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From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director		
date of receipt:	12 June 2017		
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union		
No. Cion doc.:	COM(2017) 320 final		
Subject:	Recommendation for a COUNCIL DECISION authorising the opening of negotiations on an agreement between the European Union and the Russian Federation on the operation of the Nord Stream 2 pipeline		

Delegations will find attached document COM(2017) 320 final.

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Brussels, 9.6.2017 COM(2017) 320 final

Recommendation for a

COUNCIL DECISION

authorising the opening of negotiations on an agreement between the European Union and the Russian Federation on the operation of the Nord Stream 2 pipeline

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EXPLANATORY MEMORANDUM

1. BACKGROUND / CONTEXT OF THE PROPOSAL

EU internal market, security of supply and solidarity

The objectives of the European Energy Union framework strategy include an open and competitive internal energy market, security of energy supply and solidarity within the Union.

The internal gas market is considered to function well when gas can flow freely between Member States to where it is needed most and at a fair price. A functioning market should enhance energy security in the Union. Since gas is transported mainly through pipelines, the interconnection of gas networks between Member States and non-discriminatory access to these networks are the basis for the market to function. It is also a prerequisite for effective solidarity in crisis situations between Member States and with neighbouring countries.

The EU only supports infrastructure projects that are in line with the core principles of the Energy Union, including those set out in the EU Energy Security Strategy as endorsed by the European Council in December 2015. Diversification of energy sources, suppliers and routes is crucial for ensuring secure and resilient supplies to European citizens and companies.

EU gas market

The European Union is to a large extent dependent on imports of natural gas from third countries. This trend is likely to continue due to falling domestic gas production while being only partly offset by falling gas demand due to energy efficiencies and decarbonisation policies. The share of net gas imports as compared with the EU's total gas consumption was 69.3% in 2015. The biggest source of imports to the EU is Russia (42% of overall imports in 2016), followed by Norway (34%), Algeria (10%) and imports via LNG (14%).

As regards Russian gas transport to the EU, currently, there are three major routes³ supplying Russian gas to the EU. First is the Ukraine's transit system with a technical capacity of approximately 142 bcm/year which was used at around 58% in 2016 and 47% in 2015 of its technical capacity (82 bcm in 2016, 67 bcm in 2015). Second is the Nord Stream 1 pipeline with a technical capacity of 55 bcm/year which in 2016 was used at the highest rate of its technical capacity since the beginning of its operation (80% in 2016, 71% in 2015). The third gas transit route for Russian gas is the Yamal-Europe pipeline, which in the last two years has been used at 100% of its technical capacity (33 bcm/year). Furthermore, Russian gas is supplied via pipelines to Finland, the Baltic States and through Turkey to South-East Europe. Recently, an intergovernmental agreement between Russia and Turkey has been concluded, aiming at building two pipelines with a capacity of together 31.5 bcm/year, one bringing additional gas from Russia to Turkey, the other to Europe.

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http://ec.europa.eu/eurostat/statistics-explained/index.php/Natural_gas_consumption_statistics_https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2015-q1_2016.pdf

There are also other pipelines which have a more local character, e.g. to the Baltic countries.

Nord Stream 2

The Nord Stream 2 project would come in addition to the existing Nord Stream 1 pipeline, linking Russia with Germany through the Baltic Sea, passing through the exclusive economic zones of Finland, Sweden and the territorial waters of Denmark. The pipeline is planned to be connected to the gas transportation grids in Russia and in Germany. In principle, Nord Stream 2 could supply a large part of the EU internal gas market. Nord Stream 2 is planned to consist of two pipelines, with a planned total capacity of 55 bcm/year (27.5 bcm/year each). Nord Stream 1 and 2 together would be able to transport yearly approximately 110 bcm of natural gas, equivalent to more than 80% of Russia's gas exports to the EU.

2. MARKET IMPACT

Due to its size and route, Nord Stream 2 is likely to change the delivery pattern of Russian gas to European gas markets. Current transit routes for Russian gas could to a large extent be replaced by a single dominant gas transportation corridor (consisting of Nord Stream 1 and Nord Stream 2) from Russia to Germany, wherefrom the gas could be distributed to the West, South and East of Europe, including to Ukraine. As a result, the role of existing transit routes via Ukraine/Slovakia (60-80 bcm/year) and Belarus/Poland (33 bcm/year) could decrease sharply. Nord Stream 2 could also impact the overall gas supply architecture in the EU: it could lead to a replacement of eastern entry points for Russian gas within Central and Eastern Member States by entry points in the western part of those Member States. Those western points have however been developed largely with the aim of diversifying supply sources and routes, an effort which risks being undermined by the Nord Stream 2 project. Nord Stream 2, due to its size and route, could facilitate the expansion of Gazprom's position on EU's main gas markets. This could hamper the process of creating an open gas market with competitive prices and diversified supplies in the EU.

Reasons requiring negotiation

The negotiations for which a mandate is requested aim to establish an appropriate regulatory regime for the operation of the pipeline, which introduces the key principles of EU energy law and moderates the expected negative market impacts. The negotiations are not only in the interest of the EU, but the legal clarity created should also be in the interest of the investors.

3. LEGAL ASSESSMENT

Article 194 TFEU provides the legal basis for a common European energy policy, which pursues a variety of objectives, notably competitive gas prices resulting from competition between suppliers and energy security through a multiplicity of competing suppliers. General principles of energy law have developed over time in the EU legal order. An agreement on the operation of Nord Stream 2 would affect these principles. It would also directly affect the operation of onshore transmission pipelines in the EU, as well as have significant impact on the functioning of the internal market for natural gas, on which common rules have been set out notably in Directive 2009/73/EC, Regulation (EC) 715/2009. Pursuant to Article 3.2 of

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the TFEU the EU enjoys exclusive competence to conclude agreements when their conclusion could affect or alter the scope of common rules.

Within the jurisdiction of EU Member States, the applicable provisions for gas transmission pipelines are notably set out in the legal acts mentioned above, Directive 2009/73/EC, Regulation (EC) 715/2009, and related Guidelines and Network Codes. Neither the EU nor its Member States could claim to have jurisdiction on the part of an offshore pipeline outside their territory. Likewise, no third country could impose the application of its national jurisdiction to offshore pipelines outside of its territory. Admitting a legal void for an offshore pipeline or applying two different legal regimes, in the present case the ones of Russia and the EU, to one and the same pipeline would however result in negative market impact, either by allowing to circumvent fundamental principles of energy law by specific technical pipeline configurations, or by applying several contradictory regimes to one and the same stretch of pipeline. Those approaches are thus no viable alternatives either. As a result, there is a need to establish a specific regulatory regime for the operation of the pipeline via negotiations with the respective third countries, in this case with the Russian Federation. Such agreements have in the past been agreed on different pipeline projects, such as the Nabucco project, the TANAP project, or several Mediterranean or North Sea pipelines from third countries. Such specific regulatory regime should aim at ensuring the application of fundamental principles of international law and EU law on energy, consistent with the objectives of the Energy Union, in particular of a fully integrated and competitive internal market and energy security.

Principles that the EU should seek to secure to govern such specific regulatory regime would include appropriate transparency in the operation of the pipeline, non-discrimination in tariff-setting, an appropriate level of third party access and a degree of separation between activities of supply and transmission. The application of those principles would not only contribute to the functioning of the market and to security of supply, but also provide the necessary investment security.

It is also in the interest of the EU to ensure that when built and operated, the project follows the principles of transparency and equal treatment governing public procurement. The nature and application of a tailored regulatory framework for the operation of Nord Stream 2 would have to be jointly negotiated and agreed upon between the European Union and Russia. Only via negotiation of a specific agreement can the underlying conflict of laws be resolved, which comes from contradicting legal principles in the Russian legislation and Union acquis. The negotiation of such agreement should take into account the expected impact which the operation of Nord Stream 2 will have on the current gas supply from Russia to the European Union, in particular to the Central and Eastern Member States which are currently being largely supplied via Ukraine and Belarus. To ensure security of supply via a diversification of routes, those alternative transportation corridors should remain operational. Based on the commitment in Article 337 of the Association Agreement with Ukraine⁴ to enhance cooperation on energy matters for the enhancement of energy security, the EU shall also take into consideration possible impacts on and work for an enhancement of the security of energy supply for Ukraine.

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Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part, OJ of 29.5.2014, L 161/3.

4. RECOMMENDATION

In the light of the above, the Commission recommends

- that the Council authorises the opening of negotiations on an agreement between the European Union and Russian Federation on the regulatory framework for the operation of the Nord Stream 2 pipeline, noting that the agreement should ensure that potential negative impacts on the current gas transit routes, notably through Ukraine, and on the efforts of Central and Eastern European Member States to diversify and secure their gas supplies are mitigated,
- that in accordance with the Treaty, the Commission shall be the negotiator for the European Union and will negotiate the provisions of the agreement as set out in the negotiating directives,
- that the Council designates a committee in consultation with which the negotiation must be conducted,
- that the Council issues the negotiating directives annexed to this Recommendation.

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Recommendation for a

COUNCIL DECISION

authorising the opening of negotiations on an agreement between the European Union and the Russian Federation on the operation of the Nord Stream 2 pipeline

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 218(3) and (4) thereof,

Having regard to the recommendation from the European Commission,

WHEREAS negotiations should be opened with a view to negotiate an agreement between the European Union and the Russian Federation on the operation of the Nord Stream 2 pipeline in order to ensure a coherent regulatory framework contributing to market functioning and security of supply in the Union,

HAS ADOPTED THIS DECISION:

Article 1

- 1. The Commission is hereby authorised to negotiate, on behalf of the Union, an agreement between the European Union and the Russian Federation on the operation of the Nord Stream 2 pipeline.
- 2. The Commission shall be the head of the Union's negotiating team.

Article 2

The negotiations shall be conducted on the basis of the negotiating directives of the Council set out in the annex to this Decision.

Article 3

The negotiations shall be conducted in consultation with [a special committee designated by the Council].

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Article 4

This Decision is addressed to the Commission.

Done at Brussels,

For the Council The President

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