

Occasional Paper

Nord Stream 2 – Single Gas market By Mariam Ivanishvili¹

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Nord Stream 2 – The most recent threats of sanctions in the Single Gas market

Abstract:

Nord Stream 2 has become a high-profile subject of discussions between European countries, as well as between Europe and United States. The project has produced deep divisions about its benefits, to the point where sanctions have recently been imposed by the USA. On one hand the USA views the pipeline as a threat, hence the imposition of extraterritorial sanctions. On the other hand, Europe itself is marked by controversy about the project. Some European countries are wholly supportive of completion, whereas others (like Poland) insist upon taking account of the political situation and its potential negative repercussions. Although Nord Stream 2 has been almost completed, the conflict remains. A new legislative amendment relating to the pipeline and possible consequent sanctions has maintained corrosive divisions, leaving almost no space for negotiations.

1. Introduction

Many controversies exist around the 1,200 km-long offshore natural gas pipeline - Nord Stream 2. It can be difficult to understand the reasons behind these. At first glance, the mission of this project includes energy security, safety and environmental protection.²

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² Available at: <https://www.nord-stream2.com/company/mission/> (Last access: 05.02.2020)

However, some European countries, as well as the United States strongly oppose it, stating that it will bring Europe into dependency on Russian gas.

Although Nord Stream 2 is often characterised as a purely commercial project with the focus on effective liberalisation of the single gas market, the threat of economic sanctions imposed on the participants by the USA exists. As a consequence, there is a significant probability of debates and disputes where the legal framework and jurisdiction may seem obscure.

This paper focuses on these issues, reviewing the legal contexts and the confrontations between the major players of this huge project.

2. Diversity of Economic Sanctions

Economic sanctions can be defined as measures taken “against one or more countries, (or individuals or entities) to force a change in policies, or at least to demonstrate a country’s opinion about the other’s policies.”³

Nowadays, sanctions play an important role as a tool against other countries, entities, or individuals. This is especially true for the USA which has a record of frequently applying economic sanctions with the purpose of coercing the behaviour of the targeted countries, companies and/or individuals in particular directions. The department of the USA which oversees its administration process is represented by the Treasury's Office of Foreign Assets Control ("OFAC").⁴ In addition to administration, it also enforces economic and trade sanctions against countries and individuals involved in terrorism, narcotics and other activities considered to threaten the USA.⁵

Economic sanctions can be further distinguished between primary and secondary ones.

³ U.S. sanctions on Russia, CRS report, Congressional Research Service, January 2019, p.4

⁴ Baker McKenzie, US Sanctions Summary, September 2018, p.1, Available at: <https://www.wko.at/service/aussenwirtschaft/General-Sanctions-Memorandum--Baker-McKenzie.PDF> (Last access: 05.02.2020)

⁵ Available at: <https://www.treasury.gov/about/organizational-structure/offices/pages/office-of-foreign-assets-control.aspx> (Last access: 05.02.2020)

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In terms of primary economic sanctions, the USA tends to prevent its own citizens, residents, as well as corporate entities from doing any business with the sanctioned party.⁶ Such sanctions, for example, may include trade embargoes, as in the case of Crimea. After its annexation by Russia, engagement with certain persons, as well as transactions and investments in Crimea have been prohibited to US persons.⁷

Secondary sanctions refer to additional economic restrictions⁸ and extend the nation's sanctioning capacity to cause economic harm in the sanctioned country.⁹ It directly includes third parties and attempts to force them to cease activities with the sanctioned country. The potential consequence of failure to comply, is that their relationship with the sanctioning country will be diminished or cut off entirely.¹⁰ The target in this case represents the country on which the "primary" economic sanctions have been placed. For example, sanctions were imposed on Chinese firms and individuals for the financial transactions with North Korea.¹¹

Extraterritoriality could be defined as "the unilateral use of measures which are taken under a state's sovereign powers to enforce its own law, in a territory other than its own, for actions committed outside its territory by entities or people from other countries."¹² In most cases, secondary and extraterritorial sanctions are equivalent to each other. However, there is an important difference.

Extraterritorial sanctions attempt to force entities located outside the sanctioning country's borders to follow the sanctioning country's policies. In relation to secondary sanctions, the USA does not try to force foreign parties to adhere to its policy, but rather it restricts its own

⁶ Jeffrey A. Meyer, second thoughts on secondary sanctions, University of Pennsylvania Journal of International Law, Vol. 30:3, 2009, p.905

⁷ Ole Moehr, Secondary Sanctions: A First Glance, Atlantic Council, 2018

⁸ Jeffrey A. Meyer, second thoughts on secondary sanctions, University of Pennsylvania Journal of International Law, Vol.30:3, 2009, p.905

⁹ John Forrer, Secondary Economic Sanctions: Effective Policy or Risky Business? Atlantic Council, May 2018, p.3

¹⁰ Ole Moehr, Secondary Sanctions: A First Glance, Atlantic Council, 2018

¹¹ John Forrer, Secondary Economic Sanctions: Effective Policy or Risky Business? Atlantic Council, May 2018, p.3

¹² M. H. Berars, F. Fatah, P. Lamy, EU AND US SANCTIONS: WHICH SOVEREIGNTY?, Europe, A Values-Based Power Policy Paper NO.232, October 2018

residents and entities from doing any business with them if they refuse to accept the policy.¹³

3. Nord Stream 2 pipeline system

There are three types of pipeline system: ‘transmission’, ‘distribution’ and ‘upstream’. According to the Gas Directive 2009/73/EC, Nord Stream 2 can be characterised as a transmission pipeline. This is due to the fact that as a connector of two network systems, it is not running directly from the field.¹⁴

As a transmission pipeline, Nord Stream 2 passes through the territorial waters and exclusive economic zones of Russia, Germany and other parts of Europe which include Finland, Sweden and Denmark.¹⁵ In March 2018, this project was granted the essential permission by the German government. It takes the same route and runs at a close distance to the existing Nord Stream 1, while doubling the pipeline system’s capacity.¹⁶

Originally, Nord Stream 2 was based in Zug, Switzerland and owned by the Public Joint Stock Company (PJSC) Gazprom¹⁷ with the purpose of improving Europe’s energy security. It should be mentioned that all processes which include planning and construction were operated under the provisions of the United Nations Convention on the Law of the Sea (UNCLOS) and the Espoo Convention.¹⁸

In spite of a sustained veto by other European countries, Nord Stream 2 has successfully passed the review process of the European Commission. Almost all transit countries gave

¹³John Forrer, Secondary Economic Sanctions: Effective Policy or Risky Business? Atlantic Council, May 2018, p.5-6

¹⁴ Marco Giuli, Nord Stream 2 : Rule no more, but still devide, European Policy Centre, June 2018, p.15

¹⁵ Kai-Olaf Lang, K. Westphal, Nord Stream 2 – A Political and Economic Contextualisation, SWP Research Paper, 2017, p.13

¹⁶ Nord Stream 2 : A geopolitical Lightning Rod, congressional research service, August 2018, p.2

¹⁷ At first, Shareholders included: Gazprom with 50% share, Shell, Wintershall, ENGIE, E.ON and OMV with remaining 50 %, 10% share of each. However, after the withdrawal of other parties in 2016, Gazprom remained the only owner with the 100% of share. See, Alan Riley, Nord Stream 2: A Legal and Policy Analysis, CEPS Special Report No. 151 / November 2016, p.2. Also, Marco Giuli, Nord stream 2: Rule no more but still devide, 2018, p.16

¹⁸Kai-Olaf Lang, K.Westphal, Nord Stream 2 – A Political and Economic Contextualisation, SWP Research Paper 2017, p.13

their permission for the construction of the pipelines, the Danish government being the exception.

Due to the 2 years of waiting for permission, Nord Stream 2 decided to withdraw from the original application for the route, taking the other direction which included the pending applications. To add some detail, there were two other pending applications for the routes: north-west of Bornholm and south-east of Bornholm situated within the Danish exclusive economic zone, creating the possibility of alternative route, as the recommendation from the Minister for Foreign Affairs has been considered unnecessary.¹⁹ On October 30, 2019 the construction permit for the South-Eastern Route was granted by the Danish Energy Agency, further removing obstructions to completion of the pipeline.²⁰

4. The Legal Framework of Nord Stream 2

There is substantial controversy about Nord Stream 2 and in particular, the applicability of EU energy law. In terms of legality, the main question remains - whether this project is compatible with Gas Directive 2009/73/EC or not. However, before discussing the problems and likely solutions of the legal framework of Nord Stream 2, the main principles of this directive should be highlighted. These are:²¹

- Ownership unbundling
- Third party access
- Non-discriminatory tariff setting

Due to the fact that Gazprom holds a monopoly position on exports via pipelines from Russia, one of the principles – third party access - cannot be guaranteed, and consequently non-discriminatory tariff setting plays a significant role.²²

¹⁹ available at : <https://www.nord-stream2.com/media-info/news-events/nord-stream-2-withdraws-the-2017-territorial-waters-route-application-in-denmark-130/> (Last access: 05.02.2020)

²⁰ available at : <https://www.nord-stream2.com/permitting-denmark/danish-permitting-process/>(Last access: 05.02.2020)

²¹ Marco Giuli, Nord Stream 2 : Rule no more, but still decide, EPC Issue Paper 25, 2018, p.16

²² Ibid

As we already mentioned above, all the planning and construction processes are in line with the UNCLOS. The Convention assesses the free choice in laying the pipelines, with the condition that their exact route of passing through the exclusive economic zones and/or territorial waters should be agreed beforehand.²³

From the very beginning, the main issue included the applicability of UNCLOS and EU law in the territorial waters, as well as in the exclusive economic zone (EEZ)²⁴. Regarding the first one, article 2 and 3 of UNCLOS brought true light to the situation with the statement that within territorial waters, domestic and EU laws should be applied.²⁵ However, the difficult part was the evaluation of the legal regime in the EEZ. One side argued that EU law and national law could be applied under UNCLOS. A different opinion stated that the onshore zone differed from the offshore one by its length and different laws that was the reason why EU law should not be applied.²⁶

To put it simply, there is a grey legal zone which connects two different markets – inside and outside markets of the EU. In case of dispute, pipelines cannot be subjected to two different legal regimes, and this was where the door of international agreement between the EU and Russia seemed the only solution.²⁷

All above mentioned contradictions and uncertainties led Europe to the negotiating table with the purpose of adopting the Gas directive amendment. In November 2017, this initiative was announced, including the possibilities of unbundling and third party access in terms of Nord Stream 2 and other interconnectors.²⁸ This seemed the only way to extend the EU energy rules to third countries which adopted the Gas directive amendment in 2019.²⁹

²³ Kai-Olaf Lang, K. Westphal, Nord Stream 2 – A Political and Economic Contextualisation, SWP Research Paper 2017, p.13

²⁴ United Nations Convention on the Law of the Sea, PART V, article 55

²⁵ Alan Riley, Nord Stream 2: A Legal and Policy Analysis, CEPS Special Report No. 151 / November 2016, p. 4

²⁶ Marco Giuli, Nord Stream 2 : Rule no more, but still decide, EPC Issue Paper 25, 2018, p.16

²⁷ Kai-Olaf Lang, K. Westphal, Nord Stream 2 – A Political and Economic Contextualisation, SWP Research Paper 2017, p.15

²⁸ Bent Ole Gram Mortensen, New Gas Market Directive will change balance of power between EU and Member States, April 2018, also available at <https://energypost.eu/new-gas-market-directive-will-change-balance-of-power-between-eu-and-member-states/> (last access 05.11.2019)

²⁹ Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0692&from=EN> (Last access: 05.02.2020)

However, in practice the directive created more uncertainty, raising many questions on how to deal with the unbundling of pipelines and the supply certification process defined by Article 11 of the Gas Directive.³⁰

In April 2019, the Chief executive officer of Nord Stream 2³¹ wrote a letter³² to the European Commission, in which he complained that the amended directive amounted to a huge discrimination against Nord Stream 2. It was stated that despite the adoption of the directive, all investment decisions were made before May 23, which gave this project the right to be granted a waiver. Otherwise, there would be a violation of the Articles 10 and 13 of the Energy charter Treaty.³³ According to the above mentioned letter “Nord Stream 2 pipeline and the associated project is an investment of an investor for the purposes of the ECT” as this investment was made in the EU within the meaning of Articles 1(6) and 1(7)(a)(ii) of the ECT. In July, three months of consultation defined by ECT expired, leaving only two options. Either Nord Stream 2 would have to apply to the court or international arbitration, or continue with further dialogue.³⁴

In subsequent months, Nord stream 2 both applied to the European Court of Justice (July 26, 2019), and started an arbitration process which was fully completed by the private arbiters in September 2019. Evidently, the emphasis was on the breach of the EU law; more precisely, on the principles of equal treatment and proportionality.³⁵

In his letter mentioned above, the Chief executive officer explicitly cited the possibility of infringement of articles 10 and 13 of the ECT. However, the argument which implies that the German part of the pipeline had been completed before the mentioned date may not be

³⁰ Alan Riley, Nord Stream 2: From EU Law to US Sanctions Law, Atlantic Council, June 2019

³¹ Matthias Warning - Chief executive officer of Nord Stream

³² Available at: https://trade.ec.europa.eu/doclib/docs/2019/july/tradoc_158069.pd_Redacted.pdf

³³ Energy Charter Treaty has been signed in December 1994, focusing on the promotion of energy efficiency, cooperation and dispute resolutions. Available at: <https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/> Last access: 25.03.2020)

³⁴ Siobhan Hall , Nord Stream 2 mulls options in dispute over new EU gas rules, July 2019

³⁵ Georgi Gotev, Nord Stream 2 takes unusual legal step against the Commission, Euractiv, Available at: <https://www.euractiv.com/section/energy/news/nord-stream-2-takes-unusual-legal-step-against-the-commission/> (Last access: 05.02.2020)

valid either, as due to its formalistic nature, European Court of Justice (ECJ) may easily discount it.³⁶

The recent Judgement of the Opal gas pipeline case³⁷ will also make a huge impact on the Nord Stream 2, especially it may obstruct the process of getting the necessary certificate of security of supply stated in the article 11 of the Gas Directive 2009.³⁸ In its decision, the European Court of Justice (ECJ) underlined that, ‘‘principle of solidarity requires the European Union and the Member States to endeavour, in the exercise of their powers in the field of energy policy, to avoid adopting measures likely to affect the interests of the EU and other Member States as regards security of supply, its economic and political viability, the diversification of supply or of sources of supply, and to do so in order to take account of their interdependence and de facto solidarity.’’³⁹ This kind of ruling will create more difficulties for Nord Stream 2, as there will be fewer chances left to avoid the amendment and consequently the EU energy liberalisation law.⁴⁰

In spite of the fact that the Gas directive amendment has been adopted, some issues about the legal framework still remain. Without doubt, Gazprom will not abandon its dominant position, thus further continuing the disputes on these fronts.

5. Possible Sanctions imposed by USA

Since 2017, the USA was actively considering sanctions on Russia’s Nord Stream 2, stating that it would damage the supply security and the integrity of the European Union. Most threats were based on the CRIIEEA Act, article 232. It authorised the imposition of sanctions on those who invested the funds defined by this Act or on the participants engaged in trade with the same value for the construction of Russian energy export pipelines. Later on, the

³⁶ Alan Riley, Nord Stream 2: From EU Law to US Sanctions Law, Atlantic Council, June 2019

³⁷ Available at: <https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190107en.pdf> (Last access: 05.02.2020)

³⁸ Alan Riley, The ‘principle of solidarity’: Opal, Nord Stream, and the shadow over Gazprom, Atlantic Council, October 2019

³⁹ Available at: <https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190107en.pdf> (Last access: 05.02.2020)

⁴⁰ Alan Riley, Nord Stream 2: From EU Law to US Sanctions Law, Atlantic Council, June 2019

White House announced that this article would not be applied to contracts which were signed before August 2017.⁴¹

However, in July 2019, a new U.S Senate bill quoted as the “Protecting Europe’s Energy Security Act of 2019” has been introduced to the House of Representatives, with sanctions targeted at pipe-laying vessels for the construction of Nord Stream 2 and “foreign persons that have sold, leased, provided, or facilitated the provision of those vessels for the construction of such pipelines”⁴². On July 31, it was further advanced and placed on Senate Legislative Calendar under General Order. As the last updates show, the defence bill has been agreed, playing the major role in enforcing the sanctions by the US administration.⁴³ On December 20th, 2019, the latter one was signed by the president, at the same time becoming public law.⁴⁴ This action may not have been the best option to block the project. Instead, it may become the red flag for the relationship between the United States and Germany.⁴⁵

Sometimes, extraterritorial sanctions can be considered as illegal. In order to block such illegal extraterritorial sanctions, the EU and some of its member states adopted blocking regulation⁴⁶ which came into force in 1996. It should be mentioned that, despite having some counter effects against sanctions on Cuba, Iran and Libya, this regulation is not applicable to US sanctions against Russia.⁴⁷

One measure against the US action can be the use of the German ‘Foreign Trade and Payments Ordinance 2013’⁴⁸, section 7 which “prohibits the issuance of a declaration in

⁴¹ Nord Stream 2 : A geopolitical Lightning Rod, congressional research service, August 2018, p.2

⁴² Available at: <https://www.congress.gov/116/bills/s/1441/BILLS-116s1441is.xml> (Last access: 05.02.2020)

⁴³ Georgi Gotev, US readies sanctions against Nord Stream 2 and Turkish Stream, Euroactiv, Available at: <https://www.euractiv.com/section/energy/news/us-readies-sanctions-against-nord-stream-2-and-turkish-stream/> (Last access: 05.02.2020)

⁴⁴ Available at: <https://www.congress.gov/bill/116th-congress/senate-bill/1790> (Last access: 25.02.2020)

⁴⁵ Daniel Fried, Russia Gas Pipeline Sanctions legislation (PEES Act): A way Ahead, atlantic council, 2019

⁴⁶ COUNCIL REGULATION (EC) No 2271/96, November 1996, protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom

⁴⁷ Dr. M. C. Hilgard, Dr. H. CH. Siebold, Legal and political insights: US sanctions on Russia and their impact in Europe, p.3

⁴⁸ Foreign Trade and Payments Ordinance, August 2013, Available at: https://www.gesetze-im-internet.de/englisch_awv/englisch_awv.html (Last access: 05.02.2020)

foreign trade and payments transactions whereby a resident participates in a boycott against another country (declaration of boycott)". It can be interpreted broadly by German authorities and can be a great help in case of sanctions imposed against Russia.⁴⁹ In case of a dispute, International Arbitration could be the likely solution.

6. Conclusion

To sum up, Nord Stream 2 remains a high-profile project since the formation of the Russian-European consortium. This construction project is widely represented as the cornerstone of further developing the EU single Gas market.

To highlight the pros and cons of the project, the scrutiny of this paper started with the most factual, yet perhaps ill-understood theme - definition and differentiation of economic sanctions, giving some examples of sanctioned countries.

While the main aspects of this paper focus on the sanctions, others describe the pipeline system and such legal issues such as framework, applicability to the court and attitudes of other countries, especially the USA.

Apart from the contrary argumentation about its commercial nature, this project is being reviewed as a threat to the safety of the United States and the rest of Europe, which on the other hand, raises the risk of possible legal claims.

In addition, uncertainties in terms of the future of the disputes remain unresolved, as the legal side of Nord Stream 2 regarding the applicability of EU law stays obscure.

⁴⁹Dr. M. C. Hilgard, Dr. H. CH. Siebold, Legal and political insights: US sanctions on Russia and their impact in Europe, p.3

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