

How the war is affecting the Russian gas sector

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Russia's invasion of Ukraine has multi-level implications for the Russian gas sector. On the one hand, the military activity has not resulted in gas supplies from Russia to European recipients being limited or interrupted; it has in fact led to Gazprom increasing transit through Ukraine (in relation to the amount it was sending before the invasion), and resuming its capacity booking (albeit in only insignificant amounts) on the Yamal-Europe gas pipeline. Moreover, the drastic increases in gas prices in Europe are generating additional profits for the Russian side. At the same time, it is still possible that the Kremlin will make good on the threats it has made in recent days to limit transit in response to sanctions (it signalled the possibility of suspending exports via Nord Stream 1), if it decides that such a step may serve its political goals regarding the West and Ukraine.

On the other hand, the invasion and the sanctions have reduced the capitalisation of Russian energy companies (including Gazprom) and significantly shrunk their cooperation with foreign partners, as illustrated by their withdrawal from strategic Russian energy projects. The negative effect of these decisions will be a reduction not only in sources of financing, but above all in access to the technologies necessary to carry out gas projects in Russia, in particular in the LNG industry. Moreover, although the Nord Stream 2 project was suspended after Moscow recognised the so-called separatist republics of the DPR and LPR, but still before the invasion, it is the Russian aggression which may decide the ultimate fate of this project.

No supply disruptions or threats on the horizon

Russia's invasion of Ukraine has not led to any disruptions to its gas supplies to European consumers. Moreover, in the first days after the attack, gas transit via Ukraine actually began to increase systematically, reaching the maximum contracted daily level of 109.6 million m³. On 24 February, it reached the level of 83 million m³; on 25 February, 103.8 million m³; and on 26 February, 108.1 million m³. So far, on most days in March it has reached ceilings close to 109.6 million m³. On 25 February, Gazprom resumed reservations for the Yamal-Europe gas pipeline, although it has been doing so on a daily basis, and in relatively small quantities. For example, the overnight reservations of 25–26 February made up 17% of the pipelines' daily transmission capacity; of 26–27 February, 45%; and 27–28 February, only 10%. Another signal that the Russian side wishes to maintain good relations with its foreign partners is Gazprom's repayment of its liabilities resulting from the previously issued Eurobonds. According to media reports, all the payments (US\$1.3 billion) have been settled on time, regardless of the restrictions introduced by the Russian government concerning currency flows from Russia to third countries.

Although there have been no disruptions in the export and transit of Russian gas so far, the Russian side has begun to issue open threats in this regard in recent days, for the first time since the invasion. An example of this is the statement by Aleksandr Novak, deputy prime minister of the Russian government who is responsible for the fuel and energy sector; he stated that as part of the response to the blocking of Nord Stream 2, Russia has the right to suspend transit via the Nord Stream 1 gas pipeline. He added that Russia did not intend to do so, because such a decision would not benefit either party. Moreover, Novak stated that the Russian side had information that a provocation linked to Ukraine's gas network was being prepared, noting that Russia was not interested in such a scenario. Another illustration of the possible risks is the decree President Putin signed on 8 March which allows the government to restrict the export of selected raw materials from Russia to specific third countries if necessary.

The Russian threats are most likely a political response to the demands emerging in EU countries to suspend or significantly reduce imports of Russian gas. In themselves, they do not mean that a real decision on this matter will be taken, as this would have profound economic and reputational costs for Moscow. A more likely scenario, however, is that Moscow could initiate acts of sabotage preventing gas transit through Ukraine. Although Moscow is unlikely to limit its gas exports to the EU at this stage, such a decision could be taken if it decides that it could exert additional pressure on the Western countries and Ukraine by doing so.

The first effects of the sanctions on the Russian gas sector

Although the Western sanctions have so far only covered the gas sector to a limited extent (on 8 March Washington introduced an embargo on importing Russian energy resources), it is already indirectly bearing the consequences, including Russia's deepening economic isolation. The first effect is the drastic fall in the value of shares in the most important Russian energy companies. The stocks of the most important Russian companies dropped on the London Stock Exchange to such a level that trading in these entities was suspended on 3 March. The value of Gazprom's shares had fallen by 93.7%, those of Lukoil by 99.2%, and those of Rosneft by 92.5%.

Another negative effect is the withdrawal of large energy companies from cooperation with Russian companies. Shell has decided to exit all its projects with Gazprom: these include the Sakhalin-2 oil and gas project (where Russia's first gas liquefaction plant, with a capacity of about 11 million tonnes per year, is operating), in which it has a 27.5% stake; and the joint venture with Gazprom Neft (50%/50%), which has been developing the Salym field in the Khanty-Mansi autonomous okrug. Shell was considered an important partner in the context of the construction of a third production line as part of the Sakhalin-2 project, and in Gazprom's project to build a large gas processing complex in Ust-Luga.

The British company BP (which plans to sell 19.75% of its shares in Rosneft) and the Norwegian company Equinor (which is involved in several mining projects) are also planning to withdraw from projects in Russia. Although the French company TotalEnergies has not withdrawn from its energy projects in Russia (in particular the Yamal LNG and Arctic LNG 2 projects), it has announced that it will cease any new investments in this country. The Italian company Eni has announced it plans to sell its 50% of the shares in the company that owns and operates the Blue Stream gas pipeline (which runs via the Black Sea to Turkey). The

Austrian concern OMV has announced that it will withdraw from finalising the agreement it had concluded in 2018 to acquire shares in Gazprom's production projects (24.98% of shares in the Akhimov IV and V blocks of the Urengoy gas field). On 1 March ExxonMobil announced it was withdrawing from the international consortium implementing the Sakhalin 1 project and ceasing any new ventures in Russia. It is very likely that this company's decision may significantly delay or even prevent Rosneft from implementing its plans to build its own gas liquefaction plant (the Far East LNG project).

The withdrawal of some foreign partners from their existing or planned investments in the LNG sector will be particularly painful for Russia. In the case of the large-scale LNG projects, Russia does not have the necessary technological resources. Technologies of Western companies are used in all the so-called large-scale LNG terminals currently operating in Russia: the US APCI, Germany's Linde, the British-Dutch Shell, and France's Air Liquide. Although Russia has developed its own Arctic Cascade technology, which was used on the fourth production line as part of the Yamal LNG project, industry reports show that its quality has proved to be very low, and there are many indications that it will not be used in future projects.

The definitive end of Nord Stream 2?

It is true that the Nord Stream 2 project was frozen before the Russian invasion of Ukraine, but Russia's aggression may have sealed the fate of the investment. After Nord Stream 2 AG and its management board members were subjected to US sanctions, media reports suggested that the company had filed for bankruptcy. Although the company denied this, it did also confirm that all its 140 employees had been laid off. There were also reports in the industry media about the possible liquidation of the German company Gas for Europe, which was to have been the operator and owner of the German section of the pipeline. Moreover, on 1 March the German economy minister announced that the Nord Stream 2 gas pipeline would not be certified in the foreseeable future. The decisions taken by Western European fuel companies may also determine the investment's ultimate fate. Shell has explicitly announced that it will withdraw from the Nord Stream 2 project (in April 2017, the company undertook to grant loans to the Russian side to the tune of around €950 million to implement the investment). Representatives of the Wintershall DEA concern, in turn, stated that they have written off the sum of c. US\$1.1 billion which it lent to Nord Stream 2 AG. The French company Engie has recorded a financial risk of US\$1.1 billion, especially if Nord Stream 2 AG is declared bankrupt; and OMV has announced that it will reconsider its position regarding its further participation in the project.

Although it is unclear what will ultimately happen to the gas pipeline – which after all has already been built and is ready for operation (from the technical point of view) – for political reasons it seems unrealistic to expect that it will be launched in the foreseeable future.