



## Key Developments in the External Relations of the Russian Gas Industry<sup>1</sup>

### Summary:

- *The dispute over the nationalisation of gas pipelines belonging to Lietuvos Dujos has taken a new turn. Lithuania is trying to attract European Union (EU) support and possibly even the financing necessary for the diversification of its gas supplies.*
- *The European Union is reluctant to provide funding for the modernisation of Ukraine's gas transit system without Russian guarantees that the network will continue to be used for gas deliveries to Europe in the future. The EU has suggested that Ukraine try to dissuade Moscow from the construction of the South Stream pipeline on economic grounds, and that Kiev should encourage Moscow to invest in the modernisation of Ukraine's existing infrastructure instead.*
- *The latest disclosure from Wikileaks concerns the Gazprom-Statoil partnership in the Shtockman off shore gas mega-project. The executive director of Norway's Statoil has spoken about the high political risks associated with doing business in Russia and corruption taking place in Gazprom.*
- *In accordance with plans announced by the Russian gas monopoly, this year Gazprom plans to buy 2.1 percent more gas from the Central Asian countries compared to last year, taking the overall level of purchases to 38.8 bcm<sup>2</sup>. The growth is not hugely significant, however, as Russia does not plan to return to pre-crisis purchase levels.*
- *Gazprom seeks to attract investment from China in order to build a gas pipeline from Russia to China. A final agreement is due to be reached in July 2011.*
- *Gazprom plans to enter the Indian and Pakistani energy markets, having begun to supply LNG from Bahrain. The company plans to build a re-gasification plant in Bahrain in 2014.*
- *Gazprom has registered a fall in gas production early in 2011. Experts suggest that the Russian gas monopoly lost part of its share in the domestic market, while independent producers such as Novatek are showing impressive growth.*
- *At the end of January Gazprom's shareholders forwarded lists of candidates for election to the Board of Directors in preparation for the company's Annual General Meeting (AGM). The Board of Directors remains unchanged in comparison to last year – six places out of eleven will be occupied by former and current officials, including Alexei Miller.*

---

<sup>1</sup> The EGF Gazprom Monitor is completely based on Russian sources and is translated into English by Jack Sharples, PhD candidate at the University of Glasgow, Scotland, and EGF Researcher on Russian external energy policy

<sup>2</sup> Billion cubic meters

## GAZPROM: INTERNATIONAL MARKETS

### Lithuania: pending dispute over nationalisation of gas pipelines

*The dispute over the implementation of the EU Third Energy Package in Lithuania continues: the question of Europe's energy security topped the agenda of the first ever EU energy summit which took place in Brussels on 4 February (2011). The summit began with a speech on the integrated EU energy market and general energy policy towards third countries. Special attention is being given to Russia and the dispute between Gazprom and the Government of Lithuania, which has arisen from plans to nationalise gas transmission pipelines belonging to Lietuvos Dujos.*

Lithuania has been one of the EU states most adamant about the staging of the energy summit. Audronis Azubalis, the Lithuanian Foreign Minister, recently announced that "the liquidation of energy isolation is a necessary precondition for guaranteeing the energy security of Lithuania". The matter boils down to the tensions accompanying Gazprom's purchase of a stake in the Lithuanian gas company, Lietuvos Dujos, and Gazprom's role as a monopoly supplier of gas to Lithuania. The situation is worsened by the fact that Lithuania pays one of the highest prices for gas amongst EU member states: \$356 per 1000 cubic metres to Russia's Gazprom. The discounts which have been granted to Estonia and Latvia this year have not been extended to Vilnius.

Gazprom explains that the lowering of gas prices for Lithuania's neighbours is based on agreements with Riga and Tallinn respectively, in which Latvia and Estonia pledged to continue purchasing gas at pre-crisis volumes. Gazprom states that no such guarantees have been forthcoming from Lithuania. According to the Lithuanian Government, the solution to this problem lies in the nationalisation of gas transmission pipelines. Nevertheless, the Lithuanian side may have an ace or two up its sleeve in the tough negotiations with Gazprom: the decision of the EU regarding the financing of the construction of an LNG terminal in Klaipeda, or even the construction of an interconnector between Lithuania and Latvia which would enable the connection of Inčukalns underground gas with the European gas pipeline network. The implementation of at least one of these projects may weaken Gazprom's position in the negotiations with the Lithuanian side, reducing Lithuanian dependence on Russian gas and possibly leading to a reduction in the price that Vilnius pays for its gas supplies.

### Ukraine: EU encourages Russia to invest in Ukrainian gas transit network

*On 25 January (2011) Gunther Oettinger, EU Energy Commissioner, went some way towards clarifying possible scenarios surrounding the future of the Ukrainian Gas Transit System (GTS). Oettinger announced that, in light of the implementation of the South Stream and Nord Stream projects, EU investment in the Ukrainian GTS would be pointless without guarantees from Russia that the network will (continue) to be used for the shipment of Russian gas to Europe in the future<sup>3</sup>. Some experts suggest that such statements provide stimulus for a decision on the creation of a joint venture between Gazprom and Naftogaz Ukraine.*

Experts estimate that Ukraine requires new investments of some \$2.1 billion for the sustainable functioning of its GTS. At the present moment Russia supplies the EU with 120bcm of gas, while the combined capacity of Nord Stream and South Stream is set to be around 118bcm. Thus it has recently been proposed to Ukraine that Kiev should aim to convince Moscow to abandon the implementation of the South Stream project and invest its money into the modernisation of the Ukrainian GTS. Given the figures suggested above, it would be much more costly to build a completely new gas pipeline than to maintain the already-existing Ukraine GTS infrastructure in good condition. However, the Russian counter-proposal of the formation of a joint venture between Gazprom and Naftogaz, which would include all Ukrainian gas transmission pipelines (equating to 50 percent of the GTS) has yet to be endorsed by Kiev. Nonetheless, the Verkhovna Rada (Ukrainian Upper Chamber of Parliament) has already discussed variations of amendments to the law on pipeline transport, which presently forbids the reorganisation, privatisation and other forms of divestiture of gas pipelines, which must remain under state ownership (according to the law). This could all change if/when a political decision on the merger would be made, and in such an event it is likely that these amendments will be examined by the Ukrainian parliament without delay.

### Shtockman Development undermined by new round of corruption allegations

*The latest set of documents from Wikileaks has exposed potential weaknesses in the implementation of large-scale international projects such as the Shtokman gas field*

<sup>3</sup> <http://www.osw.waw.pl/en/wiadomosci/2011-01-26/>

***development. Norway recently revealed a conversation between Helge Lund, Executive Director of Statoil, and American Consul-General in Norway, Barry White.***

Lund considers that at the time of the implementation of (Statoil's) joint projects with Gazprom, there were very serious corruption risks in existence, and furthermore, "the situation has now worsened", according to Lund. Corruption will most likely result in projects such as Shtockman being subject to continued delay, while other factors also likely to delay the project include the underdevelopment of local infrastructure; harsh Russian tax legislation; risks of lower prices due to the appearance of shale gas; and general political risks.

Lund practically equates Gazprom with the Russian state, an assessment similar to that given by the American Ambassador in Russia, John Beyrle who stated that "Gazprom represents the legacy of the Soviet Gas Ministry", and also "a company with poor management, permeated by corruption, which serves mainly political aims. These include the supply gas to the population at understated prices, the fulfilment of various social projects and Russia's ambitious plans to control global energy markets". Although Gazprom had not responded to these allegations at the time of writing, experts suggest that the risk of Statoil leaving the Shtockman project is presently not great.

#### **Turkmenistan: little choice but to look for new customers for Turkmen gas**

***Gazprom plans to buy 2.1 percent more gas from the Central Asian countries than last year, taking the planned purchase volumes to 38.8bcm. However, the growth is not of great significance – Russia does not intend to return to pre-crisis purchase levels.***

Several years ago Turkmenistan sold around 50bcm of gas per annum to Russia, but deliveries virtually ceased after the explosion on the Central Asia-Centre gas pipeline in April 2009. However, the fact that the pipeline subsequently reopened did not result in Russian demand for Turkmen gas returning to its previous level. Talks between Gazprom and the Turkmen government with respect to the possible reduction of price for new purchase volumes of Turkmen gas led only to a (further) reduction in purchases. In 2009 Ashkhabad sold around 10bcm to Gazprom. Sales volumes did not grow during 2010 (Turkmen gas sales again accounted for approximately 10bcm in Russian gas purchases from Central Asia during 2010, which totalled 38bcm overall).

On 19 January (2011) the Gazprom Board of Directors voted to continue the optimisation of volume and price parameters of gas imported from the countries of Central Asia. Such steps further confirmed to Ashkhabad that it has little choice but to reorient its gas exports towards new customers. Readers of previous editions of the EGF Gazprom Monitor will recall that in 2009 a gas pipeline linking Turkmenistan to China was launched with a potential capacity of 40bcm per year. Furthermore, some sources suggest that the level of support for the Nabucco gas pipeline from within the government of Turkmenistan is increasing. Hence there are suggestions that the East-West gas pipeline, the construction of which began in May 2010, could be used for supplying Nabucco. The East-West pipeline could also be used for supplying the Pre-Caspian pipeline, which transports gas to Russia, but it is more likely that the main aim of the East-West pipeline will be to supply the Trans-Caspian pipeline, which will potentially connect Turkmen gas reserves with Nabucco.

#### **China: a substantial business opportunity for Gazprom ?**

***The presence of Turkmenistan plays an important role in Gazprom's negotiations for new arrangements to supply gas to China. Ashkhabad sells gas to Beijing at a price of \$280 per 1000 cubic metres – exactly the price quoted by Gazprom in its negotiations with China. Furthermore, Gazprom seeks to attract investment from the Chinese market, in a similar move to the one used in the construction of the gas pipeline from Turkmenistan.***

At the beginning of February this year Gazprom confirmed the signing of an agreement which foresees gas deliveries of 30bcm per year to China via the Altai gas pipeline. Following the completion of the latest round of negotiations, it increasingly appears that Gazprom and the Chinese National Petroleum Corporation (CNPC) have moved closer to agreement on the technical parameters necessary for delivering Russian gas. Alexei Miller, head of Gazprom, recently announced that "talks on deliveries of gas to China are close to completion. If final agreements on the construction of the Altai gas pipeline are signed by the middle of 2011, gas deliveries may begin as soon as the end of 2015". The Chinese gas market is expected by some estimates to reach some 300bcm by 2015, presenting a substantial business opportunity for Gazprom. The next round of negotiations is due to take place in St Petersburg in early spring.

### **Bahrain to become a platform for Russian gas trading**

*Gazprom plans to enter the gas markets of India and Pakistan, having already begun to supply these countries with liquefied natural gas (LNG) from Bahrain. The company plans to build a re-gasification terminal in the country in 2014.*

Bahrain's Oil and Gas Minister, Dr. Abdul Hussain bin Ali Mirza, recently stated that Gazprom intends to create a regional gas centre in the island state. In the upcoming months an agreement is expected to be signed which foresees deliveries of LNG to Bahrain from Russia with its subsequent re-sale to end customers. Experts suggest it is likely that Gazprom is aiming to develop such plans with a view that Bahrain has the potential to become a major centre of LNG trading. Bahrain could become a major regional platform for Gazprom to engage in gas trading in the Gulf, given that Gazprom is already developing LNG projects in Russia and participates in the development of Iran's South Pars gas field.

## GAZPROM: DOMESTIC MARKETS

### **Novatek increases production following the arrival of new owner**

*Gazprom's gas production continues to fall, while at the same time Novatek, an independent gas producer, is actively increasing its own production volumes. In comparison with the analogous indicators from last year, in January of this year Gazprom's production fell by 3.2 percent (vs. January 2010), while Novatek increased its production by 33 percent (vs. January 2010). Nonetheless, the fall in Gazprom's revenues from domestic gas sales was offset by the growth in its foreign exports, primarily to the CIS countries.*

In the month of January 2011 Gazprom produced 63.7bcm of gas. This indicates a fall of 0.4 percent if compared to the production figure of January 2010. At the same time, Novatek increased its production by 33 percent, to 4.65bcm (compared to January 2010). Experts suggest that Novatek's increase in production was due to the acquisition of new assets during 2010. While Novatek Company sources confirm this position, they hasten to add that the production growth is also partly due to their "full utilisation of existing assets".

While experts confirm a decline of Gazprom's position in the Russian domestic gas market, Novatek's recent ascendancy has been strengthened by the appearance of a

new owner, Gennady Timchenko, who now holds a 23.49 percent stake in the company. It was evidently after the arrival of Timchenko that Novatek found itself developing new projects, whilst the Russian government offered the company new incentives to participate in the development of the Yuzhno-Tambeyskoye gas field.

### **Company hierarchy: Miller to remain, change of course unlikely**

*At the end of January of this year Gazprom's shareholders submitted lists of candidates for the Board of Directors annual election in accordance with the company's accepted procedure of governance. The Government of the Russian Federation, as the main shareholder in Gazprom, already prepared its own lists of candidates for the Board of Directors. The result: nothing changes in comparison to last year – six out of eleven Board positions will be occupied by former and current state officials, including Alexei Miller.*

Alexei Miller's second contract is due to expire on 31 May 2011. Miller has occupied the post of head of Gazprom for some ten years and "there are no plans for his replacement" according to the Russian Prime Minister's office. We had already suggested that rumours surfacing last November which alluded to his retirement were not well founded. Miller has himself stated in the past that: "I am a state official... and that is all. If the offer is made to continue my work, then I shall continue my work". With Miller likely to remain at the helm for another five years, experts are already suggesting that any significant alteration in Gazprom's overall corporate strategy is highly unlikely.

End of the EGF document



## EGF in the Media

[Follow the link](#) for EGF Director, Dr Marat Terterov's on Caspian Energy article in the January issue of Bulletin de l'industrie pétrolière (pages 10-11, in French).

[Click here](#) for Dr Terterov's remarks on EU High Representative on Foreign Affairs and Security Policy, Baroness Catherine Ashton's, vision of EU-Russia relations in Voice of America News (in Russian).

[Click here](#) for Mehmet Ogutcu's assessment of the relevance of a Turkish model for the Middle East and North Africa in Today's Zaman.

## Presentations by EGF Experts

[Justin Dargin.](#)

EGF advisor on Euro-Atlantic Relations with the Gulf.

[Dr Deniz Altinbaz.](#)

EGF Affiliated Expert on Turkey, on EU-Turkey relations.

[Mehmet Ogutcu.](#)

EGF Affiliated Expert, addressing the topic of Globalisation, Cleaner Energy and Mega-Cities: Options and Messages for Turkey/Istanbul.

## Recent Events

On March 9, 2011, Dr Marat Terterov, EGF Director, chaired a debate on "The changing role of the NATO and the relationship with Russia in new European defence architecture", between Ambassador Dmitry Rogozin, Russia's Envoy to NATO and Special Envoy for Interaction with NATO on Missile Defence, and Dr Jamie Shea, Deputy Secretary General, Emerging Security Challenges, NATO, at the University of Kent in Brussels. [Please click here for some images of the debate](#)

---

### 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](mailto: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](mailto:info@gpf-europe.com)  
[www.gpf-europe.com](http://www.gpf-europe.com)  
[www.gpf-europe.ru](http://www.gpf-europe.ru)