

## POLICY PAPER

### ***NORD STREAM 3&4: EUROPEAN COMPANIES HELPING GAZPROM AND RUSSIA TO BREAK THE ENERGY UNION AND WEAKEN UKRAINE***



**Claude Turmes**  
**Member of the European Parliament**



The Greens | European Free Alliance  
in the European Parliament

**Strasbourg, 7 October 2015**

## Introduction

On 4 September 2015, a consortium of Russian (Gazprom) and European (E.on, Wintershall/BASF, Shell, OMV, Engie - ex GDF Suez) companies concluded an agreement to build a new Nord Stream project, aiming to add some 55 bcm capacity to transfer natural gas from Russia to Germany under the Baltic Sea, along a 1 200 km distance. This project is called North Stream 3&4, as it aims to double the capacity of the first two pipelines that were built in 2011.

According to Pierre Chareyre, executive vice-president of Engie, this project will "*enable diversification and better security of supply for the European market. Gas will remain a key resource within the energy transition in Europe*".<sup>1</sup>

On the contrary, we believe that Nord Stream 3&4 is a very bad idea for the European Union. It risks to further destabilise Ukraine and to make security of supply in South-Eastern European countries more difficult. Moreover, it constitutes a major blow to EU's attempts to "speak with one voice" and makes a first test case for the energy union, less than a year after its adoption.

### Why are EU companies in the deal?

The shareholders agreement illustrates that most risks are taken by Gazprom which holds 51% of shares while the remaining 49% are spread between 5 European companies. Nord Stream 1&2 attracted a lot of investments in 2009/2010 despite the financial turmoil after Lehmann Brothers' bankruptcy. European bankers and companies took almost no risk because of the way the Nord Stream contract was designed, most risks being borne by Gazprom too. The reason for European companies to invest is another one: just like Shell, they expect to get access to Russia gas fields in the medium-term. The whole deal is a gigantic trade-off!

## 1. Nord Stream 3&4 will further destabilise Ukraine

One of the immediate consequences of the new pipelines is that Ukraine will no longer be a significant transit country. This is precisely the agenda followed by Gazprom and the Kremlin, who intend to shut

<sup>1</sup> Energy Global, 8 September 2015.

down transit of Russian gas through Ukraine, when the ongoing transit agreement between both countries terminates in 2019.

Side-lining Ukraine in a moment when geopolitical developments in the eastern part of the country and a year after Crimea was unilaterally taken away from its territory is a major risk for the stability of the country. It will also lead to a massive loss for Ukrainian economy and cut down income for the State budget, transit fee being estimated up to 2 billion euros annually. In addition, it undermines the efforts already made by the Commission, the World Bank, the European Investment Bank, and the European Bank for Reconstruction and Development to help modernising the Ukrainian gas network. It is also an attack against vice-president Sefcovic's recent efforts to broker a deal between Ukraine and Russia to ensure gas delivery this winter.

## **2. A risk for security of gas supply in Central and South East Europe**

Stress tests conducted by the Commission in 2013/2014 showed that a complete shutdown of Ukraine's transit would not be a major problem for most countries (except maybe Serbia) if it did not last more than six months. However Nord Stream 3&4 is likely to shutdown Ukrainian transit for years if not forever. Gas delivery to South-Eastern European countries from Western Europe or through Italy would not be able to compensate, due to the sub-optimal geographical deployment of the existing pipeline capacity. The project will thus reduce the liquidity of the gas market in Central and South-Eastern Europe. As a consequence, prices for customers in these countries are likely to rise, triggering heavy socio-economic damages.

## **3. Nord Stream 3&4 is reducing competition instead of increasing it**

Gazprom is known for trying to create monopolistic markets. DG COMP has a pending case which could end up with heavy fines imposed to Gazprom due to alleged unfair practices on the European market.<sup>2</sup> The new project, where Gazprom holds a majority of 51% of the shares does not go to the direction of a competitive, transparent and fair market.

This is even more a matter of concern in a context where Gazprom is trying to get control over whole gas chain, as shown by their recent acquisitions of key gas hubs like Baumgarten (in Austria) and of gas storage units in Germany and the Netherlands.<sup>3</sup>

## **4. Additional capacities do not allow for diversification**

Gas consumption in EU has gone down in recent years. Residential and services sectors consume less gas thanks to efficiency measures such as the renovation of the building stock, energy services and better energy performance of new built. In the power sector, gas is less attractive because of falling market prices for coal and because of a broken ETS failing to generate a meaningful carbon price, making both lignite and hard coal much more competitive than gas. This tendency will not change because efficiency policies will continue and the ETS reform is unlikely to deliver the right price signal to increase gas competitiveness. In addition, the integration of more renewables in the grid means that there might be

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<sup>2</sup> [http://europa.eu/rapid/press-release\\_MEMO-15-4829\\_en.htm](http://europa.eu/rapid/press-release_MEMO-15-4829_en.htm)

<sup>3</sup> [http://europa.eu/rapid/press-release\\_IP-13-1207\\_en.htm](http://europa.eu/rapid/press-release_IP-13-1207_en.htm)

more demand for flexible gas power production, but total running hours of conventional power plants will go down and the gas consumption level of the power sector will stall.

Prospect for gas volume in the EU is estimated by the Commission between 390 to 500 bcm for 2020.<sup>4</sup> A 500 bcm scenario is based on a weak energy efficiency scenario (only 27% efficiency gains and not 30% as promised by President Juncker). Stronger renewables and efficiency scenarios would lead to an annual consumption even below 390 bcm.

Even today combined-cycle gas power plants, pipeline networks and LNG terminals are clearly under-used.<sup>5</sup> Although new infrastructure is punctually needed, it would make much more sense to create diversification of suppliers than getting even more dependent on the main supplier, Russia. The 8 billion euros spent on Nord Stream 3&4 would be much better used to speed up efficiency and renewables development.

## 5. South Stream versus Nord Stream: an unfair treatment

The European Commission was right to oppose South Stream. Its efforts turned successful in 2014 when Vladimir Putin dropped the project. If the EU was incapable to prevent a similar project in the northern region, the conclusions to be drawn would be crystal clear: in the energy union, the political weight of Central and South-Eastern European countries (such as Bulgaria, Slovakia, Hungary but also Italy) is negligible compared to the weight of member states like Germany, the Netherlands, the United Kingdom.

We understand today the bitterness of countries which supported South Stream and we are concerned that Nord Stream 3&4 gives the impression of double standards applying to member states when it comes to show "*solidarity and trust*".

## 6. Conclusion and way forward

Nord Stream 3&4 does not show any gain for EU security of supply, but on the contrary risks to split and divide Europe. Its consequences for Ukraine would be dramatic. The project does not show any gain on the climate front either.

In order to move forward, we suggest the following approach:

- a) The Commission should stand firm and use all political and legal ways to stop the pursuit of Nord Stream 3&4
- b) President Donald Tusk, should put the Nord Stream question on the agenda of the next European Council. This would be an opportunity to ask governments, especially those hosting participating companies (France, United Kingdom, the Netherlands, Germany, Austria), whether they consider the project consistent with the energy union "*solidarity and trust*" principles and with the role of the EU in Ukraine.

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<sup>4</sup> European Energy Security Strategy, COM (2014) 330 of 28 May 2014.

<sup>5</sup> For example, the existing pipelines are used to 55% to 70% of their capacity, LNG terminals in Spain at 17% and 36% of their capacity (CEER, *Status Review on monitoring access to EU LNG terminals in 2009-2013*).

- c) Commission, ACER, ENTSO-E and member states should speed up the resilience of the EU energy system up by:
- Pushing for a quick completion of the "missing link" gas pipelines (such as South-Eastern European priorities identified by the Central and South Eastern Europe Gas Connectivity (CESEC),<sup>6</sup> the GIPOL pipeline between Lithuania and Poland);
  - Strengthening EU energy efficiency policies with a binding 40% objective for 2030;
  - Use financial instruments, guarantee funds and technical assistance to accelerate energy efficiency investment through a de-risking strategy, targeting Central and South-Eastern European countries in priority, as proposed in the Luxembourg Declaration;<sup>7</sup>
  - Adopting an ambitious and operational heating and cooling strategy to encourage the renovation of inefficient heating systems and promote fuel switch from gas to renewable energy sources (solar thermal, geothermal, sustainable biomass).

**Contact**

Jérémie ZEITOUN  
Assistant to Claude Turmes, MEP  
Member of the Green Group in the European Parliament



The Greens | European Free Alliance  
in the European Parliament

European Parliament  
Rue Wiertz, 60, ASP 04 F 255/253, B-1047 Brussels  
Phone: +32 2 28 47 246 - Fax: +32 2 28 49 246

<sup>6</sup> <https://ec.europa.eu/energy/en/topics/infrastructure/central-and-south-eastern-europe-gas-connectivity>

<sup>7</sup> Claude Turmes, *The Luxembourg Declaration*, 23 September 2015. Accessible online: <http://bit.ly/LuxDeclaration>