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Nord Stream 2: A Fait Accompli?

The Trump Administration and many Members of Congress have criticized Nord Stream 2, a Russian-owned natural gas pipeline project that would allow Germany to increase the amount of natural gas it imports directly from Russia via the Baltic Sea (see **Figure 1**). Although the pipeline is currently under construction, new European Union (EU) regulations agreed to in February 2019 require German and EU regulators to make a final ruling later this year on the project's compliance with EU law. Nevertheless, many observers believe the pipeline's construction will proceed.

Background

U.S. policymakers have supported EU efforts to reduce reliance on Russian natural gas, especially after Moscow temporarily halted exports via Ukraine in 2009 and 2006. Although the EU has articulated an ambitious energy diversification strategy, some European governments have not reduced dependence on Russian gas, which accounted for 43% of non-EU imports in 2017. Factors behind this continued reliance on Russian supply include rising demand for natural gas, diminishing European gas supply, financial investments, and the perception of many Europeans that Russia remains a reliable supplier.

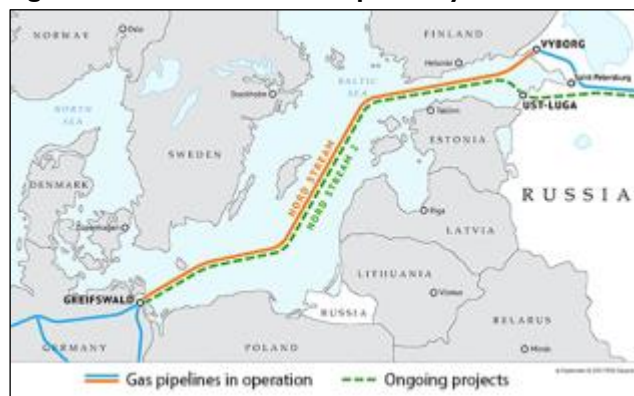
Nord Stream 2 is being constructed alongside the Nord Stream 1 pipeline, in operation since 2011. Nord Stream 1 has a total capacity of 55 billion cubic meters (bcm) per year. In 2018, it ran at 107% of stated capacity. Nord Stream 2 would also have a capacity of 55 bcm per year, doubling the full system's capacity.

Nord Stream 2 is estimated to cost about \$10 billion and is scheduled for completion by late 2019. It is owned entirely by Russia's state-owned energy company Gazprom. Half the cost is being financed by five European companies: Engie (France), OMV (Austria), Shell (Netherlands/UK), Uniper (Germany), and Wintershall (Germany). This is different than the ownership structure of Nord Stream 1, in which Gazprom has a 51% stake; four European companies—Engie, Wintershall, E.ON (Germany), and Gasunie (Netherlands)—own the rest.

Project Status

Despite opposition from some European governments and EU officials, Nord Stream 2 has secured the necessary construction permits from all but the Danish government. Even if Denmark were to reject the pipeline on national security grounds, Nord Stream 2 officials have said that the pipeline could be rerouted to avoid Danish territorial waters. Gazprom hopes to complete construction on time, though most agree that the new legal requirements (discussed below) could delay the project for at least six months.

Figure 1. Nord Stream Gas Pipeline System



Source: Gazprom, edited by CRS.

Critics of the proposed pipeline have been hopeful that the European Commission (the EU's executive agency) would block the project by invoking EU regulations intended to prevent monopoly control of energy projects. These regulations initially applied only to intra-EU pipelines. On February 8, 2019, the EU agreed to extend jurisdiction of a 2009 natural gas directive (2009/73/EC) to pipelines located in the offshore territorial waters of EU member states. This means that the key principles of the 2009 directive—requiring third-party access, tariff regulation, ownership unbundling, and ownership transparency—are to be applied to all gas pipelines entering and exiting the EU.

The impact of the amended gas directive on Nord Stream 2 remains unclear. According to the amendment, Gazprom would need to “unbundle” the pipeline, as legally it will not be able to own and administer both the offshore segment of the pipeline in German territorial waters and the gas supply that flows through it. Analysts have identified several ways in which Nord Stream 2 could seek to comply with the new regulation. These include transferring the portion of the pipeline in German territorial waters to a third party or seeking an exemption to the regulation. Ultimately, any ruling by German regulators would need to be approved by the European Commission, which in the past has spoken out against the project.

Support and Opposition

In general, supporters of the pipeline, including the German and Austrian governments, argue that Nord Stream 2 will enhance EU energy security by increasing the capacity of a direct and secure supply route at a time of rising demand for gas. German officials and others have said that once the gas reaches Germany it could be transported throughout Europe. They say they support developing additional infrastructure to ensure this is possible.

The German government maintains that its support for the new amendment to the EU gas directive demonstrates the

government's commitment to addressing concerns within Europe about the project. They argue that the extension of EU regulations to the offshore pipeline will force Gazprom to comply with EU standards, putting to rest any outstanding concerns about the project's legal status.

Still, opponents of the pipeline—including, among others, the European Commission and President of the European Council, Poland, the Baltic states, Ukraine, the Trump Administration, and many Members of Congress—argue that it would give Russia greater leverage over Germany and others that are dependent on Russian gas. Critics also contend that Nord Stream 2 could leave some countries more vulnerable to supply cutoffs or price manipulation by Russia.

Impact on Ukraine

Another major concern of Nord Stream 2 opponents is that the pipeline would reduce Ukraine's significance as a transit state for Russian natural gas exports. Before Nord Stream 1 opened in 2011, most of Russia's natural gas exports to Europe transited Ukraine. Currently, around 40%-50% transit Ukraine. According to Ukrainian oil and gas company Naftogaz, its operating profit for gas transit was over \$900 million in 2016 and \$535 million in 2017. If Nord Stream 2 moves forward, it is expected to further reduce transit through Ukraine. The current transit contract between Gazprom and Naftogaz expires at the end of 2019.

Many observers consider that reducing Ukraine's role as a transit state not only would deprive Ukraine of revenue but also threaten Ukraine's security. It would not necessarily increase Ukraine's vulnerability to energy supply cutoffs, as Ukraine stopped importing natural gas directly from Russia in 2016. It could, however, increase Ukraine's strategic vulnerability, as Russia's dependence on Ukraine for gas transit would no longer be a potential constraining factor in its policies toward Ukraine.

How the amended EU gas directive will affect negotiations between Ukraine and Russia is uncertain. In an April 2018 meeting with Russian President Vladimir Putin, German Chancellor Angela Merkel addressed a chief concern of some critics by stating the project could not proceed without guarantees that Gazprom will continue to export gas through Ukraine. Merkel did not specify in what form such guarantees could be made. In proposing the extension of the gas directive, Germany and France stated that the change would be "indispensable for a fruitful discussion on the future gas transit through Ukraine."

U.S. Policy

Congress and the Administration have expressed opposition to the Nord Stream 2 pipeline. The Countering Russian Influence in Europe and Eurasia Act of 2017 (CRIIEA, P.L. 115-44, Title II) states that it is U.S. policy to "continue to oppose the Nord Stream 2 pipeline given its detrimental impacts on the EU's energy security, gas market development in Central and Eastern Europe, and energy reforms in Ukraine."

At the July 2018 NATO Summit in Brussels, President Donald Trump criticized German support for Nord Stream

2. In November 2018, Secretary of State Pompeo said that Nord Stream 2 "undermines Ukraine's economic and strategic security and risks further compromising the sovereignty of European nations that depend on Russian gas." In December 2018, the House of Representatives passed H.Res. 1035, which called for the cancellation of Nord Stream 2 and the imposition of sanctions with respect to the project. In the 116th Congress, some Members have introduced bills and resolutions (H.Res. 116, H.R. 1081, S.Res. 27, and S.Res. 74) further expressing U.S. opposition to Nord Stream 2.

It is unclear how existing sanctions might apply to Nord Stream 2. CRIIEA authorizes (but does not require) sanctions on those who invest at least \$1 million, or \$5 million over 12 months, or engage in trade valued at an equivalent amount for the construction of Russian energy export pipelines (Sec. 232; 22 U.S.C. 9526).

The legislation does not provide for sanctions on financing specifically, although it does provide for sanctions on the provision of services and support. In October 2017, the Trump Administration released guidance noting that Section 232 sanctions would not apply to projects for which a contract was signed before August 2, 2017. Gazprom signed financing agreements with the five European companies in April 2017.

Response of Nord Stream 2 Proponents

The German government and other supporters of Nord Stream 2 have expressed strong opposition to U.S. interference in EU affairs concerning the pipeline. This includes criticism of Section 232 sanctions, which pipeline supporters argue could jeopardize what has been strong transatlantic cooperation in imposing sanctions on Russia.

Some European officials have voiced suspicion that U.S. opposition is rooted primarily in a desire to increase U.S. liquefied natural gas (LNG) exports to Europe. They contend that imposing sanctions on an ally in order to advance national economic interests—especially when U.S. LNG is more expensive than gas from Russia and cannot replace all Russian imports—could have longer-term ramifications for the U.S.-German relationship.

European concerns with U.S. sanctions were addressed in part by language inserted in CRIIEA which states that the President should "continue to uphold and seek unity" with European partners on sanctions and that new U.S. sanctions on pipeline ventures would be imposed in coordination with U.S. allies. Following the enactment of CRIIEA, the European Commission expressed satisfaction that "European interests can thus be taken into account in the implementation of any [U.S.] sanctions." Still, some remain wary that implementation of new U.S. sanctions could affect European energy projects.

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