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NORD STREAM 2: SANCTIONS, SNAPBACKS, AND SOLUTIONS

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Nord Stream 2: Sanctions, Snapbacks, and Solutions

The Nord Stream 2 pipeline is a Russian infrastructural project that has become embroiled in global geopolitics, particularly insofar as its completion could jeopardize Ukraine's national security. This report discusses the legal implications of completing Nord Stream 2 and potential challenges its supporters may face in European courts.

The Nord Stream 2 pipeline project was launched in June 2015. Almost six years later the project remains for its proponents tantalizingly unfinished. Since December 2019, when the US government imposed sanctions, the pipe-laying has stalled. Today, approximately 150km of pipeline remain to be completed with the project facing further US sanctions. One option would be to seek a deal whereby Nord Stream 2 was completed but the Ukrainian pipeline network would also continue to provide gas to Europe.¹ Such a deal, in theory, would be possible. However, the guarantees required to underpin such a deal would be extremely difficult to deliver, as long as Gazprom thinks it

has a chance of completing and then using the pipeline in full. However, even if a deal is not possible and Nord Stream 2 is technically completed despite the threat of US sanctions, it is far from clear that the pipeline can enter into operation any time soon. There is the prospect of a significant EU law battle at least over the application of the liberalization provisions of the Gas Directive 2009.² In addition, there is the prospect within that legal battle of additional US sanctions. For instance, because it has a non-EU owner (Gazprom), Nord Stream 2 would be subject to an Article 11 security of supply assessment. Given Gazprom's previous history, such an assessment may be problematic. The US could block transfer of the pipeline to any EU or other foreign owner by imposing sanctions on any acquirer. Gazprom would therefore face being trapped within the requirements of Article 11 with no effective means to transfer the pipeline to an EU third-party owner, or another non-EU, non-Russian owner.

With the prospect of an ongoing legal battle and more US sanctions, it may be that the US and the EU could develop a dual track solution. The first track would be to develop a version of a credible deal with significant underpinnings for Ukraine, which Russia would be able to accept; and the second a proactive energy security strategy to permanently disable Russian capacity to influence or threaten Central and Eastern Europe via its control of

¹ This paper is focused on the policy and legal issues surrounding sanctions and the application of Union law to the pipeline. However, one cannot wholly ignore the geopolitical context. One of the major objectives of Nord Stream 2 from a Russian perspective is to terminate or minimize the gas transit flows across the Ukrainian pipeline network. This has been clear since the coming into operation of Nord Stream 1, which saw the transit flows via Ukraine decrease as they increased via Nord Stream 1. This same 'decrease, increase' policy can be seen in play in 2017-2019 when, due to a Commission exemption decision later struck down by the EU General Court, larger gas flows were permitted to flow via Nord Stream 1's connecting pipeline, OPAL. This policy in action can also be seen in the operation of Turk Stream 2, which during 2020 has seen gas flowing via the Turk Stream 2 pipeline from Russia to Turkey and then onward into South-East Europe. At the same time, gas flows via the Balkan pipeline, which flows gas via Ukraine and then through Moldova, Romania and Bulgaria, have dropped dramatically. Even with a transit agreement with Ukraine, which provides transit of at least 40bcm annually until the end of 2024, once Nord Stream 2 is operating, the reasonable working assumption is that as in all other cases where Gazprom was able to reduce gas flows across Ukraine, once it was possible to do so that step would be taken—absent incentives to ensure that such supply flows continued.

² Directive 2009/73/EC of the European Parliament and the Council of 13th July 2009 *concerning common rules for the internal market in gas*, OJ 2009 L211/94 (hereafter Gas Directive 2009).

energy flows.

Nord Stream 2: State of Play

In March 2021, six years after the initial launch of the Nord Stream 2 project the pipeline remains tantalizingly close to completion. Almost all the pipeline at a length of two sets of pipes covering the 2300 km length has been laid. Just two lengths of pipe, 75km each, largely in Danish waters, remain to be completed.³ However, hardly any pipeline has been laid since the US Congress imposed sanctions on Nord Stream 2's pipe-laying operations in December 2019 under Section 7503 of the National Defence Authorization Act 2020. Congress expanded sanctions to a broad set of pipe laying support and service activities in January 2021 under Section 1242 of the National Defence Authorization Act. This expansion of US sanctions led to a flight of certification, supply and service companies supporting the pipelaying of Nord Stream 2. At the time of writing, Gazprom has two Russian pipe-laying ships, the *Fortuna* and *Akademik Cherskiy*, gearing up to lay the remaining pipes. However, both ships have much less efficient pipe-laying technology, which means it will take some months to complete construction—assuming US sanctions do not stop the project in the meantime.

The Problems of Doing a Deal

One option actively discussed since the advent of the Biden Administration is to strike a deal guaranteeing the completion of the pipeline while maintaining significant gas flows through Ukraine. The difficulty with any such deal is to find a way of underpinning any ostensible guarantee that gas will continue to flow across the Ukrainian pipeline network.

It would be possible to conceive of a snapback mechanism in which, in response to a disruption of gas flows via the Ukrainian transit pipeline network, would result in a corresponding closure of Nord Stream 2. The immediate problem of any snapback mechanism would be agreement on what would count as 'disruption' and who would pull the trigger on the snapback. Practically, on disruption of the Ukrainian transit network it could be politically challenging in a cold winter to further reduce Russian gas flows to Europe.

³ Gas Pipeline Nord Stream 2 links Germany to Russia, but splits Europe, Clean Energy Wire, 19th March 2021.



In reality, any guarantee of continued transit flows via Ukraine would need to be underpinned by incentives to lessen the likelihood of disruption. At the very least any underpinning would require a guaranteed contractual extension of the Ukrainian transit flows beyond the current transit contract (which currently terminates at the end of 2024).⁴ Any deal would probably require accelerated penalty payments, such as, for example, immediate payment of the total value of the transit contract on a certified disruption event. Furthermore, in order to underpin European and Ukrainian supply security, Gazprom would be required to maintain a significant gas security deposit in EU and Ukrainian gas storages which would be automatically forfeited on a certified disruption event. The gas security deposit would then make it possible to close Nord Stream 2 as EU states and Ukraine could both draw on the gas available in storage forfeited by Gazprom.

It is worthwhile outlining what would be necessary to deliver a credible deal because it illustrates the difficulty of delivering it. It is open to question whether Gazprom would ever agree to significantly extend the transit agreement, agree to accelerated payment of fees on disruption or bear the costs of a supply security deposit. Yet, without such entrenched guarantees, Ukraine and most Member States in Central and Eastern Europe will not believe that any such deal is worth the paper it is printed on.

⁴ For further details on the 2020-2024 Ukrainian transit deal. See Riley, *Russia-Ukraine Transit Deal: A Crisis Postponed?* Cidob, Barcelona, 2 February 2020.

Between Sanctions and EU Law

Without a credible deal we are left with Gazprom inching forward with the completion of the pipelines under the shadow of additional US sanctions being levied on the pipeline. It is unclear at the time of writing whether US sanctions will be able to stop the pipeline. It is clear that both Section 7503 and Section 1242 can be applied expansively to catch more suppliers and service providers to the construction of the pipeline. The State Department could also deploy the as-yet unused sanctions provisions contained in Section 232 of CAATSA enacted in 2017.⁵ Section 232 sanctions have a broader scope. They could apply well beyond the pipelaying and pipelaying activities. For instance, sanctions could be imposed on the Western partners of Gazprom Shell, Wintershall, OMV, Engie, and Uniper, which assisted in the financing of the project, though one would question at this stage whether such sanctions would assist in actually stopping the project.

However, it is important to recognize US sanctions are not the only legal threat to the project. Gazprom also faces a battery of EU laws in the way of bringing the pipeline into full operation. As a result of the 2019 amendment to the Gas Directive 2009,⁶ import pipelines such as Nord Stream 2 are fully subject to EU energy liberalization rules. Ownership unbundling, third party access, and transparent tariff regulation is required. Gazprom has no intention if at all possible of operating under EU liberalization rules. It has two current legal challenges to the 2019 amendment legislation before the CJEU⁷ and against the Union under the Energy Charter Treaty. Neither case has

a high chance of success. Direct challenges of Union law of a general character seeking to regulate the internal market are not usually favored in Luxembourg.⁸ Equally, trying to pin as discriminatory the legislation that applies to all classes of new import pipelines in order to create a common regulatory playing field will be problematic in any ECT arbitration hearing.⁹ Nevertheless, the litigation does indicate Gazprom's hostility to the obligations of EU energy legislation.

One way out would be to seek an exemption under Article 36 of the 2009 Gas Directive. However, the pro-additional supply, pro-market and pro-competition conditions required for such an exemption are difficult for Nord Stream 2 to meet. The pipeline is a diversionary pipeline: it brings no new gas to the EU, so it is not a source of additional supply. It undermines the single market by splitting the western and eastern parts of the EU gas market by flooding the west to east interconnectors.¹⁰ It removes competition by enhancing Gazprom's market dominance and it undermines supply security. Not merely are the terms of Article 36 difficult to meet, the ultimate assessment is by

⁵ CAATSA (Countering American's Adversaries Through Sanctions Act) became law in August 2017. Section 232, unlike the sanctions imposed in 2020 and 2021 are discretionary and much broader. They do not focus just on pipelaying and pipelaying services. The key text is contained in Section 232 (a) 'The President may in co-ordination with the allies of the United States, impose...sanctions...if the President determines that the person knowingly or after the date of enactment of this Act, makes a (prescribed) investment...or sells, leases, or provides to the Russian Federation for the construction of Russian export pipelines, goods, services, technology, information or support...'

⁶ Directive (EU) 2019/692 of the European Parliament and the Council of 17th April 2019, amending Directive 2009/73/EC concerning the common rules for the internal market in gas, OJ 2019 L117/1.

⁷ There is live litigation challenging Directive 2019/692 before the CJEU. The case reference is Case C-348/20 P *Nord Stream 2 AG v. Council*. This, however, is an appeal on point of law from the EU General Court where the application of Nord Stream 2 was ruled as inadmissible in Case T-530/19 *Nord Stream 2 AG v. Council*, judgment of 20th May 2020.

⁸ It is perhaps not surprising that the EU General Court ruled that the Nord Stream 2 challenge—a direct frontal attack on the legislation—was inadmissible. To obtain a substantive review of Nord Stream 2, as the Court indicated, it would be wiser to bring a case to a national court and then via an Article 267 TFEU reference to the CJEU. However, while that may bring the substantive issue to Luxembourg, the difficulty Nord Stream 2 faces is that the law is of general application, it has a legitimate policy purpose—to create a level playing field in the single market—and on the relevant due date it did not comply with the criteria to escape the operation of the liberalization rules. In particular, it was an incomplete pipeline with only 40% of the pipe laid and it did not have all the route permits in place to complete the pipeline.

⁹ For a discussion of the Energy Charter Treaty litigation see Riley, *A Risky Case: Nord Stream 2's Energy Charter Treaty Litigation*, CEPA, Washington DC, 3 December 2019.

¹⁰ In addition to the Nord Stream 2 pipeline itself, there is its connecting pipeline EUGAL. EUGAL can carry 55bcm, i.e. the full carrying capacity of Nord Stream 2. EUGAL does not enter Western markets but goes eastward from its landing point at Greifswald to the Czech border. EUGAL follows the route of one of Nord Stream 1's connecting pipelines, OPAL, which currently carries approximately 13bcm of gas into Central Europe. Altogether, therefore, Gazprom will be bringing approximately 58-68bcm into Central and Eastern Europe. Such a flow of gas at this scale from west to east will deter competitors from entering the Central and Eastern European market. At the same time the gas flows via Ukrainian transit will fall significantly or be eliminated (this is after all one of the aims of Nord Stream 2, transit agreement or no transit agreement) this will remove the competitive free trade in contracted Russian gas sold to Slovakia, Hungary and Poland, undermining reverse flow sales to other states, including Ukraine. In essence, splitting the single market in gas from west to east, increasing Gazprom's market dominance and undermining the transit security of EU states along the route of the pipeline—all while actually providing no new gas resources to the EU.



the European Commission and not the German regulator, and any decision is challengeable as of right by Member States before EU courts.

In the *OPAL* exemption case, Poland, supported by Lithuania and Latvia, challenged an extension of the terms of use of the *OPAL* pipeline (the connecting pipeline for Nord Stream 1).¹¹ That not only succeeded before the EU General Court but the Court took the view that any exemption had to take account of the principle of solidarity found in Article 194(1) TFEU so that the Commission had to take account of the interests of other Member States and not just the interests of the Member State making the exemption request. On March 18, 2021, in an opinion worth reading, Advocate General Sanchez-Bordona concurred with EU General Court on the legal application of the principle of solidarity and further grounded the principle and its scope in Union law.¹² It is likely that the CJEU will follow the General Court and the Advocate General. As a consequence, it is unlikely Nord Stream 2 will receive an exemption, and if improbably it did receive an exemption, it would be unlikely to hold in face of a

¹¹ Case T-883/16 *Poland v. Commission*, judgment of 10th September 2019, known as the *OPAL* case.

¹² Case C-848/19, *Germany v. Poland*, Opinion of Advocate General Sanchez-Bordona. 18th March 2021. Note that although the original case before the EU Court *OPAL* T-883/16 saw the Commission defending its Article 36 exemption decision, following the defeat of the Commission in that case, the Commission did not seek to appeal the ruling. However, Germany decided to seek an appeal. Therefore Germany, and not the Commission, appears as appellant in this case.

legal challenge in Luxembourg.

That is not the only legal barrier the pipeline faces. There is Article 11 of the 2009 Directive, as well. This imposes a certification requirement on a non-EU owner of a pipeline as to whether the granting of certification may put at risk the 'security of energy supply of the Member State or the Community'.¹³ Clearly the solidarity principles set out in the *OPAL* ruling could well come into play here. In addition, there is the open question of whether certification should be refused on the ground of Gazprom's willingness to undermine the security of energy supply across Europe. This has been amply demonstrated not only in the 2006 and 2009 gas supply crises, but also in the extensive research by Larsson in the Swedish Defence Research Agency Report, *Russia's Energy Policy* (which identified over 40 gas and oil related cut-offs between 1991 and 2004);¹⁴ evidence accumulated by governments across Central and Eastern Europe over the last two decades;¹⁵ and the 2014-2015 attempts by Gazprom to stop gas reverse flows to Ukraine by Hungary, Poland, and Slovakia.¹⁶ At the very least any decision to grant certification would result in litigation in the EU courts with the case entirely focused on Gazprom's reliability as an energy supplier. This would be likely to result in many EU

¹³ When Article 11 was enacted, the European Union had not been formally established in the EU Treaties. Hence the reference to 'Community' was to the European Community. As a consequence, the reference to 'Community' in Article 11 should now be read as 'Union,' as in European Union. It is also worth noting that the Article 11 procedure differs from that under Article 36. Under Article 36 the Member State regulator makes a request for an exemption to the Commission. However, it is the Commission that makes the formal exemption decision which is attackable directly before the EU Courts-and in the *OPAL* case, Poland did exactly that. In Article 11 cases the Member State regulator makes the decision but the Commission has the right to provide an opinion on the decision the Member State regulator intends to make. Clearly a decision by a Member State regulator could be attacked in national courts and then be subject to an Article 267 TFEU reference to the CJEU. However, given the political controversy surrounding any Article 11 certification decision it is likely that either the Commission would institute an infringement decision against Germany or that Poland supported by several Member States would itself bring infringement proceedings before the EU Courts.

¹⁴ Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier*, FOI (Swedish Defence Research Agency), Stockholm, 2006.

¹⁵ One overlooked danger for Gazprom is that cut offs and threat of cut offs by Russian entities will have been documented and will be available to the legal services of the Member States when intervening to challenge an Article 11 certification before the EU Courts.

¹⁶ Loskot-Strachota, *Central European Problems with Russian Gas Supplies*, OSW (Centre for Eastern Studies), Warsaw, 17 September 2014, and *Russia Threatens EU States with Gas Cut Offs*, EU Observer, 26 September 2014.

governments intervening with extensive documentation of Gazprom supply cut-offs and threats of cut-offs over the last two decades. The spectacle of a broad multi-state challenge to Article 11 certification morphing into a major CJEU case where the legal and media focus would be on the reliability of Gazprom as an energy supplier would be entirely unwelcome in Moscow.

It is also difficult to see how Nord Stream 2 can wriggle out of the terms of Article 11. It faces a two-fold problem here. First, if it transfers the pipeline to another Russian ultimate owner, that new owner will be subject to an Article 11 assessment as a non-EU owner.¹⁷ Transfer to another ultimately Russian entity will not permit an escape from the Article 11 process. Second, Recital 10 of the Gas Directive imports the concept of control of an undertaking from EU merger control law. EU merger control case law takes a very broad view of the concept of control.¹⁸ Hence Russia may well find it difficult to identify an arm's length independent undertaking that it was not deemed to control for the purposes of Recital 10. One can see that many potential Russian entities would be likely to find it difficult to avoid the contention that they were ultimately controlled by the same state entities that control Gazprom.

Furthermore, in respect of the prospect of transferring the pipeline to an entity outside Russia, Article 11 then provides another ideal opportunity for US sanctions. Using Section 232 of CAATSA, the US can sanction any entity which seeks to own or actually owns the Nord Stream 2 pipeline. Such sanctions would make it impossible to transfer the pipeline to an arms-length EU entity which

would not be subject to Article 11 or an arms-length non-EU owned entity which was not Russian which, absent sanctions, would be able to obtain certification.

The difficulties involved in complying with Article 11 and the prospect of targeted US sanctions do not make it absolutely impossible to obtain certification or transfer to any entity not subject to the certification process—but they make it considerably more difficult.

Outside the scope of EU energy law, there is the new EU foreign investment screening regulation (EUFIS). This came into force in October 2020.¹⁹ As a new or incomplete foreign investment, Nord Stream 2 could be subject to a EUFIS screening. The Commission can be required to undertake a EUFIS assessment if nine or more Member States so request such an assessment.²⁰ The Commission assessment is not binding on a Member State (here it would be Germany); however, should a negative assessment be handed down, it would be difficult for Berlin to permit the pipeline to come into operation. That would be particularly the case, as the European Parliament, mirroring the US Congress with the US foreign investment process, known as CFIUS, would hold their own parallel hearings on key investments undergoing assessment, further piling pressure on Berlin.

Developing an Effective Energy Security Solution

Even if US sanctions do not immediately prevail against Nord Stream 2, and the pipeline is technically constructed, it is likely to face a long legal battle before it can be brought fully into operation, if ever. US sanctions may yet play a key role in making it impossible for Gazprom to escape from the obligations of Article 11 of the Gas Directive. Member States led by Poland are likely to be willing to use their privileged rights of access to the EU courts to challenge each and every opportunity under EU law to delay and frustrate the operation of the pipeline.

It should therefore be clear that the controversy over Nord Stream 2 will not stop with its technical completion and, indeed, it will not be able to fully function absent a significant legal battle in the EU courts.

¹⁷ Although Nord Stream 2 is owned by a Swiss based corporation, it is likely that the Commission and EU courts would take the view that, as it is 100% owned by Gazprom, it is in fact a Russian controlled and owned undertaking. However, even as a Swiss undertaking it would be subject to Article 11 certification with Gazprom as the ultimate owner being the subject of the supply security assessment. The Swiss seat of the company would provide no immunity from a full assessment.

¹⁸ Article 3(1)(b) of the EU Merger Regulation takes a very broad definition of control. It is further elaborated in the Commission's *Consolidated Jurisdictional Notice under Council Regulation 139/2004 on the control of concentrations between undertakings* OJ 2008 C95/01. There are two points particularly worth mentioning. First, that a person who may have control can be a public body or the state itself (para 12). Second, that the key test is the possibility of exercising decisive influence to determine the strategic commercial behavior of an undertaking (para 62). Given the scope of state ownership, control and influence over much of Russian industry, the broad concept of control in EU merger law is likely to make finding a genuinely arms-length Russian partner difficult to find. Virtually any Russian entity proposed by Gazprom as the new owner of Nord Stream 2, would be likely to result in the issue of control being litigated all the way to the CJEU.

¹⁹ Regulation EU 2019/452 of the European Parliament and the Council of 19th March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ 2019 L79 I/1.

²⁰ *Ibid*, Article 6(3) and Article 7(2).

It is therefore worth considering a two-track solution. The first would be to consider again the prospect of a credible deal. This may be possible if Gazprom is mired in EU legal battles and subject to further US sanctions, with the project facing a twin EUFIS investigation by the Commission and the European Parliament. Facing such headwinds, it may be easier for Gazprom to accept a deal with credible underpinnings such as a longer Ukrainian transit contract and a gas security deposit.

The second part of a two-track solution would be for the US and the EU to support Central and Eastern Europe to remove, once and for all, Russian energy leverage from the region. In respect to natural gas flows, this would involve doubling the capacity of the Baltic and Trans-Adriatic Pipelines, increasing the number of liquid natural gas terminals and completing EU and EU-Ukraine interconnectors. Significant increase in gas supply capacity and further market integration measures would greatly reduce Gazprom's market power in the region.

In parallel, a broader rollout of renewables combined with a strengthening of power networks and full synchronization with the EU grid networks would reduce regional reliance on natural gas. Gas would, over time, end up as the mere balancing fuel in the region before it was replaced by wholly green substitutes.

With this more proactive energy security strategy there is the prospect of building consensus within the EU and between the EU and the US. Such a strategy could enhance supply security while at the same time underpinning support for a major advance in the suppression of CO₂ emissions in the region.



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