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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:

- *Gazprom announces an agreement with Poland's PGNiG to adjust gas prices and signs an asset-swap deal with BASF/Wintershall, but remains under pressure in Europe due to falling export volumes and the EU antimonopoly investigation*
- *Ukraine continues to press for reduced imports of Russian gas and receives first deliveries from RWE*
- *Gazprom appears set to expand its underground gas storage facilities and gas transmission capacity in Belarus*
- *Slovenia and Bulgaria confirm their final investment decisions for the South Stream project, as Gazprom's partners also take the final investment decision on the offshore section, while Gazprom signs a new gas supply contract with Bulgargaz*
- *Turkish regulators approve Gazprom's new long-term supply contracts with private Turkish energy companies*
- *Gazprom demonstrates the potential for shipping LNG from Europe to Japan as it charters the first LNG supertanker to traverse the Arctic during winter*
- *Novatek acquires 49 percent of Northgas, with Gazprom retaining its 51 percent stake in the company*

Gazprom and the EU

Gazprom reaches an agreement with PGNiG over the price of Russian gas exports to Poland and signs a new asset-swap agreement with BASF Wintershall, but remains under pressure in Europe due to falling demand and EU antimonopoly investigation

On 6 November Gazprom announced that it had reached agreement with PGNiG to adjust gas prices in its long-term contract (c.10 bcm pa until 2022) with the Polish energy company for gas supplied via the Yamal-Europe pipeline. The deal represents the latest of such price adjustments in Gazprom's contracts with European gas importers.

Polish sources reported in July that PGNiG was seeking a 20 percent discount on its Russian gas imports, to bring prices in line with those paid by Germany, and would file for arbitration through the Arbitration Institute of the Stockholm Chamber of Commerce. Following the deal with Gazprom, PGNiG announced that the company's core earnings would increase by 2.5-3bn zlotys (609-732m Euro), while the share price of the company rose by 10 percent.

Gazprom was also keen to portray the deal as a victory, claiming that although the new gas price formula reflected current market prices for oil and gas products, "the basic principles" of gas trade have been preserved intact, including long-term contracts, take-or-pay principle and oil-pegged prices. The spot component, taking into consideration the state of play of the Polish market, will not be incorporated directly into the contract.

On 14 November Gazprom announced that the company had signed a Basic Agreement on an asset-swap with the German energy company, BASF Wintershall. The deal purports that BASF Wintershall will receive 25 percent plus one share in the development of two new blocks of the Achimov gas field, while Gazprom will increase its shareholding in the Wingas, WIEH and WIEE gas trading companies (previously joint ventures between Gazprom and BASF Wintershall) to 100 percent. If the proposal is approved by regulators, the deal will be finalised by the end of 2013.

Despite the seemingly good news for Gazprom, the company remains under pressure in the EU gas market. Speaking at the Russian Gas Export Forum, Russian Energy Minister, Alexander Novak, predicted that Russia's 2012 gas exports would fall by 4-5 percent versus 2011 due to "economic difficulties in European countries and the quick recovery of supplies from Libya". Furthermore, senior Russian officials such as First Deputy Prime Minister, Igor Shuvalov, have criticised the EU antimonopoly investigation, claiming "All these actions are being taken for one purpose only - to make Gazprom reduce the price of the gas it supplies". The Norwegian national oil and gas company, Statoil, put further pressure on Gazprom when it announced the signing of a new 10-year gas supply contract with BASF Wintershall based on spot prices, with a total contractual volume of 45 bcm worth approximately 13.4bn Euros at current gas prices. If Gazprom fails to adapt to such developments, it could lose out to competing gas suppliers who are willing to base their long-term gas contracts on spot gas, rather than oil, prices.

Ukraine

Ukraine continues to press for reduced imports of Russian gas and receives first deliveries from RWE

On 16 November Ukraine's Fuel and Energy Minister, Yuri Boyko, announced that Ukraine's gas imports from Russia would be 27.7 bcm in 2012, and could be reduced to 18-20 bcm in 2013. In 2011 Ukraine imported 44.8 bcm of Russian gas, making it the world's largest importer of Russian natural gas. Ukraine's wholesale gas importer, Naftogaz, currently imports gas from Gazprom on a ten-year long-term contract signed in 2009, with contracted volumes of 52 bcm per year and a take-or-pay clause covering 80 percent of those volumes. Therefore, Naftogaz is contractually obliged to purchase 41.6 bcm in 2012.

As part of its efforts to reduce dependency on Russian gas supplies, Naftogaz received its first deliveries from the German energy firm, RWE, via Poland. Russian supplies cost Ukraine around $430 per thousand cubic metres in Q4 2012, while Naftogaz's Deputy Director, Vadim Chuprun, claimed that deliveries from RWE are 'around $100 cheaper'. However, the volume of deliveries from RWE is extremely small if compared to the volume of supplies from Gazprom, with contracted volumes of just 1.4 bcm in the first year.

Belarus

Gazprom announces plans to expand its underground gas storage facilities and gas transmission capacity in Belarus

During his visit to Minsk on 22 November, Gazprom CEO, Alexei Miller, stated: "At present, Beltransgaz has an opportunity to carry out the large-scale investment program aimed at advancement of the entire gas transmission system throughout the Republic, and to expand UGS and gas transmission capacities". Russian sources report that the expansion of transmission capacity would cost up to 1.5bn Euros and the expansion of underground gas storage (UGS) capacity could cost up to 850m Euros. If the expansion goes ahead as planned, Gazprom's gas deliveries to Europe via Belarus could be increased by up to 30 percent. Gazprom's gas shipments via Belarus are expected to be 44.5 bcm in 2012, with gas deliveries to Belarus amounting to 22 bcm. The potential increase in gas transit via Belarus, in the context of the recent launch of Nord Stream and Gazprom's announcements regarding South Stream, suggest a further reduction in Ukraine's share of gas transit from Russia to the EU.

South Stream

Bulgaria and Slovenia confirm the construction of South Stream on their territories; Gazprom signs a ten-year gas supply contract with Bulgargaz; the final investment decision on the offshore section of South Stream is taken by Gazprom and its international partners

The South Stream project took a significant step forward in November. With Serbia and Hungary having confirmed the implementation of South Stream on October 29 and 21 respectively, Slovenia and Bulgaria announced their final investment decisions on November 12 and 15. The 266 km Slovenian section will be built and operated by South Stream Slovenia LLC, a 50-50 joint venture of Gazprom and the Slovenian gas transmission system operator, Plinovodi. The 538 km Bulgarian section will be built and operated by South Stream Bulgaria, a 50-50 joint venture between Gazprom and 100 percent state-owned Bulgarian Energy Holding.

Also on 15 November, Gazprom signed a ten-year gas supply contract with Bulgargaz (the gas distribution subsidiary of state-owned Bulgarian Energy Holding), for annual deliveries of 2.9 bcm. Bulgaria will continue to import 100 percent of its gas from Russia, but intermediaries have now been removed from Russian-Bulgarian gas trade, with Gazprom Export delivering supplies directly to Bulgargaz. Previously, supplies were imported by intermediaries such as Overgas and WIEE. Overgas is a 50-50 joint venture between Gazprom and unnamed private investors and WIEE is a joint venture between Gazprom and BASF Wintershall. Overgas accounted for 70 percent of Bulgaria's gas imports, and WIEE accounted for 20 percent. Notably, Gazprom CEO, Alexei Miller, confirmed that the contract retained the principles of 'take-or-pay' and oil-indexed prices, both of which have been challenged in recent years by several of Gazprom's European customers.

On 14 November Gazprom CEO, Alexei Miller, met with representatives of Eni, EdF, and BASF Wintershall at a meeting of the South Stream Transport Board of Directors. At that meeting the Board adopted the final investment decision on the South Stream offshore section, which will pass under the Black Sea from Russia to Bulgaria through Turkish territorial waters. On 21 November a spokesman for South Stream Transport, Sebastian Sass, held a briefing in Moscow, where it was announced that South Stream Transport expects to complete an environmental impact assessment and receive all necessary environmental and technical permits from Russia, Turkey, and Bulgaria during 2014. Such a timeframe would allow construction and the commencement of deliveries by 2015. The fact that the necessary technical and environmental permits have not yet been issued suggests that the actual implementation of the South Stream project is still not guaranteed.

The offshore section of South Stream will consist of four 15.75 bcm p.a. capacity pipelines, with the lines being commissioned in 2015, 2016, 2017 and 2018. However, that schedule remains provisional. According to Gazprom estimates, the 925 km offshore section will cost 10bn Euros.

Turkey

Turkish regulators approve Gazprom's new long-term supply contracts with private Turkish energy companies

Turkey's gas market regulator has approved Gazprom's agreements with Akfel, Bosphorus, Kibar, and Bati Hatti to import 6 bcm per year for the next 30 years (23 years in the case of Bati Hatti) via the 'Western Line' of Ukraine, Romania, and Bulgaria. These contracts replace the 6 bcm previously imported from Gazprom by the Turkish state-owned Botaş, as part of the Turkish government's efforts to liberalise the Turkish gas market.

Asia-Pacific / Russian Arctic

A Gazprom-charted LNG supertanker makes the first trip from Europe to Japan via the Northern Sea Route during winter

The River Ob, an LNG supertanker with a cargo of 150000 cubic metres of gas in the form of LNG, is making history as the first tanker of its kind to traverse the Northern Sea Route from Europe to Japan during winter. The super-tanker, chartered by Gazprom Marketing and Trading, departed from Hammerfest, Norway, on 7 November, and will arrive in Japan in early December. For the majority of its journey along Russia's northern coast, it will be guided by a Russian nuclear-powered icebreaker. The voyage demonstrates the possibility of shipping LNG from North-Western Russia to the Asia-Pacific region, and thus offers a precedent that could be followed by the Yamal LNG project currently being developed by Novatek and France's Total. However, the status of potential exports from the Yamal LNG project has yet to be confirmed due to Gazprom's legal monopoly on Russian gas exports (with the exception of those from Sakhalin in Russia's Far East), with the possibility of Gazprom acting as an agent for the export of LNG produced at Yamal by Novatek and Total.

And in other developments…

Novatek signs a one billion Euro deal to acquire 49 percent of Northgas

Russia's largest independent gas producer, Novatek, has signed a 1bn Euro deal to acquire a 49 percent stake in another Russian gas producer, Northgas. The remaining shareholder in Northgas will be Gazprom, with a 51 percent stake. According to Gazprombank, Novatek's largest shareholder is its founder and CEO, Leonid Mikhelson (25 percent). The second largest shareholder is Gennady Timchenko, co-owner of oil trader Gunvor, which owns 23.5 percent of Novatek through the Volga Resources Fund. Other major shareholders in Novatek include the French energy company, Total (15 percent), and Gazprom (10 percent), with the remaining shares classified as 'free float'.

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