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GAZPROM IN EUROPE: FASTER EXPANSION IN 2006

Gazprom' accelerating expansion in Europe may be seen as an effort to gain a dominant position on the EU market before another stage of liberalisation is complete

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In 2006, Gazprom's expansion onto the European gas market accelerated considerably. The measures taken by the monopoly were aimed on the one hand at strengthening its market position in those states that traditionally buy Russian gas, and on the other at gaining access to new markets in Western Europe, in particular the gas-producing countries and states where Gazprom has not been a major supplier so far.
In its traditional markets, one of the ways in which Gazprom progressed towards achieving its goals was by extending already-existing gas deals. In return for offering guarantees of long-term supplies, it gained the right to directly sell gas in some of these markets, and to distribute and trade gas in most of them. In the new markets, Gazprom has established itself as a direct or indirect gas supplier, and an owner of companies authorised to operate on European markets or a shareholder of intermediary companies.
Gazprom's expansion in Europe is increasingly proceeding in accordance with the monopoly's plans. Its activities are clearly aimed at bringing about its domination of the European market, and are sometimes interpreted as an attempt to acquire a 'controlling market share' before another phase of market liberalisation is complete (by 1 July 2007, rules stimulating competition and restricting monopolistic practices should already be in force in the EU energy market). However, the fact that Gazprom is expanding into the European gas sector, including transport, distribution and trade, is making it increasingly difficult for the European Commission to enforce the EU laws on this market.

Agreements and deals concluded by Gazprom in 2006

Until recently, whenever Gazprom tried to establish itself as a direct seller and distributor on Western European markets, it had generally failed – with the one exception of Germany, where the company has long been present in all segments of the gas market. However, a year ago the situation started to change. Most contracts and deals concluded by Gazprom in 2006 with European companies enable the Russian monopoly to purchase their gas assets or participate in them, and to sell gas directly to final consumers, which in fact means that most Western companies have given up opposing the Russian expansion onto the EU retail markets.

Gazprom has extended its existing contracts with its largest permanent customers (Germany, Italy, France and Austria), often well ahead of their expiry. In return for guaranteeing long-term supplies, it has succeeded in introducing two important principles into its relations with customers: firstly, that the mechanism of long-term gas supplies contracts should be kept in place, and secondly, that the Russian monopoly should be admitted to the internal markets of the countries in question, which until now had been dominated by domestic companies. In several cases (including Germany, Austria, the Czech Republic and Romania), under the new deals with Gazprom, its subsidiaries or companies in which the Russian monopoly holds shares have concluded deals for direct gas supplies to large industrial customers. Most of the agreements concluded with these countries offer Gazprom effective instruments to pursue its objectives of strategic expansion in Europe (see Appendix I, Table 1).

In the new markets, especially of gas-producing countries including the United Kingdom, Denmark and the Netherlands, which are or soon will become gas importers as their own reserves become depleted, Russian gas has appeared relatively recently and only in small amounts, mostly in the form of spot supplies. Recently the company opened talks with these countries concerning future deals and acquisitions of stakes in their gas infrastructure, in particular, underground gas storage facilities and inter-system pipelines. Gazprom is also negotiating direct access to end users on the retail markets of the countries in question. To this end, Gazprom has registered subsidiaries authorised to operate in the entire UE market or established companies with local businesses. Most agreements and memoranda signed with the new partners aim to grant Gazprom access to the most attractive British market (see Appendix I, Table 2).

The reasons why Gazprom has gained importance on the EU gas market

The terms of new contracts and deals concluded by Gazprom with both its existing and new partners have strengthened the monopoly's position, both as a supplier and a direct player on the EU gas markets. Gazprom owes its efficiency in achieving its expansion objectives in Europe primarily to the situation on the European gas market, where a disproportion is growing between limited supply and rapidly rising demand. As European countries' own gas reserves are becoming exhausted, these markets are growing increasingly dependent on gas imports (according to the European Commission, the EU-27's dependence on imports will increase from 57% in 2005 to 84% in 2030). The vast Russian gas reserves, Gazprom's position as the world's largest gas producer and exporter, together with the gas transmission infrastructure it owns, gives the Russian monopoly a competitive advantage over other suppliers.
The European countries' concerns about a possible gas shortage, which Moscow has fanned by reports that it plans to diversify the directions of gas sales and to sell gas to Asian markets, are another asset in Gazprom's hands. Information about the company's decreasing production and its potential problems with satisfying European demand further add to these fears. In this situation, priority has been given to obtaining long-term guarantees of supplies, and Gazprom's partners are forced to accept the terms dictated by the monopoly.

Gazprom's objectives

There is an obvious economic objective behind Gazprom's expansion in Europe as well as its efforts to establish itself on the national markets as a distributor and direct seller. Retail prices of gas in Europe are several times higher than those which Russian companies pay to Gazprom. In addition, by binding the EU markets materially to the Russian supplier (the assets held by Gazprom) and legally (the long-term contracts), the Russian monopoly gets a guaranteed position in Europe in the longer term.
There is also an economic objective behind Gazprom's efforts to acquire stakes in the main gas pipelines and underground gas depots of its new partners. This infrastructure forms an integral part of the EU transport and distribution network. By gaining access to it, Gazprom also gains broader opportunities of operating throughout the EU market.
Increasingly energetic and increasingly effective, Gazprom's activities are aimed at dominating, or in the longer term, monopolising the markets of most UE member states.
The company's strategy of expansion in Europe is also in keeping with the policy of the Russian government, in which the export of energy resources is one of the main tools of rebuilding Russia's

position as a world power. The dominance of a Kremlin-controlled gas monopoly on the EU market, which is Gazprom's main customer, is another instrument of this policy. The European Commission's plans to increase competition in the EU market and co-ordinate energy policies in the Community run counter to Gazprom's objectives. The Kremlin has been trying to counter them by inspiring and supporting Gazprom's foreign expansion, with the aim of making Europe dependent on Russian supplies to the greatest extent possible.

Conclusions and forecast

Gazprom's contracts with traditional European customers extended in 2006, as well as its deals with new or future partners in the EU – in most cases concluded on terms dictated by the Russian monopoly – prove that the company's aggressive policy is starting to produce the desired effects. Its main results include strengthening Gazprom's position on the EU markets, as well as expanding and consolidating its presence in all their segments.

Gazprom has tended to considerably expand its direct stakes on the EU national markets, which makes these markets prone to evolve in the direction the company most desires, i.e. into a marketplace in which the Russian company holds a dominant position.

If Gazprom's expansion in Europe continues, this may create difficulties for the EU energy policy, which seeks to demonopolise and liberalise the European gas market and make it more competitive. Even now, the scale of Gazprom's expansion onto the markets of individual EU member states and its strong ties with domestic companies are impeding liberalisation. In the longer term, if Gazprom's expansion continues, the Russian monopoly may dominate the European gas sector, consequently monopolise it and suppress competition.

In economic terms, this could put Gazprom in a position to dictate prices, and in the political dimension, give Moscow more political influence, as the Kremlin is indeed using the current situation in the energy resources market to expand its political sway. Gazprom's moves in the CIS (such as the politically-motivated conflict with Ukraine in early 2006, as a result of which Russian gas supplies to several European states were interrupted) demonstrate that a gas monopoly controlled by the state may be an effective instrument of pressure in the Kremlin's foreign policy.

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Appendix I

Table 1. Gas deals concluded by Gazprom with European states in 2006

Country, name of partner company	Contract conclusion date	Contract duration	Volume and recipient of supplies	Purpose, terms and objectives of the contract; possible consequences
Austria Gazprom with: ÖMV Gas International (OGI); EconGas, GWH (Gazprom-export - 50%, Centrex - 24.9%, ÖMV - the rest); Centrex Europe Energy & Gas AG (a Gazprom-bank company)	28 September 2006	2012 – 2027	7 billion m³ a year 3/4 of supplies goes to OGI; 1/4 goes to Econ Gas and Centrex Europe	The contract was renegotiated and extended. Gazprom made extending the contract conditional on a change of gas recipient. Originally, OGI (an ÖMV subsidiary) was the sole recipient. Presently, two companies in which Gazprom holds shares, both authorised to sell in the retail markets of 3 Lands, will compete with OGI. The contract gives Gazprom subsidiaries the right to operate on the market, as well as direct access to the Austrian retail market.
Germany Contract concluded by WIEH (a Gazprom and Wintershalll company) with Verbundnetzgas	5 July 2006	2014 – 2031	90 billion m³ in 2014-2031 (5.25 billion m³ a year with an option to increase supplies)	The contract strengthens Gazprom's position on the German market. Through the mediation of WIEH, Gazprom also sells gas in other EU countries.
Gazprom and E.ON Ruhrgas	4 October 2005	2009 – 2020	8 billion m³ a year starting from 2009	E.ON Ruhrgas used the last option to extend one of the 7 long-term contracts.
E.ON Ruhrgas	29 August 2006	2011 – 2036	100 billion m³ (4 billion m³ a year)	Contract for supplies from the Nord Stream gas pipeline The German company is another customer in the list of operators that will buy gas from this route. The trans-Baltic project's viability depends on Gazprom's ability to sell the gas supplied by this pipeline.
Gazprom and E.ON Ruhrgas	4 October 2006	2020 – 2035	300 billion m³ in 2020-2035 (20 billion m³ a year)	Existing contracts for the supplies of gas by Weidhaus, which expire in 2020, were extended. The extended contract keeps the fixed supply-point principle in place.
Italy Eni	14 November 2006	2017 – 2035	22 billion m³ a year	The existing contract was extended within the framework of a new version of the strategic partnership agreement between Gazprom and ENI. It gives the Russian monopoly a right to sell gas directly on the Italian retail market starting from 2007, in the amount of up to 3 billion m³ a year in 2010, in return for a promise that Eni will be allowed to acquire assets in Russia.
France Gaz de France (GdF)	19 December 2006	2012 – 2030	12 billion m³ a year, plus a contract for an extra 2.5 billion m³ a year from the Nord Stream pipeline	The existing contract until 2011 was extended. Of the total amount of 12 billion m³ of gas, Gazprom will be authorised to sell 1.5 billion m³ directly on the French retail market as of October 2007. GMT France, a Gazprom subsidiary that has already concluded preliminary agreements with industrial customers, will deal with the gas sales. Since autumn 2006, GMT France has been a member of the French gas exchange; Gazprom gains another customer to buy gas from the Nord Stream.

Country, name of partner company	Contract conclusion date	Contract duration	Volume and recipient of supplies	Purpose, terms and objectives of the contract; possible consequences
Czech Republic RWE AG (subsidiary of Germany's RWE Transgas), exclusive supplier to the Czech market since 2006	21 December 2006	2014 – 2035	9 billion m³ a year	The contract extending supplies was concluded in a package with the agreement extending the deal with RWE concerning gas transit to 2035. RWE pipelines transport Russian gas to Europe via the Czech Republic.
Vemex (a Gazprom subsidiary) and the gas distributor Prazska Plynarenska	1 April 2006	no data available	550 million m³ of gas in 2006	Vemex is the second Gazprom-controlled company that entered the Czech market as RWE's competitor (Wingas Europa also supplies gas to the Czech Republic under direct contracts). Direct access to the national market (contracts with industrial customers).
Vemex with Energetika Vitkovice AS (CEZ Group)	28 November 2006	no data available	Supplies starting in 2007	
Vemex with the Spolana Chemical Plant in Neratovice	8 December 2006	no data available	Supplies starting in 2007	
Bulgaria Bulgargaz	18 December 2006	2011 – 2030	3 billion m³ a year	Gazprom extended the existing contract on the condition that its terms are renegotiated and that the two companies switch to cash settlements of gas transit (the contract which would have expired in 2010 provided for barter settlements - 1.4 billion m³ were given to Bulgaria at the rate of US$ 83 per 1000 m³). As a result, Bulgaria will pay more for its gas. The new agreement provides for increasing the volume of transit via Bulgaria (Russian gas is transported via Bulgaria to Turkey, Greece and Macedonia). In return, the Bulgarian government has committed itself to co-operate on gas pipeline projects, and has given its consent to the extension and use of its underground gas storage facilities. As a result, Gazprom will be able to use Bulgaria's infrastructure (gas pipelines and underground depots) in connection with the planned construction of the southern pipeline designed to compete with the Nabucco.
Romania Gazpromexport with WIEH (a Gazprom and Wintershall company)	23 November 2005	2012 – 2030	c. 4.5 billion m³ a year	The contract expiring in 2011 was extended. The Gazprom subsidiary WIEH has been the main recipient and seller of Russian gas imported to Romania since 1993.
Gazeksport z Romgaz	5 May 2006			Agreement concerning the establishment of a company to build an underground gas storage facility.
Gazpromexport with Transgaz	5 May 2006			Under the agreement, the company will operate and invest in gas transmission infrastructure in Romania together with Gazprom. The Russian monopoly may then use this infrastructure to increase the volume of gas supplies to Turkey and to carry out the southern gas pipeline project.
Gazpromexport with Conef (Romanian distribution and trade company)	5 May 2006	2010 – 2030	50 billion m³ in 2005-2030 (2 – 2.5 billion m³ a year)	Preliminary agreement concerning a long-term deal (2010-2030) on direct supplies to the Alro Slatina aluminium plant (without any involvement from the German partner WIEH). Since 2005, Gazprom has supplied gas for Alro Slatina through the mediation of WIEH (a Gazprom and Wintershalll company). The new agreement grants the Russian monopoly access to the national market thanks to direct contract with industrial customers.

Table 2. Selected deals concluded by Gazprom with new partners in 2006

Country, name of partner company	Deal conclusion date (or contract duration)	Type of concluded/planned transaction	Purpose and significance of deal; other information
Denmark Gazprom with Dong Energy	16 June 2006; the contract covers the period 2011-2031	Contract to supply 1 billion m^3 of gas a year from the Nord Stream to Dong (with an option to increase supplies)	Gazprom enters a new market and gains a customer to buy gas from the Nord Stream.
GMT (a British Gazprom subsidiary) and Dong Energy	16 June 2006 the contract covers the period 2011-2022	Contract for the supply of 600 million m^3 of Norwegian gas a year to the UK. GMT will purchase gas from Dong, a shareholder of Norway's Ormen Lange project.	GMT's transaction marks the Gazprom subsidiary's debut on the European market.
UK Gazprom Marketing & Trading - GMT (a British Gazprom subsidiary authorised to operate on the entire EU market) with Pennine Natural Gas (PNG)	22 June 2006	Acquisition of PNG, a small private distribution company	The transaction gives the monopoly the right to operate on the British market as an independent distributor and a starting point for further expansion onto the liberalised European market. Before, GMT operated only in the British gas exchange where it concluded small spot transactions as of 2003.
GMT	12. May 2006	Signature of BSC, a code regulating the purchase, sale and transport of electricity in the British market	By signing the BSC, GMT gains the right to perform trade deals in the electricity markets of the UK and neighbouring countries (France, Belgium, Netherlands).
Gazprom – an agreement with the Interconnector consortium (Interconnector is a pipeline connecting Belgium and the UK)	14 September 2006	Purchase of additional quotas (2 billion m^3 of gas a year) for the transport of gas via this route to the UK before the end of 2007	Gazprom holds a 10% stake in the Interconnector. The transaction increases the volume of supplies to the UK that Gazprom is authorised to send via the Interconnector as a consortium shareholder.
GMT with Norsk Hydro	10 September 2006	A one-year contract for the supply of Norwegian gas to the UK via the Langeled pipeline (a minimum of 500 million m^3 a year); the contract may be extended	GMT acts as an intermediary and a player in the European market
Netherlands Gazprom with Gasunie	5 October 2006	Memorandum on Gasunie's possible participation in the Nord Stream (9% of shares from the German companies' allocation)	In return for a stake in the trans-Baltic pipeline, Gazprom wants to acquire shares in the BBL pipeline connecting the Netherlands with the UK and gain access to the Dutch retail markets (talks with Dutch domestic companies are in progress). Gazprom has suggested that Gasunie should check the feasibility of Gazprom using its gas infrastructure to increase the volume of Russian gas transit to the European market. If Gazprom could access the British market using the BBL, it would no longer be necessary to build a branch connecting the Nord Stream with the UK, which would save costs on the trans-Baltic project.
Belgium Gazprom with Belgium's Fluxys (gas transport)	27 June 2006	Preliminary agreement concerning the construction of an underground storage facility to store gas supplied via the Nord Stream. A proposal for Gazprom to participate in the Zeebrugge gas hub, acquire shares in the LNG storage facility and participate directly in gas supplies to the hub. Gazprom is considering creating a company with Fluxys or buying its shares.	Gas is transported from Zeebrugge to the UK via the Interconnector. The storage facility would be an element of the trans-Baltic project. Gas stocks stored there would be intended for customers in Belgium as well as other customers in Europe.

Appendix II

Gazprom's paths onto the EU's national markets

Gazprom implements its expansion strategy in European markets by using a set of various tools. Many of these are included in the package of conditions offered by the monopoly when concluding new deals and extending those which are about to expire.

1. Long-term contracts, which tie the customer with the supplier for many years. More than a year ago, Gazprom started to conclude these contracts on new terms which include a right for the Russian monopoly to sell gas directly in the retail markets of the customer countries (deals with Austria, France and Italy have given Gazprom such an opportunity);

2. Measures to control gas transport routes to Europe:
– projects to build gas transport routes that will reduce Gazprom's dependence on the existing routes via Ukraine and Belarus (the Nord Stream trans-Baltic pipeline). Some gas deals with Gazprom's traditional and prospective customers include commitments or proposals to supply gas via this new gas pipeline. Gazprom's ability to recuperate the costs of this investment depends on a guaranteed market for its gas.
– efforts to prevent the construction of other gas transport routes to Europe as alternative to the Russian ones, for example the Nabucco gas pipeline which bypasses Russia, and is designed to transport Central Asian and Caspian gas to the EU. The project to compete with Nabucco by building a southern route to transport Russian gas to Europe, which involves increasing the capacity of the Blue Stream (the pipeline connecting Russia with Turkey via the Black Sea) and extending it to Central Europe, is one of the ways in which in plans to thwart the Nabucco pipeline. New gas deals with countries whose territory the southern pipeline could cross (Bulgaria and Romania) include a provision that the Russian monopoly should be granted access to their transmission network with an option to incorporate it into the new route in the future.
– investments in new inter-system connections (such as the BBL gas pipeline from the Netherlands to the United Kingdom). Proposals of this kind presented by Gazprom to new customers are usually combined with an offer to increase the planned capacity in order to accommodate the future increased volume of Russian gas supplies, including those from the Nord Stream.

3. Strengthening and expanding Gazprom's presence in the EU markets, using the following methods, among others:
– any newly-concluded or extended contracts include the condition that Gazprom should get a stake in the gas infrastructure of the customer country, i.e. its transmission and distribution network, as well as the right to sell gas directly in the retail markets (Hungary, Germany, Austria, Bulgaria and other countries);
– Gazprom creates its own companies, which are licensed agents authorised to operate in Europe (Gazprom Marketing & Trading, in the United Kingdom; Wingas-Europa, a company established together with BASF; others), and establishes distribution & trade companies with domestic businesses (e.g. the Central Energy Italian Gas Holding AG (CEIGH) established with ENI);
– gas is supplied (currently in small quantities) under individual contracts concluded by Gazprom subsidiaries (or companies in which Gazprom holds shares) with industrial customers (including Vemex and the contract between Wingas & the Vetropack glass works in the in the Czech Republic, as well as Austria and Romania);
– Gazprom participates or plans to participate in the gas storage system (the construction of underground gas depots in Austria, lease of storage facilities in Germany, plans to build gas depots in Hungary, Romania, Turkey, Belgium and other countries);
– Gazprom presents proposals to European companies (such as Electricité de France) to jointly sell gas to third countries.