

## Complications with the South Stream pipeline project

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As a consequence of new criticism from the Bulgarian government concerning both energy relations with Russia in general and the South Stream project, on 17 June Alexey Miller, the chairman of Gazprom, hinted at the possibility of a change in the route of South Stream which, according to his statement, could run through Romania. This eventuality at present seems rather unlikely (in part due to Bucharest's stance on the issue) but the fact that it has been raised bears witness to the problems Gazprom has been having in connection with the South Stream project that the Russian company has long been lobbying for. These problems, which have been lately becoming more apparent, are related *inter alia* to: the increasing energy policy independence of certain countries from southern Europe and the Balkans (especially Bulgaria and Turkey); the new dynamics of competitive projects (especially the Southern Corridor); and also the current situation on the European gas market (a decreased demand for fuel and new pipelines). Against this background we can see certain moves concerning South Stream as temporarily having mostly a significance in the lobbying-image sense—the signing of the memorandum on 19 June in Saint Petersburg aimed at making the entrance of Electricite de France to the group of shareholders in South Stream and the choice of Marcel Kramer (currently head of the Dutch Gasunie) as director general of the project's consortium. The purpose of these moves is to demonstrate the ongoing interest of European corporations in the pipeline and to show the determination of Russia and Gazprom who, in spite of the current challenges, intend to accelerate the implementation of South Stream.

### EdF's unclear participation in the project

The South Stream project sets about the creation of a new gas pipeline (with a capacity of 63 bcm) running from Russia, through the Black Sea to Bulgaria, Southern and Eastern Europe and the Balkans (see the Annexe). In 2009 a series of bilateral agreements were signed at the inter-governmental and business level determining the conditions for the construction of the overland sections of the project. The offshore section of South Stream will be implemented by a joint venture of the Italian ENI with Gazprom. Last year talks began on the possibility of the French EdF joining the consortium. This would be a real strengthening of the project – the French company is a major gas importer and the owner of a number of power plants in Southern Europe. However, the tension between ENI and Gazprom concerning *inter alia* the conditions for the participation of EdF in South Stream (regarding whose shares will go to EdF) is one of the main obstacles to EdF actually joining the project. Another memorandum signed last week, though it confirms the intentions of all

three corporations to change the share structure of the company implementing South Stream, does not unambiguously decided upon the details of the issue (leaving open, for instance, the issue of the target quantity of EdF's shares and failing to set the date they will be taken over).

### **Route problems for South Stream**

In recent weeks other weak points of South Stream have become visible; above all the wavering support from key project countries (mainly Bulgaria and Turkey), the effect of which is the current lack of a defined detailed route for the pipeline. Critical statements from the Bulgarian government concerning both energy cooperation with Russia (statements from Bulgaria's prime minister on 11 June) and the South Stream project (on 12 June the deputy minister of the Bulgarian Ministry of Foreign Affairs pointed to the priority significance of the Nabucco project which is in competition with South Stream) are among the causes for Russia to have begun to publicly raise the option of changing the route for South Stream. According to Gazprom's chairman Alexey Miller, the pipeline could – contrary to previous plans – divert around Bulgaria and run through Romania. Although Romania's possible inclusion in South Stream was one of the subjects of bilateral Russian-Romanian talks, bearing in mind Bucharest's restrained stance and its policy for diversifying supply sources, this seems to be mainly a tactical gambit from Russia.

A further unclear issue is the route of the offshore section of South Stream which would have to run along the sea bottom of the Black Sea through either Ukraine's or Turkey's exclusive economic zone. The Ukrainian government is presently clearly against the implementation of South Stream as it runs contrary to their interests concerning the transit of gas to Europe, and Turkey has an unclear stance on the issue. The decision on the possible construction of South Stream in the Turkish Black Sea exclusive economic zone is to be made by mid-November of this year. The subject has become a permanent fixture in bilateral gas talks (e.g. it was raised in the June meeting between Erdogan and Putin) and equally seems to be an element of the negotiation package concerning bilateral energy cooperation (also concerning the renegotiation of gas contracts under way, the cooperation in the oil sector and nuclear energy).

### **Turkish support for competing projects and suppliers**

Meanwhile, Turkey's energy policy goals are not always compatible with Russia's. Ankara, on the way to the creation of a strategic gas hub on Turkish territory, is negotiating the conditions for the fuel supply and transit from suppliers in competition with Gazprom. The latest manifestation of this type of behaviour was Turkey and Azerbaijan signing gas agreements on 7 June. These documents both ease additional gas supplies to the Turkish market and create the framework for launching the transit of Azeri fuel to European markets, being also final markets for Russian gas from South Stream. At the same time Ankara is backing pipeline projects alternative to South Stream – in recent weeks Turkey has, *inter alia*, clearly confirmed its participation in the Nabucco and ITGI pipeline projects, those being lobbied by the EU as part of the Southern Gas Corridor conception.

## **South Stream and the situation on the European gas market**

The obstacles currently facing South Stream are the result of general causes: an unclear economic justification of the project (as regards costs and the existing alternative export routes), a failure to work out the ultimate concept of the project (route, stakeholders), the increasing assertiveness of current partners of Gazprom (Bulgaria); and also of a number of immediate, external factors. In part these reflect the more general problems Gazprom has on the European market resulting from the reduced demand for gas, the oversupply of the fuel on the market (including LNG) and the possibility of initiating production from non-conventional sources. All these factors limit the demand over the coming few years for additional gas supplies and new routes. In consequence, it increases the likelihood of further difficulties in the implementation of the South Stream project. The desire to overcome the problems currently surfacing along with maintaining the image of a project being quickly and effectively implemented, may persuade the Russian side to intensify its efforts to gain political and financial support for South Stream and to secure markets for Russian gas.

### **Annexe**

#### **General information concerning the South Stream project**

##### **Route:**

- Russia (compression station Pochinki– compressor station Beregovaya– Black Sea – Bulgaria (Varna and branches:
  - a) Serbia – Hungary – Austria (Baumgarten hub) + sub-branch from Hungary: Slovenia – north Italy
  - b) Greece – Ionian Sea - Italy
- Among other sub-branches taken into consideration are: to Romania, Macedonia, from Greece to Turkey, to Bosnia and Herzegovina, via Croatia to Rijeka and onto central Italy.

**Length:** dependent on the route: approx. 3200 km

**Capacity:** 63 bcm

**Cost:** estimated between 8 and 24 billion euros (in May 2010 Gazprom's spokesperson spoke of costs below 20 billion euros)

##### **Consortium:**

- Offshore section: South Stream AG (Gazprom and ENI 50:50); according to a memorandum signed on 19 June 2010 by Gazprom, ENI and EdF, a minimum of 10% of (ENI's) shares are to be taken by EdF by the end of 2010

- Overland sections to be built by Gazprom in cooperation with:
  - o DESFA (Greek section, JV 50:50),
  - o Srbijagas (Serbian section, JV (51:49),
  - o Bulgarian Energy Holding (Bulgarian section, JV 50:50),
  - o OMV (Austrian section, JV 50:50),
  - o Geoplin Plinovodi (Slovenian section, JV 50:50),
  - o MFB (Hungarian section, JV 50:50)

#### **Plans:**

- by 10 November 2010 – announcement of the decision concerning the possibility to build South Stream in Turkey's exclusive economic zone
- February 2011 – completion of the feasibility study for the entire project
- 2013 – completion of construction of the submarine part of the pipeline
- end of 2015 – completion of project, initiation of supplies

#### **Most important events concerning the project since December 2009**

- December 2009 – initial agreement between Gazprom and ENI concerning the inclusion of EdF in South Stream
- January 2010 – Gazprom and the Hungarian MFB appoint South Stream Hungary to implement the Hungarian section of the pipeline
- March 2010 – inter-governmental agreement between Russia and Croatia concerning the inclusion of Croatia in South Stream
- April 2010 – inter-governmental agreement between Austria and Russia concerning South Stream and a basic agreement on cooperation between Gazprom and OMC on the formation of a joint venture (50:50) for the construction and exploitation of the Austrian section of the pipeline
- June 2010:
  - 7.06 – Gazprom and DESFA sign an agreement to appoint the joint venture South Stream Greece S.A. to implement the Greek section of the pipeline;
  - 9.06 – Gazprom completes FEED surveys (engineering and project-oriented) for the submarine section of South Stream
  - 12.06 – deputy minister of the Bulgarian Ministry of Foreign Affairs states that Nabucco has priority over South Stream
  - 16.06 – Russian-Romanian talks on, *inter alia*, surveying Romanian territorial waters and the possible participation of Romania in South Stream
  - 17.06 – Russian-Macedonian talks on the possible participation of Macedonia in South Stream
  - 17.06 – Alexey Miller in an interview for *The Moscow Times* hints at a change in the route of South Stream from that running through Bulgaria to one running through Romania

- 19.06 – a trilateral memorandum signed between Gazprom, ENI and EdF on the inclusion of EdF in South Stream AG (foreseeing a minimum of 10% of ENI's shares to be taken by EdF by the end of 2010);
- 19.06 – Marcel Kramer, head of Gasunie to become the head of South Stream AG

