

Russia activates the LNG sector

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On 10 January, Gazprom and Novatek OAO (the largest independent gas producer in Russia) signed an agreement to form a joint venture to produce liquefied natural gas (LNG) on the Yamal Peninsula. The agreement is further evidence of Russia's growing interest in LNG production, which has been observed in recent years. It forms part of Russia's declared strategy of diversifying the markets for its domestic gas. Increased LNG production in Russia could make it possible to offer flexible gas supplies to the demanding Asian market, which is seen as an alternative to Europe, where Gazprom is facing increasing difficulties. Russia's activation in the LNG sector is a response to increased competition for markets among gas manufacturers and exporters (such as the Middle Eastern states, especially Qatar; Australia, Canada and the United States). The limited progress observed so far in implementing Russian LNG projects has been caused by the Russian gas sector's main problem, which is the dominant position of Gazprom in the internal market and its export monopoly, which is guaranteed by law.

Russia's LNG projects

In comparison with other liquefied natural gas-producing countries, the Russian market for producing LNG is relatively undeveloped. At present (as of 18 February 2009), it is only produced on the Sakhalin peninsula in the Russian Far East as part of the Sakhalin-2 project, which is funded mainly by foreign partners. The production volume is about 10 million tons per year (in 2012 the figure was 10.46 million tons, or about 14.65 bcm), which represents approximately 5% of the world's LNG.

In recent years, Russia has launched new projects for gas extraction and LNG production: the Yamal LNG company (80% of whose shares belong to Novatek, and the remainder to the French company Total), which was established to exploit the South-east Tambey deposit (on the Yamal Peninsula); also, a Russian-Japanese memorandum to construct an LNG terminal in Vladivostok was signed last June in St. Petersburg. The Pechora LNG project, involving the development of the Kumzhinsk and Korovinsk fields (Republic of Komi) is at the initial stage of preparation (a feasibility study). A project to build a terminal on the Black Sea, as well as another to build on the Chukotka and Kamchatka peninsulas – if the existence of gas fields there is confirmed – are at the planning stage.

The recent agreement between Novatek OAO and Gazprom solidifies the assumptions set out in the memorandum of cooperation which the companies signed in April last year. Of the scant information that has been revealed so far, it appears that the concept for the joint venture's structure has been altered. Originally, the plan was the joint creation of two

separate companies: one to exploit the Tambey deposits belonging to Gazprom (on the Yamal Peninsula), and the other to exploit Novatek OAO's deposit on the Gydan Peninsula. Now, the plan is to create a single joint venture to operate both of these fields. As a consequence of this change, a new parity of shares will have to be established between Novatek OAO and Gazprom (which should take place by 1 August).

The main problems with carrying out the projects

LNG projects in Russia have the government's political support; last November, President Vladimir Putin ordered the managements of Novatek OAO and Gazprom to agree on contracts to export LNG from the Yamal Peninsula. The government has taken a number of measures to stimulate the projects, including granting the Yamal LNG project an exemption from the tax on the extraction of fossil fuels and natural gas (NDPI) in relation to gas processed into LNG, as long as production does not exceed 250 bcm; as well as an exemption from export duty. However, progress in implementing the LNG projects has been insignificant. The main reason for this is Gazprom's *de facto* and *de jure* privilege on the Russian gas market. Gazprom is striving to maintain its current position, especially to maintain its export monopoly in the gas sector, which is guaranteed by law. At the same time, Gazprom wants to implement LNG projects in collaboration with its partners, including foreign ones, and to push some of the costs onto them. Favouring the state-owned company makes it difficult for independent operators to obtain the cooperation of attractive foreign partners, whose funding and technologies are needed to implement their own, expensive LNG production projects. Thus in recent months, we have observed intense lobbying (led by Novatek OAO), the aim of which is to abolish Gazprom's exclusive right to LNG exports. This has been supported by several ministries (those of energy, environment and the economy), as well as the Federal Anti-Monopoly Service, which provides a chance for a proposed change in the law to go through. However, any final resolution of the issue will require a political decision, which will not be easy to take because of the close social and business ties linking Vladimir Putin with both parties in the dispute – Putin is a friend of Gazprom's president Aleksei Miller, and Novatek OAO is co-owned by another of Putin's friends, Gennady Timchenko.

Prospects for Russian LNG exports onto Asian markets

LNG production from Russian fields (primarily Yamal) is mainly intended for prospective Asian markets, in particular China, Japan, India, South Korea and Taiwan. Projections indicate that by 2025 there will be a significant growth in demand for gas in the region (to 600-800 bcm per year), of which LNG will account for almost 50%.

The Russian presence on foreign LNG markets has so far been insignificant; in 2012, exports of liquefied natural gas from the Sakhalin terminal amounted to about 14.65 bcm. Russian LNG has mainly been exported to Japan (60%), as well as China, India, South Korea and Taiwan. Exports of Russian LNG would be significantly enhanced by the production of raw material from the Yamal fields (Gazprom and Novatek OAO's joint projects are expected to produce about 20 million tons of LNG per year, or about 28 bcm, and the Yamal LNG project should yield about 16.5 million tons, or about 23.1 bcm). The cost of the joint

venture between Gazprom and Novatek OAO is about US\$18-20 billion, while that of the Yamal LNG is about US\$15-20 billion; production in both cases is scheduled to start in 2016. However, the slow pace of implementing the projects has prevented Gazprom from entering into new contracts to supply LNG. One exception is the 20-year gas deal concluded on 1 October last year between Gazprom Marketing & Trading (a subsidiary of Gazprom) and the Indian conglomerate Gail India, which provides for the delivery of 2.5 million tonnes of LNG per year no earlier than in 2018-2019. Any delay in implementing these projects may result in Russia losing an opportunity to build up a significant position on the Asian market at the expense of more active competitors (Qatar, Australia, the United States), who already have much wider opportunities for expansion.

One major challenge is the question of how profitable the Russian exports may be. One characteristic of the Asian LNG market is the wide variation in raw material prices. The potential high cost of transporting Russian LNG could increase prices; it is still unsure by which route the Russian gas from the Yamal and Gydan fields would be transported, although the first test journeys by Gazprom tankers indicate that the so-called northern route is the most likely. This may prove less competitive with regard to gas sent from Australia or Indonesia (the length of the transport route will have a significant impact on the LNG's prices). So, getting a stake in the strategically important Asian market may prove very expensive, and quite possibly not very cost-effective.

Appendix

Forecasts for gas demand in key Asian states (figures in bcm)

	China		India		Japan*		South Korea*		Taiwan*	
	all	LNG	all	LNG	all	LNG	all	LNG	all	LNG
2015	180–260	17,5–60	80–90	10–20	115–130	115–130	55–60	55–60	17,5–20	17,5
2025	270–440	35–130	120–140	30	140	140	60–80	60–80	22,5–30	22,5

* Negligible domestic production, which means practically total dependence on imports

Figures based on data from the Oxford Institute for Energy Studies

Map

LNG terminals in Russia

