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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

Key points:

- *Russia warns EU over anti-monopoly investigation; OMV enters into price-revision talks with Gazprom and Statoil; Gazprom and GDF Suez agree to revise their gas contract; Gazprom's European exports rise 9.6 percent y-o-y in H1 2013, but net profits fall 35 percent; Gazprom cancels calls for bids to prepare project documentation for the Shtokman project; Gazprom subsidiary to enter the Italian fuel market as Gazprom plans an expansion of its own natural gas vehicle (NGV) market*
- *Ukraine reduces its imports of Russian gas in favour of supplies from Europe*
- *Russian Stroytransgas to build the overland sections of South Stream in the Balkans*
- *No new developments in Gazprom-CNPC negotiations, but Putin's meeting with the Chinese President, Xi Jinping, at the G20 Summit could add fresh impetus*
- *Gazprom wins auction for Moscow power generation utility, MOEK*

Gazprom and the EU

Russia warns EU over anti-monopoly investigation

The Russian Foreign Minister, Sergei Lavrov, has warned the EU over its ongoing anti-monopoly investigation into Gazprom and its partners in Central and Eastern Europe. In an article recently published in the Journal of Common Market Studies Annual Review, Lavrov noted: "We are also concerned because of the antitrust investigation the European Commission launched last year against Gazprom – a company that makes a significant contribution to energy security on the European continent. One of the accusations is that Gazprom allegedly 'imposed unfair prices on its customers by linking the price of gas to oil prices'. But this formula (which, incidentally, was first introduced by the Dutch) has never been questioned before and is used by other companies supplying natural gas to Europe as well. If sanctions are introduced against Gazprom, it will be difficult for the company to work on the markets where it faces open discrimination". With the fine for breaching EU competition law currently standing at 10 percent of global turnover, Gazprom face a $14.5bn fine if found guilty of anti-competitive behaviour by EU investigators.

OMV in 'intensive' talks with Gazprom and Statoil over the price of gas imports

Following the publication of its Q2 operating results, the Austrian energy company OMV has announced that it has entered into 'intensive' talks with its two major gas suppliers, Gazprom and Statoil, to reduce the 'burden' of buying gas at oil-indexed prices that are significantly above European 'spot market' prices. The announcement comes less than two months after the Czech RWE Transgas (a subsidiary of the German RWE) won its arbitration with Gazprom and forced a revision of the price at which it imports gas from Gazprom, to include a 'spot price' component. According to OMV representative, Hans-Peter Floren, "This year we are entitled to adapt the prices and we have claimed what there is to be claimed". However, the timeframe for concluding the talks has not been made public, with Floren, stating, "We are in intensive discussions, but I can't comment on the timeframe. We are respecting confidentiality".

Gazprom and GDF Suez agree to revise their long-term gas contract

Russian sources report that Gazprom and the French energy company, GDF Suez, have agreed to revise the conditions of their long-term gas contract. Although no deadline has been announced for the revision of the contract, and no details of the proposed revisions have been formally announced, the Deputy President of GDF Suez, Jean-Francois Cirelli, has said that the new terms of the contract were "very comfortable" for his company.

Gazprom's European exports rise 9.6 percent y-o-y in H1 2013, but reports a 35 percent fall in net profit as exports to Ukraine fall 40 percent

Gazprom's has announced that its natural gas exports to Europe grew 9.6 percent year-on-year in H1 2013, to 78.865 bcm. In a breakdown of those exports, Gazprom's exports to Western Europe and Turkey grew 13.1 percent to 62.06 bcm, while exports to Central and Eastern Europe fell 4 percent to 16.8 bcm. Gazprom's exports to the Commonwealth of Independent States

(CIS) fell 22.03 percent to 25.31 bcm, largely due to lower exports to Ukraine, which fell 39.3 percent to 9.67 bcm. Gazprom's H1 Liquefied Natural Gas (LNG) exports have also grown 34.2 percent year-on-year, to 1.06 bcm.

However, despite increasing its gas exports to Europe, Gazprom also announced a 35 percent decrease in its H1 net profits versus H1 2012. According to Russian sources, the decline in profits can be attributed to a combination of factors, including a 14 percent rise in production costs (to 936bn Roubles), higher Mineral Extraction Taxes (MET), a 0.7 percent decline in overall sales revenues (to 1.4 trillion Roubles), and a significant decline in gas exports to Ukraine. In light of these figures, Ukraine has now fallen to Gazprom's fourth largest export customer, behind Germany, Italy, and Turkey.

Gazprom cancels calls for bids to prepare project documentation for the Shtokman project

Gazprom has announced that it has cancelled bids to prepare project documentation for the long-delayed Shtokman project. The deadline for bids had previously been set for the 30th of August. The announcement comes just over a year after Statoil withdrew from the project and returned its 24 percent stake to Gazprom, leaving Gazprom and the French energy company, Total, with shares of 75 percent and 25 percent respectively. The move to further postpone the project comes as little surprise: Given the challenging nature of the conditions of the project, which involves deep-sea drilling in the Barents Sea, some 550km (340 miles) off Russia's northern coast, the project was only ever going to be commercially feasible if there was a suitable export market for Shtokman gas. Initial plans to export Shtokman gas to the US were derailed by the US shale gas production boom, and since then European gas prices and demand have been insufficient to justify the significant capital investment needed to implement the Shtokman project.

Gazprom subsidiary to enter the Italian fuel market as Gazprom plans an expansion of its own natural gas vehicle (NGV) market

The Gazprom subsidiary, Promgas, has announced its intention to move into Italy's automotive natural gas fuel market. The Italian market is the largest in Europe, and the seventh largest in the world, with over 780000 vehicles running on compressed natural gas (CNG). The move comes less than a month after another subsidiary, Gazprom Germania, opened its 8th CNG filling station in Germany, and less than six weeks after a Gazprom-sponsored, CNG-powered Russian Kamaz truck took 8th place out of 26 in the truck category of the 2700-km Silk Way Rally from Moscow to Astrakhan.

In a meeting on the 14th of August, the Board of Directors of the Gazprom subsidiary, Gazprom Gazomotornoye Toplivo (Gazprom Gas Motor Fuel), approved a 13.8bn Rouble (312 million Euros) investment programme for 2013-2014, with a focus on expanding Russia's network of CNG filling stations, conversion shops, and maintenance centres. The Chairman of the Board, Viktor Zubkov, also noted that "Gazprom is taking large-scale efforts to expand the NGV fuel market in Russia". In a related announcement, Gazprom's oil branch, Gazprom Neft, has confirmed that it will begin adding CNG filling facilities to its network of almost 1300 filling stations in Russia and the CIS, of which 89 currently have CNG-filling capability.

Ukraine

Ukraine reduces its imports of Russian gas in favour of supplies from Europe

The Ukrainian state-owned energy utility, Naftogas, continues to reduce its imports of Russian gas from Gazprom, with imports in H1 down 39 percent year-on-year from 15.85 bcm to 9.67 bcm. This represents a continuation of Ukraine's determination to reduce its gas imports from Gazprom: In 2011 Ukraine was the world's largest importer of Russian gas, with Naftogaz importing 44.5 bcm from Gazprom.

Instead, Ukraine is increasingly sourcing its gas from Europe, albeit in small volumes. The Ukrainian Energy Minister, Eduard Stavytsky, has stated, "I think that (imports from Europe) will be 2.0-2.5 billion cubic metres this year, and in 2014 no less than 5 billion cubic metres, judging from the plans and bids that I have already seen... Technically, we can facilitate (imports of) 6.5 billion cubic metres [per year]". According to Stavytsky, gas imports from RWE (Germany) between September 2012 and September 2013 are expected to cost an average of $385 per 1000 cubic metres, compared to prices of over $400 for supplies from Gazprom.

Furthermore, Stavytsky plans to sign an agreement in September with the Slovak government to facilitate the import of European gas via Slovakia. While Ukraine's current import capacity via Hungary and Poland is limited, the opening of imports via Slovakia could add 20 bcm to Ukraine's European gas import capacity – three times Ukraine's current European gas import capacity.

The imports from Europe should not be seen as a direct replacement for supplies from Russia, but a diversification of Ukraine's gas imports that is seen in Kiev as being crucial for Ukraine's bargaining position in its energy relations with Russia. Stavytsky explains the situation as follows: "We cannot stop imports from Russia altogether today, even if we wanted to... (But) I think our partners do not fully understand our commitment to, and our actions aimed at, the diversification (of gas imports)".

South Stream

Russian Stroytransgas to build the overland sections of South Stream in the Balkans

Russian sources report that the Russian construction company, Stroytransgas, is ready to sign contracts for the construction of South Stream's overland sections in the Balkans, having already registered offices in Bulgaria, Serbia, and Slovenia. The contracts are reported to be worth 6.6bn Euros. Unlike the other partners, Bulgaria will not contribute to the construction of South Stream on its territory, but will give up its transit fees for the first 15 years of the operation of the pipeline.

Asia

No new developments in Gazprom-CNPC negotiations, but Putin's meeting with the Chinese President, Xi Jinping, at the G20 Summit could add fresh impetus

Since the most recent round of talks between Gazprom and the China National Petroleum Corporation (CNPC) in June (reported in Gazprom Monitor № 25 – June 2013), there have been no visible signs of progress in the long-running negotiations over the export of Russian gas to China. As it stands, Gazprom and CNPC have agreed that Gazprom will supply 30 bcm per year at prices not linked to the US Henry Hub. Deliveries are slated to begin in

2018 via the planned 'Power of Siberia' gas pipeline (also referred to as the 'Eastern Route' to distinguish it from the proposed alternative 'Western Route' via Russia's Altai region). With Russian President, Vladimir Putin, set to meet his Chinese counterpart, Xi Jinping, at the G20 Summit in St Petersburg on the 5th-6th of September, Russian sources are speculating that such a high-level meeting could help push the Gazprom-CNPC negotiations towards their self-imposed schedule of concluding a deal before the end of 2013.

And in other developments…

Gazprom wins auction for Moscow power generation utility, MOEK

In a move that could help Gazprom stem the decline in its share of Russia's domestic gas market, which fell from 80 percent in 2008 to 73 percent in 2012, the Gazprom subsidiary, Gazprom Energoholding, has won an auction for an 89.97 percent stake in Moscow's MOEK power generation utility. The stake was sold by the Moscow Government Property Department. Gazprom Energoholding's winning bid was 98.6bn Roubles ($3bn), with some analysts questioning the value of the purchase, given MOEK's low profitability – the company made losses in 2011 and 2012. MOEK provides heating and hot water to Moscow and the surrounding towns. MOEK is also reported to be the largest purchaser of thermal power from Mosenergo, another Gazprom subsidiary.

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