

Gazprom: Profile

by

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1. Summary

Gazprom is one of the largest companies in the world and supplies Western Europe with about a quarter of its gas. It appears to be intimately linked with the policies its majority share-holder, the Russian government, which seems to use it as an arm of national policy especially in its dealings with the former Soviet Republics. The real extent of the links are hard to determine.

The reliability of its gas supplies is key in ensuring secure energy supplies for Europe. In the past year, it has taken significant steps to expand into neighbouring countries and has reportedly been looking to acquire companies in Western Europe. Its main interests in Western Europe are in Germany. E.ON, one of the largest electricity companies in Europe owns 6.5 per cent of Gazprom. Gazprom's main subsidiary in Germany is ZGG, which in joint venture with BASF, owns Wingas and a number of other trading subsidiaries.

In January 2006, a dispute between Russia and Ukraine boiled over and led to the cutting off of supplies of gas from Russia to Ukraine. As much of Russia's gas for Western Europe transits through Ukraine, this led to significant reductions in supplies to Western Europe at a time of very high demand due to cold weather. At about the same time, other problems led to the cutting of supplies of Russian gas to Armenia, Georgia and Moldova causing serious problems of meeting demand at a very cold time of year.

For Western Europe, the problems were very short-lived being essentially resolved in only a couple of days, but the issue of dependence on Russian gas is now a major political issue, despite Gazprom's almost unblemished supply reliability to Western Europe up to that time.

2. Introduction

Gazprom was established as a joint stock company in February 1993.¹ According to its web-site, the State held 38.37 per cent of the stock (as of September 2002), although since the end of 2004, the level has increased to at least 50 per cent. It is the largest gas producing company in the world with a share in the world gas production of about 20 per cent. Gazprom controls almost 60 per cent of the Russian gas reserves, produces about 90 per cent of Russian gas and supplies gas to generate around 50 per cent of electricity in Russia. The company is responsible for 8 per cent of Russia's GDP and provides about 20 per cent of earnings to the federal budget.

The Russian government is often seen as controlling its policies and it is often argued that Russia can use the supply of gas as a very powerful political lever.²

This profile focuses especially on its activities outside Russia. It is making significant efforts to integrate itself into Western European circles and in December 2005, former German Chancellor Gerhard Schroeder, was named head of the North European Gas Pipeline shareholder committee, a joint venture between Gazprom and Germany's E.ON and BASF that is building a link from Russia to Western Europe under the Baltic Sea.

2.1. Role of Russian gas in Europe³

Russian gas, controlled by Gazprom, makes up about a quarter of Europe's gas supplies. Sales have increased by about a quarter in the past 15 years, but the share of Russian gas in total European supplies has fallen from about a third to about a quarter (see Tables 1 and 2).

Table 1 Russia's gas supplies to Europe – bcm⁴ (%)

	1990	1995	2000	2004
Russian gas	110 (33)	117.4 (31)	129 (28)	140.5 (27)
Other gas	220.5	263.5	329.8	378

Source: RPI (2006) Russian Natural Gas on Global Markets: Capabilities and Limits

¹ For an earlier analysis of gas liberalisation in Europe and the role of Gazprom, see S Thomas, D Hall & V Popov (2002) 'Gas industry liberalisation, restructuring and employment in the European Union', PSIRU, London.

<http://www.psiru.org/reports/2002-04-E-GasEU.doc>

² See for example, Financial Times, 'Energy of the State', March 14, 2006.

³ For more data on Gazprom, see <http://www.gazprom.com/documents/Statistika%20En.pdf>

⁴ Gas volume units used are: bcm = billion cubic metres and 1,000 cm = thousand cubic metres

Table 2 Prices obtained for Russian gas in Europe and the FSU (\$ per 1,000 cm)

	2000	2001	2002	2003	2004
Europe	103.2	120.1	105.9	134.1	139.6
FSU	53.34	48.34	53.19	49.77	54.22

Source: RPI (2006) Russian Natural Gas on Global Markets: Capabilities and Limits

Gas Imports

EU-15 (in Mio cubic metres)

Origin	2000	2002	2003	2004	Share 2004(%)
Russia	78 484	68 807	74 160	76 709	32.5
Norway	46 714	61 351	66 707	67 212	28.5
Algeria	56 644	53 162	52 086	49 879	21.2
non spec. origin	6 808	15 966	18 700	24 899	10.6
Nigeria	4 283	6 276	8 746	10 538	4.5
Qatar	293	2 070	1 893	3 770	1.6
Other origins	1 857	2 972	1 666	2 747	1.2
Total Imports	195 083	210 604	223 958	235 754	100.0

Source: European Union 'Energy and Transport in Figures 2005' Eurostat

http://europa.eu.int/comm/dgs/energy_transport/figures/pocketbook/doc/2005/etif_2005_energy_en.pdf

2.2. Ownership

As a result of the risk that a controlling stock interest or a blocking minority would emerge, restrictions on the sale of Gazprom shares were imposed in the second half of the 1990s. Foreigners could own no more than 20 per cent of the authorized stock and the market for Gazprom shares was split into two. In the non-Russian markets, only 'depository receipts' (derivatives) could be traded, in London and New York. The actual shares could be traded on only four Russian exchanges, with most shares being bought and sold at the St Petersburg stock exchange, with almost no trade at the Moscow exchange. Before 2006, about 10 per cent of Gazprom's shares were owned by foreign entities through 'gray schemes'.

As of September 2002, the State still held 38.37 per cent of the voting shares but in 2005, the government increased its stake to more than 50 per cent. The only substantial foreign share-holder is the German company, E.ON with 6.5 per cent of the shares and a seat on the Board of Directors. On December 9 2005, the Duma approved a change in the law and required that the state (or joint stock companies in which the state had more than 50 per cent of the shares) hold at least 50 per cent +1 share in Gazprom. However, restrictions on foreign ownership of shares were removed and shares could be traded on the two largest Russian exchanges both based in Moscow, RTS and MICEX.

This liberalisation is expected to lead to a huge increase in demand for its stock and a considerable increase in Gazprom's market capitalisation from about US\$120bn to US\$300bn. This valuation would reflect better the value of the oil and gas reserves it owns.

3. Gazprom in Russia

Gazprom's main assets are located in Russia where most of its 380,000 employees are located. It is the largest Russian company and the eighth largest company in the world. It is the largest gas producer and the third largest energy company in the world.

Gazprom owns about 60 per cent of Russia's gas reserves but accounts for nearly 90 per cent of production. It has 43 100 per cent owned subsidiaries which are primarily involved in producing, transporting and selling gas. It strengthened its position in Russia in 2005 by purchasing 75 per cent of Sibneft and Sevmorneftegas, two major Russian oil and gas companies.

While the Gazprom group does own companies, sometimes high profile, operating in other sectors, these have little impact on the finances of the company, accounting for only about 6 per cent of revenue. The Gazprom Group is also the main shareholder of Gazprombank, which meets most of its domestic banking needs (other than borrowings); the founder of NPF Gazfund, the largest non-government pension fund in Russia, which provides pension services to employees of Gazprom; the shareholder of the insurance

company Sogaz. Gazprom also has shareholding in various other businesses that are not related to its core operations. These include Gazprom-Media, a holding company that owns various mass media assets, other media companies, agricultural, power, construction, medical care, and telecommunications activities.

Majority holdings in companies run by Gazprom-Media include Russia's leading commercial broadcaster NTV, its affiliate TNT, satellite service NTV Plus, radio stations, magazines and newspapers with a combined annual turnover of more than \$400m. In June 2005, there was speculation that Gazprom would take over Izvestia but this came to nothing and in November 2005, Gazprom announced it would be selling its media assets because they were not part of the core business.⁵

4. Foreign subsidiaries

The Gazprom web-site lists 66 major companies in which Gazprom is the 100 per cent owner and 43 in which it has more than a 50 per cent stake. Most of these are Russian based companies operating in Russia. It lists a further 51 companies, in which it has a lower stake and these represent some of the more interesting ventures.

4.1. Armenia: ArmRosgazprom

This is a Russian - Armenian joint venture company formed in December 1997. Gazprom and Armenia's Energy Ministry each own 45 per cent and Itera International Group (a private Russian company which operates as a gas trader in the CIS and the Baltic states) owns 10 per cent. The company organises natural gas supplies for the domestic market in Armenia and handles transport, storage, refinement, distribution, and sale of gas. Armenia bought gas from Russia last year for \$54 per 1,000 cm but the price is to grow to \$110 per 1,000 cm this year. Armenia bought 1.685 bcm of gas from Russia last year, up 26.5 per cent from 2004.

4.2. Belarus

Gazprom is negotiating with Beltransgaz, the state owned gas company to set up a joint venture to manage the national network but by March 2006, no agreement had been reached. In March 2006, Belarus agreed a gas purchase deal through till 2020 (up to 25 bcm per year). Prices were not announced but were assumed to be well below European market prices. In 2005, Belarus was paying only \$46.68 per 1,000 cm. Belarus is a strategically important partner not only because of impending political union but also because 15 per cent of Russian gas to Western Europe passes through Belarus, a percentage that will increase when the Yamal pipeline is completed. Beltransgaz has accumulated debts for gas purchase with Gazprom estimated at \$30m, but it expects to pay of about half of this during 2006.

4.2.1. Belgazprombank

This is a Belarus bank (8th largest out of 31 Belarus banks) in which Gazprom holds 33.9 per cent of the stock.

4.3. Estonia: Eesti Gaas

Eesti Gaas is Estonia's natural gas company. It is owned mainly by Gazprom (37.0 per cent), Fortum (17.7 per cent), E.ON Ruhrgas (34.7 per cent) and Itera Latvija (9.7 per cent).

4.4. Finland: Gazum

Gazum is the main Finnish gas utility and is a joint venture between Fortum (25 per cent), the main Finnish electricity company (majority state-owned) and Gazprom (25 per cent). The other shareholders are the Finnish government (24 per cent, Ruhrgas/E.ON (20 per cent) and a consortium of Finnish timber processing companies with a 6 per cent stake. In 2004, Gazprom extended its long-term gas supply contract to Finland to 2025. Russia is currently the only supplier of gas to Finland.

4.5. Germany

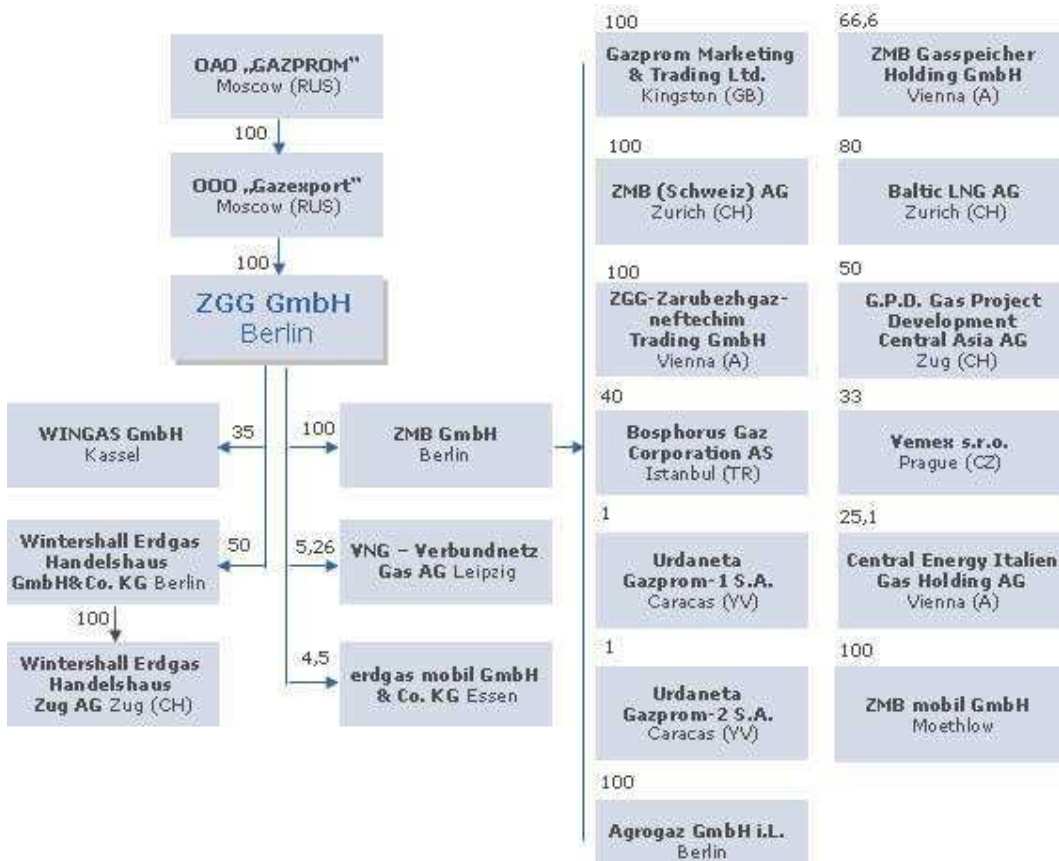
4.5.1. ZGG⁶

Gazprom's key subsidiary in Germany is ZGG GmbH, which is a company that markets Russian gas in Germany and Western Europe in general and which owns a number of subsidiaries and holdings such as

⁵ The Hollywood Reporter 'Gazprom sees future without media assets', November 18, 2005.

⁶ <http://www.zgg.de/english/company/index.php>

Wingas, WIEE and WIEH. ZGG also owns 5.26 per cent of the Leipzig gas company Verbundnetz Gas AG (VNG) and 4.5 per cent of Erdgas Mobil (Essen). ZGG's main subsidiary is Gazprom Marketing & Trading Ltd (100 per cent), which operates their business in the UK. It also has businesses in Switzerland (ZMB Schweiz – 100 per cent and Baltic LNG - 80 per cent) and Turkey (Bosphorus Gaz Corporation – 40 per cent). The following diagram shows the main subsidiaries of ZGG.⁷



Source: <http://www.zgg.de/english/company/konzern.php>

4.5.2. ZMB⁸

ZMB (Zarubezhgaz Management und Beteiligungsgesellschaft mbH) is a company owned by ZGG, which markets Russian and Central Asian natural gas in Germany and Western Europe and which owns a number of other significant companies (see below). Gazprom, through ZMB, has made its first entry into the UK North Sea in January 2006 with the purchase of a 25 per cent stake in North Sea Block 44/19a. Exploration drilling is planned to start on the Wintershall-operated block in the second quarter of this year.

4.5.3. Wingas⁹, WIEH, WIEE

Wingas is a joint venture between Wintershall (owned by BASF) with 65 per cent and Gazprom through ZGG (35 per cent). Wingas owns Western Europe's largest storage facility (4 bcm) at Rehden in north Germany, an extensive gas transport network in and across Germany, plus 25 per cent of shipping rights in the 16 bcm/yr Holland-England BBL gas pipe due for start up late 2006. Gazprom (through ZGG) and Wintershall own 50 per cent of the German trading company, Wintershall Erdgas Handelshaus GmbH, (WIEH) and the Swiss trading house Wintershall Erdgas Handelshaus Zug AG (WIEE).

4.6. Hungary: Panrusgaz

Panrusgaz is a gas trading company owned jointly by Gazprom and the Hungarian oil and gas company, MOL. In December 2005, E.ON was given clearance to take over Mol's gas assets including its Panrusgaz shares. In February 2006, it was not clear whether E.ON would take up this option.

⁷ <http://www.zgg.de/english/company/konzern.php>

⁸ <http://www.zmb.de/english/>

⁹ <http://www.wingas.de/wga/wg/html/default/fmin-5bufqr.en.html>

4.7. Italy: Blue Stream Pipeline Company

This is an equal partnership between Gazprom and the Italian oil and gas company, ENI, set up in 1998 to operate the Blue Stream Pipeline from Russia to Turkey

4.8. Kazakhstan: KazRosGaz

KazRosGaz is a 50/50 joint venture between Gazprom and Kazakhstan's national oil and gas company KazMunayGas (KMG) created in 2002 to buy and market Kazakhstan's natural gas, process gas in Russia, and other types of activity.. Up to 2005, Gazprom was the sole supplier of gas to Georgia, but in January 2006, it was announced that KazRosGaz would supply about 30 per cent of Georgia's gas needs from Kazakhstani gas fields.

4.9. Latvia: Latvijas Gaze

This is the Latvian gas utility in which Gazprom owns 34 per cent, E.ON Ruhrgas AG has a 48 per cent stake and Itera Latvia currently possesses 16 per cent.

4.10. Lithuania: Lietuvos Dujos

Lietuvos Dujos is Lithuania's largest gas importer and Gazprom bought a 37 per cent stake in this company from the government in 2004. The other owners are E.ON (39 per cent) and the Lithuanian state 17 per cent. Part of the deal was that Gazprom would supply 90 per cent of Lithuania's gas up to 2015 at prices indexed to oil.

4.11. Moldova: Moldovagaz

Moldovagaz is the gas utility for Moldova. In January 2006, Gazprom increased its stake from 50 per cent + 1 share to 63.4 per cent taking over the stake previously held by the Trans-Dniester government. Most of the rest of the shares (35.3 per cent) are held by the Moldovan government.

4.12. Poland: EuRoPol Gaz

EuRoPol Gaz is the operator of the Polish section of the proposed Yamal pipeline that takes Russian gas to Northern Europe. Gazprom owns 48 per cent of the venture but in December 2005 was trying to increase its stake to 50 per cent. PGNiG, the Polish gas company also owns 48 per cent with another Polish company, Gas Trading (in which PGNiG and Gazprom both own stakes), owns 4 per cent. The Yamal pipeline currently reaches Poland but there are doubts whether the rest of the Yamal pipeline will be completed with Gazprom apparently favouring construction of a pipeline under the Baltic Sea (NTG).

4.13. Serbia: YugoRosGaz

YugoRosGaz has the rights to develop a pipeline connecting the Serbian gas network with Bulgaria and other pipelines within South East Serbia. A Gazprom statement in January 2006 said YugoRosGaz was co-owned by Gazprom (50 per cent), NIS GAS (20 per cent), Progresgas Trading (10 per cent) and other former Yugoslav companies (20 per cent). However, Gazprom has built stakes in its partners and its holding may now be 75 per cent.

4.14. Slovak Republic: SPP

In 2002, Gazprom was part of consortium, with GDF and E.ON that took 49 per cent of the shares in the Slovak gas company SPP. This allowed it to take up to a third of the consortium's shares. However, Gazprom has not taken up the shares and decided to liquidate a joint venture with SPP, Slovrusgas, in August 2005.

4.15. UK

4.15.1. GAZPROM Marketing & Trading Ltd¹⁰

Gazprom Marketing and Trading Limited (GM&T) manages Gazprom's gas supply and trading activities in the liberalised European markets. GM&T supplies natural gas to customers in the United Kingdom, France, Belgium and The Netherlands.

¹⁰ <http://www.gazprom-uk.com/>

4.15.2. Interconnector (UK)

This is the company that owns and operates the main gas connection between the UK and mainland Europe at Zeebrugge (Belgium), in which Gazprom holds a 10 per cent stake. Other shareholders are Amerada Hess Limited, US (5 per cent), British Petroleum gas Market Limited, UK (10 per cent), BG Energy Holdings Limited, UK (25 per cent), ConocoPhillips (UK) Limited (10 per cent), Distrigas SA, Belgium (5 per cent), Distrigas & Co SCA, Belgium (5 per cent), ENI International BV (5 per cent), Ruhrgas UK Exploration & production Limited (10 per cent), TotalFinaElf gas & Power UK Limited (10 per cent). This link will be an important one if Gazprom attempts to increase its presence in the UK gas market.

4.15.3. Saltfleetby

In 2004, Wingas bought the depleted onshore Saltfleetby gas field for conversion into a gas storage facility expected to open in 2008

4.16. Ukraine: Gaztransit

In January 2006, it was announced that a Russian-Ukrainian joint venture to sell gas to Ukrainian consumers would be set up, which would be called Gaztransit.

5. The Ukraine Crisis of winter 2005-06

Russia supplies about a third of the gas consumed in Ukraine, the rest coming mainly from Turkmenistan (45 per cent) with some supplies from local sources, Uzbekistan and Kazakhstan. Gas from Turkmenistan has to pass through Gazprom's Russian lines. A dispute about prices from 2006 that became public in December 2005, culminating in threats to cut off gas supplies to Ukraine in January if Ukraine did not agree to Russia's new terms. It was widely reported that Russia was attempting to increase the price from about \$50 per 1,000 cm to about \$230 per 1,000 cm, the Western European price.

At 10.00 AM Moscow time, Gazprom cut off gas supplies to Ukraine. Falling pressures and non-delivery of gas was reported the same day in several European countries (for example, Hungary, Austria, and Slovak Republic) some of which suffered reduced volumes by up to 40 per cent. However, on January 2, Gazprom said it would pump an extra 95 million cm into the network to compensate for Ukraine's withdrawals and by January 3, some countries such as Austria and Hungary were back to normal levels and by January 4, when Gazprom and Naftogaz announced an end to the dispute, Russian gas deliveries to Europe were back to normal.

The seeds of the dispute go much further back and there is little consensus on who was to blame. The main factors that led to this dispute appear to be:¹¹

- Nearly all Russia's gas exports must pass through Ukraine;
- There is a long history stretching back more than a decade of Ukraine having difficulty paying for its supplies of gas from Russia and allegations that Russian export gas was used in Ukraine;
- Turkmenistan, the other main supplier of gas to Ukraine can only export gas through Russia and much of its production has been contracted to Gazprom at prices well below European levels;
- The collapse of a consortium based on Gazprom and Naftogaz, which was expected to refurbish and operate the Ukrainian transit pipeline network;
- Russia and Gazprom's attempts to increase the price paid by CIS states for Russian gas to Western European levels; and
- Gazprom's attempts to move into the downstream gas market in CIS countries.

The dispute caused widespread concern in Western Europe as it appeared to jeopardise supplies of Russian gas to Europe (which pass through Ukraine). Russia supplies about a quarter of Western Europe's gas and up till that time, Russia record of reliability was excellent.

The terms of any deal are complex, involving fees paid to Ukraine for transit of Russian gas to Western Europe, and imports of gas at differing prices from Russia, Turkmenistan and Kazakhstan.¹²

A key player is a Swiss registered company RosUkrEnergo, 50 per cent owned by Gazprom and 50 per cent by investors represented by an Austrian bank Raiffeisen Investment. This company purchases gas from

¹¹ For a detailed description of the issues, see J Stern (2006) 'The Russian-Ukrainian gas crisis of January 2006' Oxford Institute of Energy Studies. http://www.oxfordenergy.org/pdfs/comment_0106.pdf

¹² See Stern (op cit) for details of the deal.

Russia and Turkmenistan. Gazprom has a long-term co-operation agreement with Turkmenistan through its oil and gas company Turkmenneftgaz and is reported to be buying gas for 2006 at \$65 per 1,000 cm. Ukraine also has a deal with Turkmenistan to buy gas at \$44 per 1,000 cm for 2006, but it is not clear whether Turkmenistan can fulfil both contracts.

On January 4 2006, it was reported that a five-year deal was reached that would allow Gazprom to supply Russian gas at \$230 per 1,000 cm but with Turkmenistan gas and transit fees, the overall cost of gas from RosUkrEnergo would be about \$95 per 1,000 cm.¹³ RosUkrEnergo would sell the gas to Ukgaz-Energo, its joint venture with Ukraine's national oil and gas company Naftogaz Ukrainy.

While this solved the immediate problem, removing the threat of disruption of supplies of Russian gas, the deal appears to raise a number of issues. First, it is reliant on cheap gas from Turkmenistan and Turkmenistan is expecting to increase the cost of its gas substantially in the fourth quarter of 2006, perhaps to \$100 per 1,000 cm. Second, whether Ukraine would be able to meet its gas needs without buying very expensive gas from Russia. Third, questions were raised about RosUkrEnergo with concern about who the investors represented by Raiffeisen Investment were and about links between the company and organised crime.¹⁴ However, reports in both the Gazprom-owned newspaper Izvestia and British newspaper The Financial Times confirmed in May 2006 that two Ukrainian men - Ivan Fursin and Dmitry Firtash - own half of RosUkrEnergo. Fursin is a banker and Firtash, who owns a Kiev basketball club and is based in Hungary, has been involved with the Turkmen gas trade for some time. There were also questions about the need for an intermediary in the deal, which apparently could have been done directly between Gazprom and Naftogaz.

In January 2006, there was growing concern about the opacity of the deal and in response Gazprom transferred its stake from its investment bank, Gazprombank to its own balance sheet. In February 2006, Ukraine's Prime Minister proposed that RosUkrEnergo be replaced

6. Negotiations with former CEE and Eastern European countries

Gazprom seems to be taking the opportunity of higher European gas prices, driven up by high oil prices to negotiate higher prices in former Soviet Republics and to increase stakes in the gas companies in these countries. It appears that \$110 per 1,000 m³ is the target.

6.1. Belarus

Belarus was able to maintain its 2005 price for 2006 of about \$46 per 1,000 m³, the only former Soviet Bloc country to do so. However, there have been reports that when talks between Belarus and Russia began about the price for 2007 onwards, Belarus would have to pay a dramatically higher price, perhaps a trebling to \$145 per 1,000 m³.¹⁵ It has been reported this might be a tactic to allow Gazprom to acquire the Belarus pipeline operator company, Beltransgaz.

6.2. Moldova

After a two-week cut in supplies in January 2006, Moldova gave Gazprom control of a 13.4 per cent stake now held by the breakaway region of Trans-Dniester in the Russia-Moldova gas transportation joint venture Moldovagas. Gazprom already held 50 per cent plus one share, while Moldova and Trans-Dniester held 35.3 per cent and 13.4 per cent, respectively, and individuals 1.2 per cent. Moldova is the main transit hub for Russian gas exports to the Balkans. In return, Moldova will pay \$110 per 1,000 cm, up from \$80 per 1,000 cm in 2005 but well under the \$160m per 1,000 cm Gazprom initially sought. The price applies for the first quarter of 2006 but beyond that, Moldova may have to cede up to 8 per cent of its holding in Moldovagas, leaving it with little more than the 26 per cent required to block major corporate moves.¹⁶ In May, it was reported that Gazprom was negotiating with Moldova to maintain the 2006 price for 2007.¹⁷

6.3. Armenia

In January 2006 Russia suspended gas supplies to Armenia and Georgia for a week because of terrorist action on the gas pipeline through Armenia to Georgia. Gazprom already has a 45 per cent holding in

¹³ World Market Analysis, January 5, 2006.

¹⁴ Associated Press 'Ukraine's Security Service investigating RosUkrEnergo' February 17, 2006.

¹⁵ Associated Press, May 2, 2006, 'Russia's Gazprom hints at Ukrainian-style gas price face-off with Belarus.'

¹⁶ Energy Compass, January 20, 2006, 'Gazprom alters terms for more gas customers'.

¹⁷ RIA Novosti, May 2, 2006, 'Gazprom could maintain natural gas prices for Moldova after 2006'.

ArmRosgazprom, which has monopoly rights over supply and distribution to Armenia's domestic market. Under a new agreement Gazprom will supply gas to Armenia at a new price of \$110 per 1,000 cm from April 1 2006 until 2009. The agreement also foresees Gazprom taking a majority stake in Armrosgazprom -- a joint venture currently owned 45% each by Gazprom and the Armenian energy ministry, and 10% by Russian independent gas company Itera. Gazprom said Armrosgazprom would take ownership of Armenian power station Razdan 5 and "some assets of Armenia's gas sector."¹⁸

6.4. Georgia

Gas from Russia to Georgia has to pass through Armenia and was therefore affected by the suspension of supplies to Armenia in January 2006. Georgia is able to obtain pipeline supplies from Azerbaijan and Iran and this reduced the impact of the cut-off. There are plans to link Western Europe, via Georgia, to a new gas field in Azerbaijan and to build further pipelines to Caspian producers such as Turkmenistan and Kazakhstan. As with most other former Soviet republics, the price for 2006 will be \$110 per 1,000 cm up from \$64 per 1,000 cm in 2005. However, in addition, if Georgia wants to avoid costs rising to \$200 per 1,000 cm gas in 2007, it must agree to sell its pipelines linking Russia to Armenia to Gazprom. If Georgia agrees to sell 2006 prices will be held for ten years.

6.5. Estonia

It was reported in November 2005 that Gazprom was planning to raise the export tariff of gas for the Baltic countries from 80 dollars to 120-125 dollars per 1,000 cm.¹⁹ No details of the new price had been conformed by March 2006.

6.6. Latvia

In September 2005, it was reported that Gazprom's prices for gas would increase substantially from the \$90 per 1,000 cm that existed in 2005 but no new figure was given. In December 2005 Latvijas Gaze spokesman Vinsents Makars said that the price of gas supplied by Gazprom would rise by 30-40 per cent from January 1, 2006. Assuming the previous price was about \$90 per 1,000 cm, this would imply a price of \$117-126 per 1,000 cm.²⁰

Table 3 Russian gas prices for Eastern Europe and the FSU

	Company (per cent Gazprom)	2005 price \$/1,000 cm	2006 price \$/1,000 cm	2007 price \$/1,000 cm
Armenia	ArmRosGazprom (45)	56	110	110
Belarus	Beltransgaz (0)	46	46	145?
Moldova	Moldovagaz (64.3)	80	110	110?
Georgia	?	89	110	
Latvia	Latvijas Gaze (34)		120-125?	
Lithuania	Lietuvos Gaze (37)		~125	
Estonia	Eesti Gaas (37)		~125	
Hungary	Mol (0)		~250	
Poland	PGNiG (0)		190-220	
Bulgaria	Bulgargaz (0)		83/260	
Ukraine			95/230	

Source: Author's research

6.7. Lithuania

In November 2005, it was announced that Lietuvos Dujos would pay \$123 per 1,000 cm of gas in 2006 compared to \$84 in 2005.²¹ Lithuania is concerned about dependence on Russian gas and is looking at options, such as construction of a new nuclear plant (to replace the two old Soviet designed plants) or construction of an LNG terminal.²²

¹⁸ Nefte Compass, April 13, 2006, 'Armenia: Gazprom Gets Its Hands On The Goods'.

¹⁹ Baltic News Service, November 29, 2005

²⁰ AFX, December 28 2005

²¹ AFP November 30, 2005.

²² World Market Analysis 'Lithuanian PM Clashes with Minister over Draft Gas Law, Mulls LNG Import Terminal', January 16, 2006.

6.8. Poland

In November 2005, it was reported that PGNiG was paying \$120-130 per 1,000 cm but that Gazprom expected to raise its prices to those of Western Europe, then \$190-220 per 1,000 cm.²³

6.9. Bulgaria

Bulgargaz, the state-owned gas company signed a 12-year agreement with Gazprom in 1998 to take gas at a price of \$83 per 1,000 cm for 1.4 bcm per year (about 45 per cent of consumption) as payment for transit of Russian gas to Western Europe, with the rest charged at about \$260 per 1,000 cm.²⁴ In 2006, talks were beginning on terms for sales post 2010.

6.10. Hungary

Hungary gets about 60 per cent of its gas from Russia. A spokesman for the Ministry of Economic Affairs said in January 2006 that Hungary was already paying Western European prices for gas (\$250 per 1,000 cm).²⁵

6.11. Others

The Slovak and Czech Republics (and Finland), who receive all their gas from Russia are reported to be paying much higher prices than in 2005 and compared to the former Soviet Republics

7. The North European gas pipeline

The North European gas pipeline (NEG) was planned principally to create a new route for Russian gas exports to Europe. It is expected to diversify Russian gas export flows, directly connecting the gas network of Russia with the countries of the Baltic region and with the European gas grid. Its route means that issues of transit are avoided because it is routed under the Baltic Sea, potentially reducing the costs of gas transmission, and enhancing reliability of gas export supplies. It will run under the Baltic Sea from Vyborg (Russia) to the coast of Germany (near Greiswald). It is planned that further pipelines will deliver gas to Finland, Sweden, the UK and other countries.

A company, North European Gas Pipeline Company SA (NEGPC) was founded in Switzerland on November 30, 2005, by Gazprom (51 per cent), E.ON AG (24.5 per cent) and BASF AG (24.5 per cent). The company was set up to build the offshore section of the pipeline. The project, originally planned for completion in 2007 has slipped and is now not expected to be complete before 2010, but it is designated a priority project under the EU's Trans European Network (TEN) programme demonstrating the strategic significance with which it is seen in the EU.

The NEG has raised concerns, particularly in Poland that it is a politically driven project designed to bypass Poland, reducing security of supply to Poland and putting pressure on it to reduce transit fees and increase gas prices to Poland. It might also lead to the cancellation of the Yamal II pipeline from Russia to Western Europe, passing through Poland even though the Yamal pipeline is expected to cost only a third of the cost of NEG (€1520m compared to €4700m for NEG²⁶). While Yamal II is also a priority project under the EU TEN programme, that is no guarantee that the pipeline will be built as TEN funding only covers a small proportion of the total cost of projects.

8. Strategic acquisitions in Western Europe

There was considerable speculation at the end of 2005 that Gazprom was interested in buying downstream gas companies, especially in the UK, so its business was fully integrated from production to retail to final consumers.

Possible targets in the UK mentioned were Centrica, Scottish & Southern and Scottish Power but it seems that the press read more into Gazprom statements that it hoped to provide 20 per cent of UK's gas by 2015 than was justified. The UK government signalled it would not be happy with such a takeover. Energy minister Malcolm Wicks said any Russian move would face "very rigorous scrutiny, not least on competition

²³ Russian Oil and Gas Report, November 23, 2005.

²⁴ International Oil Daily, Feb 3, 2006

²⁵ Hungarian News Agency, January 13, 2006.

²⁶ http://europa.eu.int/comm/ten/energy/documentation/doc/cesi/chapter_5_gas.pdf

grounds" as well as national interest objections.²⁷ It now seems clear that Gazprom has no immediate plans to bid for any large UK companies although it will be difficult to achieve its objective for 2015 if it does not take over an established UK energy retailer. Other mergers and acquisitions have been mooted but there seems little substance behind these rumours.

In May, it was reported that Gazprom could take a stake in Centrica in exchange for Centrica taking a stake in the North European gas pipeline.²⁸

In April 2006, BASF and Gazprom announced an asset swap which would see Gazprom's stake in Wingas increasing from 35 per cent to 49 per cent in exchange for 35 per cent of Gazprom's Yuzhno Russkoye gas field in Western Siberia. A similar asset swap with E.ON for the same field was expected to be completed in the summer of 2006.

In May 2006, the EU Energy Commissioner, Andris Piebalgs and the Austrian Federal Minister for Economics and Labour Martin Bartenstein, wrote to the Russian Energy Minister suggesting that Gazprom's position as exclusive exporter of Russian gas to Europe would make it difficult for the EU to allow Gazprom to take over EU energy companies (see Annex for the full text of the letter).²⁹ Gazprom had already ruled out the possibility of Russia signing the EU Energy Charter, a move that would have required the breaking of Gazprom's monopoly. In April 2006, Gazprom appeared to threaten to divert its gas supplies away from Europe to China and the USA, although it subsequently denied this.

9. Assessment

Gazprom is in a process of transformation. The Russian government, by increasing its stake to 51 per cent, clearly wants to retain control over it so it can be used to obtain political leverage, especially in former Soviet Republics such as Ukraine, Belarus and Turkmenistan. It also wants to increase the revenue it obtains from Gazprom by increasing prices in the former Soviet Bloc, where possible, to Western European levels. Removing restrictions on foreign holdings in Gazprom will give Gazprom better access to capital and might increase the company's value by about 2.5 times. However, especially if a single investor or group of investors builds up a blocking minority holding (25 per cent), this could reduce the scope for government influence over the company.

Gazprom is keen to move down-stream in its foreign markets, taking stakes in local gas utilities. In the former Soviet Republics, it has been able to do this by use of gas sales. However, in Eastern and Western Europe, it is more likely to require cash, although swap deals, such as are being completed with BASF might reduce the need for cash. It has yet to make any major acquisitions in this area. It failed to take up a stake in the Slovak company SPP and reports that it was considering a bid for the UK companies Scottish Power or Centrica seem premature.

Whatever its motives, Gazprom has not had a good press in the West. The cutting off of supplies to Ukraine, the possible takeover of Centrica and the apparent threat to divert supplies of gas to markets other than Europe have all been portrayed in the press as demonstrating the risks of reliance on Russian gas. How far this is commercial ineptitude on the part of Gazprom and how far there is a political agenda in the West behind this presentation is not clear.

²⁷ The Scotsman Feb 13 2006, p 30.

²⁸ Prime Tass, May 2, 2006, 'Russia's Gazprom, Centrica hold talks on North European pipe'

²⁹ Prime Tass, May 2, 2006, 'EU says Gazprom's monopoly status will hurt its bids'.





Source: <http://www.eurogas.org/database/documents/Annual%20Report%202004-2005.pdf>

Annex Letter from Commissioner Piebalgs and Minister Bartenstein to the Russian Government

IP/06/556

Brussels, 2 May 2006

Commissioner Piebalgs and Minister Bartenstein clarify key points of the EU-Russia gas trade relationship in a letter to the Russian Government

Today, Energy Commissioner Andris Piebalgs and Austrian Federal Minister for Economics and Labour, Martin Bartenstein, on behalf of the Presidency, have written to Russian Energy Minister Victor Khristenko, responding to recent comments that have been made in Russia regarding the EU energy market.

Commissioner Piebalgs and Minister Bartenstein acknowledge that Russia, and Gazprom in particular, have been, and remain, a reliable supplier of natural gas to the European Union. They consider it important that this relationship is maintained, given that the EU looks to Russia for increased deliveries of gas in the future. In addition, they note their agreement that long term gas supply contracts can facilitate the very significant investments in Russia that will need to be undertaken to meet future demand. Under the EU competition rules, contracts that promote new investment and other benefits are, in principle, viewed favourably.

The letter points out that the EU and Russia are, and must remain, in a position of mutually beneficial interdependence. Russia, on the one hand, needs the predictability and certainty that the EU market will, in the medium to long term, take the gas that will result from huge new investments and the EU, on the other hand, needs the transparency and certainty that those deliveries will be made in a timely fashion. In this light the Commissioner and Minister welcome recent statements on Gazprom's ability to meet future EU demand and suggest that an EU-Russia energy partnership should be further developed and that relations should be deepened further to the mutual benefit of both sides.

Finally, they comment on Gazprom's perceived concerns on possible limitations imposed by the EU on its aspirations to become a global energy company. Their letter recalls that many energy companies are active in the EU's oil, electricity and gas markets, both upstream and downstream. "The rules applied to Gazprom will be no different to those applied to these and other companies, notably under the competition rules of the EU Treaty, and that they will be applied in exactly the same manner", the letter says. The fact that Gazprom is the exclusive exporter of gas from Russia to the EU, when other Russian companies and foreign joint ventures with gas reserves would otherwise be in a position to supply the EU market, will be a significant fact that will necessarily be taken into account in any such objective analysis. But there is clearly no question of any discrimination.

Finally, Commissioner Piebalgs and Minister Bartenstein stress the importance that the EU places on ratification of the Energy Charter Treaty and the Transit Protocol, a valuable mechanism that can provide the basis for the long term management of the wider European energy market, including such issues as the right of transit and third party access, which remain of great interest to the EU.