



Key Developments in the External Relations of the Russian Gas Industry¹

Summary:

- *According to export plans for 2011 revealed by Aleksei Miller, Gazprom will export more gas than in 2010, but still less than during the pre-crisis period*
- *Gazprom plans to enter the Spanish and Portuguese gas markets, having organised deliveries from Africa*
- *During his recent visit to Brussels, Russian President, Dmitry Medvedev, signed a memorandum allowing Gazprom to pump 300 million cubic metres of natural gas per year into Belgian gas storage*
- *In line with its policy of diversification of energy sources, Croatia has become the first country to decline imports of Russian gas, having engaged ENI as its main supplier*
- *Gazprom, has responded to the Lithuanian Government's gas market reforms by denying Lithuania discounts similar to those granted to neighbours Estonia and Latvia*
- *Gazprom has transferred \$1.5 billion to Naftogaz Ukraine as an advance payment on fees for gas transit to Europe. Gazprom has paid for the transit of 112 bcm² of gas per annum, which is greater than current export volumes of 94 bcm per annum*
- *The Altai gas pipeline project, which was largely inactive during 2008-09, has been resurrected. However, a final decision on the construction of the pipeline to China will be possible only after an agreement on gas prices has been reached with Beijing*
- *India, Afghanistan, Pakistan and Turkmenistan have reached an agreement on the Trans-Afghan Pipeline (TAPI), which will supply 33 bcm per annum from 2015. Moscow may gain from the construction of TAPI, as the project will cast doubt over the implementation of the Trans-Caspian gas pipeline*
- *Wikileaks: In the event of disagreements with the Kazakh authorities, ENI SpA and BG Group risk losing their Kazakh deposits to Gazprom and the Chinese National Petroleum Corporation (CNPC)*

¹ The EGF Gazprom Monitor was originally written in Russian and translated into English by Jack Sharples, PhD candidate at the University of Glasgow, Scotland, and EGF Researcher on Russian external energy policy

² Billion cubic meters

Gazprom's Export Plans - Europe

According to export plans for 2011 revealed by Aleksei Miller, Gazprom will export more gas than in 2010, but still less than during the pre-crisis period.

Despite the fact that demand for gas in Europe has recovered strongly since the global financial crisis, Gazprom's export plans for 2011 remain modest. The company plans to export 140-145 bcm of gas. In 2008 export volumes reached 159 bcm.

The loss of market share during the crisis was primarily due to the difference between spot market and long-term contract gas prices. In winter 2010 this difference reached more than \$100 per thousand cubic metres of gas – Russian gas cost around \$290 per thousand cubic metres at a time when the spot market price for gas was around \$170 per thousand cubic metres.³ The increase in exports of liquefied natural gas (LNG) from Qatar, coupled with the gradual introduction into operation of European LNG terminals led to surplus of supply relative demand and a subsequent decrease in European gas prices. The situation changes depending on weather conditions – during sustained periods of cold weather spot prices may rise and surpass long-term contract prices. However, predictions regarding further fluctuations of prices cannot be made with any certainty.

Long-term forecasts regarding gas production were lowered in the course of a recent meeting of Gazprom's Board of Directors. Gazprom plans to produce 570-580 bcm per annum until 2015. Taking into consideration the growth of gas prices, analysts believe that discrepancy between supply and demand will disappear by 2015, and the forecast for growth (in production) may be increased. Nonetheless, a number of factors remain which may substantially influence Gazprom's export volumes, including the situation in the shale gas producing regions, and the prospects for gas exports to China of around 30 bcm.

³ It should be noted, however, that price fluctuations are continuing throughout the winter and at times the price of gas on the spot market was more expensive than that offered by Gazprom.

Gazprom - Europe - New Markets

Gazprom plans to enter the Portuguese and Spanish markets, having arranged deliveries of gas from Africa.

Boris Ivanov, Managing Director of Gazprom EP International has announced that the company plans to buy a number of gas-producing assets in Africa.

Nigeria is the primary contender for Gazprom investment. Gazprom is also actively working in Libya via a joint enterprise with Wintershall AG and Algeria, where it is taking part in the development of the El-Assel block. Such actions are part of Gazprom's strategy of entering those European markets where it is not currently present – for example, those of Spain and Portugal. Analysts remain sceptical, however, as to the degree that such a strategy can realistically be put into place.

Gazprom – Belgium

During Dmitry Medvedev's recent visit to Brussels, a memorandum was signed allowing Gazprom to pump 300 million cubic metres of natural gas per year into Belgian gas storage.

The memorandum of mutual understanding regarding the underground storage of gas, which was signed by Gazprom Export and Belgium's Fluxys, enables the Russian gas monopoly to use the gas storage facility at Leonhout to facilitate actively gas deliveries to the countries of North West Europe.

In 2005 Gazprom tried to build underground gas storage facilities in Belgium, but the project was deemed unprofitable – the maximum volume of potential stored gas was barely 120 mcm per annum. Gazprom needs access to gas storage in Belgium in order to conclude spot contracts in North West Europe. Fluxys has an extensive network of gas pipelines, providing for gas deliveries to neighbouring countries. Fluxys is currently working to upgrade working volume of gas storage capacity at Leonhout to 700mcm by 2011 and is also in talks with Norwegian Statoil over the use of the new capacity. The increased gas storage capacity and the

partnerships with the new users of this facility will help Belgium itself to diversify its sources of supply.

Gazprom – Croatia

In line with its policy of diversification of energy sources, Croatia has become the first country to decline imports of Russian gas, having engaged ENI as its main supplier.

From the 1st of January 2011 the Croatian enterprise, *Prirodni plin*, which manages the import of gas into the country, will forego supplies of gas from Gazprom. In the words of a representative of the company, this will enable Croatia to reach “greater flexibility in the quantity and price parameters of gas”. Italy’s ENI will be Croatia’s sole external supplier, while around 60 percent of the country’s internal demand is met by Croatian domestic gas production.

There are several reasons for Croatia’s preference for supplies from ENI over those from Gazprom. Firstly, an LNG terminal has recently opened close to Naples, enabling ENI to develop gas export volumes and build a more active export policy. Secondly, Croatia’s plan for the construction of its own LNG terminal will ensure security of energy supplies by diversifying their sources.

Croatia is unlikely to resume its purchases of Russian gas in the near future, while Gazprom’s concessions to ENI on this question appear to be a favour to the Italian company in return for its participation in the South Stream project. If this is the case, then recent discounts to ENI and the lowering of the level of minimal take-off for the company may also be regarded as concessions from Gazprom Export.

Gazprom - The Baltic

Gazprom has responded to the Lithuanian Government’s gas market reforms by denying Lithuania discounts similar to those granted to neighbours Estonia and Latvia.

As part of its gas market reforms in line with the Third Energy Package of the European Union, the Lithuanian Government passed a new law in May 2010 ‘On Natural Gas’, according to which *Lietuvos Dujos* (37.1 percent of which belongs to Gazprom, 38.9 percent to

E.ON Ruhrgas, and 17.1 percent to Lithuania) must give up its control over central gas transmission pipelines. The decision drew sharp criticism from representatives of Gazprom and the Russian Government – during his visit to Germany Prime Minister V. Putin called the action of the Lithuanian side “robbery”.

Gazprom’s allocation of 15% price discounts to Latvia and Estonia were made possible thanks to the commitment of those countries to buy gas at 2007 levels. The overall volume of deliveries to the Baltic countries is 4.9 bcm per annum. Of this volume, Lithuania is the largest consumer, buying 2.7 bcm, whilst Latvia and Estonia account for 1.5 bcm and 700 mcm respectively.

The declaration regarding discounts to Latvia was made after a meeting between Aleksei Miller and the Latvian Minister of Economy, Artis Kampars, during which the process of liberalisation of the EU gas market was discussed. Assurances that the implementation of the provisions of the Third Energy Package will take into account the interests of both exporters and consumers of natural gas proved to be sufficient to reach mutually beneficial decisions on the export of gas in 2011.

At the same time discounts will not be extended to Belarus. The contract with Gazprom elapses at the end of 2011. Moreover, the launch of Nord Stream is planned for 2011-2012, which means that Belarus will not be able to rely on payment for transit as a bargaining chip in its negotiations over the price of imported gas, which in turn will render the bargaining position of Gazprom more durable and uncompromising.

Gazprom uses its position as a monopoly supplier skilfully. Therefore only countries which have alternative channels of supply are able to secure lower prices. The actions of Croatia in refusing supplies of Russian gas, having concluded an agreement with the Italy’s ENI (as mentioned above) are testament to this.

Gazprom - Ukraine - Gas Transit

Gazprom has transferred \$1.5 billion to Naftogaz Ukraine as an advance payment on fees for gas

transit to Europe. Gazprom has paid for the transit of 112 bcm of gas per annum, which is greater than current export volumes of 94 bcm per annum.

After the settlement of the gas debt dispute between Gazprom, the gas trader RosUkrEnergo and Naftogaz Ukraine, the latter stated that it has no need for additional credit. Nevertheless on the 1st of December 2010 Gazprom paid Naftogaz \$1.5 billion as an advance on fees for transit for a volume of 112 bcm, which is higher than current transit volumes.

Gazprom is winning in this case, receiving a favourable rate for transit. Taking into account the advance payment, the cost of transit for 100 cubic metres over 100km is \$1.34, against the current price of \$2.78.

The overall volume of Russian gas supplied to Europe in 2008 was 159 bcm. Of this almost 120 bcm was delivered via Ukraine, with the rest being delivered via Belarus. After the launch of Nord Stream export deliveries will be partially redirected through the new pipeline, and in view of the advance payment for increased transit via Ukraine, Belarus seems to be the most likely candidate for a reduction in transit through its territory.

Gazprom - Ukraine – JV

According to the results of talks between Gazprom and Naftogaz Ukraine, two small joint enterprises will be created instead of one larger entity.

The plans voiced in spring 2010 for the creation of a Ukrainian-Russian joint venture (JV) for the production of gas have led to the creation of two joint companies. The decision to do so was announced on the 1st of December 2010, and was the result of a meeting between Aleksei Miller and the Minister for Fuel and Energy of Ukraine, Yuri Boyko. According to Gazprom sources, the companies will be concerned with the production of gas from coal seams on the territory of Ukraine and with the development of the gas exploration projects on the Black Sea shelf.

Gazprom considers the creation of two Joint Ventures to be the first step on the road to the creation of a company which will include the assets of the Ukrainian gas transportation system. Both companies are regarded by analysts as fully viable, and their

creation is considered to be in the interests of both sides: Gazprom will develop experience in the production of gas from non-traditional sources, while Naftogaz will be granted access to further gas deposits. Further consolidation or even unification of the companies is envisaged in the foreseeable future. Such plans reflect a long term outlook, however, and strong doubt exists as to whether they will be realised at all.

Gazprom's Export Plans – China

The Altai gas pipeline project, which was largely inactive during 2008-09 has been resurrected. However, a final decision on the construction of the pipeline to China will be possible only after an agreement on gas prices has been reached with Beijing.

On the 15th of December Aleksei Miller announced during a visit to the city of Tomsk that preparatory works for the beginning of the construction of the Altai gas pipeline were close to completion. Miller reinforced that the “synchronized schedules of design and exploration work, procurement, construction and commissioning for the Altai gas trunk line as well as reconstruction and overhaul schedules for existing gas transmission facilities will be prepared by the end of the first quarter (of 2011). From then on we will be ready to begin construction. We can consider the project to have started once a commercial gas supply contract will be signed with our Chinese partners⁴”.

Assuming that the two sides come to terms over such an agreement by mid-2011, the first deliveries via the new pipeline may begin by the end of 2015.

The necessity of implementing the Altai gas pipeline project was first announced in 2006. The cost of the pipeline was originally estimated to be \$5 billion, but soon rose to \$13.6 billion. The project was rendered largely inactive with the onset of the 2008-09 global financial crisis, but as a result of the revival of talks with China the Altai gas pipeline has once again come into prominence. The project was listed in the national programme for the development of the

⁴ Gazprom website press release, 15.12.2010, <http://www.gazprom.com/press/news/2010/december/article106725/>

Russian gas sector, with 2015-18 indicated as the implementation time frame. The cost of construction of the Altai pipeline remains at around \$14 billion, due to the high costs of laying pipelines through mountainous terrain.

Gazprom – Turkmenistan – Asia

India, Afghanistan, Pakistan and Turkmenistan have reached an agreement on the Trans-Afghan Pipeline (TAPI), which will supply 33 bcm per annum from 2015. Moscow may gain from the construction of TAPI, as the project will cast doubt over the implementation of the Trans-Caspian gas pipeline.

The idea of the delivery of Turkmen gas to South Asia arose soon after the collapse of the USSR and was actively lobbied by the United States. In 1995 Ashkhabad and Islamabad signed a memorandum of mutual understanding, but the actual construction of the pipeline did not take place due to the continuing war in Afghanistan.

After Gurbanguliy Berdimukhamedov became President of Turkmenistan in 2007, however, the project was revived. One reason for the revival of the project was the sharp drop in purchases of Turkmen gas by Russia, which caused a substantial reduction in Turkmenistan's export revenues. Talks regarding the active support of Washington resulted in the signing of an agreement for the laying of a 1730 km-long pipeline across the territory of Afghanistan to connect Turkmen gas fields with Fazlik on the India-Pakistan border. Some 14 bcm of gas from the supplied volumes are intended for Delhi and Islamabad, and 5bcm for Kabul.

While the successful implementation of the TAPI project will significantly reduce Turkmenistan's dependence on Russian purchase of Turkmen gas, TAPI may yet be profitable for the Russian side. If TAPI goes ahead, it is likely that the Trans-Caspian pipeline project, which foresees the delivery of Turkmen gas to Europe whilst circumventing Russia, will be frozen.

Nonetheless, the documents signed by India, Afghanistan, Pakistan and Turkmenistan do not stipulate a precise date for the implementation of the pipeline project, nor do they stipulate the terms of financing. Considering the ongoing instability in

Afghanistan and the route of the pipeline, which passes through territories controlled by local tribes, it is far from certain that investors will be willing to take such risks, given the near impossible task of guaranteeing the security of the pipeline.

Gazprom - Wikileaks – Kazakhstan

Wikileaks: In the event of disagreements with the Kazakh authorities, ENI SpA and BG Group risk losing their Kazakh deposits to Gazprom and the Chinese National Petroleum Corporation (CNPC).

One of the diplomatic messages sent by the US Ambassador in Kazakhstan, Richard Hoagland, at the beginning of 2010 contains extracts from his conversation with Maksat Idenov, First Vice-President of KazMunaiGaz. According to Idenov, Gazprom and CNPC will "circle like hawks over international consortiums producing oil at the Kashagan and Karachaganak oil fields, hoping to receive a slice in the event that their business in Kazakhstan should collapse". Idenov himself promised not to permit such developments "as long as he would continue working at the company".

About a year ago the Government of Kazakhstan announced its wishful intentions of receiving a stake in the Karachagan oil and gas field, which is being developed by investors on the basis of production-sharing agreements. Foreign companies developing the Karachaganak field, however, did not support this initiative. In April 2010, the government of Kazakhstan presented the foreign companies with a claim of \$2.5 billion against them for alleged violations of nature conservation legislation and non-payment of taxes. In May (of 2010) further actions (by the government of Kazakhstan) followed, while in the same month Maksat Idenov left his post at KazMunaiGaz.

A substantial level of uncertainty continues to overshadow the position of foreign companies in the Kazakh petroleum sector. In autumn 2010 the tax committee of the Ministry of Finance of Kazakhstan announced that it has "several questions and claims towards" Karachaganak Petroleum Operating BV – a joint venture enterprise founded by ENI and Britain's BG Group.



The European Geopolitical Forum

www.gpf-europe.com

EGF Gazprom Monitor

Issue 2: January 2011

Disclaimer

The information presented in this report is believed to be correct at the time of publication. Please note that the contents of the report are based on materials gathered in good faith from both primary and secondary sources, the accuracy of which we are not always in a position to guarantee. EGF does not accept any liability for subsequent actions taken by third parties based on any of the information provided in our reports, if such information may subsequently be proven to be inaccurate.

EGF Gazprom Monitor
Published by European Geopolitical Forum SPRL
Copyright European Geopolitical Forum SPRL
Director and Founder: Dr Marat Terterov
Email: Marat.Terterov@gpf-europe.com

Suite 1/Level 3, Avenue Du Manoir D'Anjou 34
Brussels 1150 Belgium
Tel/Fax: +322 770 1001
info@gpf-europe.com
www.gpf-europe.com
www.gpf-europe.ru