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Gazprom's call for proposals: how many new gas pipelines to Europe?

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On 18-19 June, during the annual St. Petersburg International Economic Forum, a protocol was signed on the construction of a new gas pipeline from Russia via the Baltic Sea to Germany; an Agreement of Strategic Cooperation between Gazprom and Shell; and a memorandum between Russia and Greece on the construction on Greek territory a gas pipeline which is intended to be an extension of the Turkish Stream project.

These documents will help Russia to carry out the current objectives of its foreign gas policy: they will put negotiation pressure on Turkey in the absence of any progress on the Turkish Stream project; they make the announcement that gas transit will be suspended through Ukraine more credible; and they will deepen internal EU discussions and divisions regarding new infrastructure projects. They also suggest that, contrary to previous announcements about reducing its presence in Europe, Gazprom has not altered its strategy, and still treats Europe as its key market. Moreover, in the context of the political tensions in EU-Russian relations (including the recently extended EU sanctions), as well as the EC's policy of diversifying gas supplies, the signing of these memoranda and the discussions being held represent a success for Moscow.

At the same time, the declarations concerning new projects and the documents signed show that European companies are interested in reactivating gas cooperation with Russia, which would both improve the situation on the EU gas market and strengthen the position of individual companies on that market. The agreements are general and preliminary in nature, and it is not certain that they will come to fruition. The eventual success of any of these projects will depend largely on political decisions taken in Brussels and the most important EU capital cities.

The content of the agreements

The protocol signed by Gazprom and the European energy companies (Shell, E.On, OMV), envisages the construction of a pipeline from Russia via the Baltic Sea to Germany (two branches with a total capacity of 55 bcm, costing around €11 billion), which would mean the *de facto* reactivation of the plan to construct the third and fourth branches of the Nord Stream gas pipeline. Gazprom also signed a strategic cooperation agreement with Shell, and a memorandum on the construction of a third production line for the Sakhalin-2 LNG terminal. In addition, on 18-19 June, Gazprom also held talks with ENGIE (formerly GDF-Suez), EDF, Fluxys and Total on Russian gas supplies to Europe, and with VNG on gas

storage.

In turn, the Russian-Greek intergovernmental memorandum provides for the construction of a new pipeline on Greece's territory, which is intended to function as an extension of the Turkish Stream gas pipeline (the proposal to build a pipeline from Russia across the Black Sea to the Turkish-Greek border was announced by Vladimir Putin in December 2014, after Russia abandoned the South Stream project). The pipeline is intended to allow the transit of 47 bcm of gas annually via Greek territory. Its construction, which is planned for the period 2016-19, is to be managed by a Russian-Greek joint venture, and funded by Russia's Vneshekonombank.

Russia's motivations

Although the agreements signed are preliminary and very general (non-binding declarations of intent), they are an important instrument of Russia's energy policy towards the European Union and Turkey.

The Russian plans to build new pipelines in Europe testify to the fact that – contrary to Moscow's declared reorientation eastwards, its ambitious plans for gas expansion onto the Chinese market and numerous statements from Gazprom's CEO about limiting his company's presence on the EU market – the European market is and will remain a priority for Russia. These new plans also confirm that Russia's continuing strategic goal is to diversify its gas transit routes to European customers. The memoranda described above confirm Russian plans to completely cease gas transit via Ukraine as of January 2020. In this way, Moscow is sending a signal to Brussels and Kyiv that it is serious about excluding Ukraine as a transit country, and intends to go through with the plan. Russia hopes that this will intensify internal discussion in the EU on the development of the gas infrastructure via which Russian gas could reach EU markets after being diverted from the Ukrainian transit route. This effect has already been partially achieved by the mere announcement of the Turkish Stream project; proof of this includes the nature of the discussion about the possible connection to Turkish Stream of the planned Eastring pipeline (a project announced by Slovakia to build a pipeline linking it with Bulgaria, Romania and Hungary), as well as the reports in the Western press about a possible reactivation of the Nabucco project (which was originally supposed to be an alternative to Russian supplies; the new route would operate as a route for importing Russian gas to the EU, from Turkey via Bulgaria, Romania and Hungary to Austria). By creating the impression of a kind of 'rivalry' between European projects, Russia can continue its traditional policy of undermining the fragile energy solidarity within the EU.

It is also possible that the reactivation of the project to expand Nord Stream is related to the European Commission's ongoing anti-monopoly proceedings against Gazprom. In a written statement of objections issued on 22 April, the European Commission accused Gazprom of making gas supplies to *Bulgaria* and *Poland* conditional on obtaining unrelated commitments from wholesalers concerning gas transport infrastructure; it is therefore possible that Gazprom will be forced to give up its shares in EuRoPol Gaz, which owns the Polish section of the Yamal-Europe pipeline. This in turn could mean a falling-off in Gazprom's interest in gas transit to Germany via Polish territory, and a willingness to redirect some of its supplies to the new Nord Stream branches.

Russia will use both the memoranda signed in St. Petersburg in forcing through the Turkish Stream project. On one hand, the announcement of the construction of the third and fourth branches of Nord Stream can be seen as a way of putting pressure on Turkey (Ankara has not yet signed any agreements with Moscow on Turkish Stream, as it is still haggling over the size of the gas discounts which Gazprom promised, and probably over other conditions concerning the project); Gazprom is thus sending the signal that Turkish Stream is not the only important project in Russia's European gas strategy, and is hoping to wear down their Turkish partner's negotiating position. On the other hand, meanwhile, the Russian-Greek memorandum indicates the progress of the Turkish Stream project, despite the intensifying concerns of the media on this matter.

The interests of European companies and the EU's gas policy

The agreements on cooperation which Gazprom signed in St. Petersburg, on both the global and specific levels, involve some of the biggest Western European companies: Shell, E.On and OMV. Interest in expanding Nord Stream has also been expressed by Germany's Wintershall, and VNG has confirmed the continuation of its cooperation with Gazprom on expanding gas storage facilities in Germany. French and Belgian companies have also held talks on gas supplies from Russia. This demonstrates that – regardless of what really happens with the expansion of Nord Stream and the other detailed plans – a large part of European gas business not only sees a need to normalise gas relations with Russia, which have been difficult for more than a year now, but is also trying to revive and strengthen these ties by supporting new joint strategic projects.

This readiness to cooperate and draw up concrete plans to construct direct supply routes, in particular, may be a European-Russian attempt to strengthen the role of gas on the European market. Gas consumption in the EU has been declining since 2008, and this negative trend deepened in 2014, for reasons including the exceptionally warm winter and the deteriorating public image of gas: not least because of the continued risk to the stability of supplies from the largest external gas supplier to the EU – Russia. According to data from BP, gas consumption fell by a record 12% last year, to levels not seen since the mid-1990s. This has had a negative impact on the financial results of both European gas companies and Gazprom.

At the same time, each of the EU companies involved has its individual interest in cooperating with Gazprom. Shell may wish to further strengthen its leading position on the gas market (after its acquisition at the beginning of this year of US$70 billion of British Gas's shares, and the significant strengthening of its position on the global LNG market); the German companies are working to strengthen the role of Germany in the European trade and transit of gas (a role which has increased significantly since the worsening of the Russian-Ukrainian gas conflict in the middle of last year); while OMV wants to counterbalance challenges to its position on the Central European gas market and the future of the Central European Gas Hub, such as the collapse of the Nabucco project and the fall in export of Russian gas via Ukraine.

Moreover, the Greek government is seeking cooperation with Russia, as a way to strengthen its role on the regional gas market in South-East Europe (including a negotiating position in its pipeline talks with alternative gas suppliers on the one hand and the EU on the other), and

also in hope of gaining financial benefits from the gas transit.

So far, there have been no clear official statements from the German or Austrian governments on the participation of their countries' companies in the planned joint strategic investments with Gazprom. However, it is very likely that in the current unfavourable political context (as confirmed by the recent extension of the EU sanctions), these decisions were discussed in Berlin, Vienna, etc.

At the same time, the memoranda signed by the European companies and Gazprom and the declarations contained therein contradict the EU's policy over the last year on the diversifying gas supplies, increasing energy security in Central and South-East Europe, and gas cooperation with Ukraine – including the provisions made in a series of strategic European Commission documents, such as the document on the Energy Union and the European Strategy for Energy Security (one of whose objectives was to reduce the EU's dependence on Russian gas). Both Maroš Šefčovič, the European Commission's Vice-President for the Energy Union, and Miguel Arias Cañete, the energy commissioner, have approached the plans to expand Nord Stream, limit Ukraine's transit role and increase gas imports from Russia to the EU with obvious reservations.

The chances for the planned gas pipelines

The preliminary and general nature of the agreements signed, the multiplicity of projects which Russia has promoted recently (Turkish Stream, the third and fourth branches of Nord Stream, the Power of Siberia and Altai pipelines, Baltic-LNG, Vladivostok LNG), and finally the difficult political context for implementing joint Russian-EU projects of strategic importance do not yet allow us to precisely predict the future of the planned pipelines. It is unlikely that all the currently planned projects will be completed at their planned capacities. It is likely, however, that Gazprom will seek to simultaneously implement a more limited version of the Turkish Stream gas pipeline (up to two lines with a total capacity of 32 bcm) and at least one new branch of Nord Stream, which would allow it to maintain its supply levels onto the key European market, and to circumvent the problems connected with the implementation of the so-called Third Energy Package. At the same time it is still possible that the Russian side, despite its declarations, will not push for the complete cessation of gas transit via Ukraine by 2020, but will rather use the alternative routes it has promoted and implemented as a tool for putting more pressure on Ukraine.

The key to the implementation of these new projects, including in particular the new Nord Stream branches – considering Gazprom's current financial situation and the problems Russian companies are having with acquiring foreign capital thanks to the international sanctions – would be obtaining binding commitments, especially financial, from the European companies. However, at the present time such obligations are largely dependent on political decisions; they would not be contrary to the sanctions regime, although they would violate its spirit.

The presence of representatives from major European energy companies in St. Petersburg and the documents they signed show that, from their perspective, cooperation with Gazprom and Russia is crucial for the future of both the European gas market and the specific companies operating on it. In contrast to the European Commission's statements and actions, which are aimed at reducing the EU's dependence on Russian gas, this may

indicate a growing conflict of interest within the EU on finding an optimal formula –acceptable both politically and by the European businesses – for gas cooperation with Russia. Such a conflict will make it even harder to implement the European Commission's already demanding gas policy objectives, and could even lead to their being changed. This will also affect the future shape of the European gas market.