



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:

- *Gazprom and the EU – EU antitrust investigators continue to prepare ‘statement of objections’; Gazprom excluded from expanded EU sanctions list*
 - *Nord Stream – Planned capacity auction for OPAL cancelled, as European Commission postpones ruling indefinitely*
 - *South Stream - Gazprom subsidiary Centrgaz is awarded the construction contract for South Stream in Serbia; Bulgarian government willing to listen to the European Commission over South Stream; European Commission recommends that Serbia halt work on South Stream pending legal clarifications*
 - *Gazprom and Ukraine - Naftogaz and Ukrainian government announce plan to avoid Russian gas imports until March 2015; Ukrainian government and Naftogaz disagree over reports of reduced gas deliveries from Europe to Ukraine; Gazprom and Naftogaz arbitration cases could be combined*
 - *Asia-Pacific region - Gazprom continues design process for proposed Vladivostok LNG terminal*
 - *Elena Burmistrova replaces Alexander Medvedev as Director-General of Gazprom Export*
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Gazprom in the EU

EU antitrust investigators continue to prepare 'statement of objections'

The European Commission antitrust investigators are continuing to formulate their 'statement of objections'. In March, the EU Competition Commissioner, Joaquin Almunia, issued a statement, in which he noted, "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". At the same time, a spokesperson for the European Commission, Antoine Colombani, told reporters that work on the case would go on, regardless of the current political climate. "We are continuing to work on the preparation of the draft statement of objections, which has not been finalized at this point".

The combination of Almunia's comments and Colombani's admission that the draft statement of objections has not yet been finalised suggested 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. It has been speculated that both Almunia and the EU Energy Commissioner, Gunther Oettinger, would prefer to see the statement of objections issued before they leave office on the 31st of October. However, unless a major breakthrough takes place, the current tensions in the EU-Russia relationship are unlikely to ease before then.

Gazprom excluded from expanded EU sanctions list

On the 31st of July, the European Commission announced its extended list of individuals (95) and

companies (23) that will be subject to asset-freezes and travel bans, in relation to ongoing events in Ukraine. Gazprom and its management are absent from the list.

Two measures could affect Russia's gas industry. The first is a restriction of Russia's access to capital markets. European investors are barred from purchasing securities from Russian state-owned banks and from trading them on the European stock market. This move could result in higher borrowing costs inside Russia, and make it harder for energy companies to find external financing.

The second measure that could affect the Russian gas industry is a ban on the export of advanced technology for use in Arctic or offshore exploration and production. However, the European Council President, Herman Van Rompuy, issued a statement on the 25th of July, noting, "The measures in the field of sensitive technologies will only affect the oil sector in view of the need to preserve EU energy security". Whether the initial sanctions could be later expanded to include European companies that are currently participating in Russian gas projects (such as the Italian pipe-laying company, Saipem, which is contracted to build the offshore section of South Stream) remains to be seen.

Nord Stream

Planned capacity auction for OPAL cancelled, as European Commission postpones ruling indefinitely

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, where it connects with the Transgas pipeline, which brings Russian gas to Germany via Ukraine, Slovakia, and the Czech Republic. At its mid-point, OPAL also connects

with the Yamal-Europe pipeline, which brings Russian gas to Germany via Belarus and Poland.

Since its launch in 2011, OPAL has been subject to negotiations over third party access. Gazprom wants to use the full capacity of OPAL, as part of Nord Stream. However, the European Commission is keen to enforce third party access provisions, and force Gazprom to allow other energy companies to make use of part of OPAL's capacity.

In February, the German energy regulator, BundesNetzAgentur (BNetzA), proposed a compromise solution: "Under the updated agreement, OPAL Gastransport can still keep 50% of the capacity for its own use, but there is no gas release program. Instead it has to offer the other 50% to the market using the PRISMA platform, and regular third-party access rules apply," said BNetzA press officer, Armasari Soetarto. The first auction was proposed for July 2014.

On the 10th of March 2014, in the context of the tensions in EU-Russia political relations and the ongoing EU antimonopoly investigation of Gazprom, the European Commission announced that it would delay its decision on granting OPAL an exemption from third party access provisions, citing the need for technical clarifications.

Then, on the 15th of July 2014, the proposed OPAL capacity auction was cancelled, and the European Commission announced its agreement with BNetzA to indefinitely prolong the deadline for a decision on OPAL. 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.

South Stream

Gazprom subsidiary Centrgaz is awarded the construction contract for South Stream in Serbia

On the 8th of July 2014, the 99.99 percent Gazprom-owned subsidiary, Centrgaz, was awarded the contract for the construction of the Serbian section of South Stream. The move comes a month after another Russian company, Stroytransgaz, was awarded the construction contract for the Bulgarian section of South Stream. The European Commission has since called on Bulgaria to halt work on South Stream, due to concerns that the construction contract was awarded without a competitive tender process. The announcement that a Gazprom subsidiary was awarded the construction contract for the Serbian section is likely to be met with a similar level of concern in Brussels.

European Commission recommends that Serbia halt work on South Stream pending legal clarifications

On the 21st of July, Serbian sources reported that the European Commission had recommended that Serbia halt work on South Stream until the legal status of the pipeline had been clarified; "Not a single intergovernmental agreement on South Stream, signed by Russia, complies with EU law. Our position is uniform both for EU member states and for third countries, such as Serbia. It is in the best long-term interest of Serbia, as a candidate EU member, to comply with EU law with regard the South Stream pipeline".

Bulgarian government willing to listen to the European Commission over South Stream

Following the visit of Russian Foreign Minister Sergei Lavrov to Bulgaria at the beginning of the month, the Bulgarian Prime Minister, Plamen Oresharski, released a

statement, suggesting that the Bulgarian government could revise its handling of South Stream: "We will try to persuade the Commission that we acted in the right way - we have enough arguments for that. But if we fail, we will make corrections to those actions of which the Commission does not approve, because this might subsequently lead, if we do not reach an agreement on the issue, to an infringement procedure".

Gazprom and Ukraine

Naftogaz and Ukrainian government announce plan to avoid Russian gas imports until March 2015

Since the 16th of June, Naftogaz has neither paid for, nor received, any gas supplies from Gazprom. In July, the Ukrainian government announced a plan to limit Ukrainian gas consumption during the 2014-15 winter heating season. Strict consumption limits will be introduced for industries and public utilities. The government intends to limit total gas consumption between August 2014 and March 2015 to 30 bcm.

With 23 bcm of supplies reportedly available through a combination of domestic production and gas storage, the deficit will stand at 7 bcm. The government then announced that Ukraine has the reverse-flow pipeline capacity to import up to 10.5 bcm from Europe, thus rendering Russian gas supplies unnecessary.

Reverse-flow supplies to Ukraine are currently available via Poland (4 mcm per day, or 1.5 bcm per year) and Hungary (15 mcm per day, or 5.5 bcm per year). Ukraine also hopes to start receiving up to 27 mcm per day (reported elsewhere as 8-10 bcm per year) via Slovakia from September. The flows via Slovakia will be delivered through the Vojany-Uzhgorod connection. The connection, which has not been used for 15 years, will require up to €20m (\$27m) of investment by Slovak

pipeline operator Eustream before it can become operational.

According to the Chairman of Eustream, Tomas Marecek, the full capacity of the Vojany-Uzhgorod connection has now been booked for the next five years, with Naftogaz having booked the majority. The remainder was booked by European energy companies.

Naftogaz also sought to reverse-flow one of the four large-diameter transit pipes that deliver Russian gas across the border from Ukraine to Slovakia. However, Gazprom has already booked the available capacity of those pipelines for deliveries of gas from East to West, and is in no mood to offer assistance to Naftogaz's plans for import diversification.

Ukrainian government and Naftogaz disagree over reports of reduced gas deliveries from Europe to Ukraine

In late July, sources reported mixed messages coming from Ukraine over the level of reverse-flow gas supplies from Europe. The Ukrainian Energy Minister, Yurii Prodan, reported that daily flows had been reduced from 16 mcm per day to just 7 mcm: "Reverse gas supplies are reduced at present. This is linked to certain actions by Gazprom," Prodan told reporters. "You heard the threats Gazprom made to European energy companies that this reverse is illegal".

However, the CEO of Naftogaz, Andriy Kobolev, did not blame Gazprom and instead suggested that flows from Poland remained stable and that flows from Hungary were reduced because Hungarian energy companies were refilling their own gas storage facilities: "We hope the lowering of reverse flows is temporary... This is unpleasant but not critical".

According to a report by ICIS on the 24th of July, "Volumes shipped from Hungary to Ukraine have dropped from an average rate of 8 million cubic metres (mcm)/day between 16-30 [of] June to 3mcm/day so far in July. In the same period, Hungarian daily storage injections have ramped up by 9mcm/day to 13mcm/day. Deliveries to Ukraine from Poland have remained practically unchanged throughout June and July at an average rate of 3.6mcm/day".

Gazprom representatives refused to comment on the reports, but reiterated their view that such reverse-flow supplies were 'semi-fraudulent'.

Gazprom and Naftogaz arbitration cases could be combined

Gazprom is currently pursuing an arbitration cases against Naftogaz, in a bid to recover debts of \$4.45bn. Naftogaz has its own arbitration case against Gazprom, in which it claims that it overpaid by \$6bn for gas supplies since 2010. It is unlikely that Naftogaz will settle its debts with Gazprom until a ruling has been made on its own arbitration case.

On the 29th of July, Naftogaz CEO Andriy Kobelev, announced that the two cases had been combined into one, and that arbiters were currently being assigned. An interim ruling could be made during winter 2014-15.

Gazprom in Asia

Gazprom continues design process for proposed Vladivostok LNG terminal

According to Gazprom sources, the design documentation for the proposed LNG terminal in Vladivostok is currently being prepared and should be completed in Q3 2014. Gazprom plans for the terminal to consist of two or three LNG trains, with a total export

capacity of 10-15 million tonnes of LNG (19.2 bcm of natural gas) per year. The first train could have a capacity of 5m tonnes of LNG (6.4 bcm of natural gas) and is planned for commissioning in 2018. No timescale has yet been announced for the second train, and a decision has not yet been taken on whether to construct a third train.

The gas supply for the first two trains of the Vladivostok terminal will be produced as part of Gazprom's Sakhalin II and Sakhalin III projects. If Gazprom decides to construct a third LNG train, gas supplies will be sourced from the Yakutia and Irkutsk gas production centres in Eastern Siberia. The participation of the Japanese Agency for Natural Resources and Energy and the Japan Far East Gas Company in the project is a clear indication that Japan will be the main target market for Vladivostok LNG.

And in other developments...

Elena Burmistrova replaces Alexander Medvedev as Head of Gazprom Export

In a surprise move, Gazprom has replaced Alexander Medvedev with Elena Burmistrova as the Director-General of Gazprom Export. According to Gazprom Export, "This decision was made due to a considerable increase in the day-to-day business and its geographical expansion, as well as product diversification within the Company's international activities and, particularly, in Gazprom Export".

The Financial Times noted, "Medvedev has a reputation as a hardline conservative and he is a tough and sometimes bombastic negotiator". Despite his successes on the European market over the past decade and the conclusion of the long-term contract with CNPC in May, Medvedev faced criticism for failing to adapt to change



in management. A new face means new hope”.

Burmistrova started her career at Glencore International (Switzerland) in 1992. After working for various international companies, she joined Gazprom Export in 2003. In 2007, she completed the American Business and Practices program at Boston Northeastern

University (USA). In 2009, she received her MBA degree from the Lomonosov Moscow State University. From 2011 to 2014, Burmistrova was the Deputy Director General for Petroleum Products, LNG and New Gas Markets of Gazprom Export. Medvedev had been Director-General of Gazprom Export for 12 years.

Disclaimer

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