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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:

- *Reports claim that Gazprom plans lower European gas export prices for 2013 in a bid to compete with spot price contracts, while Russian officials continue to press for exemptions from the Third Energy Package for Nord Stream and South Stream*
- *Sources report that Gazprom could lower its gas export price for Ukraine for 2013 from the predicted $421 per thousand cubic metres to $352, as Ukrainian President, Viktor Yanukovich, announces a last-minute postponement of his meeting with Russian President, Vladimir Putin, in Moscow to discuss Russian-Ukrainian energy relations*
- *Gazprom holds a ceremony to mark the start of the construction of South Stream, but the EU remains sceptical about the implementation of the project due to the lack of necessary assessments and permits*
- *The Estonian government refuses permission for Nord Stream AG to conduct research in Estonia's territorial waters, as part of plans for Nord Stream's proposed expansion*
- *Gazprom's second-largest European customer, Turkey, proposes increasing its Russian gas imports by 3 bcm 'in the near future'*
- *Gazprom restarts high-level talks with the Chinese National Petroleum Corporation (CNPC) over Russian gas deliveries to China, with the two sides united by a focus on the Altai pipeline, but divided over gas prices*
- *Two months after missing out to Rosneft on a lucrative deal to supply gas to Russian electricity utility, Inter RAO, Novatek signs a $4bn deal to supply 27 bcm to Moscow-based electricity generator, Mosenergo, as Gazprom loses more of the domestic Russian gas market*

Gazprom and the EU

Reports claim that Gazprom plans lower prices for its exports to Europe in 2013, in a bid to compete with European spot market prices and maintain export volume; Russian officials press for exemptions from the Third Energy Package for Nord Stream and South Stream on the eve of the EU-Russia Summit

Russian sources report that Gazprom is preparing to reduce the price of its long-term contract based gas exports to Europe, in a bid to compete with European spot market prices and increase export volumes. In 2011, the average price of Russian gas exported to Europe was $390 per thousand cubic metres. The 2012 price is expected to average out at $405-415. The price for 2013 could fall to $370. In spot market terms, the 2012 price equates to around 30 Euros per Megawatt Hour (MWh), while the 2013 price would equate to 26 Euros per MWh, slightly below current German spot prices of 27 Euros per MWh. A Gazprom source has predicted that such a price reduction could help Gazprom (as Russia's monopoly gas exporter) increase its European exports from 140 bcm in 2012 to 152 bcm in 2013. Such volumes, although far below Gazprom's peak European exports of 168.5 bcm in 2007, would represent the continuation of a recovery in export volumes from a low of 138.6 bcm in 2010. A spike in Gazprom's European exports of 150 bcm was largely due to disruptions in gas supplies from Algeria and Libya, which explains the year-on-year fall in 2012.

It is likely that Gazprom's pricing strategy is driven by desire to recapture European import demand, and the need to remain competitive with other suppliers: Earlier this month the Norwegian gas exporter, Statoil, announced that the majority of its future gas exports would take place using spot market pricing models. Thus far, although Gazprom has been willing to grant pricing discounts in order to keep its long-term contract supplies competitive with spot market supplies, the Russian company has been reluctant to include a greater 'spot pricing' component in its own contracts.

With the second EU-Russia Summit of 2012 taking place on the 21st of December, Russian officials have again called for Russia's two major gas pipeline projects, Nord Stream and South Stream, to be granted exemptions from the EU's Third Energy Package legislation, and in particular the provision of Third Party Access (TPA). According to the TPA provision, 50 percent of the capacity of a gas transmission pipeline on EU territory must be reserved and made available to 'third party' energy companies (i.e. those that do not own the pipeline). The provision aims to increase competitiveness between energy companies in the transmission and sale of gas, while also preventing monopoly behaviour by energy companies that own pipeline infrastructure. Gazprom representatives and Russian officials have criticised the legislation, claiming that it discourages investment in new pipeline infrastructure.

Although the provisions of the Third Energy Package do not apply to the Russian and offshore sections of Nord Stream, they do currently apply to the two pipelines (OPAL and NEL) that connect Nord Stream with the German gas pipeline network on German territory. Given that the South Stream pipeline will be laid across several EU Member States (Bulgaria, Hungary, and Slovenia), the resolution of the issue also has great importance for that project.

In a bid to have Nord Stream and South Stream exempted from the terms of the TPA provision of the Third Energy Package, Gazprom and Russia's Energy Ministry have proposed the signing of an intergovernmental agreement on cross-border infrastructure projects. Russia's Energy Minister, Aleksandr Novak, announced on the 14th of December that "We have prepared a draft of a new modified agreement and expect to pass it on in Brussels on Dec. 21. We've left projects in it like Nord Stream with the OPAL and NEL branches, as well as South Stream". Marlene Holzner, a spokesperson for EU Energy Commissioner, Gunther Oettinger, replied on the 17th of December that, "We welcome that Russia takes the initiative to discuss Nord Stream and South Stream, because Member States have asked the Commission to coordinate the EU position towards the project, for example the inter-governmental agreements and the environmental impact assessments".

Ukraine

Sources suggest that Gazprom could lower its gas export price for Ukraine for 2013 from the predicted $421 per thousand cubic metres to $352, as the Ukrainian President announces a last-minute postponement of his meeting with Russian President, Vladimir Putin, in Moscow to discuss Russian-Ukrainian energy relations

Russian and Ukrainian sources have reported that Gazprom could grant the Ukrainian wholesale gas importer, Naftogaz, lower prices for 2013, by lowering its export price to $352 per thousand cubic metres. During 2012 Naftogaz paid $416 in the first quarter, $425 in the second quarter, $426 in the third quarter, and the fourth quarter price is expected to be $417. The Ukrainian state budget had previously forecast a price of $421 for 2013. The discount appears to be based on Naftogaz's willingness to purchase 40 bcm (the minimum offtake volume permitted under Naftogaz's current take-or-pay gas supply contract with Gazprom) of Russian gas in 2013, although

Ukrainian officials have repeatedly stated the intention for Ukraine to reduce its Russian gas imports to just 18-20 bcm in 2013, as reported in previous editions of the Gazprom Monitor.

Such reports have been contextualised by the last-minute postponement of the planned visit by Ukrainian President, Viktor Yanukovich, to Moscow on the 18th of December to discuss Russian-Ukrainian energy relations with his Russian counterpart, Vladimir Putin. In particular, the meeting planned to address the possibility of a trilateral consortium of Ukrainian, Russian, and European energy companies to manage Ukraine's gas transit system, while Ukrainian sources have reported that the country may be willing to join the Russian-led Customs Union in exchange for a gas price discount. According to Kremlin foreign policy aide, Yurii Ushakov, the meeting was postponed due to the need "to conduct additional expert work to complete all the documents which we had initially planned to sign".

Naftogaz currently imports gas from Gazprom according to a ten-year long-term contract signed in January 2009. Prices are updated ever quarter on the basis of average international oil prices for the preceding nine months, with a 30 percent price discount up to the value of $100 per thousand cubic metres agreed in April 2010, in exchange the extension of Russia's lease of Ukraine's Sevastopol naval base. However, Ukraine's continued desire for reduced Russian gas imports and price discounts, coupled with the cancellation of Yanukovich's trip to Moscow, suggests that unless a long-term agreement is reached, Russian-Ukrainian gas relations could remain tense throughout the winter.

South Stream

The ceremonial first welding of South Stream takes place in Anapa, southern Russia, while EU representatives claim that Gazprom has yet to clarify the precise pipeline route, carry out technical and environmental assessments, and acquire the necessary permits

On the 7th of December the symbolic first welding of the South Stream pipeline took place in Anapa, southern Russia, in the presence of President Putin, Gazprom CEO, Alexei Miller, Executive Director of the South Stream consortium, Marcel Kramer, and representatives of the major consortium partners: ENI, EdF, and BASF/Wintershall. Also present were diplomatic representatives from the states involved in the South Stream project: Austria, Bulgaria, Croatia, France, Greece, Hungary, Macedonia, Serbia, Slovenia and Turkey. A notable absentee was EU Energy Commissioner, Gunther Oettinger, citing other commitments.

A week later, at a meeting with the Executive Director of Bulgargaz, Dimitar Gogov, Gazprom CEO, Alexei Miller, announced that construction of the Bulgarian section of South Stream would begin in 2013.

Russian sources have reported that the 16bn Euro pipeline project will consist of four 15.75 bcm capacity pipelines, with deliveries scheduled to commence in 2016 and full capacity to be reached in 2018. However, EU representatives have cast doubt on the implementation of the project, due to a lack of clarification over the final route and environmental impact assessments. Just 24 hours before the ceremonial groundbreaking in Anapa, Marlene Holzner, a spokesperson for EU Energy Commissioner, Gunther Oettinger, told the press that "To the European Commission, it has never been communicated that there is a final route. That means where South Stream starts, where it ends, and which countries the exact route goes through. That has not been done... There is no environmental impact assessment for the whole route. As far as we can see it, we don't regard this as a final investment decision". EU representatives have also claimed that not all of the relevant intergovernmental agreements between Russia and its European South Stream partners have been submitted to Brussels for inspection. The deadline for doing so is the 16th of February 2013, after which the European Commission will have nine months to evaluate the agreements and to raise any concerns. This means that final approval from Brussels could still be a year away. Therefore, the Anapa should be regarded as a ceremonial affair designed to prove that Gazprom has met the widely-publicised December 2011 directive from President Putin to Gazrom CEO, Alexei Miller, that the construction of South Stream should begin 'before the end of 2012'.

Nord Stream

The Estonian government refuses permission for Nord Stream AG to conduct research in Estonian territorial waters, citing environmental and security concerns, as the consortium explores possibilities for expanding the Nord Stream pipeline

At the beginning of December the Estonian government refused permission for Nord Stream AG to conduct exploratory research in Estonian territorial waters, citing environmental and security concerns. In August Nord Stream AG requested permission to explore a four-kilometre stretch of seabed in Estonia's maritime economic zone, as part of the consortium's plans to add third and fourth branches to the Nord Stream pipeline. A similar request from Nord Stream AG was declined by the Estonian government in 2007, which called on other regional governments to follow their lead. The Estonian government's call went unheeded, and two lines of the Nord Stream pipeline have since been built. In response Nord Stream AG released an official statement: "Nord Stream AG will now concentrate on developing further the Finnish route alternative in the Gulf of Finland".

Turkey

Turkey proposes increasing its Russian gas imports by 3 bcm 'in the near future'

Following a meeting between President Putin and Turkish PM, Recep Tayyip Erdogan, Russia's Energy Minister, Aleksandr Novak, announced that Turkey wishes to import an extra 3 bcm per year of Russian gas. Gazprom currently supplies 26-27 bcm per year of gas to state-owned Botas and a small number of private Turkish energy companies. This makes Turkey the second-largest importer of Russian gas outside the Former Soviet Union.

Novak did not provide any specific details about logistics of the proposed deliveries, stating "It's all just on the drawing board at the moment", but he did confirm that the gas deliveries were intended "for the near future". The additional purchases are likely to be made by Botas, while the delivery could be made either by the Blue Stream pipeline, or by the 'Western Route' via Ukraine, Moldova, Romania, and Bulgaria.

China

Gazprom restarts high-level talks with the Chinese National Petroleum Corporation (CNPC) over Russian gas deliveries to China, with the two sides united by a focus on the Altai pipeline, but divided over gas prices

At the beginning of December Gazprom hosted a working meeting being CEO, Alexei Miller, and President of the China National Petroleum Corporation (CNPC), Zhou Jiping. According to official Gazprom sources, both sides have confirmed their interest in the 'Altai Project' – A plan to build a gas pipeline from Russia's West Siberian gas fields to the Russian-Chinese border, through Russia's Altai region. However, construction of the pipeline will begin only after a gas supply contract is agreed between the two parties.

The deal could see Gazprom supplying CNPC with up to 68 bcm per year for the next 30 years, but while the volume and contract length have been agreed in principle, the two sides remain far from agreed on the price at which Gazprom will sell gas to the CNPC. Russian sources suggest that CNPC is willing to pay $250 per thousand cubic metres, approximately the same as it currently pays for gas imports from Central Asia, while Gazprom is holding out for a price similar to that paid by its European customers, of around $400.

In the 18 months since the last round of Russian-Chinese gas talks collapsed, Gazprom has stepped up the development of its 'Eastern Gas Programme', according to which Gazprom proposes the development of its East Siberian gas fields (primarily the Chayandinskoye gas field in the Yakutia region), the shipment of that gas via a new pipeline to Vladivostok, and the export of that gas in the form of LNG to the Asia-Pacific region from a new LNG terminal. Official Gazprom sources claim that production at Chayandinskoye could begin as early as 2017. The development of the Eastern Gas Programme accounts for Gazprom's reluctance to build a pipeline from Eastern Russia to Eastern China, using East Siberian gas fields as the supply base: The Eastern Gas Programme provides Gazprom with far greater flexibility of exports for its East Siberian gas, whilst the Altai Project would provide Chinese competition for West Siberian gas, which is currently exported to Europe, potentially enabling Gazprom to 'balance off' the European and Chinese markets for the first time.

And in other developments…

Two months after missing out to Rosneft on a lucrative deal to supply gas to Russian electricity utility, Inter RAO, Novatek signs a $4bn deal to supply 27 bcm to Moscow-based electricity generator, Mosenergo, as Gazprom loses more of the domestic Russian gas market

Russia's largest independent gas producer (and second-largest gas producer behind Gazprom), Novatek, has signed a $4bn (121 billion Roubles) deal to supply 27 bcm per year to Moscow-based electricity generator, Mosenergo from 2013 to 2015. Mosenergo provides 60 percent of the Moscow region's electricity needs. Following the announcement of the deal, Novatek shares rose 3 percent.

The deal comes two months after the independent Russian gas producer, which is 10 percent owned by Gazprom, missed out to state-owned oil company, Rosneft, on a lucrative long-term deal to supply national electricity generator, Inter RAO, and one month after Novatek's acquisition of a 49 percent stake in gas producer Northgas, whose remaining 51 percent shareholder is also Gazprom. The expansion of Rosneft and Novatek represents a contraction of Gazprom's share in the domestic Russian market.

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