

The dispute over Nord Stream 2: the stances and the outlook

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Russian ships resumed laying the Nord Stream 2 (NS2) gas pipeline on the Baltic Sea bed in February this year. Russia's goal is to complete the project and put it into operation as soon as possible. This coincided with media reports that representatives of Germany and the new US administration had been searching for compromise arrangements to determine the conditions for construction to be completed and operation to commence. These would include options for a moratorium on launching it but, above all, the creation of guarantees to maintain the limited transit of Russian gas through Ukraine or a 'snapback' mechanism enabling shutting off/limiting flows via NS2 in the event of problems with supplies or transit through Ukrainian territory. Berlin hopes to agree on the terms on which the US will tolerate the gas pipeline, or will at least play for time so that construction can be completed while the talks are underway and the certification necessary for its launch can be obtained. It is unclear what actions the Joe Biden administration will take regarding this issue. On the one hand, it has criticised the project but on the other, it has not imposed any sanctions that could stop its implementation as yet (19 March 2021) and it is striving to improve relations with Germany.

Nord Stream 2 AG needs to complete the pipeline's construction (this may happen in the next few months) and subsequently to obtain the certification in order to secure its future. If this happens, then any potential conditions and limitations regarding the principles of its opening might either not come to pass or might not have any major impact on the effects of its operation. In particular, there is no real possibility that the Russian side can be forced to accept an obligation (especially long-term) to transit gas through Ukraine. Furthermore, the mechanisms limiting NS2 gas flows are legally questionable and operationally unrealistic.

On 6 February, (due to weather conditions it in fact began on 16 February), the Russian ship Fortuna resumed pipe-laying activities in the missing sections of Nord Stream 2 (approx. 120 km in Danish waters and approx. 30 km in German waters) on the Baltic Sea bed, defying US sanctions. At the same time, the German media (mainly *Handelsblatt*) began reporting that representatives of Germany and the new Joe Biden presidential administration had been probing for possibilities to determine the terms of completing the construction of the gas pipeline and its launch. In the meantime, the Biden administration decided, despite pressure from Congress, to impose new sanctions only on two Russian entities involved in the construction of NS2, and these are already subject to US restrictions.



Therefore, the coming months will determine the future of this project, which adversely affects Poland's essential economic, political and security interests.

The interests and the stances of the key actors

Russia: a *fait accompli* and no compromise

Russia's strategic goal is to first complete the construction of Nord Stream 2 and then to launch it as soon as possible. Proof of this includes the resumption of pipe-laying in German territorial waters in December 2020 (2.6 km long) and in the Danish Exclusive Economic Zone on 6 February 2021. As of mid-March, approx. 15 km of pipes have been laid in Danish waters. Russia's determination is evidenced by the fact that its pipe-laying vessel, the Fortuna, on which US sanctions were imposed on 19 January (CAATSA) and 21 February (PEESCA) this year, is continuing the construction. It has been confirmed by the Danish Energy Agency that towards the end of March another Russian vessel, the Akademik Cherskiy, will be engaged to lay the pipes. The construction work has not been affected by the fact that over 22 Western European companies (mainly providing insurance and reinsurance services) have withdrawn from the project (this was announced in February this year), nor by the suspension of granting further tranches of loans by Gazprom's main partners as part of the project (OMV, Wintershall Dea, Shell and Uniper).

However, the US sanctions against NS2 since 2019 have changed Moscow's tactics. Although representatives of the Russian government,

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Gazprom and Nord Stream 2 AG (the latter is controlled by Gazprom) regularly confirm their will to complete the project, at the same time they are laconic in providing information about the next steps in its implementation, and they usually do so at short notice. For fear of restrictions, Gazprom did not publicly reveal clear data on the technical condition of the vessels planned for use in the resumption of construction. In 2020, Gazprom made several ownership changes regarding the above-mentioned ships. In addition, it transferred its stakes in Nord Stream AG and Nord Stream 2 AG to one of its newly established subsidiaries – OOO Gazprom Mezhdunarodnye Projekty (established in March 2020). In December last year, Reuters reported that, in order to complete the project, Gazprom had bought and was modernising another ship, the Oceanic 5000, in the Canary Islands.

Moscow has consistently criticised the US-imposed sanctions against the project, while exerting official, and most likely unofficial pressure on its European partners (in particular Germany) to ease US restrictions through diplomatic negotiations. It has employed a wide range of arguments in this process: 1) the need for Europe to maintain energy sovereignty, while pointing out that the NS2 gas pipeline increases its security in this respect; 2) accusing the West (the US) that its opposition of NS2 is aimed at forcing Russia to “finance the Western geopolitical project in Ukraine”; 3) highlighting the importance of the project for the achievement of the objectives of the EU energy and climate agenda. Point 3) refers to NS2 as infrastructure that could be used to transport hydrogen or gas used for the production of hydrogen in Germany.

Germany: a seeming compromise for the *fait accompli*

Finishing the construction of the gas pipeline and then – as far as possible – putting it into operation is a matter of priority for the German government. Administrative and political support for the construction work carried out by the Russian investor has been offered to help these plans work out, regardless of the US sanctions imposed on the Fortuna pipe-layer and its owner. This has been manifested in the government's unchanged position towards NS2 (despite increasingly strained relations with Russia) and in the joint efforts of the Mecklenburg-Vorpommern government and Nord

Stream 2 AG in the climate foundation operating in this federal state (established at the beginning of this year to circumvent US restrictions). Another indication of the preferential treatment of this project is the fact that permission was granted for work in the German Exclusive Economic Zone during the bird protection period. The optimal scenario for supporters of the gas pipeline in Germany is for conditions to be created for its launch before the new government is formed after the Bundestag elections in September this year.

German politicians are interested in close cooperation with the US and assume that the new administration wants to build good

” **The Biden administration seems ready to seek a compromise with Germany on NS2 and the sanctions, but the US Congress is against this.**

relations with Berlin and develop a functional solution to the dispute over the gas pipeline. So they believe that a compromise with Washington is achievable and will not necessarily entail excessive costs. Moreover, since the US government has refrained from taking any further steps against NS2 due to its search for possibilities of compromise, it will be easier to complete the work. Furthermore, by suggesting to America that it has been actively seeking a solution to the dispute, Germany initially protected itself in case its Russian partner overestimated its own technical capabilities (it was uncertain whether Russian vessels were in fact capable of laying pipes in deeper waters). By prioritising the completion of construction work, Germany may be prompted both to present proposals to the United States and to signal its readiness to initially accept US proposals regarding the future operation of the gas pipeline, with the assumption that the precise rules of implementation will be determined in the future. It may make some concessions, believing that it will be impossible to enforce them. Pressure from US opponents of the NS2 gas pipeline on the new Biden administration is viewed as a risk factor by Berlin. Therefore, it can be expected that Germany will be willing to cooperate with its American partners to reduce the domestic political costs of a possible deal in the USA, as long as the deal guarantees that NS2 will function in the future. Such cooperation, however, may actually be limited to political declarations and communication policy, without making excessive commitments. From the German perspective, it would not be necessary to lift the sanctions (which would be unattainable for Biden's team) – it would only be sufficient to ensure that they are not applied.

The USA: to punish or to forgive?

Since Joe Biden took office as president, the US stance on both Nord Stream 2 and the sanctions against it has been neither unambiguous nor clearly formulated for a considerable amount of time. The new administration in Washington aims to improve transatlantic relations, primarily with Germany, and therefore there have been signals that it is ready to seek a compromise regarding NS2. According to media reports, talks on lifting the restrictions affecting the gas pipeline would be possible if Berlin presented a package of proposals solving the key problems related to it. In particular this means those concerning the future of gas transit and the security of gas supplies to Ukraine and the transformation of the country's role in the European energy market.

The scope of the mandatory PEESCA sanctions (which were imposed at the end of February) envisaged in the US defence budget seemed to be a confirmation of the new US administration's goodwill and readiness to compromise on NS2. According to the guidelines presented by the Department of State, sanctions have been imposed on only two Russian entities: the barge Fortuna (which is currently laying pipes in the Danish waters of the Baltic Sea) and its owner, the company KVT-Rus. The restrictions are unlikely to stop the ongoing construction of the gas pipeline. Both entities had previously been subject to CAATSA sanctions (imposed towards the end of Donald Trump's presidency), and this has not prevented them from resuming work on NS2. The American restrictions will not apply to any ships supporting the Fortuna in the construction work, the company Nord Stream 2 AG itself,

nor other entities involved in the specified activities related to the construction of the gas pipeline (according to the expanded PEESCA provisions applicable since 1 January).

Statements by the spokesman for the Department of State that the US side will closely cooperate and consult with allies and partners also suggested an openness to search for a compromise on the future of NS2.

The way Biden's cabinet operates gave rise to controversy in Congress, where the full implementation of sanctions against Nord

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Stream 2 is supported by a clear, bipartisan majority. The list of entities identified as involved in the construction of NS2 has been criticised by Republican senators who, along with the Democrat Senator Jeanne Shaheen, called on the administration to explain its recent moves. On 23 February, the co-chairs of the bipartisan Senate's caucus for Ukraine (Ukraine Caucus) appealed for the full implementation of the mandatory sanctions and for halting the construction of the pipeline. During a briefing for Congress held in the last week of February, representatives of the Department of State (according to media reports) fended off congressmen's questions as to why they had not acted faster and more decisively on the issue of sanctions, and denied reports of talks with Germany regarding the pipeline.

It is not formally clear why the Department of State did not impose the mandatory sanctions envisaged in the defence budget (NDAA) for 2021 on all entities breaking the provisions of the document already in February. The absence of legal grounds for the failure to take the action envisaged in the NDAA resulted in the escalation of tension over NS2 between the administration and Congress. On 3 March, 40 Republican senators sent a letter to President Biden criticising his cabinet for failing to comply with the law and to impose sanctions on all entities involved in Nord Stream 2. Suspending the procedure of the US Senate's approval of the new CIA head and deputy secretary of state on 5 March by the Republican Senator Ted Cruz was an even stronger manifestation of protest against the steps taken by the White House with regard to NS2. This way the senator demanded that the Biden administration intensify its efforts to block the construction of Nord Stream 2. On the same day, a group of Republican congressmen sent a letter to the secretary of state listing 15 entities (13 Russian, 1 Norwegian and 1 registered in Liberia) which, according to publicly available data, were involved in the pipeline laying or related activities from 1 January 2021. The congressmen asked in a letter to explain what kind of additional information the Department of State needed about these entities in order to impose sanctions on them. The way the White House addresses the NS2 issue was also criticised by the Democrats – Senator Bob Mendez, chairman of the Senate's Foreign Affairs Committee, called on 9 March to accelerate efforts to stop the construction. He emphasised that in its efforts to improve relations with Germany the USA should focus on the NS2 issue.

On 18 March, the US Department of State published the first official statement from the US Secretary of State regarding Nord Stream 2. Antony Blinken confirmed the previous US position that NS2 was a Russian geopolitical project aimed at dividing Europe and undermining its energy security, and assessed that it was a bad deal for Germany, Ukraine and the US allies and partners in Central and Eastern Europe. He also stated that the Biden administration would implement the sanctions regulations currently in force and supported by the bipartisan Congressional majority. He also reminded the entities involved in the project about the risks of sanctions associated with them and the need to immediately halt work. According to a publication by Bloomberg (also on 18 March), the US administration is considering imposing further sanctions which could potentially affect Nord Stream 2 AG (which is project company responsible for the construction and subsequent operation of the pipeline), the insurer of the pipe-laying ships and other companies providing support vessels and materials.

Blinken's statement suggests that the US administration is ready to apply tougher measures regarding NS2 and may indicate that the pressure from Congress has been effective. It also met with an immediate reaction. In response to the statement, Senator Ted Cruz allowed the US Senate to confirm two of the blocked nominees, which happened the same day. At the same time, he announced that he would maintain the blockade of subsequent nominations to the Department of State until sanctions against NS2 were fully implemented. It is difficult to predict at present when and to what extent the administration will decide to impose them. Applying the stricter provisions envisaged in PEESCA in full – unless this happens too late – could make it genuinely difficult to complete construction. Another report identifying entities involved in the pipe-laying activities as subject to PEESCA restrictions is due to be presented by the Department of State to the US Congress by 17 May this year.

The ways to regulate the problem under consideration and the possible consequences

According to reports from the German media (mainly *Handelsblatt*), the measures currently under consideration include: a moratorium on the construction or launch of the gas pipeline, the introduction of a 'snapback' mechanism to block gas supplies by NS2 (in the event that Gazprom cuts off transit via Ukraine) and investment support for the reconstruction of the Ukrainian energy sector (primarily switching it to hydrogen production). It was also suggested that the agreement concerning continuing the transport of Russian gas through Ukraine might be renegotiated.

A moratorium on the pipeline construction or launch

The appeal to temporarily suspend construction of NS2 appeared in the German debate following the poisoning of Alexei Navalny. The possible period of the work stoppage would depend on Russia meeting certain conditions. However, a wide circle of NS2 supporters invariably perceives any further delays in the implementation of the project as disadvantageous. The arguments against the moratorium option include the risk of claims for damages. Therefore, it is highly unlikely that Germany will unilaterally suspend construction work due to exceptional circumstances.

It should be noted that a short delay in operation within the German Exclusive Economic Zone could actually take place if the Federal

» **Germany assumes that an agreement with the US is achievable and will not necessarily entail excessive costs.**

Maritime and Hydrographic Agency maintained the original version of the work schedule; this would be in line with the demands of environmental organisations. A formal suspension of pipe-laying would probably not mean a ban on necessary technical work. Court proceedings regarding the permit granted by the Stralsund Mining Authority could also be used as a procedural measure to suspend construction work.

A moratorium based on a multilateral agreement in which the EU, the US or possibly Russia would be engaged would be a more convenient approach for Berlin. In such a case, Germany would avoid the bilateralisation of the dispute with the Russian investor and all stockholders of the project. Moreover, responsibility for its consequences would be shared by all the parties involved. However, Germany would only accept a possible moratorium, if it concluded that it was possible to meet the conditions necessary to end it. This would also require the involvement of EU institutions, especially the European Commission. However, Russia is unlikely to participate in any such moratorium.

Germany certainly prefers the option of delaying the launch of the pipeline than suspending construction. Again, it may be more interested in making such a decision multilateral, as long as the conditions for the suspension are kept under control. At the same time, it does have real influence

by employing the administrative procedures concerning the installation under construction in a manner that – within the formal framework – would clearly be understood by the Russian side as an element of negotiations (e.g. strict inspections, commissioning).

In practice, the US views the proposed moratorium as a preparatory phase for other instruments that are being considered. In turn, both talks on the possible terms of the compromise and limiting any moratorium to when the pipeline launches would let Germany and Russia gain time to complete the project during the ‘ceasefire’. Possible progress in talks on the conditions of use of the installation or on other demands would increase the chances that Germany and Russia will carry out certification without the risk of restrictions from the United States. At the same time, the finalisation of construction work would weaken US pressure, and certification would effectively deprive the US of the possibility of exerting it.

Transit and compensation guarantees for Ukraine

Any political agreement involving the consent to complete the construction and launch of NS2 in exchange for guarantees that Russian gas will continue to be shipped via Ukraine may turn out to be completely ineffective.

Firstly, the strategic goal of Russian infrastructure projects oriented towards the European market (Nord Stream 1, Nord Stream 2 and TurkStream) is to reduce transit dependence on third countries, in particular Ukraine. This can be inferred from the statements of government officials and Gazprom, as well as from the strategic documents adopted in 2000–2020 concerning the energy and transport sectors. Any declarations by President Vladimir Putin or the company regarding the desire to maintain transit via Ukraine also after the launch of NS2 should be treated as part of the Russians’ negotiating strategy. An illustration of this is the significant reduction in shipping Russian gas through Ukraine after the launch of the Nord Stream 1 gas pipeline in 2011–2012. Besides, even if the transit was not completely suspended upon the launch of NS2, the limited volumes of gas transport via the Ukrainian Gas Transmission System would reduce its cost efficiency. Some statements by Gazprom suggest that once Nord Stream 2 and TurkStream operate at full capacity it will be possible to send only 10–15 billion m³ of gas via Ukraine annually.

Secondly, the legal form of granting the guarantees is problematic. Any political deal between Washington and Berlin to this effect

» **At this stage, it seems unrealistic to force Russia to grant long-term, legally binding guarantees of gas transit via Ukraine.**

could end up being completely ineffective, especially if Gazprom regulated the legal aspects of supplies via the new route with Western European customers (with new or amended contracts). An enforceable commitment to ship a certain amount of gas through Ukraine would therefore require Russia to sign an appropriate long-term transit agreement with its Ukrainian partners determining the minimum transit volume (the current contract is valid until 2024). Forcing the Russians to enter into this kind of deal seems completely unrealistic at this stage. Even if they declared their readiness to consult this issue, the consultations would be conducted only for the sake of appearance, until the construction of Nord Stream 2 was over.

As for possible compensation for Ukraine in the form of investments in its capacity and infrastructure for renewable energy production (including the production and transmission of hydrogen), it is unlikely that the scale will be comparable to the losses incurred as a result of a serious cut or suspension of Russian gas transit once NS2 is launched (US\$1.5 billion to US\$3 billion annually in transport charges). Additionally, it seems that in order to launch hydrogen exports with the use of the existing infrastructure, it would be necessary to keep it operational and to ship (at least in the medium term)

amounts of raw material sufficient to guarantee its cost-effectiveness. According to technical tests, the Gas Transmission System of Ukraine could now ship gas with a 10–20% hydrogen admixture, but the possibility of transmitting only hydrogen has not yet been confirmed.

The mechanisms restricting or withholding gas flow via NS2

The ‘snapback’ mechanism to block gas flow through Nord Stream 2 is one of the recurring options in the media for a possible German-American compromise on this project. It would be implemented after the pipeline is completed and would make it possible to suspend gas flow in the event of problems with supplies or transit through Ukraine, or if Moscow takes any other aggressive actions against Kyiv. Ukraine has not imported gas from Russia since November 2015, so – unless this changes – it would only make sense to use the mechanism if it was linked to the transit of Russian gas. It is not clear what the legal grounds for imposing a blockade would be. Any moves that would interfere with the EU’s trade and/or energy policy should be negotiated not only by Germany but also by the European Commission and be in line with the applicable law.

It cannot be ruled out that, in order to enable a formal gas transport cut off, in certain cases it would be necessary to amend EU

” The implementation of a mechanism blocking gas flow via NS2 would be legally difficult and will entail excessive costs for EU gas consumers.

regulations, such as the security of gas supply regulation. However, the European Commission is in no way engaged in working out a possible compromise on NS2, and it is not known whether and on what terms this could change. So far, Germany has avoided cooperation with EU institutions on issues related to NS2, and the commission has recently unambiguously distanced itself from actions aimed at stopping the project, arguing that this is within Germany’s competencies. The compliance of the blocking mechanism with selected international law regulations (in particular with the provisions of the Energy Charter Treaty or the WTO legal system) is unclear.

There are also questions as to how this solution would affect the market. The simultaneous suspension of gas transport (and thus the supply of Russian gas) both via Ukraine and (as a consequence) via NS2 would result in the shutdown of approx. 70% of the entire capacity of Russian gas export pipelines to Europe. This would entail a surge in prices and, in the event of a longer suspension of transport via both routes, the risk of a gas crisis. Despite the progress in diversification of sources, such a cut-off would seriously affect European economies and societies. This would also require a carefully prepared contingency plan for gas supplies. Even if a plan is developed, this move would entail significant additional costs for providing alternative gas supplies and would provoke social discontent. It would be particularly difficult and costly to supply gas at the time of peak demand in winter. It became clear in 2021 that, in the event of a wave of frosts around the world and an outflow of LNG to Asia, Russia remains a key supplier capable of satisfying the growing demand. It also seems that the blocking mechanism would be ineffective. It is unlikely that Russia will decide to resume gas transit via Ukraine, if Germany or the EU blocks gas transport via Nord Stream 2 in retaliation for problems with Ukrainian transit. The experience of several Russian-Ukrainian gas crises shows that Moscow may even use European problems with gas supplies as an opportunity to pursue its own interests (in this case, to enable unrestricted use of NS2 at full capacity). Therefore, it seems unlikely that during a time of high demand, Germany/the EU would be able to maintain the blockade on the gas pipeline for more than a few days, maybe weeks, and this would significantly undermine the effectiveness of this instrument.

Summary and conclusions

Once the pipe-laying is over, the bargaining power of the main actors interested in launching the new gas pipeline (Russia and Germany) will become stronger. The existing sanctions regime will remain a serious obstacle to the pipeline's certification, which is a necessary step preceding its launch. Nevertheless, finalising the construction phase will allow the parties to focus their efforts on making the pipeline operational. The determination which Germany and Russia have demonstrated to continue this controversial project so far suggests that they will focus their efforts on finding a legal solution to the problems related to the future operation of the gas pipeline.

No political deals that make consent to complete and launch Nord Stream 2 conditional on possible political or economic concessions from Russia or Germany will neutralise the threats that implementation will entail for Poland, Central Europe and the EU as a whole. Firstly, most of them should be treated primarily as elements of the negotiation strategy, the main goal of which is to complete the construction of the pipeline. Secondly, it would be difficult to give such informal arrangements any concrete form (such as an agreement to guarantee transit via Ukraine or the rules of suspending gas flow through NS2). This will be problematic, especially since Germany wants them to be political, legally non-binding arrangements, which would in fact prevent them from being enforceable. Furthermore, the compromise options currently under consideration contradict the strategic goals of the main stakeholders (especially Russia) and raise doubts as to compliance with the provisions of European law and selected regulations of international law (the Energy Charter Treaty). Thirdly, such arrangements would not reduce the harmfulness of NS2. This involves undermining the declared goals of the EU energy policy, such as improving the security of energy supplies (for example, by diversifying the sources of supply). It also involves strengthening Gazprom's dominant position as a gas supplier to Central European countries and weakening the economic foundations of alternative projects aimed at improving the region's energy security (such as the Baltic Pipe gas pipeline running from Norwegian fields via Denmark to Poland, LNG supplies and the expansion of the North-South gas corridor).

The text was updated on 19 March 2021.