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EGF Forum Outlook: Assessing Gazprom's Next Movements

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New uncertainties cloud Gazprom's prospects

In a recent briefing on Russia, this Forum expressed the view that Moscow is becoming an increasingly assertive regional player in the wider Black and Caspian Sea (BCS) basin and that energy remains a key Russian priority for the region. We commented in that report that the Russian state-controlled energy holding, Gazprom, provided Moscow with a significant instrument to exercise power in the region. The company has been widely employed as a means of developing (geo)-politically relevant energy cooperation with other former-Soviet states of the region, as well as securing bilateral energy deals with select foreign corporate and state partners. Yet a substantial degree of uncertainty has recently begun to emerge around Gazprom's corporate prospects for the near term, clouding its capacity of advancing Russian geopolitical interests both in the BCS region as well as the wider European context. Internal as well as external factors should be considered in order to account for the uncertainty surrounding Gazprom's potential to both fulfill shareholder value (at the corporate level) as well as serve as an operational instrument for Moscow's foreign policy objectives (at the level of geopolitics). Cautious observation of the entity's ensuing movements is recommended given this state of affairs.

The collapse in the oil price of latter 2008 and the unprecedented reduction in demand for natural gas which followed inside the EU during the period of last year's economic crisis have been the primary external factors resulting in a weakening of the Russian gas monopoly's position over international energy markets. While demand for gas fell by an average of 9% per country among the 27 member states of the EU (which remains Gazprom's primary market for its gas exports) last year, Gazprom's external image as an aggressive, unpredictable and unreliable supply partner was reinforced by the two-week long gas dispute with Ukraine in January 2009. The company's difficulties with its Europe-bound gas exports were further compounded by several other factors, including its inability to break into the North American gas market; the increasing abundance of liquefied natural gas with which Russia's competitors have flooded gas supply routes; and new, additional supplies of gas produced through unconventional, non-hydrocarbon energy sources such as shale. Gazprom's market capital has fallen dramatically from close to US\$300 billion in



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mid-2008 to estimates ranging from US\$144 billion to US\$90 billion earlier this year. It has plummeted in the rankings of the world's leading energy companies while its debts have likewise risen significantly.

A looming exodus of key Gazprom officials ?

Gazprom's weakened position with respect to its main export markets has resulted in substantial discussion about a shift in its gas marketing strategy as well as internal restructuring of the company's assets. While senior Gazprom officials cite forecasts of rebounding demand for natural gas in order to instill greater shareholder confidence in the enterprise, recent Board meetings reflect internal discussion of "a new export strategy, removal of intermediary gas traders and centralization of revenue collection systems to be controlled by Gazprom's Moscow offices". Furthermore, in the lead up to the company's Annual General Meeting (AGM) held on June 25, it appeared that reflections on how to put the company's gas export business back on track would be accompanied by the imminent departure of several high profile Gazprom officials, including Alexander Medvedev, Deputy-Chairman of Gazprom's Management Committee and Director General of Gazprom-export (the Gazprom daughter company responsible for its gas export business), and Stanislav Tsygankov, Director of the Department for Foreign Economic Relations.

While it is difficult to pinpoint the precise reasons for (widespread rumors both within the company and in the wider Russian gas industry) Medvedev's alleged departure, the fact that it was widely perceived that he would be replaced as Gazprom-export chief by either Russian deputy-Prime Minister, Igor Sechin, or the oil trading magnate, Gennady Timchenko, suggests that Russia's gas exports would fall yet under even closer supervision of the realm of Prime Minister Vladimir Putin. Sechin, who is also the country's top energy official, remains amongst the Russian Prime Minister's closest political allies, having shadowed Putin's rise to political prominence since the St.Petersburg days of the early 1990s. Timchenko is another highly trusted Putin St.Petersburg acolyte, who has acquired dominant stakes in some of Russia's major energy assets under Putin's patronage during the last decade (including gas company NOVATEK, energy engineering contractor StroiTransGaz and the oil trading company, Gunvor, of which he is co-owner).



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Intensifying competition between Russian energy personalities

Furthermore, competition for control over prized energy assets and influence over the direction of energy policy between the political-business elites in the Russian energy sector appears to be intensifying. Particular reference can be made to Sechin and Alexei Miller, Gazprom's Chairman of the Management Committee and Deputy Chairman of the Board of Directors (of which Russian First-Deputy Prime Minister, Victor Zubkov, is Chairman). Sechin has been overseeing Russia's expanding energy relations with Turkey and earlier in the year prepared a "road map" for wide ranging energy cooperation between Moscow and Ankara, which the Russian President, Dmitry Medvedev, was due to sign upon an official visit to Ankara in May. While the new Moscow-Ankara energy accords were to include a full spectrum of articles on inter-state energy cooperation (including provisions on the South Stream gas pipeline, expansion of the existing Blue Stream gas pipeline, long term gas supply agreements, Russia participation in the Samsun-Ceyhan oil pipeline), Ankara's persisting interest in the EU's NABUCCO gas pipeline (with which Moscow's South Stream project remains in fierce competition) resulted in a circumspect approach from the Turkish side towards Moscow's advances, weakening Sechin's position in the short term.

Moscow intent on hostile takeover of Ukraine's gas assets

Alexei Miller, in the meantime, has been pushing for a merger between Gazprom and Ukraine's national gas transportation network operator, Naftogaz Ukraine. Amidst the backdrop of Kiev's tilt back towards the Russian geopolitical orbit since the election of Victor Yanukovich as Ukraine's president last February, a merger of the two companies was first raised during Putin's meeting with Ukraine's Prime Minister, Mykola Azarov, in late April. Whilst Miller, speaking on the sidelines of Gazprom's recent AGM, offered Naftogaz substantial stakes in Russian gas deposits if the Ukrainian side would contribute assets to a joint venture between the two companies, there is concern both within Ukraine and amongst Russia-skeptics within the EU that such a move would precipitate a hostile takeover (of Naftogaz assets) orchestrated by Moscow.

Turkish cooperation with Russian energy projects hardly guaranteed

For Miller, however, this could be a way of winning greater favour from Russian Prime Minister Putin (who appointed him as Gazprom chief in 2001), since it would give Moscow a further option on leveraging influence over gas export routes if Turkey continues to withhold on firmer



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commitment to the South Stream project. If the energy “road map” with Ankara remains on hold, Miller’s overtures towards Naftogaz could allow Gazprom the option of delaying South Stream and continuing to export gas to Europe via Ukraine (particularly now that relations between Moscow and Kiev have improved and scope for transit disputes such as those taking place between 2006-09 seems to have faded) or route the (South Stream) pipeline through the Ukrainian section of the Black Sea to Romania, instead of Turkish territorial waters to Bulgaria.

While Putin meets regularly with Miller, and with Sechin, the three men rarely meet together privately, according to a number of local sources. It is unlikely that Russian energy cooperation with Turkey and with Ukraine will materialise simultaneously and much is at stake, both for countries and for personalities. Miller’s contract as the head of Gazprom is soon due to expire and he responded to no shortage of questions about his future at the company on the occasion of last month’s AGM. Recent discussion of the departure of Gazprom deputy-Chairman of the Management Committee, Alexander Medvedev, it is thought, may have surfaced as a result of falling gas demand in Europe and unfulfilled promises (to Putin) of Gazprom entering the North American gas market. Despite the seniority of such persons in Gazprom management structures and their influence over the course of the Russian energy business, the margin for error for such officials (who are essentially) delegated the task of implementing the mega-projects within the framework of Russian energy policy is extremely narrow.

The South Stream gas pipeline is Moscow’s next priority

Moscow, in the meantime, appears intent on advancing with the South Stream pipeline, a project which holds a geopolitical agenda just as much as it serves a corporate one. South Stream is Russia’s answer to the EU’s NABUCCO gas pipeline project, which seeks to diversify European gas import routes away from Russia by establishing a (gas) supply corridor linking Europe directly to the energy producing countries of the Caspian, where gas reserves are in abundance. Moscow has long argued that South Stream is necessary in order to avoid costly (gas) transit disputes (with Ukraine and Belarus) since the pipeline will diversify (gas) export supply routes and thereby strengthen European energy security.

Both projects are in the feasibility stage of development at present. Moscow and Brussels have endorsed their respective South Stream and NABUCCO consortium companies, both of which are exercising ebullient energy diplomacy at present, as they seek to sign up governments from the



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countries across whose territories the respective pipelines will transit. From October 1, the Russian effort to raise international support for South Stream will be led by Marcel Kramer, a prominent European energy personality and outgoing CEO of Dutch national gas pipeline operator, N.V. Nederlandse Gasunie, whom Moscow persuaded to become head of the South Stream consortium last month. Moscow has already started building its other main bypass project, the Nord Stream gas pipeline, which links North West Russia directly with Germany via the Baltic Sea. As is widely known in energy circles, the present Chairman of the Swiss registered gas pipeline company, Nord Stream AG, is former-German chancellor, Gerhard Schröder. While both Nord Stream and South Stream are written-off by many in Europe as projects of purely geopolitical motivation, which make little commercial sense and will simply make Europe yet even more dependant on Russian gas supplies, Nord Stream has already won priority project status from the European Commission in Brussels.

Russia-Belarus gas dispute as a means of extracting concessions from the EU

It is widely believed that both projects have become (and always have been) the personal undertakings of Vladimir Putin, through which the Russian prime minister has come to instrumentalise relations with the troika of the Brussels-EU, the governments of its member states and the European energy consumers – thereby legitimising Russia's new foreign policy agenda and its proximity to energy diplomacy. Having won a major concession from the EU in witnessing the European Commission recognise Nord Stream as a project of (European) priority standing, Putin, it is thought, is now eager to win similar priority project status for South Stream. Whilst last year's unprecedented gas dispute between Russian and Ukraine (during which Russia effectively halted gas supplies to Europe for almost two weeks) created a strong case for investment into bypass gas pipeline projects, no shortage of experts in Moscow believe that June's gas feud between Russia and Belarus was little more than another maneuver by Moscow designed to extract concessions for its projects from Brussels – this time for South Stream.

During the course of June's dispute, Moscow reduced gas supplies to Minsk after the latter allegedly defaulted on its payments to Gazprom for Russian gas deliveries. Minsk in turn accused Moscow's Gazprom of failing to pay the Belorussian gas pipelines operator, BelTransGaz, agreed fees for the transit of Russian gas to Europe, whilst the country's president, Alexander



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Lukashenko, appeared personally insulted at Moscow's ridicule of Belarus' offer to pay for its debts to Gazprom in goods rather than currency. Whilst the crisis was only a shadow of the January 2009 gas dispute between Russia and Ukraine (with only one EU member state, Lithuania, partially feeling the impact of reduction in gas volumes), it again reinforced the view that transit disputes will continue to bear negative impact on EU energy security (despite improved relations with Ukraine). Further bypass gas pipeline projects with firm Russian political support and an evident resource base (of Russian gas supplies) are the answer, according to the view from Moscow. Senior Gazprom officials (including Stanislav Tsygankov mentioned earlier) are frequent participants at international energy conferences at present, voicing their conviction that European gas demand will shortly return to full swing and that projects like South Stream will be of utmost importance for the EU in order to avoid costly transit disputes and enhance energy security.