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Russia's Nord Stream 2 Pipeline: Will Sanctions Stop It?

The Trump Administration and many Members of Congress have expressed opposition to Nord Stream 2, a Russian-owned natural gas pipeline project that, if completed, will enable Germany to increase the amount of natural gas it imports directly from Russia via the Baltic Sea (see **Figure 1**). Reflecting concerns about European dependence on Russian energy, the Protecting Europe's Energy Security Act of 2019 (PEESA), enacted as part of the FY2020 National Defense Authorization Act (NDAA, P.L. 116-92, Title LXXV), establishes sanctions related to the construction of the Nord Stream 2 pipeline. Given sanctions-related delays, the pipeline currently is scheduled for completion by the end of 2020 or early 2021.

Background

U.S. policymakers have supported European Union (EU) efforts to reduce reliance on Russian natural gas, especially after Moscow temporarily reduced exports via Ukraine in 2006 and briefly halted them in 2009. Although the EU has articulated an ambitious energy diversification strategy, some European governments have not reduced dependence on Russian gas, which accounted for 46% of EU imports in 2018. Factors behind continued European reliance on Russian supply include rising demand for natural gas, diminishing European gas supply, financial investments by Russia in European infrastructure, 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 also is to have a capacity of 55 BCM per year, doubling the system's capacity.

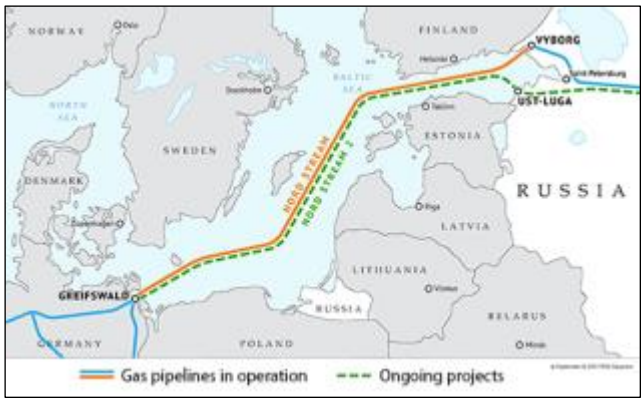
Nord Stream 2 is estimated to cost about $10 billion. It is owned entirely by Russia's state-owned energy company Gazprom. Half the cost is being financed by five European companies: Engie (France), OMV (Austria), Shell (Netherlands/UK), Uniper (Germany), and Wintershall (Germany). This ownership structure is different than that 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, construction of Nord Stream 2 began in 2018. In October 2019, the Gazprom-owned Nord Stream 2 AG pipeline company secured its last necessary state-level construction permit from Denmark. As of January 2020, about 100 miles of the approximately 760-mile pipeline reportedly remain to be constructed.

Critics of Nord Stream 2 were initially 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. In early 2019, the EU amended an existing gas directive to extend its rules to EU territorial waters. Proponents hoped that the amendment would require Gazprom to adhere to EU rules prohibiting operators from owning both the pipeline and a majority of the gas flowing through it. In November 2019, however, the German parliament ruled that the restrictions would not apply to Nord Stream 2, as the pipeline was already under construction at the time they were agreed.

Figure 1. Nord Stream Gas Pipeline System



Source: Gazprom, edited by CRS.

Support and Opposition

Supporters of Nord Stream 2, including the German and Austrian governments, argue that the pipeline will enhance EU energy security by increasing the capacity of a direct and secure supply route at a time of rising European demand for gas. German officials and others have said that once the gas reaches Germany it could be transported throughout Europe. These advocates say they support developing additional infrastructure to ensure this is possible. The German government stresses that it also supports broader European energy supply diversification efforts, including by backing construction of a new liquefied natural gas (LNG) terminal in northern Germany.

Opponents of the pipeline—including, among others, some EU officials, Poland, the Baltic states, Ukraine, the Trump Administration, and many Members of Congress—argue that it will give Russia greater political and economic leverage over Germany and others that are dependent on Russian gas, leave some countries more vulnerable to supply cutoffs or price manipulation by Russia, and increase Ukraine's vulnerability to Russian aggression.

Impact on Ukraine

One concern of Nord Stream 2 opponents is that the pipeline would reduce Ukraine's significance as a transit state for Russian natural gas exports to EU members. Before Nord Stream 1 opened in 2011, most of Russia's natural gas exports to Europe transited Ukraine. Currently, around 40% transit Ukraine. According to Ukrainian oil and gas company Naftogaz, its revenues from gas transit totaled $2.65 billion in 2018.

If Nord Stream 2 becomes operational, observers expect it to further reduce transit through Ukraine. In December 2019, Gazprom and Naftogaz negotiated a contract to transit 65 BCM in 2020, a volume equal to about 75% of the 2018 volume of 87 BCM, and 40 BCM a year from 2021 to 2024, a volume equal to about 46% of the 2018 volume. Despite the reduction in export volumes, Ukraine's Minister of Energy has said the agreement provides for about $3 billion a year in transit revenue.

Many observers consider that reducing Ukraine's role as a transit state would not only 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.

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 (CRIEEA, 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 a July 2018 NATO Summit in Brussels, President Donald Trump criticized German support for Nord Stream 2. 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.

U.S. Sanctions Related to Nord Stream 2

The Protecting Europe's Energy Security Act of 2019 (PEESA) requires sanctions on foreign persons who the President determines have sold, leased, or provided subsea pipe-laying vessels for the construction of Nord Stream 2 and TurkStream (another Russian pipeline that is to supply natural gas to Europe), or any successor pipeline, since December 20, 2019 (the date of the NDAA's enactment). PEESA provides for a 30-day wind-down period; exceptions for repairs, maintenance, environmental remediation, and safety; and a national security waiver.

PEESA provides for the termination of sanctions if the President certifies to Congress "that appropriate safeguards have been put in place" to minimize Russia's ability to use the sanctioned pipeline project "as a tool of coercion and political leverage," and to ensure "that the project would not result in a decrease of more than 25 percent in the volume of Russian energy exports transiting through existing pipelines in other countries, particularly Ukraine, relative to the average monthly volume of Russian energy exports transiting through such pipelines in 2018."

As of January 2020, PEESA's impact on completion of the Nord Stream 2 pipeline is uncertain (TurkStream was inaugurated on January 8, 2020). On December 21, 2019, Allseas, the Swiss-Dutch company laying the pipeline, stated that it had "suspended its Nord Stream 2 pipelay activities [and would] proceed, consistent with the legislation's wind down provision." On December 27, 2019, the State Department said that "the United States' intention is to stop construction of Nord Stream 2" and that PEESA's sanctions would be imposed "unless related parties *immediately* demonstrate good faith efforts to wind-down." Russian officials have said that Russia should be able to finish construction of the pipeline. In January 2020, Russian President Vladimir Putin said that he expected the pipeline to be completed no later than the start of 2021.

Other relevant sanctions legislation is included in Section 232 of CRIEEA, which 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 the same amount for the construction of Russian energy export pipelines (22 U.S.C. §9526). In October 2017, the Administration published guidance noting that Section 232 would not apply to projects for which contracts were signed prior to August 2, 2017, the date of CRIEEA's enactment. Gazprom signed financing agreements with five European companies in April 2017. Section 232 does not provide for sanctions on financing specifically, although it provides for sanctions on the provision of services and support.

European Response to U.S. Sanctions

Some European opponents of Nord Stream 2, including the European Commission, have joined supporters of the pipeline in criticizing U.S. sanctions established by PEESA. EU officials have stated that the EU rejects as a "matter of principle" the imposition of sanctions against EU companies conducting legitimate business in line with EU and European law. Other opponents of the pipeline, such as the Polish government, support PEESA as a necessary mechanism to prevent completion of the project.

European critics of PEESA have expressed concerns that the threat of U.S. secondary sanctions could jeopardize what has been strong U.S.-European cooperation in imposing sanctions on Russia. Others have voiced suspicion that U.S. opposition is rooted primarily in a desire to increase U.S. 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.

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