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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:

- *The Lithuanian Supreme Court postpones its hearing of Gazprom's complaint against the Lithuanian Court of Appeal; RWE Supply and Trading CZ wins a gas price dispute with Gazprom in the Vienna Commercial Court; Gazprom fails to bid for Greece's gas distribution system operator, DEPA; Gazprom officially announces its plans to construct an LNG export terminal on Russia's Baltic coast; Gazprom predicts a year-on-year increase in gas exports in 2013*
- *Gazprom pays Ukraine $1bn in an advance for gas transit fees until 1st of January 2015; Gazprom is not pursuing legal action against Naftogaz Ukraine for failing to meet its 'take or pay' commitments; There are no ongoing talks about the establishment of a consortium to manage Ukraine's gas transportation system (GTS)*
- *Gazprom continues to examine the potential for a second line of the Yamal-Europe pipeline to Europe via Belarus*
- *Gazprom confirms that the construction of South Stream's offshore section will begin in the second quarter of 2014, to be launched in 2015; Collapse of the Nabucco pipeline project clears the way for South Stream in South-East Europe*
- *Gazprom and GDF Suez agree to explore the possibility of expanding the Nord Stream pipeline*
- *Gazprom and CNPC aim to sign gas supply contract by the end of 2013; Gazprom and the Japan Far East Gas Co. Ltd sign a Memorandum of Understanding on the latter's participation in Gazprom's Vladivostok LNG project.*
- *Gazprom's Chairman and Chief Executive are re-elected at the company's Annual General Meeting; CNPC purchases a 20 percent stake in Novatek's Yamal LNG project*

Gazprom and the EU

The Lithuanian Supreme Court postpones its hearing of Gazprom's complaint against the Lithuanian Court of Appeals, which has refused to implement the December 2012 ruling of the Stockholm Arbitration Institute.

On the 7th of June, the Lithuanian Supreme Court announced the postponement of its hearing of Gazprom's complaint against the Lithuanian Court of Appeals, which had refused the implement a prior arbitration ruling by the Stockholm Chamber of Commerce Institute for Arbitration. The hearing was scheduled to be resumed on the 18th of June, with the results eagerly anticipated.

This dispute has been covered in detail in previous issues of the Gazprom Monitor (see issues № 15 – August 2012, № 17 – October 2012, №22 – March 2012, № 23 – April 2012, and № 24 – May 2013). It centres on relations between Gazprom and Lietuvos Dujos, which is a vertically integrated energy utility that imports natural gas from Russia, operates Lithuania's gas pipeline network, and sells gas to final consumers. Gazprom currently holds a 37 percent stake in the company, with other significant stakes being held by the German energy company, E.On (39 percent), and the Republic of Lithuania (18 percent).

The dispute originated in a request by the Lithuanian Energy Ministry in March 2011 that the Vilnius Commercial Courts investigate possible conflicts of interest in Lietuvos Dujos, particularly regarding the high price of Lithuania's imports of Russian gas. Gazprom protested that such an investigation would represent a breach of the Lietuvos Dujos Shareholder Agreement, and sought arbitration in Stockholm. In July 2012, the Stockholm Arbitration Institute ruled that the Vilnius Commercial Courts could continue with their investigation, but could not rule on gas price negotiations, which remained under the jurisdiction of the Shareholder Agreement. In December 2012, the Lithuanian Court of Appeals ruled that the Stockholm ruling represented a challenge to public order and contradicted the independence of the Lithuanian Courts, and should therefore not be implemented. Gazprom then responded by lodging an appeal with the Lithuanian Supreme Court, the hearing of which began in May 2013.

The dispute has been contextualised by further disagreements between Gazprom, Lietuvos Dujos, and the Lithuanian government over gas prices and the 'unbundling' of Lietuvos Dujos in line with EU Third Gas and Electricity Directive legislation. The spin-off of Lithuania's gas pipeline network from Lietuvos Dujos to a new company, Amber Grid, is due to take place in the 31st of July, although Gazprom has protested that it was coerced into accepting the unbundling.

RWE Supply and Trading CZ wins a gas price dispute with Gazprom in the Vienna Commercial Court.

On the 27th of June, it was announced that the International Court of Arbitration in Vienna had ruled in favour of RWE Supply and Trading CZ (formerly RWE Transgas) in its dispute over the price of gas supplies in its long-term contracts with Gazprom. The ruling states that RWE overpaid for its purchases from Gazprom since May 2010, and that Gazprom must reimburse RWE for those overpayments.

In a press release, RWE also announced that the ruling "adjusted the purchase price formula of the contract by also introducing a gas market indexation, which according to the arbitral tribunal reflects the relevant conditions on the gas market at the time of the price revision in May 2010". Gazprom Export responded by claiming that "RWE Supply & Trading CZ had been putting forward many weakly substantiated demands on the free fall of price and radical pricing formula revision, however most of these claims were rejected by the arbitration. As a result, the pricing formula has been adjusted in a certain way, but this adjustment is far away from the original demands made by RWE Supply & Trading CZ".

While the ruling may or may not have satisfied all of RWE's original demands, it certainly represents a potentially significant precedent for other European energy companies that wish to revise their gas import contracts with Gazprom, seeking a greater share of hub-based pricing rather than contractual prices based entirely on oil-indexation, as traditionally preferred by Gazprom.

Gazprom fails to bid for Greece's gas utility, DEPA.

Following months of speculation, and some Euro-Atlantic concern over the further direct involvement of Gazprom in the EU gas market, Gazprom stunned Greek privatisation officials by failing to submit a final, binding bid for Greece's gas utility, DEPA. Indeed, the Greek government failed to draw a single binding bid for DEPA by the final deadline of the 10th of June. Five other bidders – including Mytilineos SA, Motor Oil Hellas SA, OJSC Negusneft, and Gekterna SA – failed to submit binding bids for DEPA, while the Azerbaijani state-owned oil company, SOCAR, was the only bidder for Greece's gas grid operator, DEFSA.

In a statement, Gazprom blamed financial risks and a failure by the Greek side to guarantee the continuing financial health of DEPA as the reasons for Gazprom's lack of a bid. Greek officials reacted by blaming the European Commission, which it claims had warned Gazprom not to bid for DEPA. The Greek privatisation agency added that it had offered to guarantee up to €180m of potential debts to DEPA until 2015, and that the failure of Gazprom to submit a binding bid for DEPA was not the fault of the Greek privatisation agency.

Gazprom officially announces its plans to construct an LNG export terminal in Russia's Leningrad region, on the Baltic coast.

Following the initial reports cited in last month's Gazprom Monitor, Gazprom has officially announced its plans to construct a new liquefied natural gas (LNG) export terminal on its Baltic coast, in the Leningrad region. According to Gazprom, preliminary feasibility studies concerning the economic viability of the project have been completed. In the first half of 2014 Gazprom plans to complete the investment rationale and devise a comprehensive action plan for the project, which is planned to have a capacity of 10m tonnes per year and could be launched in 2018.

As noted last month, if the project is implemented as planned, Gazprom will benefit from EU gas market legislation on Third Party Access, which would give Gazprom's LNG deliveries access to existing LNG import terminals across the EU, including in Spain and Portugal, to which Gazprom does not currently supply gas.

Gazprom predicts an increase in gas exports to Europe and the Commonwealth of Independent States (CIS).

Gazprom's gas exports are classified by region: The CIS and Baltic States (former Soviet Union) on the one hand, and the 'Far Abroad', often referred to in Gazprom publications simply as 'Europe') on the other. At the Gazprom press conference 'Gas exports and enhancing the reliability of gas supplies to Europe', Gazprom officials predicted that Gazprom's exports to Europe would increase from 138.8 bcm in 2012 to 152 bcm in 2013, and that Gazprom's exports to the CIS and Baltic States would increase from 64.4 bcm in 2012 to 74.8 bcm in 2013.

Ukraine

Gazprom pays Ukraine $1bn in an advance for gas transit fees until 1st of January 2015.

Gazprom has paid Naftogaz Ukraine $1bn as an advance payment for transit fees until the 1st of January 2015. This brings Gazprom's total advanced payment of transit fees to $5.15bn since the start of 2012. However, Gazprom CEO, Alexei Miller, has since told the Gazprom Annual General Meeting that this would be the last such advance payment for transit fees. Russian sources suggest that the $1bn prepayment would cover Gazprom's gas transit via Ukraine until the planned launch of South Stream. This suggests that the post-2015 prospects for Ukraine as a transit state for the delivery of Russian gas to Europe are, at best, uncertain.

Sergei Kupriyanov confirms that Gazprom is not pursuing legal action against Naftogaz Ukraine for failing to meet its 'take or pay' commitments.

In an interview with the Russian radio station, Echo Moscow, Gazprom spokesman, Sergei Kupriyanov, confirmed that Gazprom is not pursuing litigation against Naftogaz Ukraine for failing to meet its 'take or pay' commitments, as the company has no funds with which to pay the reported $7bn penalty.

Gazprom CEO, Alexei Miller, confirms that there are no ongoing talks about the establishment of a consortium to manage Ukraine's gas transportation system (GTS).

Gazprom CEO, Alexei Miller, has confirmed that there are currently no ongoing talks about the establishment of a consortium to manage Ukraine's gas transportation system (GTS). According to Miller, "There is no reason to hold negotiations on the consortium. In order to hold substantive talks, it is necessary to make changes to the Ukrainian legislation, it is necessary to amend a dozen of laws and regulations of Ukraine. This has not been done yet".

Belarus

Gazprom continues to examine the potential for a second line of the Yamal-Europe pipeline to Europe via Belarus.

During the St Petersburg Economic Forum, Gazprom CEO, Alexei Miller, met with the First Deputy Prime Minister of Belarus, Vladimir Semashko, to discuss the 'Yamal-Europe 2' pipeline project. In April 2013, the Russian President, Vladimir Putin, had ordered Gazprom to investigate the possibility to expanding the Yamal-Europe pipeline, which delivers gas from Russia to Germany via Belarus and Poland.

According to Belarusian sources, a total of 64.5 bcm of Russian gas was pumped into the Belarusian pipeline network in 2012, of which 44.3 bcm was transited to customers further west, and 20.2 bcm was delivered to Belarusian consumers. The current capacity of the Yamal-Europe gas pipeline is 32.9 bcm per year, meaning that approximately 11.4 bcm of natural gas was transited via Belarus through pipelines other than Yamal-Europe in 2012. The capacity of Yamal-Europe 2 is planned to be 15 bcm. Following Miller's meeting with Semashko, Gazprom sources noted that "phase one of the (Yamal-Europe 2] project in Belarus will only require reconstructing and upgrading the gas transmission capacities and this can be done within the shortest time possible". This appears to suggest that the Belarusian section of Yamal-Europe 2 will not be an entirely new pipeline, but rather represents the upgrading of existing infrastructure, which correlates with the current levels of non-Yamal-Europe pipeline gas transit via Belarus.

With Gazprom already the owner of Gazprom Transgas Belarus (formerly Beltransgas), which owns and operates Yamal-Europe on Belarusian territory, the reaching of an agreement on Yamal-Europe 2 in Belarus is little more than a formality. However, if the project is to proceed, it will be necessary for Gazprom to strike a deal with the PGNiG, which operates, and owns a 48 percent stake in, the Yamal-Europe pipeline on Polish territory. A Memorandum of Understanding between PGNiG and Gazprom to explore the possibilities of implementing Yamal-Europe 2 was signed in late April, reportedly without the consent the Polish authorities. As reported in Issue № 23 of the Gazprom Monitor (April 2013), this led to the sacking of the Polish Treasury Minister, Mikolai Budzanowski, and the PGNiG Chief Executive, Grazyna Piotrowska-Oliwa. Therefore, a deal with Poland now seems unlikely, without which the Yamal-Europe 2 project cannot move forward, despite the apparently constructive dialogue between Russia and Belarus on the issue.

South Stream

Gazprom confirms that the construction of South Stream's offshore section will begin in the second quarter of 2014.

Following a meeting between Gazprom CEO, Alexei Miller, and the Chief Executive Officer of Eni, Paolo Scaroni, during the St Petersburg Economic Forum, Gazprom announced that the construction of the offshore section of South Stream would begin in Q2 2014 as planned. South Stream is planned to be commissioned in four lines, reaching a total projected capacity of 63 bcm per year, with the first line scheduled for launch in 2015.

Speaking at a conference in Bulgaria dedicated to the South Stream project, the Deputy Head of Gazprom's Project Management Department, Aleksandr Syromyatin, confirmed that the construction of the first line in Bulgaria would begin by the end of 2013, and would be completed by 2015.

The Nabucco pipeline project collapses, clearing the way for South Stream in South-East Europe.

The decision of the Shah Deniz consortium to commit its gas to the Trans-Adriatic Pipeline project has effectively ended any lingering hopes of implementing the Nabucco pipeline project in South-East Europe. Nabucco was originally designed to deliver gas from Iran and Azerbaijan to Austria, via Turkey, Bulgaria, Romania, and Hungary. Iran's isolation on the international political stage had effectively left Azerbaijan as the only possible supplier of gas to the Nabucco project. But the decision of the Shah Deniz consortium, which is currently developing gas production in the Caspian sea of the coast of Azerbaijan, to commit its gas to the Trans Adriatic Pipeline (TAP) project has left the Nabucco project with no gas supplies at all. Gerhard Roiss, Chief Executive of OMV – the Austrian energy company leading the Nabucco project – has stated: "The Nabucco project is over for us".

TAP is a more modest project, which aims to deliver gas from Azerbaijan to Southern Italy, via Turkey and Greece. While the costs of implementing Nabucco had spiralled to an estimated €10bn, TAP is estimated to cost a more modest €1.5bn. The decision to commit Shah Deniz gas to TAP means that the South Stream project now faces no competition in its bid to deliver gas to Bulgaria, Serbia, Hungary, and Austria.

Nord Stream

Gazprom and GDF Suez agree to explore the possibility of expanding the Nord Stream pipeline.

During the St Petersburg Economic Forum a meeting took place between Alexander Medvedev, Director of Gazprom Export and Deputy Chairman of the Gazprom Management Committee, and Jean-Francois Cirelli, President and Vice-Chairman of GDF Suez. During the meeting, the two sides agreed to explore the possibility of expanding the Nord Stream gas pipeline, in which Gazprom and GDF Suez hold stakes of 51 percent and 9 percent respectively. The agreement comes two months after Gazprom reached a similar agreement with the Dutch energy company, Nederlandse Gasunie, which also holds a 9 percent stake in the Nord Stream consortium.

However, the commercial necessity of such an expansion remains in doubt, given the slump in Gazprom's exports to Europe since 2009, the variety of predictions for European gas demand in the coming decade, and Gazprom's own announcements of plans to build South Stream, expand the Yamal-Europe pipeline, and build an LNG terminal on Russia's Baltic Coast. If there is one lesion to be drawn from the combination of these factors, it is that Gazprom appears to have made a definite decision to reduce its gas transit via Ukraine to the bare minimum, as demonstrated by Gazprom's boycott of the EU-Ukraine meeting to discuss the future of Ukraine's gas transportation system (GTS) – an asset in which Gazprom had previously expressed strong interest in obtaining a stake.

Asia

Gazprom and CNPC aim to sign gas supply contract by the end of 2013, but prices will not be linked to those of the Henry Hub in the United States.

Following a working meeting between Gazprom and the China National Petroleum Corporation (CNPC) on the 19th of June, Gazprom CEO, Alexei Miller, noted that although the two parties intend to sign a contract before the end of 2013, the price at which Gazprom will sell gas to the CNPC remains the major obstacle to the conclusion of negotiations. Despite Gazprom's desire for prices comparable to those of its exports to the Asia-Pacific region from Sakhalin-2 (which are based on the oil-indexed benchmark – the Japanese Crude Cocktail, or JCC), the CNPC are seeking lower prices, comparable to those of the gas it imports from Turkmenistan via the Central Asia-China gas pipeline. The only confirmation offered by Miller after the meeting was that "the price of gas supplied to China won't be linked to the US spot market prices", which are currently far below those in Europe, while Alexander Medvedev, the Director of Gazprom Export, claimed that "there is no reason to deviate from the JCC". Given the strategic importance of the deal for both sides, which could see Gazprom export 68 bcm per year to China via a completely new pipeline, it is unsurprising that the two sides are in no hurry to make unnecessary concessions.

Gazprom and the Japan Far East Gas Co. Ltd sign a Memorandum of Understanding on the latter's participation in Gazprom's Vladivostok LNG project.

A meeting between the Gazprom CEO, Alexei Miller, and the Executive Officer and Chief Operating Officer of Japan Far East Gas Co Ltd, Masanori Toyoshima, has yielded a Memorandum of Understanding on the Vladivostok LNG project, which is planned to export up to 15 million tonnes of LNG to the Asia-Pacific market from 2018. Gazprom's taking of the final investment decision was reported in the Gazprom Monitor in February (Issue № 21), while the possibility of Japanese participation in the project was reported in April (Issue № 23). Japan is currently the world's largest importer of LNG (around 100 bcm per year) of which Russia currently supplies approximately 10 percent. Japanese participation in the Vladivostok LNG project is therefore an important factor in Gazprom's ability to increase its exports to the growing Japanese market.

And in other developments…

Zubkov and Miller re-elected as Gazprom Chairman of the Board and Chairman of the Management Committee respectively.

Following Gazprom's Annual General Meeting, it was announced that Viktor Zubkov had been re-elected as the Chairman of the Board of Directors of Gazprom, and that Alexei Miller had been re-elected as Deputy Chairman of the Board of Directors and Chairman of the Management Committee of Gazprom.

CNPC agrees to buy 20 percent stake in Yamal LNG project, providing competition for Gazprom's potential pipeline exports to China.

CNPC is set to become the first Chinese company to participate in a Russian gas export project, with the company agreeing to buy a 20 percent stake in the Yamal LNG project – An 80-20 joint venture between Russia's Novatek and Total of France. The deal comes a month after the Gazprom Monitor (Issue № 24 – May 2013) reported that the Urals Federal District authorities intended to make their first commercial freight delivery to China via the Northern Sea Route, thus demonstrating the possibility of sea-based deliveries from Northern Russia (home of the Yamal LNG project) to the Asia-Pacific region. The deal, which also includes a long-term contract for the delivery of 3 million tonnes of LNG per year from 2016 onwards, provides some competition for Gazprom in its efforts to conclude a long-term pipeline-based gas supply agreement with CNPC. The approval by the Russian government of CNPC's entry into the Yamal LNG project is another sign that the Russian government could be preparing to exempt LNG exports from Gazprom's monopoly over Russia's gas exports.

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