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# Oil, Gas & Energy Law Intelligence

## EU Gas Market Amendment - Despite of Compromise, Problems Remain by K. Talus

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# EU Gas Market Amendment - Despite of Compromise, Problems Remain

*Kim Talus<sup>1</sup>*

## **Summary**

*After two unsuccessful attempts to affect the Nord Stream 2 pipeline project by virtue of EU gas market regulation, the Commission tabled a legislative proposal to amend the Gas Market Directive in a way that would extend its scope of application to external gas pipelines bringing gas to the EU internal market. After extended talks and several consecutive versions of a possible amendment, on 12 February 2019 the trilogue<sup>2</sup> reached a compromise on key issues relating to the amendments to the Gas Directive.<sup>3</sup> The trilogue cemented the agreement suggested by France and Germany, where the application of Gas Market Directive was restricted to “territory and territorial sea of the Member State where the first interconnection point is located”.<sup>4</sup>*

*Unlike the initial proposal from the Commission, the new wording means that the Gas Market Directive amendment only applies to the section of the pipeline located in the territorial sea of the Member State where the first connection point is located. This is an improvement to the original proposal as it excludes the violation of United National Law of the Sea Convention (UNCLOS) as well as eliminates the problems arising from multiple jurisdictions applying the Gas Market Directive to their offshore territories. However, despite of this, several key issues in the amendment remain problematic.*

*This article will first provide for some background to the amendment and then move to examine its details. Before concluding, the article will discuss the tension of the amendment with WTO rules and general principles of EU law.*

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<sup>1</sup> Kim Talus is the James McCulloch Chair in Energy Law and founding Director of the Tulane Center for Energy Law (Tulane Law School). He is also a Professor of European Energy Law at UEF Law School (University of Eastern Finland) and a Professor of Energy Law at Helsinki University. Kim Talus is also the Editor-in-Chief for OGEL ([www.ogel.org](http://www.ogel.org)). He has provided legal advice on cross-border infrastructure projects, including Nord Stream 2. The author can be contacted at [ktalus@tulane.edu](mailto:ktalus@tulane.edu).

<sup>2</sup> Trilogue is a part of the EU legislative process where Parliament, the Council and the Commission negotiate over a legislative proposal.

<sup>3</sup> 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 (14 February 2019, 2017/0294(COD)) (hereafter the “amendment”).

<sup>4</sup> This has been widely reported in various news, see for example: <https://www.france24.com/en/20190208-france-germany-compromise-russias-nord-stream-ii-gas-pipeline>

## 1. Brief Background to the Amendment

The Gas Market Directive amendment cannot be separated from the ongoing Nord Stream 2 pipeline project.<sup>5</sup> Initially the Commission claimed that the existing Gas Market Directive<sup>6</sup> would apply to the offshore sections of the project. When the Commission legal service<sup>7</sup> and various energy experts<sup>8</sup> had made it clear that this is not the case, the Commission changed its strategy and sought a mandate to negotiate an intergovernmental agreement between EU and Russia on the operational aspects of the pipeline. This was based on a claim that the applicable regulatory framework was unclear, that there was a conflict of laws (between EU and Russian law) and that there was a legal void in the project. Because of these reasons, the Commission asked EU Member States for a mandate to negotiate a Nord Stream 2 specific intergovernmental agreement with Russia. The objective was that general principles of EU energy law would apply to the operation of the pipeline.<sup>9</sup>

After examining the Commission's request for the negotiating mandate, the Legal Service of the Council of the EU – the EU institution representing the Member States – rejected most of Commission's claims.<sup>10</sup> The Commission thereafter changed its strategy. Next the Commission tabled a proposal for a legislative change extending the applicability of the Gas Market Directive to external pipelines bringing gas to the EU internal gas market. It is this Commission proposal and specifically the final version accepted by the trilogue on 12 February 2019 that is the focus of this article.

## 2. The Commission Proposal for Amendment to the Gas Market Directive

The European Commission tabled its proposal for the Gas Market Directive amendment in a rush. The first indication of this legislative change came only in September 2017 in the Commission President Juncker's 2017 State of the Union letter of intent to the Parliament and Council.<sup>11</sup> Less than two months later, on 1 November 2017, the European Commission presented a proposal for the amendment.<sup>12</sup> The considerable haste in preparing this legislative

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<sup>5</sup> Katja Yafimava explains: "Indeed, on 11 October 2017, the DG Energy's Director for the Internal Energy Market (IEM), Klaus-Dieter Borchardt, presenting at the European Parliament's Committee on Information, Research and Energy (ITRE) – which is responsible for scrutinizing the proposal – stated that one of the proposal's main aims was to ensure that the amended Directive would apply to (the European end of) Nord Stream 2. The fact that the latter is scheduled to become operational at the end of 2019 explains the urgency with which the EC has been trying to advance the proposal, in order for it to be adopted prior to Nord Stream 2's starting operation." in Katja Yafimava, 'Building New Gas Transportation Infrastructure in the EU – what are the rules of the game?' Oxford Institute of Energy Studies (OIES Paper NG 134).

<sup>6</sup> Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, 2009, O.J. L211/94 (hereafter the Gas Market Directive).

<sup>7</sup> 'Legal opinion undermines EU's ability to block Nord Stream pipeline', Politico, 7. February 2016.

<sup>8</sup> For example, Andreas Goldthau, 'Assessing Nord Stream 2: regulation, geopolitics & energy security in the EU', Central Eastern Europe & the UK (EUCERS report 2016), Simon Pirani and Katja Yafimava, 'Russian Gas Transit Across Ukraine Post-2019: pipeline scenarios, gas flow consequences, and regulatory constraints' (OIES paper NG 105, February 2016), Kim Talus, 'Application of EU energy and certain national laws of Baltic sea countries to the Nord Stream 2 pipeline project', *The Journal of World Energy Law & Business* 10 (2017) 1, p. 30-42

<sup>9</sup> <http://www.politico.eu/wp-content/uploads/2017/07/NS-Draft-Mandate.pdf>.

<sup>10</sup> <http://www.politico.eu/wp-content/uploads/2017/09/SPOLITICO-17092812480.pdf>.

<sup>11</sup> Jean-Claude Juncker. State of the Union 2017 Letter of intent to President Antonio Tajani and to Prime Minister Jüri Ratas. 13 September 2017.

<sup>12</sup> European Commission, '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, 2017/0294 (COD)

proposal and the choice not to conclude a separate impact assessment, as required by the Commission's own "Better regulation guidelines", has been noted and criticized by most commentators.<sup>13</sup> For example, Leigh Hancher and Anna Marhold note:

'The targeted nature of the Commission proposal was used as justification for the choice not to pursue a full impact assessment. However, the latter decision may also reflect the sudden urgency attached to a legislative proposal that was not foreseen either in the Commission's energy union strategy of February 2015 or in subsequent updates on the state of energy union.'<sup>14</sup>

This considerable rush can only be explained by the attempt to complicate one single project: Nord Stream 2. From the initial Commission proposal to the version accepted by the trilogue, the attempt to isolate the impact of the legislative change to this project with limited collateral damage to other pipelines has been clear. The intention to isolate the impact of the proposed legislative change to one pipeline only gets to almost comical proportions when examining some of the amendments that have been suggested to the original Commission proposal.<sup>15</sup> For example, limiting the applicability of the amended Gas Market Directive to interconnectors with third countries to those interconnectors with annual transmission capacity of over 40 bcm would have conveniently limited the applicability to Nord Stream 1 and Nord Stream 2 pipelines only, with exclusion of other pipelines bringing gas to EU internal gas market. Not only is this problematic from EU law perspective, it also raises fundamentally problematic questions of WTO law.<sup>16</sup> These issues will be discussed in more detail below.

### 3. The Compromise and the Amendment

After more than one year of negotiations, EU Member States were divided in their approach to the proposal to amend the Gas Market Directive and extend the scope of the EU gas market regulation to external pipelines. This in itself is not surprising, given that this would undoubtedly 'raise political controversy as well as complex legal issues'.<sup>17</sup> The lack of an impact assessment, the collateral damage to existing pipelines, the competence shift from the Member States to the European Commission in deciding the fate over existing and future pipelines, amongst other problematic aspects of the proposal to amend the Gas Directive, made this amendment highly problematic for many EU Member States that would be affected. The core countries in favour of the amendment, Poland and certain other eastern European Member

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<sup>13</sup> Katja Yafimava, 'Building New Gas Transportation Infrastructure in the EU – what are the rules of the game?' Oxford Institute of Energy Studies (OIES Paper NG 134), July 2018 and Leigh Hancher and Anna Marhold, 'A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission's Proposal to Amend the 2009 Gas Directive', *Journal of Energy and Natural Resources Law* (2019, online version available), Kim Talus, Discriminatory nature of the proposed changes to the gas market directive – extension to external pipelines or only one of them?' *Utilities Law Review* 22 (2018) 2, 55-60.

<sup>14</sup> Leigh Hancher and Anna Marhold, 'A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission's Proposal to Amend the 2009 Gas Directive', *Journal of Energy and Natural Resources Law* (2019, online version available).

<sup>15</sup> See for example, European Parliament: draft report, Jerzy Buzek 2017/0294(COD) (26.1.2018).

<sup>16</sup> Similarly, Leigh Hancher and Anna Marhold, 'A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission's Proposal to Amend the 2009 Gas Directive', *Journal of Energy and Natural Resources Law* (2019, online version available).

<sup>17</sup> Leigh Hancher and Anna Marhold, 'A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission's Proposal to Amend the 2009 Gas Directive', *Journal of Energy and Natural Resources Law* (2019, online version available). Similarly, Kim Talus and Moritz Wüstenberg, 'Risks of Expanding the Geographical Scope of EU Energy Law' (2017) 26 *European Energy and Environmental Law Review* 138, 138-41.

States, like the Baltic States, have been vocal in their opposition to Nord Stream 2 pipeline and this appears to be their motivation to support the amendment. Germany, on the other hand, remained a supporter of the project as did a number of other EU Member States.

After the change in Council presidency, Romania tabled a legislative text to be voted on. Germany and France appeared to have reached a compromise on some key details of the legislative text. Under the compromise that was subsequently accepted by other EU Member States, with the exception of Bulgaria,<sup>18</sup> the amended Gas Market Directive would apply only in the “territory and territorial sea of the Member State **where the first interconnection point is located**”. The text of the compromise states: “first, to unify the wording in order to clarify that the mentioned rules refer to the territory and the territorial seas of the Member State concerned. Secondly, it is our understanding that the rules of the internal market should be applied in the territory and the territorial sea of the Member State where the first interconnection point with the Member State’s network is located.”<sup>19</sup> This compromise accepted by the Member States and subsequently in the trilogue is now reflected in the text of the amendment.

## 4. Details of the Amendment

### 4.1 Territorial Scope of the Amendment

The most important amendment that was accepted is the definition of an ‘interconnector’ under Article 2, point (17), read in conjunction with recital five. The new wording now states:

(17) ‘interconnector’ means a transmission line which crosses or spans a border between Member States for the purpose of connecting the national transmission system of those countries or a transmission line between a Member State [ ] and a third country [ ] up to the territory [ ] of the Member States or the territorial sea of the Member State [ ];

As the new provision now indicates, the applicability of the Gas Market Directive and all the other instruments of EU energy law that follow, is now extended to the territorial sea of the Member State *where the first interconnection point is located*. Recital five of the amendment makes this clear:

The applicability of Directive 2009/73/EC [ ] to gas [ ] transmission lines to and from third countries remains confined to the territory [ ] of the Member States. [ ] As regards offshore [ ] gas transmission lines, it should be applicable in the territorial [ ] sea [ ] of the Member State [ ] where the first interconnection point with the Member States’ network is located.

This key amendment eliminates the violation of UNCLOS, which restricts the sovereignty of coastal states to the territorial sea and does not extend the right to decide over operational details of a pipeline to the exclusive economic zone.<sup>20</sup> Restricting the applicability of the Directive to the territorial sea of the Member State where the first interconnection point with

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<sup>18</sup> For example, see <http://bnr.bg/en/post/101079390/bulgaria-does-not-support-france-germany-compromise-on-nord-stream-2-gas-pipeline>

<sup>19</sup> <https://www.politico.eu/wp-content/uploads/2019/02/FR-DR-gas1.jpeg>

<sup>20</sup> For more details, see Kim Talus, ‘Application of EU energy and certain national laws of Baltic sea countries to the Nord Stream 2 pipeline project’, *The Journal of World Energy Law & Business* 10 (2017) 1, p. 30-42.

the Member States' network is located also eliminates problems arising out of regulation of the pipelines separately in various neighboring coastal states or having one Member State regulating the pipeline in the territory of other Member States. This solution is in line with the existing situation in countries like Denmark where the national law already states that transmission networks in the territorial sea or the EEZ that are not connected to the Danish natural gas system are excluded from the scope of the Act.<sup>21</sup> This approach is logical as it would make little sense applying the national (or EU) laws to a pipeline that has no connection with the national gas markets.

In practice, this means that a virtual entry point is established at the border of the territorial waters and EEZ of the country with the first physical connection. In the case of NSP2 that is Germany. The rules of EU energy law will start to apply from this entry point. For example, third party access is available from this entry point. Given however that there is no access to the pipeline at the other end, this third-party access is physically only possible later downstream of the pipeline.<sup>22</sup>

#### *4.2 Derogations Under Article 49a*

Article 49a of the amendment includes wording providing Member States the right to grant derogations from the applicable gas market rules:

[ ] In respect of gas [ ] transmission lines between a Member State and a third country [ ] completed before [PO: date of entry into force of this Directive], the Member State [ ] where the first connection point of the said transmission line with a Member State's network is located may decide to derogate from Articles 9, 10, 11 and 32 and Article 41(6), (8) and (10) for the sections of such [ ] gas transmission line located in its territory and territorial sea, [ ] for objective reasons [ ], such as enabling the recovery of the investment made or due to reasons of security of supply, provided that the derogation would not be detrimental to [ ] competition on or the effective functioning of the internal market in natural gas in the Union, or the security of supply in the Union.

The derogation shall be limited in time up to 20 years based on objective justification, renewable if justified and may be subject to conditions which contribute to the achievement of the above conditions.

While the intention is to provide the Member State where the first connection point of the transmission line with a Member State's network is located the right to decide over the derogation for existing pipelines located in its territory and territorial sea, the powers of the relevant Member State are significantly restricted by the wording of this provision. Even if the wording "such as" suggests that recovery of the investment made or security of supply are not the only reasons for a derogation, it clearly suggests that it is along these lines that the national

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<sup>21</sup> Article 2(4) of the Danish Natural Gas Supply Act (Lov om naturgasforsyning)

<sup>22</sup> According to reporting from Euractiv, Jerzy Buzek (EP) has noted that "By its very nature, therefore, the rules will apply to the entire length of the pipeline, because it would be physically impossible to differentiate between its European part and the above-mentioned short one outside of the EU territory." <https://www.euractiv.com/section/energy/interview/jerzy-buzek-deal-on-nord-stream-2-is-good-for-poland-and-eu/>. This of course is inaccurate as a virtual entry point can easily be established to the outer limit of German EEZ.

decisions will be evaluated by the Commission and possibly by the European Court of Justice. As such, very limited deviations from these criteria are likely to be accepted.

Also, and very importantly, the same reference to recovery of the investment made or security of supply will also be central when evaluating the appropriate duration of a derogation. The new reference “recovery of the investment made” would clearly suggest that older pipelines to Italy and Spain, like Transmed or Maghreb and possibly Greenstream or Medgaz, would not be subject to a 20-year derogation. As such, the 20-year duration is not likely for these pipelines.

Article 49a also includes a confusing element. The fourth section of the article provides that:

Where the gas transmission line [ ] in question is located in the territory of more than one Member State, the Member State in the [ ] territory of which the first [ ] connection point with the Member States' network is located shall decide on a derogation for the [ ] gas transmission line [ ] after consultation with all concerned Member States.

The confusion comes from the reference to “all concerned Member States”. There is no explanation on who these “concerned Member States” may be. Given that the derogation can only apply to the “gas transmission line located in its territory and territorial sea” and the entire amendment is only “applicable in the territorial [ ] sea [ ] of the Member State [ ] where the first interconnection point with the Member States’ network is located”, there should be no other concerned Member States. One explanation for this provision could be that it has been left in the text from an earlier version and was made redundant by the German – French compromise confirmed by the trilogue.<sup>23</sup>

#### *4.3 Competence Shift Under Article 49a*

Given the substantial and restrictive requirements over the derogation and its duration, the competences of Member States to act in this area are significantly restricted. In practice the Commission will have control over the application of Article 49a derogation. Where it considers that the derogation does not meet the requirements of EU law, European Commission may initiate infringement proceedings against a Member State. These proceedings could be based both on the amended Directive, which includes very restricting terminology, and on general Treaty law.

When these new restrictions on national decision-making are combined with the new powers the European Commission would have over all new pipelines under Article 36 of the Gas Market Directive, as these pipelines would be within the scope of the Directive, the Commission is effectively granted significant control over all existing and future pipelines bringing gas to EU Member States. (I expect that all or most new pipelines will seek to benefit of the so-called merchant exemption<sup>24</sup> where Commission would also have the final say over the application of Article 36 to a specific pipeline project.)

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<sup>23</sup> This would not be a surprise as various revisions of the amendments have been consistently marked by mistakes and sections left from previous versions or unrelated EU regulations used as models for details of the amendment. This is another indication of the pressure to work (too) fast.

<sup>24</sup> This is also suggested in recital 35 of the Gas Market Directive.

Arguably, this control over any existing or new pipelines may also impact the national energy rights under Article 194(2) TFEU. Were this the case, the amendment should not take place without the agreement from the Member State concerned and impacted by the change. In practice, this means the Member State where the first physical connection takes place. It may also be that this agreement is not enough but that the entire proposal is outside EU competence.<sup>25</sup> This is significant as the lack of clarity over this question may lead to illegality of the amendment under Article 194(2) TFEU. The limits of Article 194(2) TFEU were first tested in T-356/15 - Austria v Commission where the General Court rose to defend the national energy rights.<sup>26</sup>

#### *4.4 Empowerment Procedure Under Article 49 aa Entails a Competence Shift*

The empowerment procedure under Article 49 aa does not change the transfer of competence to negotiate any future intergovernmental agreements over external pipelines or renegotiate any such existing intergovernmental agreements. This new Article provides the Commission with full control over any negotiations over any existing or future intergovernmental agreements.

In addition to this, the reference to “conflict with Union law” as a requirement for opening of formal negotiations as well as for the final agreement, seems to suggest that nothing in the agreement can be in conflict or deviate from the Gas Market Directive, Gas Regulations or network codes as these form part of “Union law”.

As such, the amendment marks a significant change to *status quo* and entails a competence shift from the Member States to the European Commission. It appears that the Member States have accepted this as part of the collateral damage the amendment causes to all Member States.

#### *4.5 Protection of Existing Private Law Agreements*

Similarly to what has been described above, the rights that the amendment appears to give the national transmission system operators is largely illusory. Article 48a provides that:

This Directive does not affect the freedom of transmission system operators or other economic operators to maintain in force or to conclude technical agreements on issues concerning the operation of transmission lines between a Member State and a third country, insofar as these agreements are compatible with Union law and relevant decisions of the national regulatory authorities of the Member States concerned. These agreements shall be notified to the regulatory authorities of the Member States concerned.

However, given that Gas Market Directive, Regulations and network codes (such as the Network Code on Interoperability and Data Exchange Rules, which appears particularly significant here) are part of “Union law” and as “decisions of the national regulatory authorities” of course have to be compatible with Union law, this provision is largely empty of any real content. Transmission system operators cannot deviate from any of the applicable EU

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<sup>25</sup> See also Leigh Hancher and Anna Marhold, ‘A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission’s Proposal to Amend the 2009 Gas Directive’, *Journal of Energy and Natural Resources Law* (2019, online version available). The impact of Article 194(2) TFEU has been examined in detail in K. Talus and P. Aalto, ‘Competences in EU energy policy’, J. Wouters ja R. Leal-Arcas (eds) *Research Handbook on EU Energy Law and Policy* (Edward Elgar 2017).

<sup>26</sup> T-356/15 - Austria v Commission (ECLI:EU:T:2018:439), the appeal C-594/18 P - Austria v Commission is pending.



rules and all existing private agreements with third country transmission system operators need to be renegotiated. In addition, it may be noted that it remains unclear what a “technical agreement” actually is.

## 5. The Amendment is in Tension with the WTO Rules

In examining the proposal to amend the Gas Market Directive, Leigh Hancher and Anna Marhold note that “[t]he proposal may open a Pandora’s box in terms and may raise serious issues of discrimination under the rules of the World Trade Organization – issues that have to be kept in mind by the Commission.”<sup>27</sup> Indeed, given that the amendment appears to primarily target one pipeline, Nord Stream 2, with collateral damage to other pipelines, there is a real risk that the amendment violates WTO related obligations of the EU. This is clear from the recent WTO Panel Report in the *EU – Energy Package* dispute brought by Russia (“Panel Report”).<sup>28</sup>

The Panel Report contains elements that speak against the WTO-consistency of this new legislative proposal. A key message from the *EU-Energy Package* Panel Report is that measures to diversify away from Russian gas, either through restrictions on imports or advantageous treatment of gas of non-Russian origin could constitute quantitative restrictions and discrimination.<sup>29</sup> The developments prior to the amendment and the attempts to restrict the impact of the new rules to Nord Stream 2 pipeline appear to do exactly that.

## 6. Violations of General Principles of EU Law

According to the amendment, the possibility for a derogation under Article 49a is available for pipelines, which are “completed before the date of entry into force of this Directive”. Recital four of the amendment provides more reasoning for this and explains the reason for the derogation under Article 49a:

To take account of the previous lack of specific Union rules applicable to gas [ ] transmission lines to and from third countries, Member States should be able to grant derogations from certain provisions of Directive 2009/73/EC to such [ ] gas transmission lines which are completed at the date of entry into force of this Directive.

This presumably means legal certainty and protection of legitimate expectations for investors and owners of pipelines where the investments have already been made under the current regulatory framework where EU energy law was not applicable to these pipelines. This reasoning, however, is problematic when it comes to pipeline projects where the final investment decision has been made and significant capital has been committed and spent already before the intended legislative change became known, while the pipeline has not yet been completed.

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<sup>27</sup> Leigh Hancher and Anna Marhold, A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission’s Proposal to Amend the 2009 Gas Directive, *Journal of Energy and Natural Resources Law* (2019, online version available).

<sup>28</sup> European Union and its Member States – Certain Measures Relating to the Energy Sector (*EU Energy Package*), Report of the Panel, WT/DS476/R, 10 August 2018

<sup>29</sup> This has been examined in detail in Kim Talus and Moritz Wustenberg, ‘WTO Panel Report in the *EU – Third Energy Package* and Commission proposal to amend the 2009 Gas Market Directive’, *Journal of Energy and Natural Resources Law* (2018).

Does this mean that these investments do not merit the legal protection under general EU law principles like non-discrimination, non-retroactivity, legal certainty and protection of legitimate expectations? It must be noted that in some cases, the capital already committed in ongoing projects may exceed the total costs of some existing pipelines.

### *6.1 Principle of Non-discrimination*

As I have argued before,<sup>30</sup> the amendment violates the general EU principle of non-discrimination. As a general principle of EU law, it requires consistency and rationality: it requires the EU institutions to justify their policies and prohibits them from engaging in arbitrary conduct.<sup>31</sup> A difference in treatment is only justified if it is based on an objective and reasonable criterion, that is, if the difference relates to a legally permitted aim pursued by the legislation in question, and it is proportionate to the aim pursued by the treatment.<sup>32</sup> None of these requirements have been respected in this case. In fact, the entire amendment is designed to affect and complicate one project, Nord Stream 2. Certain collateral damage to other pipelines does not change this fact.

The fact that Article 36 exemption would in principle be available for interconnectors that have not been completed by the cut-off point under Article 49a, one could argue that there is no unreasonable difference in treatment as pipelines that do not qualify for an exemption under Article 49a, could still qualify to another type of exemption under Article 36 of the same Directive. This reasoning however is flawed. There is a fundamental difference between the rationale and function of the two derogations: while the rationale and function of Article 36 (exemption) is to enable investments, the rationale and function of the proposed Article 49 (derogation) is to protect investments. Projects in advanced stages should fall under the derogation, rather than the exemption.

For advanced projects like Nord Stream 2 where the investment decision has been made, it is the derogation under Article 49a that should be applied as its rationale is to protect investments and legal certainty. The rationale of promoting new investments like under Article 36, does not square well with such projects.

There is also a significant practical difference between the two: while Article 36 exemption is subject to a wide range of requirements and the European Commission has the final say, Article 49a exemption is more readily available for all projects and the decision-making is national.<sup>33</sup> Also, the requirements for the two are different and Article 36 exemption includes a stricter requirement of “must enhance competition” in gas supply and security of supply, whereas the derogation under Article 49a only requires that the derogation would not “be detrimental to [ ] competition on or the effective functioning of the internal market in natural gas in the Union, or the security of supply in the Union.”

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<sup>30</sup> Kim Talus, Discriminatory nature of the proposed changes to the gas market directive – extension to external pipelines or only one of them? *Utilities Law Review* 22 (2018) 2, 55-60.

<sup>31</sup> Takis Tridimas, *The General Principles of EU Law* (OUP 2006), p.62.

<sup>32</sup> C-127/07, Arcelor Atlantique and Lorraine and Others [2008] ECR I-09895, para. 47, see also Case 114/76 *Bela-Mühle Bergmann* [1977] ECR 1211, para. 7; Case 245/81 *Edeka Zentrale* [1982] ECR 2745, paras. 11 and 13; Case C-122/95 *Germany v Council* [1998] ECR I-973, paras. 68 and 71; and Case C-535/03 *Unitymark and North Sea Fishermen's Organisation* [2006] ECR I-2689, paras. 53, 63, 68 and 71.

<sup>33</sup> As noted above, in practice the Commission will have control over the application of Article 49a derogation. European Commission may initiate infringement proceedings against a Member State where it considers that the derogation does not meet the requirements of EU law.

For projects like Nord Stream 2, this difference is significant. Applying for a merchant exemption is riddled with uncertainty due to different requirements (based on different rationale than Article 49a) as well as Commission's public opposition against the project. This uncertainty was not known at the time of the investment decision (as the Gas Market Directive was not applicable to the project at that time) and could have affected the decision. As such, Article 36 exemption, even if it was available to projects like Nord Stream 2, does not change the discriminatory nature of Article 49a. Here it must be noted that the wording of Article 36 would suggest that it may not be available for projects where the final investment decision has been taken.

It must finally be added that this discriminatory intent of the amendment becomes all the more apparent when it is placed in its context and various developments prior to the proposal to amend the Gas Market Directive are considered.<sup>34</sup> When considering background developments towards the proposal to amend the Gas Market Directive and Article 49a that excludes its applicability to Nord Stream 2, it becomes clear that there are no objective and reasonable criteria that would distinguish various pipelines and enable different treatment. The true objective behind the proposal appears to be an attempt to limit the ability of Gazprom to import more gas to EU through this new pipeline.<sup>35</sup> That is not a legally permitted aim pursued by the legislation in question. The decisions on the use of different energy sources and structure of energy supply is reserved for the Member States under Article 194(2) of the Treaty on the Functioning of the European Union. Not only would this run contrary to the Member State national energy rights, but it would also risk being contrary to the rules of the WTO system, as noted earlier.

## *6.2 Legal Certainty and Protection of Legitimate Expectations*

The principles of legal certainty and the protection of legitimate expectations are among the fundamental principles of the EU.<sup>36</sup> Relevant for the purposes of the amendment is, that they among other things require that rules involving negative consequences for individuals should be clear and precise and their application predictable for those subject to them.<sup>37</sup> This is hardly the case with the amendment, which appeared without warning and which would be applied retrospectively.

The principle of legal certainty normally precludes measures from taking effect from a point in time before their publication. It may exceptionally be otherwise where the purpose to be achieved so demands and where the legitimate expectations of those concerned are duly respected.<sup>38</sup> Neither of the two requirements are met in this particular case. Contrary to legitimate expectations of Nord Stream 2 being respected, the fact that Nord Stream 2 project

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<sup>34</sup> The linkage between the three attempts to complicate the pipeline project is obvious and has also been noted in Katja Yafimava, 'Building New Gas Transportation Infrastructure in the EU – what are the rules of the game?' Oxford Institute of Energy Studies (OIES Paper NG 134), July 2018 and Leigh Hancher and Anna Marhold, 'A Common EU Framework Regulating Import Pipelines for Gas? Exploring the Commission's Proposal to Amend the 2009 Gas Directive', *Journal of Energy and Natural Resources Law* (2019, online version available).

<sup>35</sup> [http://europa.eu/rapid/press-release\\_MEMO-17-4422\\_en.htm](http://europa.eu/rapid/press-release_MEMO-17-4422_en.htm). The Commission notes that its priority is diversification away from Russian gas.

<sup>36</sup> C-17/03, *VEMW* [2005] E.C.R. I-4983; C-104/97 P *Atlanta v European Community* [1999] ECR I-6983, para. 52; and Joined Cases C-37/02 and C-38/02 *Di Lenardo and Dilexport* [2004] ECR I-6945, para. 70.

<sup>37</sup> C-17/03, *VEMW* [2005] E.C.R. I-4983, para. 80; 325/85 *Ireland v Commission* [1987] ECR 5041; C-143/93 *Van Es Douane Agenten* [1996] ECR I-431, para. 27; and Case C-63/93 *Duff and Others* [1996] ECR I-569, para. 20.

<sup>38</sup> 98/78, *A. Racke v Hauptzollamt Mainz* [1979] ECR 69, para. 20.

is the only project to fall into the scope of this retroactive application suggests that this change in the regulatory framework is specifically designed to intervene with the Nord Stream 2 project.<sup>39</sup>

As sovereign actors, States and their governments, including EU and its institutions, have broad rights in amending the regulatory frameworks for the future consequences of situations that arose under the former rules.<sup>40</sup> However, this right is not without boundaries. Among other things, this right is restricted by the legitimate expectations of affected market players. In order to protect those affected by sudden legislative changes, the European Court of Justice has required that the implementation of new rules is combined with a transitional period to allow market players to adapt to the new "rules of the game".<sup>41</sup> This transitional period may be excluded where there is an overriding consideration of public interest.<sup>42</sup>

There are no public interest considerations involved in this particular situation that would require the exclusion of a transitional period. On the contrary, circumstances (including publicly made statements by European Commission) indicate that the rapid change in law is connected to one specific project, the Nord Stream 2 pipeline, and is only based on discriminatory considerations, rather than a legitimate public interest, security of supply or functioning of the EU gas markets.

The retroactive application of the new rules amounts to violations of legal certainty and protection of legitimate expectations. The situation is made worse by the fact that the sudden legislative change targets only one project and one company, Nord Stream 2. The collateral damage that the change causes to other pipelines does not change this intent.

## 7. Conclusion

After two unsuccessful attempts to complicate the Nord Stream 2 project, the Commission tabled its proposal to amend the Gas Market Directive. After a compromise between Germany and France was reached, the Member States accepted the new wording and the trilogue confirmed the compromise. The amended Gas Market Directive, if formally approved by the EU co-legislators, will now apply to gas transmission lines in the territorial sea of the Member State where the first interconnection point with the Member States' network is located. This is an improvement to the original proposal which included a number of difficult legal issues.

The amendment still includes a number of confusing elements as well as violations of WTO rules and EU legal principles. Given its clear objective to undermine one project and the retrospective application of new rules to Nord Stream 2, it may also be regarded as unfair and unequitable treatment under the Energy Charter Treaty. As such, it may well be that we are yet to experience the last turns of this ongoing development.

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<sup>39</sup> Both the intention to apply the new changes primarily to Nord Stream 2 and the problematic aspects of the retroactive application of the new rules to Nord Stream 2 have also been noted in Katja Yafimava, 'Building New Gas Transportation Infrastructure in the EU – what are the rules of the game?' Oxford Institute of Energy Studies (OIES Paper NG 134), July 2018.

<sup>40</sup> C-60/98, *Butterfly Music Srl v Carosello Edizioni Musicali e Discografiche Srl (CEMED)* [1999] ECR I-3939 para. 25; 1/73, *Westzucker GmbH v Einfuhr und Vorratsstelle für Zucker* [1973] ECR. 723, para. 5.

<sup>41</sup> C-17/03, *VEMW* [2005] ECR I-4983 and C-347/06, *ASM Brescia C-347/06, ASM Brescia* [2008] ECR I-5641. See also Anatole Boute, *The Quest for Regulatory Stability in the EU Energy Market: An Analysis Through the Prism of Legal Certainty* (2012) 37 *European Law Review*, p. 675-692.

<sup>42</sup> 74/74, *Comptoir national technique agricole (CNTA) SA v Commission* [1975] ECR 53.