

Russian-European gas relations tensing up

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Valdaiclub.com interview with Tatyana MITROVA, Head of the Center for the Study of World Energy Markets at the Russian Academy of Sciences' Institute of Energy Research (since 2006), Head of Global Energy at SKOLKOVO Energy Centre.

Why has Ankara rejected significant amounts of gas ahead of the winter season? How will it affect the general situation with gas supply in Turkey?

The contract in question expires on December 31, 2011, and the parties may either extend it or not. Turkey was supposed to announce its decision six months in advance, but postponed it several times, haggling over the gas price in the extended contract, where the formula would be reworked. Russia and Turkey failed to agree on the price, and by the last deadline, September 30, the Turkish state-owned company Botas notified Gazprom that it would not extend the agreement on gas supply along the so-called western route.

The whole situation reflects the difficulty of all negotiations with Turkey. The latest events can even be seen as an attempt to put pressure on Gazprom to make it lower the price or to offer other concessions. Overall, Turkey has contracted about 30 billion cubic meters of gas, but the actual deliveries are about 18 billion. Obviously, it will now have to pay huge fines under the take-or-pay provisions. So the latest developments are Turkey's response to the need to pay huge compensations, an attempt to get its preferred price for extended contracts.

Turkey consumes almost 40 billion cubic meters of gas, but produces almost none. Having refused to extend the contract, it gave up 6 billion cubic meters, which is especially difficult with winter on the horizon. I would like to recall that gas deliveries to Turkey from other suppliers, first of all, Iran, have always been plagued with disruptions and high risk. Not just once or twice has supply from Iran been disrupted, and each time Turkey asked Gazprom to help and to supply gas in the winter. And Gazprom would mount gas supply along the Blue Stream and the western route, saving the day – this is no exaggeration.

Apart from Russia, Turkey receives pipeline gas from Iran and Azerbaijan and liquefied natural gas from Nigeria and Algeria. How does it plan to meet its gas needs

now?

This is the most interesting question: from which sources does Turkey plan to get cheap gas? After all, it emphasized that there were a lot of sellers on the market and it could get a lower price. In reality, however, all projects in question are still at the stage of discussion and development. Be it supply of additional gas from the second stage of the Shah Deniz field in Azerbaijan; or the elusive gas supplies from Central Asia – Turkmenistan, and, possibly, Kazakhstan and Uzbekistan – via the Trans-Caspian gas pipeline. This project has not even been implemented yet, given that it is illegitimate until the status of the Caspian Sea is settled; or supply from Iraq and other Arab countries via the Trans-Arab gas pipeline, which will hardly be feasible in the foreseeable future due to immense political risks. Yes, Turkey has two regasification terminals with an aggregate capacity of 12.2 billion cubic meters a year. But their work load is already 65%. The most Turkey can get from loading them at full capacity will be another 4 billion cubic meters. This is the only real room for maneuver the country has. However, never in the global practice have regasification terminals been loaded 100%, and the same goes for other systems. So in reality, it will not be more than 2 billion cubic meters.

Given Turkey's high economic growth rate, it is obvious that these 2 billion will not suffice to meet domestic demand already in a year or two. Without additional amounts of Russian gas, the country will be unable to meet its gas needs in the near term.

In this regard, Gazprom has made a remarkable statement pointing out that as the Turkish gas market is being liberalized, it has got other players apart from Botas. Moreover, some of Gazprom's contracts were transferred over from Botas to some other companies on request of the Turkish government in order to develop competition on the Turkish market. These companies are perfectly aware of the market's needs and growing demand and are willing to buy additional gas from Gazprom. So this contract will actually go from Botas to other suppliers in some way or other; it will be a change of the counteragent.

Do you believe Gazprom will be willing to make concessions unless Turkey meets it halfway? Will Ankara agree to the construction of the South Stream pipeline across the Black Sea to get a discount for Russian gas?

This involves a wide range of issues. Russian-Turkish long-term relations in the energy sector include talks on the construction of a nuclear power plant and Gazprom's participation in the construction of underground gas storage facilities... Apart from energy, there is a significant political component. Turkey is actively declaring its foreign political stance as a leader in the Arab world, which results in fairly ambiguous actions. So it is very difficult to say how the negotiating process will end and what benefits there will be.

Turkey is still hypnotized by recent low prices on the market. But the current prices on the spot market are completely different. As the situation on global market is developing further – first of all, with the soaring demand in the Asia-Pacific region after the Fukushima disaster – relatively cheaper gas is available. It is quite likely that this excess is going to evaporate in the next 12 or 18 months. Then it will be impossible to get any serious discount, because prices will not be low even on the spot market.

Will Gazprom be forced to agree to a further decrease of contract gas prices?

It did make certain concessions in 2010 and 2009. Given the crisis and the plummeting demand, Gazprom agreed to index 15% of the supplied amounts to spot prices, which at the time were significantly below the prices pegged to petrochemicals. It also introduced additional conditions in connection to the unique situation on the global gas market, reducing the liabilities under the take-or-pay requirements, when consumers have to pay for a specified amount regardless of whether they accept it or not.

These concessions were provided for one or two years in order to go back to the previous schemes

later. Perhaps, new contracts will also have similar schemes of indexing to spot prices and with other take-or-pay terms. However, the illusion that the world has plenty of cheap gas available is dwindling fast. It is getting more difficult to threaten by “buying from others unless you sell it cheap,” given these others are not that numerous. They continue upholding the moratorium on additional LNG production, yet some LNG producers have closed their plants for repairs, and the market is not receiving these amounts. Given the destabilization in North Africa, the Asian-Pacific region is directing all its efforts to make up for energy shortage caused by the shutdown of nuclear power plants in Japan. The situation on the global gas market has changed, but it seems that Europe is still moving by inertia and has yet to realize that prices will not fall further.

What, in your opinion, was the reason for the European Commission’s large-scale operation to check Gazprom’s activities on the EU markets? Do you agree with experts that say that Europe was trying to get it to lower gas prices this way?

These views do exist, even though official statements mention straightforward contract checks and document confiscation, but in any case, these measures smack of psychological pressure. There is a certain connection between the pressure the EU puts on Central Asian countries and Azerbaijan in order to have the Trans-Caspian pipeline built. Russia’s tough response could also move the European Commission to take this harsh step. We can state that Russian-European energy relations are tensing up, which, of course, is nothing to be happy about.

Officially, the European Union cites Lithuania’s complaints about Gazprom’s allegedly dominating position and about violations of the European anti-trust legislation. These old complaints have been brought to light just recently. It seems that the European Commission’s Directorate-General for Energy and Transport is trying to rid national companies and governments of their powers, taking over the functions of negotiating with current suppliers and formulating energy policy in general. An important link in this is access to information on long-term contracts, something the European Commission doesn’t have at the moment. It is no coincidence that it has chosen this way of getting information in order to put pressure on both Gazprom and national companies to change the rules of the game and to concentrate the managing and regulating potential on the European level instead of the national one.

Alongside these searches and confiscations of documents, the European Commission presented its complaints to many European companies and national governments for insufficient implementation of the requirements of the EU Third Energy Package. In fact, we are watching a power scramble, the outcome of which will decide who will dominate the European gas business.