Transparency International Association – College of Europe

Gazprom Case Study

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Gazprom and Energy Security Implications in the EU

1. Introduction

The presence of the third actors in the EU energy market is not a new phenomenon, given the large influx of energy imports to the EU. However, the actors that enter to the EU market shall comply with the article 10 of TUE that envisages transparent functioning of the EU institutions. Gazprom, with its particular political nature inherent in energy companies, operates not only within the scope of economic interests. Namely, to strengthen its visibility in the EU energy market, the company works with the external consultancy Gplus Europe since 2007. Thus, the paper will assess the economic implications of Gazprom activities along with its interest representation within the EU energy market.

2. Executive Summary: Strengths, Weaknesses, Opportunities, Threats

The EU has comparatively limited opportunities of substituting natural gas imports from Gazprom which makes the EU companies overly dependent on Russian gas supply. However, by 2020 countries in the Baltic region and south-eastern Europe which are highly dependent on Gazprom and sensitive to gas interruptions can significantly or even fully substitute Russian gas imports by mixing LNG from US, Asia, Middle Eastern, South America and pipeline gas from Azerbaijan. Still such scenario is less possible for the countries in Central Europe which can substitute Russian gas imports just partially.

According to the conditions of Gazprom long-term contracts the European companies are obliged to import at least 115 bcm/year which accounted for approximately 75 per cent of total EU gas imports in 2013. Even after the existing long-term contracts will expire, the EU will still need approximately 100 bcm/year of Russian gas up to 2030[1]. There are some alternatives which the EU can use in order to decrease the dependency on Gazprom gas, such as Liquefied natural gas. However, Gazprom can still considerably influence the market prices and in this way the overall market demand.

Countries which are highly dependent on Gazprom gas supplies are facing substantial energy security threat because of possible interruptions. Therefore they should terminate or not prolong the existing long-term gas contracts and search for alternative substitutes such as LNG which might require significant infrastructure investments for import terminals and pipeline connections.

3. Gazprom in the EU market

3.1. Gazprom position in the EU energy market (comparative perspective)

Gazprom is the Russian biggest gas company which is responsible for extraction, production, transport, and sale of natural gas. It is also characterized as legal monopoly which wholly controls Russian gas export to the international markets. Geographical proximity, availability of necessary gas supply capacity, comparatively low prices on gas and transportation made Gazprom one of the major gas suppliers to the EU market. Its' share in total EU's gas imports was estimated at 39% in 2013.

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[1] https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/NG-92.pdf

The general natural gas consumption in the EU is characterized by decreasing trend: between 2013 and 2014 it reduced by 10 percent. In 1970 the European indigenous gas production could satisfy all the natural gas demand of the internal market. In 2013 the internal natural gas production covered already just 57 per cent of the EU's internal demand. Such shift happened both because of the declining gas production and increasing gas demand. Norway and the Netherlands are representing 70 per cent of the total gas production in the EU, while the UK, Germany, Poland, Romania, Denmark and Italy are responsible for all the rest natural gas supply. In these circumstances the EU becomes highly dependent on the external gas supply by Gazprom which at the moment has a limited number of alternatives. Nevertheless, liquefied natural gas is viewed as the promising alternative to Russian natural gas supplies. It is predicted that before 2020 the non-US LNG supply to the EU will increase by 100 bcm/year which can almost fully substitute current natural gas imports from Russia which in 2013 was equal to 130.7 bcm/year. The major problem existing within this issue, is if the EU will be capable to deliver gas to the Member States which are heavily dependent on Gazprom.

3.2. Gazprom Contracts with the EU companies

Russian gas exports to the Europe are sold on long-term contracts varying from 10 to 35 years in length (legally binding and subject to international arbitration). These contracts are based on take-or-pay clauses which require buyers to pay for a minimum annual quantity of gas. At the moment European gas buyers represented by the EU companies are committed to purchasing more than 125 bcm of gas from Gazprom in 2020 and around 70 bcm in 2030.

Gazprom leaves the right to set different prices depending on the market where it operates. Such conditions created significant disparities between the gas prices charged from the companies across the EU Member States. For example, while Germany buys gas for €366 and the United Kingdom for €285, such countries as Lithuania and Greece are paying €480 and €469 respectively. Simple prices comparison shows that they significantly differ depending if the Member States are highly relying on Gazprom supplies and if the countries are geographically close which makes it difficult to have other alternatives to Gazprom because of the necessity to make significant infrastructure investments for import terminals and pipeline connections. For instance, the share of the total natural imports of the gas originating from Russia in such countries as Estonia, Finland, Latvia and Lithuania equals to 100%, while in France just 15% of total natural gas consumption if imported form Gazprom.

3.3. Leverages of influence: Gazprom in the EU

One of the most effective leverages of influence which the EU can undertake in order to decrease the influence of Gazprom is to intensifying the market competition by switching to alternative gas suppliers. Such alternative is feasible due to the increasing LNG supplies capacities from Asia and available technologies of building the LNG terminals. While these alternative requires substantial investments into the infrastructure, by 2020 it can almost fully substitute Gazprom natural gas supply in the Baltic region and south-eastern Europe. Secondly, the EU can effectively use competition and internal market rules towards companies operating on the internal market. And lastly, the EU can reduce the share of gas in energy mix by switching to the alternative energy sources.

4. Transparency of Gazprom commercial activities in the Energy Market

While reviewing Gazprom activities within the EU internal market, the company is to operate in accordance with the EU competition law. This aspect primarily refers to the economic activities of the energy giant. Yet, besides the economic implications, Gazprom has been working with the consultancy Gplus, with the official purpose of strengthening the image of the company operates through the external actor. Thus, this subchapter will briefly discuss the activities of both sides: interest representation and antitrust case.

4.1. Interest representation of Gazprom within the European Institutions: Gplus Europe

Besides the common forms of interest representation that is projected through the economic interests, Gazprom also referred to the extended instruments for strengthening its image. For the first time the idea of working with foreign consulting companies Kremlin then the Minister of Media Mikhail Lessin announced in 2001, however it did not gain sufficient support.

But in 2006, on the eve of preparations for the summit of G8, the Russian government still started cooperation with foreign consulting companies: Ketchum in the US and its sister organization Gplus Europe in Brussels. It is however unclear whether there was a transparent tender procedure that led to the final choice of the consultancy, or personal contacts comprised the decisive factor for further cooperation between the Russian energy company and the consultancy firm.

At that time, the need to improve the image of Russia and "Gazprom" was the official narrative for working with the company. But the goals appear to be different from the stated objectives. Essentially, working with the Western PR-agencies comprises a tool of Russian use of “soft power”, as established informal contacts with the officials working in the EU institutions do not require necessary accountability, and yet illustrate positive effects.[2] Working with Western PR-agencies is the tool that Russia uses successfully as a "soft power". Yet, certain constraints in transparency matters could be noted since 2009, when Gplus was suspended from the Transparency Register for failing to disclose entirely all of its clients.

Moreover, because of limited accessibility of information on which Gplus specifically consulted Gazprom, it is rather complicated to identify who was behind the services that a lobbying company has been providing for the Russian giant. Then consequently, it is to identify where exactly Gazprom was behind the decisions made. However, the fact that Gazprom CEO Alexey Miller was not sanctioned by the EU in the wake of Ukrainian crisis illustrates potential effects of lobbying within the EU institutions behind the scene. However, with the limited information, it unclear whether the heavy lobbying was the result of the work by Gplus, or other aspects were taken into consideration.[3]

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[2] This can be concluded from the fact that Gazprom works with the consultancy firms until now.
[3] Aigner K, ‘*Spin doctors to the autocrats: how European PR firms whitewash repressive regimes’*, p.14.

4.2. Gazprom Antitrust Case

In September, 2012 European Commission started proceedings against the dominant position of Gazprom in the EU energy market. Namely, it accused Gazprom of breaching the EU competition law, in particular EU antitrust rules. Until this year, there has not been an eventual court ruling regarding the case.[4] However, with the potential loss of billions of euros, Gazprom went chose the strategy of strengthening its image in the center of European institutions. Thus, potentially Antitrust case served the key reason for opening the Gazprom office in Brussels. With the unknown fate of the antitrust case and the overall cost for the company, active engagement of Gazprom representatives in seeking *rapprochement* with the EU officials was a natural and expected step. Thus, with the ongoing antitrust case the key energy operator chose the strategy of improving its image in the West and seeking closer engagement with the EU partners through opening its office, once the lawsuit commenced.

5. Policy Recommendations

Gazprom, with its largely dominant position in the European energy market, not only has a direct impact on the EU energy market, but has some lessons that the EU should learn. First of all, the EU should set more strict constraints to the duration of gas contracts which is today one of the main binding conditions which prevents the EU companies from diversifying their gas imports. Secondly, the EU should exclude the opportunity of preventing the cross-border flows of gas which are introduced by Gazprom contracts. Thirdly, the EU should require more transparency and accountability from Gazprom and its PR consultancies in terms of lobbying and policy advising within the EU institutions. And finally, the EU should insist on more transparent price setting policy by gas suppliers in order to eliminate internal price discrimination or possible dumping which hinders the energy security and market competition.

6. Conclusion

To conclude, the research proves that there are transparency constraints within the activities of the Russian energy giant in the EU. The company is not purely driven by its economic interests but also with the political engagements. The fact of working with the external consultancy provided Gazprom with additional instrument of influence in the West, where the role of informal meetings and personal contacts of the staff might have played a decisive role. Thus, interest representation by Gazprom partially strengthened the image of the company in the West with the tools that were not fully transparent.

[4] The ruling is expected to come up in 2016.