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A Snapshot of Key Developments in the External Relations of the Russian Gas Sector

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Key points:

- *Gazprom prepares to settle in EU Antitrust investigation*
- *Gazprom finalises asset-swap with BASF Wintershall, with deal approved by EU competition watchdog*
- *Russia offers Ukraine 33 percent discount on gas price as part of package designed to keep Ukraine in Russia's political orbit*
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Gazprom and the EU

Gazprom prepares to settle in EU Antitrust investigation

In a formal response to the EU antimonopoly investigation into Gazprom, the Russian gas giant has submitted a list of proposals to EU regulators, in the hope of settling the case before formal charges are levelled at the company.

The process began back in September 2011, when EU antitrust investigators raided the offices of Gazprom subsidiaries and of several of Gazprom's European partners at 20 sites across 10 EU member states in Central and Eastern Europe. The member states under investigation include Germany (E.ON, RWE, Gazprom Germania), Austria (OMV, Econgas), Poland (PGNiG, TSO Gaz-System), the Czech Republic (RWE Transgas, Vemex), Slovakia (SPP), Hungary (E.ON Magyarorszag), Latvia (Latvijas Gaze), Lithuania (Lietvos Dujos), Estonia (Eesti Gaas), and Bulgaria (Bulgargas, Bulgartransgas, Overgas). As noted at the time in the Gazprom Monitor (Issue № 8: Aug-Sept 2011), the raids were carried out under Articles 101 (restriction of competition) and 102 (abuse of dominant position) of the Treaty on the Functioning of the EU (TFEU). The fact that the initial raids coincided with the launch of EU legal proceedings against 18 EU member states that had failed to transpose EU Third Energy Package legislation suggests that the investigation into Gazprom is part of a broader effort by the European Commission to ensure the development of competitive, liberalised EU internal gas market.

A year after the initial raids, the European Commission officially launched its investigation, claiming that Gazprom was suspected of three sets of anti-competitive practices: "First, Gazprom may have divided gas markets by hindering the free flow of gas across Member States [by effectively preventing gas-importing states from re-exporting that gas]. Second, Gazprom may have prevented the diversification of supply of gas [by denying other gas suppliers to Gazprom-owned infrastructure]. Finally, Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil prices".

The Russian President, Vladimir Putin, responded to the launch of the investigation by signing the 'Decree on Measures for Protecting the Interests of the Russian Federation in the Course of Foreign Trade Operations Performed by Russian Legal Entities'. The decree states that strategic companies such as Gazprom may disclose information about their operations to foreign countries, companies, and regulators, sell foreign assets, and alter contracts with foreign entities, only with the permission of the authorised Russian federal agency.

Reports in October 2013 then suggested that the EU antitrust investigators were preparing their 'statement of objections' – essentially a list of accusations against Gazprom that would form the basis of legal charges. The Russian Prime Minister, Dmitrii Medvedev, responded in writing to the European Commission President, Jose Manuel Barroso, on behalf of the Russian state (the majority shareholder in Gazprom), which led to a meeting between the EU Commissioner for Competition, Joaquin Almunia, the Head of Gazprom Export, Alexander Medvedev, and Russia's Deputy Energy Minister, Anatolii Yanovskii, in early December.

The meeting was apparently constructive, and in mid December Gazprom formally submitted its response to the EU investigators: a series of commitments that would mitigate the accusations, which the EU regulators could make binding on Gazprom, as a means of settling the investigation without bringing the matter to court. Further bilateral meetings are expected in the coming months as the two sides enter into a period of negotiation that could have a significant impact on Gazprom's strategy and presence on the European gas market.

Gazprom finalises asset-swap with BASF Wintershall, with deal approved by EU competition watchdog

In some welcome news for Gazprom, at the beginning of December EU competition regulators approved Gazprom's asset-swap deal with the German energy utility, BASF Wintershall. The agreement, first signed in November 2012, will see Gazprom exchange 25 percent shares in two blocks of the Achimov deposits of its Urengoy gas field (West Siberia) for 100 percent shares in the Gazprom-BASF Wintershall joint venture gas trading and storage companies, Wingas, WIEH and WIEE. Gazprom will also receive a 50 percent share in BASF Wintershall subsidiary, WINZ, which carries out exploration and gas production in the North Sea. The Master Agreement, which finalised the deal, was signed at the end of December, and will be backdated to the 1st of April 2013.

Wingas is a wholesale gas trader that currently holds 20 percent of the German wholesale gas market, and supplies gas to Belgium, the Netherlands, the UK, Austria, the Czech Republic. WIEH supplies gas to consumers in Germany, and WIEE supplies gas to consumers in Bulgaria and Romania. The Wingas subsidiary, Astora, operates the largest gas storage facility in Western Europe, at Rehden in Germany, and holds a 30 percent stake in the second-largest gas storage facility in Central Europe, at Haidach in Austria.

For the sake of clarity, it should be noted that in May 2012 the original Wingas joint venture was renamed W&G Beteiligungs GmbH & Co KG (W&G). The name 'Wingas' now denotes the gas trading subsidiary of W&G. WIEH, WIEE, and Astora are subsidiaries of Wingas. The asset-swap gives Gazprom control over Wingas, WIEH, WIEE, and Astora. However, sources currently suggest that Gazprom's shareholding in W&G will remain at 50 percent. This is important, because W&G controls other subsidiaries apart from Wingas.

W&G has a gas transport subsidiary, Gascade, which owns a significant network of gas pipelines across Germany, including those that allow Germany to receive Russian gas via Poland (JAGAL) and via the Czech Republic (STEGAL), and those pipelines that connect Germany to Belgium (WEDAL) and the Netherlands (MIDAL). Gazprom's shareholding in Gascade will remain at 50 percent. The fact that Gascade recruited Andrei Krutko from Gazprom Export to be their new Managing Director from the 1st of October 2013 therefore seems to be symbolic of the close ties between Gazprom and Wintershall, rather than a sign of Gazprom's imminent takeover of Gascade. W&G also holds a 51 percent shareholding in the NEL gas pipeline, which connects Nord Stream to the Rehden gas storage facility, and an 80 percent shareholding in the OPAL gas pipeline, which connects Nord Stream with Olbernhau on the German-Czech border. Gazprom's shareholding is set to remain at 25.5 percent and 40 percent respectively. In a presentation at the BASF Oil & Gas Roadshow in Frankfurt on the 2nd of December 2013, the Wintershall CEO, Dr Rainer Seele, stated that "ownership of [the] gas transportation [is] unaffected".

Ukraine

Russia offers Ukraine 33 percent discount on gas price as part of package designed to keep Ukraine in Russia's political orbit

Failure of the Ukrainian President, Viktor Yanukovych, to formally sign Ukraine's previously agreed Association Agreement with the European Union on the 21st of November, triggered massive protests in Kiev. Reports suggested that Yanukovych had been under 'significant economic pressure' from Russia not to sign the agreement, which would have taken Ukraine a step closer to integration with the EU and a step further away from integration into the Russia-led Customs Union (of Russia, Belarus, and Kazakhstan). The situation is contextualised by Ukraine's parlous economic state – reports suggest that Ukraine would need to find $17bn next year to pay outstanding loans, including a $2bn outstanding bill to Gazprom. The IMF had offered a $15bn bailout, but on conditions of economic reform that the current Ukrainian government is unwilling to undertake.

Then, on the 17th of December, it was announced that the Russian government had agreed to buy $15bn of Ukrainian government bonds, and that from the 1st of January 2014 the price of Ukraine's imports of Russian gas would be reduced from $400 per thousand cubic metres to $268.5 – a discount of 33 percent. The Ukrainian Prime Minister, Mykola Azarov, confirmed that "The head of state managed to agree lower gas prices as of January 1st and until the contract ends". The Russian President, Vladimir Putin, also stated that Ukraine's accession to the Customs Union played no part in the Russian-Ukrainian negotiations.

However, the downward revision of the price Ukraine pays for Russian gas comes at a significant cost to Gazprom. Given that Gazprom currently supplies around 25 bcm per year to Ukraine, a price reduction of $131.5 per 1000 cubic metres equates to a loss (for Gazprom) of $3.29bn per year. However, the current contract between Gazprom and Naftogaz has a delivery volume of 52 bcm with an 80 percent take-or-pay clause, equating to a minimum delivery volume of 41.6 bcm per year. Over the past two years Gazprom's leadership has oscillated between threatening to impose financial penalties on Naftogaz (as Gazprom is contractually entitled to do) and simply ignoring the issue. With the granting of a gas price discount, one is left wondering whether this spells the end for Ukraine's diversification of gas imports away from Gazprom, and whether gas imports from Russia will start to creep up again, thus benefitting Gazprom in the long term.

Nord Stream

EU and Gazprom to agree terms for use of OPAL pipeline in early 2014

Russian sources report that EU regulators will make a ruling in early 2014 on the subject of how much Gazprom-supplied gas is allowed to flow through OPAL. The OPAL pipeline has a capacity of 35 bcm per year. Its sister pipeline, NEL, has a capacity of 20 bcm per year. The capacity of the two pipelines matches the overall capacity of Nord Stream (55 bcm).

However, Gazprom's usage of OPAL and NEL has been limited to 50 percent of their capacities, with current EU legislation on Third Party Access requiring that the remaining 50 percent of the capacity of OPAL and 35 percent of the capacity of NEL are left available for use by other gas suppliers. This means that Nord Stream has also been operating at half capacity, delivering just 21.3 bcm between January and November 2012. Gazprom, as the only company currently capable of feeding gas into OPAL and NEL (via Nord Stream), argues that such limitations make no sense, and that Gazprom should be granted an exemption from Third Party Access legislation that would allow them to make full use of OPAL and NEL as onshore extensions of Nord Stream.

Gazprom's request may yet find sympathetic ears in Brussels. According to Marlene Holzner, a spokesperson for EU Energy Commissioner, Gunther Oettinger, "Russia has accepted that Opal is on EU territory. That is why EU legislation is the crucial thing. They have asked formally for an exemption".

South Stream

South Stream faces legal hurdles as European Commission claims aspects of South Stream's intergovernmental agreements are in breach of EU law

At the beginning of December, the European Commission recommended that the EU members participating in the South Stream project should renegotiate their bilateral agreements with Russia. On the 5th of December, Marlene Holzner, a spokesperson for EU Energy Commissioner, stated that; "We have looked into the intergovernmental agreements [IGAs] that were made between the member states through which South Stream would flow and Russia, and we have seen that on a number of very important core issues of our energy market, these core principles are not reflected in the IGA and that is why we have advised those member states to renegotiate these IGAs".

The European Commission's concerns over the IGAs are rooted in two key issues: Firstly, that Gazprom's 50 percent ownership (51 percent in non-EU Serbia) essentially equates to Gazprom managing the pipeline, in contravention of European legislation on 'unbundling'. Secondly, the IGAs do not provide for Third Party Access, and essentially describe South Stream as a pipeline for Russian gas – again, on contravention of EU energy market legislation. While the European Commission is unable to prevent the construction of South Stream, it can take action once the pipeline is in operation, if it is in contravention of EU energy market legislation. According to Holzner, if at that point Gazprom refused to renegotiate the terms and conditions of South Stream, then the European Commission would first advise the participant EU member states not to apply the IGAs. Then, "if they go ahead we may have to start infringement procedures".

On the 12th of December, the EU Energy Commissioner, Gunther Oettinger, met with Energy Ministers from the six EU participants in the South Stream project (Bulgaria, Hungary, Greece, Slovenia, Croatia, and Austria). At that meeting, it was agreed that Oettinger would hold negotiations with Gazprom in January, on behalf of the EU and the six EU member states.

The South Stream pipeline as a whole, which is planned to run over 900km under the Black Sea from Russia to Bulgaria, and then a further 1500km on to the Slovenian-Italian border via Serbia and Hungary, will cost an estimated 17bn Euros. According to Gazprom, the first gas supplies via South Stream are scheduled for late 2015, with the pipeline expected to reach full capacity in 2018.

Asia

Gazprom fails to conclude deal with CNPC before year end

Despite numerous optimistic claims from Gazprom representatives and Russia's Energy Minister, Alexander Novak, Gazprom failed to live up to its promises and seal a deal for gas exports to China before the end of 2013. Gazprom is currently locked in negotiations with the China National Petroleum Corporation (CNPC). At the beginning of September it was reported that the two sides had agreed on the route (from Eastern Siberia to

Northeast China), the volume of deliveries (reported to be 38 bcm per year, although Gazprom sources continue to refer only to 'up to 68 bcm' without giving a definite figure), and the start date for deliveries (2018). Following this announcement, when asked if the final negotiations would be concluded by Chinese New Year (31st January 2014), the Gazprom Chief Executive, Alexei Miller replied, "Definitely. The contract is in a high state of preparedness, we have to agree on a basic price only". However, that 'basic price' has proved a significant sticking point in the negotiations, and the conclusion of an agreement before the end of January is far from guaranteed.

And in other developments…

Gazprom opens representative office in Brussels

At the beginning of December, the Head of Gazprom Export, Alexander Medvedev, took part in a ceremony to mark the opening of Gazprom's new representative office in Brussels. Medvedev was joined by Russia's Deputy Energy Minister, Anatolii Yanovskii, the Ambassador Extraordinary and Plenipotentiary of the Russian Federation to the Kingdom of Belgium, Alexander Romanov, the Permanent Representative of Russia to the EU, Vladimir Chizhov, the EU Energy Commissioner, Gunther Oettinger, Belgium's Secretary of State for Energy, Melchior Wathelet, several members of the European parliament, and the heads of several European oil and gas companies.

At the ceremony, Medvedev noted; "As a global energy Company, Gazprom has a vast network of international representative offices and aims to build up its presence both in existing and prospective markets. For over 40 years Europe has been the Company's major export market. Gazprom supplies natural gas to 20 European countries and invests billions of euros in major trans-European infrastructure projects. Today we are engaged in an active dialogue with the EU bodies and the opening of Gazprom's representative office in the EU capital will make it more efficient".

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