

NORD STREAM 2

Position paper

February 2018

Divisive project of the Russian government

NS2 remains fully controlled by the Russian government, contrary to its supporters' narrative about it being a "European" project.

Gazprom owns 100% of Nord Stream 2 AG. Its partners on the project are to provide loans to fund it. For this financing, Gazprom offers rates way above the market level. The arrangement therefore incentivizes lobbying and political support from Gazprom's partners.

The partners on the project are gas suppliers, not gas transmission system operators. If the project falls under the EU legislative regime, such arrangements are illegal unless specific exemptions are granted.

No commercial or operational sense for Gazprom

NS2 makes no commercial sense for Gazprom. It requires dozens of billions of investment in Russia, the Baltic Sea and the EU. After NS2 completion, the transmission costs for Gazprom via NS2 are going to be several times higher than via the UA system.

NS2 increases risks for Gazprom. NS2 will divert transit gas flows from the Ukrainian system and eventually eliminate it. Therefore, Gazprom risks losing a versatile and reliable route, which has excessive back up capacities, for the fragile underwater NS2.

Unlike with the Ukrainian system, in the case of NS2, Gazprom will carry the full responsibility for any emergencies (incl. potential terror attacks and accidents with WWII munitions buried in the Baltic Sea).

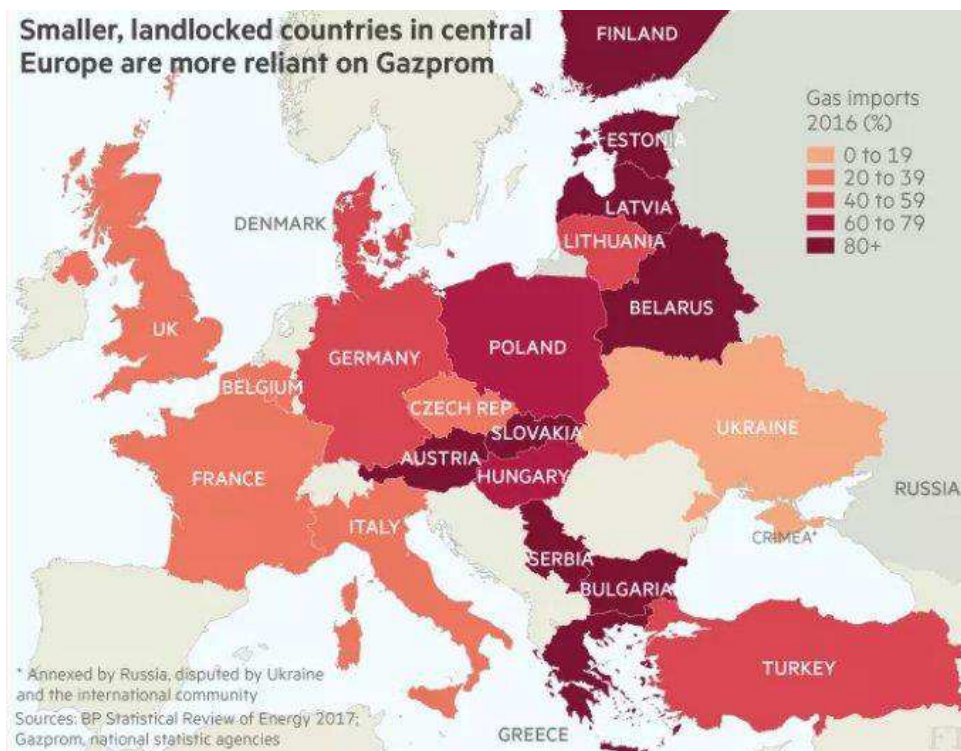
Gazprom's market capitalization reflects the view that NS2 and other recent pipeline investments pursued by the company are commercially unreasonable. In 2010, Gazprom's shares were valued at US\$150bn, whereas by the end of 2017 its market capitalization dropped to US\$50bn.

The only purpose justifying Gazprom's active engagement in redundant pipeline projects aimed at circumventing the traditional gas transmission routes across Ukraine, Slovakia, Poland and Hungary is the geopolitical agenda of the Russian government.

Energy security, national security and environmental concerns

NS2 will affect European energy security. In 2016, Germany, most countries of CEE (except Czech Republic, Romania and Ukraine), Southern Europe and Turkey were reliant on Gazprom for more than 40% of their gas imports. A number of CEE and Balkan countries depend on Gazprom for 100% of their gas supplies.

Launching NS2 will reinforce Gazprom’s dominant position in these countries. The dependent countries, already susceptible to the Russian influence in their political agenda, will face much higher risks of coercion.



The project creates national security risks for countries in Northern Europe. By concentrating nearly 80% of Russian gas supplies to the EU, the Nord Stream 1 and Nord Stream 2 pipelines will become infrastructure of strategic importance.

With both the pipelines and the gas they carry owned by the Russian state-owned company, one can expect that Russia will propose reinforcing its military presence in the Baltic Sea to “protect” the fragile infrastructure.

The prospect of the additional Russian military deployment in the EEZ of a number of EU member states and NATO members will lead to undesired tensions within these alliances.

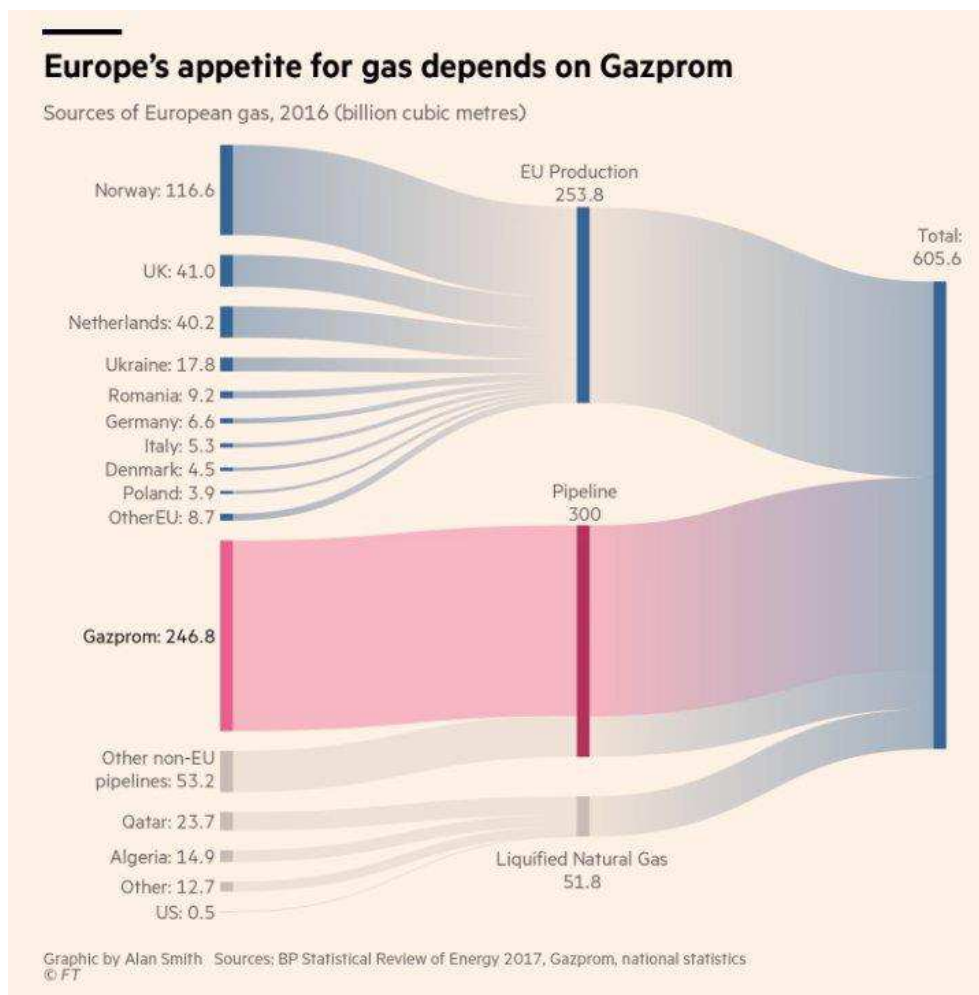
WWF, NABU and other influential organizations emphasize environmental risks of NS2. In the same time, the European Commission has repeatedly stated that NS2 serves no public interest and is not essential for the EU energy security. Given this position, there is no justification to set aside the threats of the project to the Baltic Sea wildlife and Natura 2000 sites.

Threat to a free and competitive gas market in Europe

Gazprom remains a major single supplier of gas to Europe. In 2016, the Russian state-owned monopoly has supplied nearly 50% of gas consumed in the region.

With the falling production in Norway and EU member states, Gazprom’s position is able to strengthen its position even relying on existing pipeline infrastructure.

NS2 will concentrate Russian gas delivery routes to Europe under control of Gazprom. This will provide Russia with an exceptional ability to fluctuate between price dumping to discourage LNG supplies and halting supplies to enforce its political agenda.



The NS2 supporters often say that the US opposes the project because it wants to win the European market for the US LNG suppliers. In reality, LNG accounted for less than 9% of gas consumption in Europe in 2016, and US LNG has covered less than a negligible 0.1% of the total demand.

Given the decrease of gas production in Europe, diversification of gas supplies falls fully in line with the energy security interests and agenda of the European allies of the US.

Three combat arenas to stop the project: US sanctions, EU legislation revision, Ukrainian unbundling

The upcoming 6 months are crucial for the NS2 fate. Should Gazprom fail to start physical construction before the fall 2018, the project is not likely to be implemented in its current shape and will be critically behind the schedule, if not cancelled.

The threat of US sanctions is one of the efficient ways to prevent the NS2. The bipartisan bill adopted by the US Congress last summer has already caused anxiety among the project's EU partners. In particular, raising the necessary funding remains at risk.

In private discussions, some of Gazprom's closest allies voice concerns of being "overreliant" on their cooperation with the Russian company and seek ways to diversify their partnerships.

The energy security, national security and geopolitical risks posed by NS2 to US allies in Europe fully justify the introduction of the sanctions. While they are not in place, it is important to preserve a credible threat of such a possibility to discourage the project's partners and suppliers from participation.

The initiative of the European Commission to expand the Gas Directive so that it covers export pipelines like NS2 is another important counter measure. If the European Parliament and the European Council support the initiative, the project's implementation chances are bleak.

The lobby of NS2 in Germany, Austria, the Netherlands and Belgium actively opposes the adoption of the proposed resolution by the European Parliament. Bulgarian and Austrian presidencies in 2018 are likely to use available formal instruments to delay the decision making on this issue.

It is therefore crucial to convey a unified public position in support of the Gas Directive expansion by as many parties as possible in the US, EU and individual member states. The support is necessary both on political and expert level.

Finally, the gas market reform process in Ukraine is an important dimension in preventing NS2. In particular, the unbundling of the gas transmission function from Naftogaz and engaging a reputable Western transmission system operator to co-manage the system will make European gas shippers comfortable using the Ukrainian gas transmission system. It is therefore important to actively monitor and support the gas market reform process in Ukraine.

Currently, the Ukrainian system is used exclusively by Gazprom. The Russian company illegally blocks interconnectors between Ukraine and the EU. By doing so, it cuts European competition from the markets of Turkey, CEE and the Balkans. If the Ukrainian system is unblocked and managed by a reputable Western operator, the European suppliers will have a clear business case to negotiate with Gazprom to move gas transfer points to the eastern border of Ukraine and compete in the markets now fully dominated by the Russian company.

Contrary to the Russian narrative, the Ukrainian system does not need external investment and is in a robust operating condition. It generates sufficient operating cash flow to finance necessary repairs and maintenance. In 2017, the system has delivered a record high 93 bcm of Russian gas to the EU, nearly ½ of total Russian gas exports, in full compliance with the contract.