

Russia offers a reminder of South Stream in Bulgaria

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The construction of the land section of the South Stream gas pipeline was inaugurated on 31 October in Bulgaria (the whole route includes the offshore section from Russia along the bottom of the Black Sea bed and onshore section via Bulgaria, Serbia, Hungary, Slovenia and Italy; with branches reaching out to Croatia and Bosnia and Herzegovina). The ceremony was preceded by the conclusion of a new agreement setting new terms for financing the Bulgarian section. The Bulgarian Energy Holding (BEH) will obtain a low-interest loan of 620 million euros from Gazprom, and will thus be able to finance its equity contribution to the investment, the estimated value of which is 3.5 billion euros. Contrary to initial arrangements, Bulgaria will charge transit fees as soon as in the first year of the pipeline's operation. BEH and Gazprom also signed a protocol obliging the companies to comply with Bulgarian law, both at the construction stage and throughout the operation of the pipeline. Sofia understands by this that Moscow has given its consent for the pipeline to be covered by EU legislation, including the third-party access principle.

Commentary

- The ceremony marking the inauguration of construction was important for political reasons, and does not *per se* mark a milestone in the investment process since the company in charge of the investments has not yet signed construction work contracts. This fact was announced after the ceremony, when President Rosen Plevneliev forced the government to provide an explanation. Russia has used the construction launch to demonstrate that it will not relinquish at least partial implementation of the project (i.e. the construction of at least one of the planned four branches). Additionally, the commencement of the construction is being used as an instrument to put pressure on Ukraine in the gas negotiations which have been ongoing for many months, and at the same time to prove that Russia is playing an active role as a partner for the countries South-Eastern Europe.
- The new funding model has resolved Sofia's main problem, i.e. the lack of funds for the implementation of the investment. However, the employment of this model will worsen the indebtedness of the state-owned energy companies and lead to Russia having a greater influence on their financial condition. South Stream will offer Bulgaria direct access to Russian gas supplies and also an essential transit role. Nevertheless, Bulgaria's incomes from transit fees generated by South Stream could turn out to be a little lower than those currently generated by the transport of Russian gas from Romania

to Turkey, Greece and Macedonia. According to unofficial information leaked to the Bulgarian media, their present value is around 100 million euros annually, while according to the Bulgarian minister for energy, incomes from transit fees generated by South Stream are expected to reach 93 million euros annually.

- The declaration of readiness to comply with Bulgarian (and thus EU) law regarding South Stream may be a tactical concession from Gazprom in its talks with the EU. It cannot be ruled out that the company is hoping this will help it increase its chance for South Stream to be recognised by Brussels as a EU's Project of Common Interests. This could facilitate Russians in the achievement of their overriding goal in the future, namely the exemption of the pipeline from the rules of the third energy package, in particular the third-party access principle. However, given the EU's scepticism, it appears at present quite unrealistic that this expectation will be met.