EU, such as the security of the EU's gas supply, the EU's security in general, competition, the internal gas market and diversification of gas supply. It should be similarly possible to consider legal arguments independently – e.g. whether, in light of the current state of EU law, Nord Stream 2 should be subject to the TEP and the 2016 OPAL Exemption complies with its legal base. Put another way, it should be possible for one to (for example) oppose Nord Stream 2 for *economic and geopolitical reasons*, following the Optimal Capacity and Regulatory-Based Model, and yet believe that Nord Stream 2 falls outside of the scope of the TEP as a matter of law.⁴¹

In practice, however, these two categories of arguments cannot so easily be disentangled; in fact, they are often inseparable. This is particularly so with respect to the dispute over the 2016 OPAL Exemption. The provisions of Article 36(1) of Directive 2009/73/EC, the legal basis for that exemption, contains conditions precisely anchored in economic and geopolitical factors (e.g. the security of gas supply and competition in gas markets). Three things follow. First, it is not possible to distinguish economic and geopolitical arguments from purely legal ones. Second, it is unsurprising that the 2016 OPAL Exemption is economically and geopolitically instrumentalised. Third, the legal dispute concerning that regulatory exemption is a battleground between these two economic and geopolitical models, and thus a particularly useful way to understand how they clash.

⁴⁰ See, e.g., Alan Riley, "Nord Stream 2: A Legal and Policy Analysis," *CEPS Special Report* No. 151 (November 2016) // <https://www.ceps.eu/system/files/SR151AR%20Nordstream2.pdf>; Agata Łoskot-Strachota, *supra* note 30; Sławomir Raszewski, *supra* note 2: 229–230.

⁴¹ Kim Talus, *supra* note 4: 30.

In light of the above, it is wholly unsurprising that the proponents of both models above adopt predictable and defined positions with regard to the Nord Stream 2 and OPAL legal disputes, justifying their position using precisely the legal arguments one would expect. The proponents of the first model (Overcapacity and Exemption-Based), including Russia, undertakings belonging to Gazprom group, officials in Germany⁴² and some interested gas undertakings in the EU, contend that the TEP does not apply to Nord Stream 2 (or Nord Stream)⁴³ and that the 2016 OPAL Exemption fully complies with Article 36 of Directive 2009/73/EC.⁴⁴ In contrast, the advocates of the second model (Optimal Capacity and Regulatory-Based), especially political groups and economic organisations in the EEC countries, argue that the TEP already applies in full to the Nord Stream 2 pipeline, including its offshore section.⁴⁵ They also contend that the 2016 OPAL Exemption and 2016 EC OPAL Decision violate Article 36(1) of Directive 2009/73/EC, because the EC incorrectly considered and applied that provision's conditions concerning competition, security of gas supply and the effective functioning of the internal gas market.⁴⁶

Having clarified the relationship between economic/geopolitical and legal arguments here, we turn now to evaluate the two rival models for building and using the eastern import and connected pipelines. The next Sections of the present article will consider the economic and geopolitical arguments underlying both models. At the same time, we will evaluate these arguments in light of specific provisions and objectives of the TEP, and also in the light of the gas supply energy policy implicit in those provisions and objectives.

⁴² I refer to Germany as a proponent of the first model (Overcapacity and Exemption-Based) in the sense that, at the government level, it: officially supports (or at least does not oppose) the construction of Nord Stream 2; argues that the TEP does not apply to Nord Stream or Nord Stream 2; and supports the regulatory exemption for OPAL (see notes 43-44 below). However, it has to be remembered that the construction of Nord Stream and Nord Stream 2 has been subject to significant political controversy in Germany (see, e.g., Anna Herranz-Surrallés, "Energy diplomacy under scrutiny: parliamentary control of intergovernmental agreements with third-country suppliers," *West European Politics* 40(1) (2017): 194; Andreas Heinrich, "Securitisation in the Gas Sector: Energy Security Debates Concerning the Example of the Nord Stream Pipeline": 61; in: Kacper Szulecki, ed., *Energy Security in Europe: Divergent Perceptions and Policy Challenges* (Basingstoke: Palgrave Macmillan, 2018)).

⁴³ See, e.g., this statement of a representative of the Gazprom group, available at: <https://www.euractiv.com/section/energy/interview/nord-stream-2-official-we-see-a-lot-of-smokescreens-thrown-around>. The same position is further held by the President of BNetzA (i.e. the President of a German authority that granted the 2016 OPAL Exemption) and the German government (which now supports, before the General Court, the 2016 EC OPAL Decision and the 2016 OPAL Exemption, and also supports the construction of Nord Stream 2 pipeline) – see this letter of Jochen Homann, President of BNetzA, available at: <http://en.euractiv.eu/wp-content/uploads/sites/2/2017/03/German-regulator-on-Nord-Stream-2.pdf>.

⁴⁴ The 2016 OPAL Exemption was granted at the request of the operator of OPAL, which is a subsidiary of Gazprom. Furthermore, in proceedings concerning the 2016 OPAL Exemption, now pending before the General Court, the legal position of OPAL's operator and the EC (which accepted the 2016 OPAL Exemption) is supported by the German government – see case *PGNiG Supply & Trading GmbH v. Commission*, T-849/16 R.

⁴⁵ See the legal opinion presented in that regard by the Polish government, available at: <http://biznesalert.com/poland-smashes-nord-stream-2-reveal-legal-opinions>.

⁴⁶ See the positions of the Polish and Lithuanian governments in case *Poland v. Commission*, T-883/16.

4. THE OVERCAPACITY AND EXEMPTION-BASED MODEL AND ITS UNWELCOME CONSEQUENCES

We start by considering the first model (Overcapacity and Exemption-Based). This section concludes that this model – particularly in the cases of Nord Stream 2 and OPAL – would undermine the objectives of EU energy law and policy, namely: competition in gas markets, security of gas supply, internal gas market, energy solidarity and the diversification of gas supply. A number of the points here generalise the specific points made above with respect to Nord Stream 2 and OPAL.

We begin with competition. The first model envisages a substantial increase in both the capacity and number of routes for transporting Russian gas to Western Europe, including by the construction of Nord Stream 2 and by the 2016 OPAL Exemption. This will strengthen the market power of Russian undertakings and weaken competition in the EU gas market. First, it will enhance the market power of those Russian undertakings, especially in those upstream wholesale gas supply markets where Gazprom and Gazprom Export are already dominant (namely those of the CEE countries and Germany).⁴⁷

Second, it will give those undertakings more options (routes) to transport their gas so as to foreclose certain undertakings or regions within the EU, take advantage of price arbitrage on rates for gas transmission via various pipelines, and/or influence the price of gas across the European gas market.⁴⁸

Third, the ability of Gazprom and Gazprom Export arbitrarily to favour certain transmission routes (e.g. Nord Stream-OPAL or Nord Stream 2-EUGAL) at the expense of others (e.g. Yamal-Europe or Brotherhood) by directing the majority of their gas down the former, will enable them to harm the competitive position of the operators and users of the latter. As noted above, the operators depend on the revenues that this gas transmission brings⁴⁹ in order to invest in transmission infrastructure. This will in turn entail higher tariff rates for both transmission and

⁴⁷ Not only do Gazprom and Gazprom Export have dominant positions on these markets; they also abuse that position, as the EC rightly alleges. According to the EC, Gazprom abuses its dominant position by, *inter alia*: imposing territorial restrictions in its supply agreements with wholesalers; pursuing an unfair pricing policy in the CEE countries, charging prices to wholesalers that are significantly higher compared to Gazprom's costs or to benchmark prices; and making gas supplies to some EEC countries conditional on obtaining unrelated commitments from wholesalers concerning gas transport infrastructure. See the Statement of Objections sent by the EC to Gazprom for alleged abuse of dominance on Central and Eastern European gas supply markets, available at: http://europa.eu/rapid/press-release_MEMO-15-4829_en.htm. See for more Alan Riley, "Commission v. Gazprom: The antitrust clash of the decade?" *CEPS Policy Brief* No. 285 (31 October 2012) // https://www.ceps.eu/system/files/PB%20No%20285%20AR%20Commission%20v%20Gazprom_0.pdf; Elena Kropatcheva, "EC's Anti-Trust Inquiry into Gazprom's Practices: Its Significance and Meaning for Gazprom's Role in the EU Market," *Russian Analytical Digest* No. 174 (26 October 2015): 9–12 // https://www.files.ethz.ch/isn/194606/Russian_Analytical_Digest_177.pdf; see also note 34.

⁴⁸ Alan Riley, *supra* note 40: 15, 17 and 22.

⁴⁹ For example, the Ukrainian economists assess that after the construction of Nord Stream 2, Ukraine and its national transmission operator will lose about 2 billion USD of gas transit fees: <http://en.interfax.com.ua/news/economic/289356.html>.

reverse flow, thereby increasing the operating costs and worsening the competitive position of wholesale gas suppliers that currently buy gas transported through the marginalised pipelines. The end result will be harm to consumers, who will be subjected to higher prices and a less competitive environment.

Fourth, the decision to immunise the eastern import and connected pipelines from the pro-competitive obligations of the TEP will undermine competition. Exemption from the TEP – including its provisions on unbundling, third party access and price regulation – permit those pipelines' operators to favour Russian or European undertakings which supply gas and are affiliated with them, at the expense of their (very often more efficient) market rivals. Again, this harms the interests of gas consumers.

We now turn to gas security. Implementation of the first model (Overcapacity and Exemption-Based), including by the construction of Nord Stream 2 and the 2016 OPAL Exemption, will severely undermine the EU's gas supply security. First, it will reduce the gas supply to the CEE countries. As noted above, it will reduce supply via the existing pipelines from the east (Yamal-Europe, Brotherhood), and there are serious obstacles to the consequent shortfall being filled by physical reverse flows, via those existing pipelines, from the west. These obstacles include: (1) scarcity of reverse flow capacity (congestion, cross-border bottlenecks) and an increase in tariff rates for such reverse gas transmission;⁵⁰ (2) a shortage of Russian gas available for Western (mainly German) suppliers to resell to the CEE countries, including due to the potential for Gazprom to strategically reduce its supply to that end;⁵¹ and (3) the lack of necessary transport infrastructure in certain south-eastern countries, especially Bulgaria and Macedonia, which are still connected by pipelines and interconnectors to Ukraine alone.⁵²

Secondly, these new pipelines and actions add nothing to the EU's gas supply security ('no new supplier, no new source of supply'),⁵³ instead only unnecessarily duplicating the transmission infrastructure that currently already exists in Poland, Ukraine, Slovakia and the Czech Republic. They merely enable the gradual replacement of the latter infrastructure.

⁵⁰ Kai-Olaf Lang and Kirsten Westphal, *supra* note 2: 24–25; see also note 33.

⁵¹ Giovanna De Maio, "A Tale of Two Countries: Italy, Germany, and Russian Gas," *Center on the United States and Europe at Brookings, U.S. – Europe Working Paper* (August 18, 2016): 4 and 11 // https://www.brookings.edu/wp-content/uploads/2016/08/fp_20160818_demaio_tale_of_two_countrie.pdf.

⁵² Kai-Olaf Lang and Kirsten Westphal, *supra* note 2: 28–29, 34; Jack Sharples and Andrew Judge, "Russian Gas Supplies to Europe: the Likelihood, and Potential Impact, of an Interruption in Gas Transit via Ukraine," *The European Geopolitical Forum* (March 24, 2014) // <http://gpf-europe.com/forum/?page=post&blog=energy&id=157>.

⁵³ An observation made by Jean-Claude Juncker, the president of the EC, cited in Agnia Grigas, *supra* note 39, 112.

Thirdly, these actions remove the gas security the CEE countries enjoy by being the primary gas transmission corridor between Russia and Western Europe, isolating them from the rest of the EU and making them more susceptible to Russian pressure.

Fourthly, they discourage investment in liquefied natural gas ('LNG') terminals and interconnectors.⁵⁴ These could otherwise provide new and alternative sources and routes of gas supply to the EU.

Fifthly, it all increases the dependency of Germany and other Western and Northern European countries on a single gas supplier. This inherently decreases their safety.⁵⁵

It is important to note, in this regard, that the connected and eastern import pipelines interact in this regard. This is because the following can be reasonably assumed with respect to the connected pipelines (like OPAL or, in the future, EUGAL): the greater the capacity of these pipelines that is both exempted from the TEP under Article 36 of Directive 2009/73/EC and open to free use by Gazprom or Gazprom Export, the greater the incentive for Russia and its undertakings to build the new eastern import pipelines (like Nord Stream 2) and to increase the use of the already existing Nord Stream pipeline.⁵⁶ As shown above, this will come at the expense of other pipelines running through the CEE countries and appreciably diminish the security of gas supply to those latter countries.

A final point must be made with respect to gas security, and this concerns solidarity. Even if it is predicated that the 2016 OPAL Exemption and the construction of Nord Stream 2 will bring a slight increase in Germany's and/or other Western European countries' gas supply security, this should not occur at the expense of a drastic reduction in the gas supply security of the CEE countries. Such an outcome would be clearly contrary to the principle of solidarity. Article 194(1)(b) TFEU stipulates that one of the objectives of the EU energy policy is to ensure the security of energy supply in the EU 'in a spirit of solidarity between Member States'.⁵⁷ It follows that even if the 2016 OPAL Exemption and the planned

⁵⁴ In particular, it has been argued that construction of Nord Stream 2 may lead to the abandonment of the planned project to build an LNG terminal in Wilhemshaven (northern Germany): Agata Łoskot-Strachota, "The case against Nord Stream 2," *Energypost* (November 23, 2015) // <http://energypost.eu/case-nord-stream-2>; Hannes Adomeit, *supra* note 38: 4–5.

⁵⁵ Alan Riley, *supra* note 40: 12–13, 15, 17, 18, 21, 22, 25.

⁵⁶ The removal of the capacity cap applied to Gazprom and Gazprom Export's use of OPAL – which was the result of the 2016 OPAL Exemption – and the changes in the ratio of utilisation of particular routes for transporting Russian gas to the EU which followed, indicate that Gazprom and Gazprom Export prefer to export their gas via Nord Stream and OPAL rather than through Ukraine and Slovakia. This also suggests that these undertakings will prefer Nord Stream 2 and its onshore extension (when built) over the Ukrainian-Slovak route – see Katja Yafimava, *supra* note 26: 25.

⁵⁷ On energy solidarity in the EU see Kim Talus, *EU Energy Law and Policy: A Critical Account* (Oxford: Oxford University Press, 2013), 278; Michèle Knodt and Anne Tews, "European Solidarity and Its Limits:

construction of Nord Stream 2 do increase Western European gas supply security, this would not affect their lawfulness: the contrary conclusion would manifestly infringe the principle of solidarity between EU Member States by privileging the interests of Western Europe countries over their eastern and southern neighbours.

The implementation of the first model (Overcapacity and Exemption-Based) is, moreover, detrimental to the functioning of the internal gas market. 'Internal gas market' should be understood as an area without barriers or obstacles to the free cross-border flow of natural gas.⁵⁸ In addition, it is a physically interconnected area where there are many different routes for the transmission of gas and differentiated gas sources. This area should be uniformly subject to the provisions of EU energy law and enjoy a uniformly high degree of security of gas supply.⁵⁹ Yet implementation of the first model – including the 2016 OPAL Exemption and the proposed construction of Nord Stream 2 – will adversely affect this. It will result in the partitioning of the EU gas market into two distinct areas: a well-supplied Western and Northern Europe, benefitting from a liquid market, and a much worse-supplied CEE area which is more dependent on external gas supplies.⁶⁰

It follows, moreover, that the failure to apply the provisions of the TEP to the eastern import pipelines (like Nord Stream and Nord Stream 2) and the connected pipelines (like OPAL and, in the future, EUGAL) undermines the proper functioning of the internal gas market. This is because, in practice, it prevents third parties from making use of these pipelines, thereby creating barriers to the free flow of gas between EU Member States.

Having considered the economic and geopolitical side of this model, we turn to consider the law. From the provisions of the TEP – both those declaring general objectives and those relating to specific regulatory instruments, including the regulatory exemption under Article 36 of Directive 2009/73/EC – it is clear that EU energy law seeks to achieve the following objectives: increased competition in the transmission and supply gas markets; optimal security of gas supply, in a spirit of solidarity between the EU Member States; and the effective functioning of the internal gas market.⁶¹ Implementation of the Overcapacity and Exemption-Based Model with respect to the eastern import and connected pipelines would undermine all three objectives placing that model in direct contradiction with the provisions and objectives of the TEP.

Insights from Current Political Challenges": 47, 55; in: Andreas Grimm and Susanne My Giang, eds., *Solidarity in the European Union: A Fundamental Value in Crisis* (Berlin: Springer, 2017).

⁵⁸ See Article 26(2) TFEU.

⁵⁹ Alan Riley, *supra* note 40: 21.

⁶⁰ *Ibid.*: 21-22

⁶¹ As regards the aforementioned objectives of the TEP, see, e.g., the general declarations made by the EU legislature in paras. 1-5, 8, 17, 22 of the preamble to Directive 2009/73/EC.

It would further contradict the EU's stated policy of seeking to diversify its gas supply: this means the diversification of suppliers (i.e. from different regions of the world), sources of gas (including LNG) and infrastructures transporting gas.⁶² In striking contrast to this policy, the first model makes the EU strongly dependent on one external dominant gas supplier, hinders the flexible diversification of sources of gas (for instance, by making actions that aim to increase LNG supplies to the EU less attractive)⁶³ and risks starving so as to make superfluous the existing CEE import pipelines (by enabling Russia to concentrate the import of its gas to the EU in one or two pipeline routes, such as Nord Stream-OPAL, and in the future Nord Stream 2-EUGAL). In turn, this concentration (as opposed to diversification) is clearly harmful to both competition in gas markets and the security of gas supply, again contradicting EU energy law's provisions and objectives.

This is all the more striking given the broader legislative context. Currently, the EU institutions are considering moving to an even more advanced stage of gas market regulation and integration, strengthening EU energy law's pro-competitive and pro-integrative instruments.⁶⁴ Significantly, many market participants – including energy companies – are demanding a far-reaching strengthening of those instruments in the gas sector (e.g. more extensive unbundling).⁶⁵ By contrast, implementation of the Overcapacity and Exemption-Based Model with respect to the eastern import and connected pipelines leads to entirely different effects – not least because it requires the EU and Member States to renounce existing EU regulatory law in the gas sector, precisely in the parts of the sector which are most important for ensuring the EU's gas supply. Further implementation of this model will mean that a significant part of the EU gas transmission infrastructure, transporting the great majority of the volume of gas that is currently transported through all EU pipelines, will simply fall outside of EU energy law. At this stage of the development of the EU internal gas market and its regulation, this regulatory gap cannot be accepted. When – as is only a matter of time – that market becomes still more

⁶² See, e.g., *The EC Communication: European Energy Security Strategy*, COM (2014) 330 final, point 7; *Commission Staff Working Document: In-depth study of European Energy Security*, SWD (2014) 330 final/3, points 2.1.3 and 4.3; *Regulation (EU) 2017/1938 of the European Parliament and of the Council of 25 October 2017 concerning measures to safeguard the security of gas supply and repealing Regulation (EU) No 994/2010*, OJ L 280, 28.10.2017, p. 1, paras. 8 and 44 in the preamble thereof, and Articles 7(4)(e), 9(1)(e) and 13(4) thereof.

⁶³ See note 54. It is also argued that transport infrastructure emerging in the CEE countries as part of the north-south corridor would not be used to import and transport gas from alternative sources, but instead primarily from Russia: Kai-Olaf Lang and Kirsten Westphal, *supra* note 2: 29.

⁶⁴ To that end the EC invited stakeholders to carry out and comment on studies on a gas market design for the EU, entitled: "Quo vadis EU gas market regulatory framework". See the notice available at: <https://etendering.ted.europa.eu/cft/cft-display.html?cftId=1818>.

⁶⁵ See the discussions papers and stakeholder responses received by the EC and collected as "Study on Quo vadis gas market regulatory framework" (11/2016) // <https://ec.europa.eu/energy/en/studies/study-quo-vadis-gas-market-regulatory-framework>.

integrated and regulated, the gap will become still deeper, risking systemic dysfunction in the EU's regulation of the gas sector.

However, there is a chance that this negative scenario will not materialize in full, even if the Overcapacity and Exemption-Based Model is implemented. Under the latter model, there are two indispensable conditions of reversing the aforementioned threats for competition, security of gas supply and internal gas market: the consequent construction of new LNG terminals in EU (also in Baltic Member States) and consistent enforcement of EU competition law with regard to Gazprom and its affiliates – thus far this was rather problematic.

5. THE OPTIMAL CAPACITY AND REGULATORY-BASED MODEL AS THE METHOD OF ENSURING CONSISTENCY IN THE EU ENERGY LAW AND POLICY

In the final substantive section of this article, we turn to consider the second model (Optimal Capacity and Regulatory-Based) as applied to the eastern import and connected pipelines. The present article argues that in contrast to the first model, this model is fully consistent with the provisions and objectives of the TEP. Moreover, it promotes the diversification of the suppliers, sources and routes of gas supplies to the EU – one of the primary aims of EU energy policy.

Let us begin by defining 'Optimal Capacity' more precisely. This requires that the number and capacity of the eastern import and connected pipelines be tailored, not excessive. That is, their number and capacity should be approximately adapted to the demand for Russian gas in the EU, both that currently existing and that realistically predicted for the future.⁶⁶ This should take into account the need to also derive gas from other sources, including from the EU's own internal deposits;⁶⁷

⁶⁶ In 2017, the EU imported 179 bcm of Russian gas, which amounted to 34% of the EU's total gas supply (526 bcm). This was an all-time high and amounted to a further consolidation of Russia's position as the main gas supplier to the EU: "Annual Report on the Results of Monitoring the Internal Electricity and Gas Markets in 2017: Gas Wholesale Markets Volume," ACER/CEER (September 2018): 14 (hereinafter – 'the 2017 ACER Report') // https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202017%20-%20Gas%20Wholesale%20Markets%20Volume.pdf. The future demand for Russian gas in the EU will depend on the EU's overall demand for gas and on the EU's policy towards diversification of gas supply. According to various forecasts, based on uncertain economic and political scenarios, in 2025 the Russian gas supplies to the EU will amount to between 120 to 151 bcm (26-31% of the then total gas supply to the EU), and in 2030 they will amount to between 112 to 145 bcm (24-30% of the then total gas supply to the EU): Harald Hecking, Simon Schulte, Adnan Vatansever, and Slawomir Raszewski, *supra* note 38: 73–85. The security of gas supply in the EU requires that Russian supplies should not significantly exceed 30% of total gas supplies.

⁶⁷ In 2017, EU gas production amounted to about 128 bcm, which was 24% of the EU's total gas supply: "Quarterly Report on European Gas Markets", DG Energy Volume 10, Issue 4 (Fourth Quarter of 2017): 9 (hereinafter – 'the 2017-4 Quarterly Report') // https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2017_final_20180323.pdf. It is expected that the share of the EU's domestic production could drop to below 20% by 2030, unless there is progress in exploring shale gas and biogas resources.

from other, external sources and suppliers (in Norway, Africa, the Middle East and Caucasus);⁶⁸ and from the development of LNG terminals.⁶⁹ It should also incentivise Russian suppliers to differentiation, rather than concentration, of gas transmission routes to the EU.⁷⁰

Having clarified what the first part of this model consists of, we can consider its consequences. First, this model creates the optimal conditions for diversifying the EU's gas supply in terms of suppliers, sources and routes. Such diversification is highly beneficial to competition within EU gas markets. It does not reinforce the market position of one external supplier of gas alone, or of only those very few gas undertakings which enjoy close relations with that supplier, Gazprom. Instead, it sustains the balance, and adequate dispersion of market power, of gas undertakings active in various geographical markets in the EU – including by maintaining the competitive position of gas undertakings in the CEE countries. Second, this diversification is in turn advantageous for the EU's gas supply security, ensuring that the EU is supplied with gas from various alternative suppliers and sources and that Russian gas flows evenly throughout the CEE countries. This disables Russian gas suppliers from concentrating the vast majority of their gas supplies on arbitrarily-selected transmission routes and removes their incentive to favour or discriminate against certain of the same. Moreover, it contributes to the realization of energy solidarity in the EU and ensures that charges for the transmission of Russian gas are fairly distributed between all of the transit countries concerned.

Turning to the second part of this model – regulation – equally positive results are achieved by subjecting the eastern import and connected pipelines to relevant EU law. First, this means that all of these pipelines are managed by independent operators with no incentive to favour any one gas supplier. They can concentrate their efforts on developing the transmission system not in the interest of one dominant gas supplier (here, Gazprom), but rather in the interest of the security of gas supply throughout the EU, especially by building interconnection points and

⁶⁸ The second main external gas supplier to the EU is Norway (about 122.4 bcm in 2017, which amounted to 23% of the EU's total gas supply – the 2017-4 Quarterly Report, 2 and 11). The others external gas suppliers are: Algeria (via pipeline and LNG), Libya (via pipeline), Qatar (LNG) and Nigeria (LNG): the 2017 ACER Report, 14. In order to further diversify the suppliers and sources of gas to the EU, it is planned to construct the East Med pipeline to transport natural gas from Israel and Cyprus to Europe; this would provide access to the Israeli offshore gas fields. There are also plans to import gas to the EU from the Caucasus via Turkey through the Southern Gas Corridor.

⁶⁹ As regards some recently completed and proposed LNG terminals, see "Quarterly Report on European Gas Markets", *DG Energy*, Volume 10, Issue 1 (First Quarter of 2017): 11 // https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q1_2017.pdf.

⁷⁰ In 2017, the share of the main supply routes of Russian gas imports was as follows: Ukraine (both through Brotherhood and Balkan routes) 44%, Nord Stream 30% and Yamal-Europe 24%: the 2017-4 Quarterly Report, 12. In the interests of differentiation of transport routes, this balance should not be significantly distorted.

interconnectors. Second, the relevant EU law entails gas price regulation. This helps ensure that tariff rates for the transmission of gas are proportionate to costs, do not favour any particular direction or destination of gas flow and do not distort competition on transmission gas markets in other geographical areas. This also lowers the price of gas ultimately supplied to consumers. Third, EU law ensures that third party access to the gas pipelines, especially the connected ones, is guaranteed.

How, then, can this model be achieved? Its 'optimal capacity' limb can be achieved, with respect to the eastern import and connected pipelines, by the Member States and EU as follows: first, by denying public financial assistance for investments in these and/or by setting appropriately high and enforceable environmental requirements;⁷¹ second, by subjecting those pipelines to the full requirements of the TEP, without any general immunities or regulatory exemptions under Directive 2009/73/EC;⁷² third, by reducing the capacity of the connected pipelines that benefits from regulatory exemptions under Article 36 of Directive 2009/73/EC, especially where those exemptions favour Gazprom. As shown above, the smaller the exempted capacity of the connected pipelines, the lower the economic incentives for Russia and Gazprom to increase the number, capacity or actual use of the existing and proposed eastern import pipelines at the expense of other pipelines running through the CEE countries.⁷³

As for the second limb, the eastern import and connected pipelines should be subjected to the appropriate level of regulation in the following way. First, the EC

⁷¹ This is not to say that these requirements should be established with the aim of deliberately obstructing a given pipeline. Nonetheless, they should effectively protect the environment from any undesired impact by a pipeline, especially in such an ecologically sensitive area as the Baltic Sea. On the environmental impact of the Nord Stream pipeline see, e.g. Ellen Karm, "Environment and Energy: The Baltic Sea Gas Pipeline," *Journal of Baltic Studies* 39(2) (2008); Alexander Lott, "Marine Environmental Protection and Transboundary Pipeline Projects: A Case Study of the Nord Stream Pipeline," *Utrecht Journal of International and European Law* 27(73) (2011); Andrey Kostianoy, Olga Lavrova, Marina Mityagina, and Dmytro Solovyov, "Satellite Monitoring of the Nord Stream Gas Pipeline Construction in the Gulf of Finland": 221; in: Andrey Kostianoy and Olga Lavrova, eds., *Oil Pollution in the Baltic Sea* (Berlin: Springer, 2014).

⁷² Even if this regulatory strategy does not prevent construction of any given eastern pipeline, it may nevertheless reduce the capacity of that pipeline that is exclusively available to Gazprom and Gazprom Export. As previously argued, such exclusive access disadvantages both competition in the internal market and EU gas supply security.

⁷³ The actions proposed in this paragraph aim to avoid an excessive number and/or capacity of eastern import pipelines by market principles alone. In particular, they do not include any legislative or administrative bans, or oblige any undertaking to withdraw from a given project. Instead, they are confined to the *elimination* of any public regulatory or financial *support* for these pipelines. These propositions are therefore in harmony with the principle that decisions to build or refrain from building new pipelines in the EU should be left to private market actors driven by market considerations only (e.g. existing and predicted gas demand and the prospects of profit). In general, the EU market economy should have no legislative or administrative prohibitions against the construction of pipelines, as these would recall a time of centrally-planned and state-controlled energy markets: Severin Fischer, "Nord Stream 2: Trust in Europe," *Policy Perspectives* Vol. 4(4) (March 2016): 3-4 // <http://www.css.ethz.ch/content/dam/ethz/special-interest/gess/cis/center-for-securities-studies/pdfs/PP4-4.pdf>. In this respect see also Kim Talus, "Decades of EU energy policy: towards politically driven markets," *Journal of World Energy Law and Business* 10(5) (2017).

should adopt a more stringent approach to, and undertake a more careful review of the actual effects of, granting regulatory exemptions to the connected pipelines under Article 36 of Directive 2009/73/EC. It should require national regulatory authorities to change or even withdraw an exemption if it turns out that – contrary to initial predictions – the exemption undermines the TEP’s objectives.⁷⁴ Secondly, the EU legislature should amend Directive 2009/73/EC so as to clarify definitively that the provisions of the TEP apply in full to the eastern import pipelines, including their maritime sections. The EC’s proposal in this regard presented in 2017 is suboptimal and should be amended, as it currently enables Member States to derogate unilaterally from the Directive’s requirements with respect to existing import pipelines under their jurisdiction, without any ex ante or ex post control by the EU institutions.⁷⁵ Thirdly, the EU and/or Member States should conclude international agreements with the third countries in which the eastern import pipelines start or run, requiring those countries to apply provisions similar or analogous to the TEP to the section(s) of the pipeline falling within their jurisdictions. Thus, effective regulation should also be implemented extraterritorially (i.e. outside the EU). This would both preserve the coherence of EU energy law and policy and ensure individual import pipelines are subject to the same regulatory standards throughout their length, so far as possible.⁷⁶

There is no doubt that Russian gas is and will remain one of the most important sources of the EU’s energy security. The aim of this model is not to undermine this; rather, it is to diversify the EU’s gas supply and to subject the pipelines transporting Russian gas to the ordinary rules of EU energy law.

CONCLUSIONS

The recent legal disputes concerning the 2016 OPAL Exemption and the applicability of the TEP to Nord Stream 2 have shown clearly that there is a fundamental division in Europe regarding the approach to the construction and exploitation of the eastern import and connected pipelines. That division is clear not

⁷⁴ Article 36(9) of Directive 2009/73/EC grants EC such competence, but in fact the EC has never made use of it.

⁷⁵ See Article 49(9) of Directive 2009/73/EC, as provided for in the EC proposal of 8 November 2017.

⁷⁶ In particular, the TEP’s provisions on third party access cannot be effectively applied to the EU sections of Nord Stream or Nord Stream 2 unless those provisions are also applied in substance to the Russian sections of the same pipelines. On the EU’s actions to promote its internal gas regulatory model outside the EU see, e.g., Filippos Proedrou, *EU Energy Security in the Gas Sector: Evolving Dynamics, Policy Dilemmas and Prospects* (London: Routledge, 2012), 69; Thijs Van de Graaf, “Rule-maker or rule-taker? The EU and the shifting global political economy of energy”: 165; in: Rafael Leal-Arcas and Jan Wouters, eds., *supra* note 2; Heiko Prange-Gstöhl, “Enlarging the EU’s internal energy market: Why would third countries accept EU rule export?” *Energy Policy* 37(12) (2009).

only in the fact of these disputes, but also the economic and geopolitical arguments put forward by the parties involved in these disputes.

It is argued that the first model (Overcapacity and Exemption-Based), promoted by certain economic and political groups, is in conflict with the provisions and objectives of the EU energy law. It is also inconsistent with the EU's energy policy on gas supplies, which aims to diversify external gas suppliers, sources of gas and gas transport routes. It jeopardizes competition on the EU gas markets, diminishes the security of gas supply to the CEE countries and creates unnecessary barriers to gas flows between Member States. Even for the Western European countries it gives only an illusory feeling of increased gas supply security: it is clear that the first model will weaken gas supply to the CEE countries, negatively impacting not only their economies but also those of Western Europe, given the strong interdependence between the two lungs of Europe. Finally, this Overcapacity and Exemption-Based Model is anachronistic and regressive in light of the current state of integration of the internal gas market and the contemporary regulatory achievements of the EU, particularly in light of emerging proposals to make the EU's energy market still more competitive and integrated.

Therefore, it is contended that all EU institutions and Member States should now be far-sighted. In their own enlightened self-interest, they should ensure that the eastern import and connected pipelines are subject to EU energy law in its entirety, without unwarranted derogations or exemptions. The EU institutions and Member States should also strive to ensure the number and capacity of those pipelines are not excessive, but rather approximately adapted to the current and forecasted demand for Russian gas in the EU, taking into account the need to diversify gas supply to the EU (by stimulating internal production, increasing external supply from non-Russian suppliers and sources, and building LNG terminals). They should incentivise Russian suppliers to differentiation, rather than concentration, of gas transmission routes to the EU.

EU energy law and policy must be characterised by elementary coherence and rationality. To that end, the future fate of the eastern import and connected pipelines should be rooted in the Optimal Capacity and Regulatory-Based Model.

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