



A Snapshot of Key Developments in the External Relations of the Russian Gas Sector

By Jack Sharples, EGF Associate Researcher on the external dimensions of Russian gas

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Gazprom in the EU

EU antitrust investigation into Gazprom – victim of the deterioration in EU-Russia relations?

Last month, the Gazprom Monitor reported that the European Commission antitrust investigators were continuing to formulate their 'statement of objections'. In accounting for the lack of further developments, we referred to a statement by the EU Competition Commissioner, Joaquin Almunia; "These days are not the most adequate ones to have a quiet discussion on the question related with Russian gas and how the Russian gas arrives to the territory and to the markets of the EU... (But) antitrust investigations should be protected from any kind of external influences".

On the basis, we concluded that the results of the EU antimonopoly investigation into Gazprom could be delayed, at least until the current tensions have eased, lest they be interpreted as being unduly influenced by the current political climate.

Another month has passed with no further developments regarding the antitrust investigation, while political relations between the EU and Russia continue to worsen. More than ever, the antitrust investigation risks being characterised as a tool of pressure on Russia by the EU. In such a climate, it is unsurprising that the investigation has effectively been put on hold. When it might be resurrected depends on the situation in Ukraine and the dynamic of EU-Russia relations, two factors that remain highly unpredictable. Notwithstanding a dramatic shift in EU-Russia relations, the statement of objections appears unlikely to be issued before the EU Competition Commissioner, Joaquin Almunia, steps down next month. Whoever replaces him – and the race for his post remains wide open – will take over a highly complex investigation, which could have far-reaching consequences for the EU gas market.

Nord Stream

Russian sources report imminent ruling from European Commission on OPAL pipeline

On the 1st of September, Russian sources reported an imminent ruling on Gazprom's use of the OPAL pipeline in Germany. On the 29th of August, the Vice-President of the European Commission, Gunther Oettinger, met with the Russian Energy Minister, Alexander Novak. In that meeting, the two representatives discussed the situation regarding the OPAL pipeline and current gas relations between Russia and Ukraine.

According to the subsequent European Commission press release, "use of the OPAL pipeline" was one of four elements of an "interim solution" to the breakdown in Russia-Ukraine gas relations. However, following the meeting, Novak gave a press conference to Russian journalists. During that press conference, Novak stated; "At the last meeting, we discussed the full loading of the OPAL pipeline, giving the full capacities. It will improve the situation with living through the autumn-winter period, [and it] will give more opportunities to supply gas bypassing Ukraine's transit risks... Oettinger has promised us to make a decision by September 15. There is no reason not to do it".

Last month, the Gazprom Monitor reported on the failed capacity auction, which could have seen Gazprom bid for some, if not all, of OPAL's capacity. At the time, a spokesperson for the European Commission stated, "It is difficult to specify the exact timing of the decision". However, the Russian Energy Ministry issued a statement, in which it expressed its expectation of a decision by mid-September. The recent curt statement

from the European Commission and the more optimistic announcement from the Russian Energy Ministry once again reflect the different approaches of the two sides towards the issue. The European Commission remains unwilling to promise anything concrete, while the Russian Energy Ministry (on behalf of Gazprom) is keen to resolve the issue as soon as possible.

The 35 bcm-capacity OPAL pipeline is one of two that connect Nord Stream with the German gas pipeline system. It transports gas from Nord Stream south to Olbernhau on the German-Czech border.

South Stream

*Bulgaria halts work on South Stream for a second time.
Or does it?*

Back in June, we reported that the Bulgarian Prime Minister of the time, Plamen Oresharski, had ordered that all work on South Stream in Bulgaria be halted, pending further consultations with Brussels. However, in its final days in office in late July, the Bulgarian government continued to make plans for financing the Bulgarian section of South Stream, and agreed a €620m loan from Russia to cover the participation of the Bulgarian partner in the project, Bulgarian Energy Holding.

The contract for constructing South Stream in Bulgaria was awarded in May, to a consortium comprised of the Bulgarian Gazproekt Jug and the Russian Stroytransgaz. In May, Stroytransgaz was placed under US sanctions, as it is controlled by Gennady Timchenko (through his investment vehicle, Volga Fund). Because Timchenko himself had been placed under sanction, this sanction was extended to Stroytransgaz. At the beginning of August, Stroytransgaz pulled out of the South Stream project in Bulgaria. In an interview with the Russian media outlet, ITAR-TASS, Timchenko stated, "From the viewpoint of business, the loss of the South Stream is an

unpleasant thing for us, but who should I lodge complaints with? The Americans?"

In late August, the consortium responsible for implementing South Stream in Bulgaria, ('South Stream Bulgaria'), announced that it was suspending all procurement activities. This move followed a demand made by interim Minister of Economy, Vasil Shonov, on the 18th of August that all work on the project should be halted until it is clarified whether the project meets EU regulations.

Despite the demand from Shonov, work may not have entirely halted. During the final week of August, Bulgarian sources reported that one of the four pipeline-laying vessels arrived in the Bulgarian port of Burgas, while deliveries of pipes to the port of Varna have also continued.

At the beginning of September, Russian sources reported that Russia and Bulgaria were considering re-classifying the Bulgarian section of South Stream as a 'field pipe'. According to the source, "pipes carrying gas from EU shelf fields have a special field status, which removes them from the effect of the legislation... Austria's OMV, Gazprom's partner in South Stream, produces gas production on the Bulgarian shelf, and its pipeline carrying gas from the shelf can be later included in the project by reassignment of rights".

However, it is far from clear how the two projects could be combined. Logic suggests that only the pipe carrying gas from the offshore (shelf) field to a link with the onshore gas pipeline network would be considered exempt from third party access. This would not apply to transmission pipelines crossing the country, as South Stream would.

Srbijagas announces that work is proceeding as scheduled, despite last month's warning from the EU that the project should be halted

The Director of Srbijagas, Dusan Bajatovic, has announced that work on South Stream in Serbia is continuing according to schedule, and that 30km of the pipeline will be built by the end of 2014. Bajatovic told reporters, "Soon we will finish (land) expropriation for the third section of the pipeline route and are awaiting construction permits to begin construction works".

Serbia's apparent progress on South Stream follows last month's recommendation from the European Commission that the project be halted, pending clarification of the legal status of the pipeline.

Gazprom and Ukraine

Ukrainian Energy Ministry proposes 'interim' agreement with Gazprom, pending results of arbitration

The Ukrainian Energy Ministry and Naftogaz have proposed an 'interim' agreement with Gazprom on price and volumes, pending the outcome of arbitration at the Stockholm Commercial Court Institute for Arbitration. However, the proposal seems to have fallen on deaf ears. The Ukrainian Energy Minister, Yuri Prodan, announced, "We are ready to talk about some kind of reasonable compromise gas price until the situation is resolved (by the court)... but Gazprom is not taking part in the negotiation process... There is no compromise yet from the Gazprom side".

In June, Gazprom switched to a 'pre-payment' regime with Naftogaz, meaning that Naftogaz would only receive gas for which it paid in advance. This had the practical effect of halting Gazprom's exports to Naftogaz. Gazprom then filed a \$4.5 billion suit at the Arbitration Institute of the Stockholm Commercial Court, in a bid to recover outstanding debts. Later, Kiev responded by

filing a \$6bn claim against Gazprom, for alleged overpayment for gas since 2010, caused by Gazprom imposing unfairly high prices.

The hearing is expected to take 12-18 months, during which time either an interim solution must be found or Ukraine must learn to live without Russian gas.

Naftogaz opens pipeline from Slovakia

At the beginning of September, the Slovakian gas pipeline system operator, Eustream, officially opened a reverse-flow pipeline link to Ukraine. The link, from Vojany in Slovakia to Uzhgorod in Ukraine, will be able to supply 27 million cubic metres per day, or 10 bcm per year, from West to East. A spokesperson for Eustream, Vahram Chuguryan, told reporters; "Supplies will begin on a regular basis in September, subject to certain technical conditions, and will become permanent from March 2015". Chuguryan added, "The company [Naftogaz] has purchased the biggest part of the new gas pipeline's transit capacities until 2019". The remaining capacity will be available to European energy companies.

Ukraine also has the capacity to import up to 4 mcm per day (1.5 bcm per year) from Poland and 15 mcm per day (5.5 bcm per year) from Hungary. The Slovak Prime Minister, Robert Fico, noted, "If we put together three reverse points in Slovakia, Hungary and Poland then we can reach 25 billion cubic meters a year in the mid-term which would provide the solution Ukraine needs at the moment".

The Vojany-Uzhgorod interconnector is not part of the main East-West pipeline link between Ukraine and Slovakia, and is not covered by Gazprom's transit contract with Naftogaz.

The municipal pipeline was originally built to serve a power plant in Vojany, and is being refurbished and upgraded with €21m of investment from Eustream.

Ukraine imported 14.5 bcm of gas from all sources in H1 2014 (more than 40 percent more than in H1 2013), but is expected to import significantly less in H2, following the suspension of gas imports from Russia. Indeed, it appears that Naftogaz may have been expecting the suspension of imports from Russia, and stockpiled gas accordingly. Indeed, Ukraine's gas imports in May 2014 (just before the cut-off) were 450 percent higher than in May 2013. In 2013, Ukraine imported approximately 27 bcm, equal to 60 percent of Ukraine's total consumption of 45 bcm. The Ukrainian Energy minister, Yuri Prodan, has expressed his hope that reverse-flow imports from Europe could cover all of Ukraine's gas import needs, thus eliminating the need for imports from Russia.

Ukrainian parliament votes to allow leasing of gas transmission system

On the 14th of August, the Ukrainian parliament (Verkhovna Rad) voted to allow the leasing of 49 percent shares in Ukraine's natural gas transmission system (GTS) to European and US companies. It is hoped that the move could attract foreign investment. However, given that the primary purpose of Ukraine's GTS is to distribute imported Russian gas around Ukraine and transit Russian across Ukraine to Europe, it is far from clear why American and European energy companies would want to invest in the system.

Naftogaz returns \$10m of 'unused' transit fees to Gazprom

In late August, Naftogaz returned \$10.5m of pre-paid transit fees to Gazprom, reflecting the lower levels of transit of Russian gas via Ukraine in July. According to a Naftogaz statement, "Gazprom has earlier transferred an advance payment for transit supplies. The formula calculating the transit price takes into account the price

for Russian gas delivery to Ukraine. According to Naftogaz's estimates, the prepayment has not been used fully".

Gazprom in Asia

Gazprom launches construction of 'Power of Siberia' gas pipeline to China

On the 1st of September Gazprom officially launched the construction of its 'Power of Siberia' gas pipeline to China. The ceremony consisted of a symbolic welding of the first joint of the pipeline in the city of Yakutsk, which was attended by the Russian President, Vladimir Putin, the First Vice Premier of China's State Council, Zhang Gaoli, the Deputy Prime Minister of the Russian Federation and Presidential Plenipotentiary Envoy to the Far Eastern Federal District, Yury Trutnev, the Chairman of the Gazprom Management Committee, Alexei Miller, the Vice President of China National Petroleum Corporation (CNPC), Wang Dongjin, and the Acting Head of the Republic of Sakha (Yakutia), Yegor Borisov.

In launching construction of the pipeline, the Gazprom CEO, Alexei Miller, commented; "Gazprom is entering a totally new gas market of China... Great in all senses, this project has boosted the development of entire industries of the Russian economy: metallurgy, pipe production and machine building. Power of Siberia opens up new opportunities for gasification of eastern Siberia and the Far East. Due to this project thousands of new jobs will be created, accommodation and social infrastructure will be constructed".

By 2018, the pipeline is planned to span 3000 km, connecting the Chayandinskoye and Kovyktinskoye gas

production centres in Eastern Siberia with the cross-border connection to China at Blagoveshchensk and Gazprom's planned LNG terminal at Vladivostok.

The launch of construction of the 'Power of Siberia' is the first step in implementing the agreement between Gazprom and CNPC, which was signed in May. That agreement stipulates the delivery of 38 bcm of natural gas from Russia to China for 30 years. The availability of Russian gas supplies will diversify China's gas imports.

China currently imports gas by pipeline from Central Asia (Turkmenistan, Uzbekistan, and Kazakhstan) via the Central-Asia – China (CAC) pipeline. The third line of this pipeline became operational on the 31st of May 2014, bringing the pipeline capacity to 55 bcm. Construction of a fourth line (Line D) is scheduled to begin in December, and be complete by 2020. This will bring the pipeline's total capacity to 80 bcm per year. China's gas imports from Central Asia totaled 27.5 bcm in 2013, in addition to LNG imports of 24.5 bcm.

And in other developments...

Gazprom takes delivery of its fifth LNG tanker, brings fleet capacity to 800,000 m3

On the 26th of August, the Deputy Chairman of the Gazprom Management Committee (and former Head of Gazprom Export), Alexander Medvedev, attended a

ceremony in the city Jinhae, South Korea, where Gazprom took delivery of a new LNG carrier, the Pskov.

The Pskov has a capacity of 170.2 thousand cubic metres, and is certified as an Ice2 class vessel, meaning it can ship LNG cargoes in low-temperature conditions, including the Northern Sea Route in the open water. Gazprom Marketing & Trading (GM&T) will charter Pskov from Russian shipping company, Sovcomflot.

The Pskov is the fifth carrier in Gazprom's fleet, and brings the total capacity of the fleet up to 800,000 cubic metres. The remainder of Gazprom's LNG carrier fleet consists of the Yenisei River (cargo capacity – 149 thousand cubic meters), Lena River and Ob River (155 thousand cubic meters each), and Velikiy Novgorod (170.2 thousand cubic meters).

Gazprom gas production in 2014 expected to fall vs. 2013

Gazprom natural gas production in August fell 19.6 percent year-on-year as the company faces stiffer competition at home and reduced demand abroad, especially in Ukraine. Accordingly, Gazprom has revised its annual production forecast down to 463 bcm. In December 2013, Gazprom predicted that it would produce more than 490 bcm of gas in 2014. For comparison, Gazprom produced 487.4bcm of natural gas in 2013.

Disclaimer

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