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The Nord Stream 2 project is frozen due to Russia's aggression against Ukraine

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On 22 February, German Chancellor Olaf Scholz announced that he had instructed the economy minister Robert Habeck to withdraw the positive assessment of the impact of launching the Nord Stream 2 (NS2) gas pipeline on the security of gas supplies to Germany and the EU. This step effectively freezes the process of granting NS2 certification, because a positive opinion from the ministry is a prerequisite for completing the procedure and the granting of operator status by the Federal Network Agency (BNetzA), and thus for the launch of the gas pipeline. BNetzA received the just-withdrawn analysis from Minister Peter Altmaier in October 2021, before the change of government in Berlin.

Scholz announced that the economy ministry would re-examine what impact launching the gas pipeline would have on the security of supply, taking the new circumstances into account, and suggested that this process could take a very long time. According to Habeck's statements, the reassessment will consider both Russia's aggressive policy towards Ukraine and Gazprom's actions on the European gas market in recent months.

On 23 February, a day after the German decision, US President Joe Biden announced the imposition of sanctions on Nord Stream 2 AG (NS2 AG), the pipeline's owner-operator, and its president Matthias Warnig. The restrictions were implemented on the basis of the PEESA (Protecting Europe's Energy Security Act) sanctions. They mean the revocation of the waivers that the US administration granted to both NS2 AG and Warnig in May 2021, citing national interest. According to Washington, the sanctions on NS2 are part of an initial tranche of US restrictions and have been consulted & coordinated with Berlin.

Commentary

- The German and American actions targeted at Nord Stream 2 AG will suspend the launch of the gas pipeline for an indefinite period of time: they have made it impossible both to develop formal rules for the operation of the gas pipeline and its future use. Both decisions have a significant political dimension, and were dictated by the escalation of Russia's actions against Ukraine. As a consequence, it seems a foregone conclusion that as long as the Russian war or the possible subsequent occupation of Ukraine continues, together with the resulting conflict between Russia and the West, then these restrictions (in particular the US sanctions) will not be lifted and Nord Stream 2 will not start. According to some commentators, the Russian armed aggression against Ukraine on 24 February 2022 marks the effective end of the project.

- Germany's freezing of the NS2 certification process marks a reverse of the German government (i.e. the economy ministry under Altmaier)'s previous decisions. This has been brought about by political events (the escalation of Russian aggression and the situation on the European gas market), and not by any formal or legal requirements. Berlin's decision is temporary, and does not mean the end of the NS2 project. The formula adopted for freezing the certification procedure will allow Germany to reconsider it in the future. The duration of its suspension will most likely depend on how the situation in the east develops, and on a possible future normalisation of EU relations with Russia. On the other hand, if the German economy ministry were to present a negative recommendation, this would be a serious step towards a more permanent blockade of commissioning NS2: such a step would *de facto*prevent any positive consideration of the application for certification. The speed of Germany's reaction and its autonomous nature are significant. In contrast to previous crises, the decision on NS2 was taken before the joint EU & US sanctions were announced. At the same time, Berlin has not presented the decision to freeze the certification process as a sanction. In the official narrative, Russia's actions towards Ukraine have led to a far-reaching change of the facts which formed the basis of the recently withdrawn analysis, forcing Berlin to revise its assessment based on the new realities. This step can therefore be presented as procedural in nature, and not as a sanction in the strict sense. This formulation may be related to the fear of possible claims for compensation by Nord Stream 2 AG, which – as it is registered in Switzerland – could sue Germany at the Permanent Court of Arbitration on the basis of the Energy Charter Treaty, in connection with the political repercussions of the investment.
- The problems of Nord Stream 2 have been significantly aggravated by the US sanctions, pursuant to which it will be impossible to use the assets of the economic entity which they cover, or to conduct any commercial or financial transactions with that entity. This prevents the gas pipeline from being used in the future until the restrictions are upheld. Everything indicates that the US approach to the Russian aggression and the will to counteract it, including the measures being taken against NS2, are acts of principle. The White House's decision has been supported by the US Congress: Senator Ted Cruz praised it, and announced that he would unblock in the Senate the State Department nominations , which approval he had previously blocked when the implementation of sanctions against NS2 was waived. At the same time, some voices are saying that sanctioning NS2 will minimise the risk of Germany having to pay compensation for the blocking of pipeline launch.
- Germany's suspension of the NS2 certification process had an immediate impact on gas prices. In reaction to Berlin's decision, the price on the Dutch TTF exchange (monthly contracts for March) rose by €8 to almost €80/MWh. On 24 February, a further increase in natural gas prices was observed (to around €119/MWh), but this was mainly a direct result of the Russian invasion of Ukraine. As a consequence of the war, we may now expect further increases and increased volatility of gas prices on European stock exchanges.
- The suspension of the NS2 project should not formally affect current gas supplies from Russia to Europe. Nord Stream 2 has not operated so far, and under the existing

contracts, Russian gas has been delivered via the existing routes albeit for the last six months at clearly lower levels than in the previous years. At the same time, since the moves by Berlin and Washington have affected a project which is strategically important for Moscow, and have effectively coincided with Russia's military aggression against Ukraine, there is a risk that Russia might retaliate, which would affect gas exports to the EU. Although it is still considered unlikely in Europe that Russian gas exports onto EU markets would be suspended, Germany and the EU have declared that they are prepared for such an eventuality this winter. There are many indications that as a result of intensive EU-US diplomatic efforts to find alternative sources of natural gas for Europe (in which leading representatives of the German government were also involved), EU countries (including Germany) have been guaranteed access to emergency supplies in the event of disruptions in this area. It seems, however, that any such agreed emergency supplies will not be sufficient to completely replace Russian gas, especially in the longer term (for more see '*Preparing for a crisis on the European gas market*').

- Russia's responses to Germany and the US moves against NS2 to date have been limited and largely restrained in tone, which indicates that Berlin & Washington's decisions came as a surprise to Moscow. Additionally, in connection with the invasion of Ukraine, the question of Russia's response to the sanctions was relegated to the background. Nord Stream 2 AG stated that it acknowledges the announcements of the German chancellor's decision, and expects information from the BNetzA regarding the certification process. Among Russian government representatives Dmitri Medvedev, the former president and prime minister, and now deputy head of the Russian Security Council, made an emotional comment on Twitter that Germany's decision may lead to customers in Europe paying up to €2000 per 1000 m³ of gas. The presidential spokesman Dmitri Peskov regretted the German move; he also repeated that the project is purely business-related and has nothing to do with politics. He added that it is intended to stabilise the gas market in Europe and is popular with both supplier and customers, primarily in Germany but also in other European countries. In turn, Maria Zakharova the Ministry of Foreign Affairs' spokeswoman, considered Germany's decision to be a form of political pressure on business. Neither Gazprom nor Vladimir Putin has commented on the German and American sanctions.

- On the one hand, the decisions taken by Germany and the US do not affect Gazprom's ability to fulfil its obligations towards its European customers in any way. The capacity of the existing and operating transit routes is fully sufficient to transport Russian supplies under the existing contracts and more. On the other hand, the suspension of the certification and the sanctions are severe for Russia in the political dimension. The construction and commissioning of NS2 has been one of the key projects aimed at making Moscow independent of the Ukrainian transit route, which is a very important goal of Russia's external energy policy, and is also an important element of Moscow's overall policy towards Ukraine. Meanwhile, the German decision and the sanctions introduced by the US will mean that there is at least a further delay in launching the pipeline. Moreover, in view of the Russian military actions initiated on 24 February, it is more likely that the pipeline will not be launched at all. This could help maintain Gazprom's transit dependence on Ukraine even after the current Russian-Ukrainian gas transit agreement expires (it is currently valid until 31 December 2024).

- The Western actions aimed at NS2, including, in particular, the imposition of US sanctions on the gas pipeline, are a serious blow to the strategic interests of Gazprom and Russia. At the same time, Russia’s attack on Ukraine on 24 February will significantly exacerbate Moscow’s conflict with the West. As a consequence, more decisive steps by Russia cannot be ruled out at present; these may come in response not so much to the decisions concerning Nord Stream 2, but above all to the entire package of severe sanctions which Washington and Brussels have announced & planned. Although limiting or suspending gas exports to Europe would hurt both Gazprom’s image and its finances, there is no doubt that the Kremlin will be ready to take drastic steps if it believes they would serve its political goals, which in the face of the war with Ukraine will take absolute priority. The range of radical measures it could take also includes actions aimed at damaging or partially destroying the Ukrainian gas transmission infrastructure. Moscow could use this as an objective justification for putting pressure to launch deliveries via Nord Stream 2, if transporting gas via the existing route was thus made impossible. In a milder variant, Moscow could decide to further physically limit gas transmission via the Ukrainian main in response to the actions of Berlin and Washington and as part of deepening the destabilisation in Ukraine. The chances of Russia undertaking retaliatory actions by disrupting gas supplies to Europe are boosted by the fact that the prices of both gas and oil have been high for many months, and have brought in significantly higher revenues for Russian companies. These funds may be added to the reserves if export volumes fall in the coming months. There are other factors working in favour of Russia at the moment: the energy crisis in Europe has been going on for many months, and the resulting high prices have hit both the societies and public finances of individual countries hard. Also, there are limited amounts of gas available on the world markets, and the EU’s gas reserves at the end of this heating season are currently standing at record lows.