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RUSSIAN GAS MARKET | LIBERALIZATION "A LA RUSSE"?

This paper looks at the recent reconfiguration on the Russian gas exports market. With the liberalization of LNG exports introduced in late 2013 and the contracts signed with Chinese importers in May 2014, the positions of Gazprom, which had long been holding a monopoly in the sphere, have been seriously challenged. The main challengers to Gazprom seem to be Russia's two major independent gas suppliers – Rosneft and Novatek –, which not only gained access to foreign clients but have also strengthened their positions on the domestic market. By bringing into focus the strategies of the key market players as well as by analyzing the current balance of power at the top decision-making level, the author seeks to explain the main drivers of the ongoing reforms.

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Recent moves regarding regulation of Russian energy market have cast doubt on Gazprom's status as the country's sole exporter of natural gas. Late in 2013, the company's monopoly was questioned for the first time when liberalization of liquefied natural gas (LNG) exports allowed the so-called independent gas suppliers (IGS) – Rosneft, Novatek –, to start selling gas abroad.

Russia is the world's second largest gas producer[1] and the main gas supplier to EU countries. Up until recently the only company with the right to export gas from Russia was Gazprom – a corporation founded in 1989 as a result of transformation of the Soviet Ministry of Gas Industry. In addition to holding a monopoly on gas export, Gazprom has also been dominating the domestic market.

However, today Gazprom's monopoly seems to be challenged. First of all, over the last few years we observed a constant contraction of Gazprom's share on the domestic market: although the company remains a leader, its market share decreased from 86% in 2000 to 73,7% in 2012, creating room for other stakeholders (Rosneft and Novatek, most notably)[2].

Second, the LNG exports policy liberalization introduced in November 2013 has undermined the very basis of the Russian gas market - Gazprom's steadfast position as a gas-export monopolist.

Third, a contract signed with China as well as a package of measures proposed by Rosneft's CEO Igor Sechin during the last session of the Presidential Commission on the fuel and energy sector in June 2014 could be a sign of an upcoming gas exports de-monopolization: today the pipeline network remains in Gazprom's sole proprietorship, but the IGS seem to be contesting this state of affairs.

All in all, what one observes today could be a major transformation as far as the Russian energy market is concerned. However, Gazprom, on one hand, and Rosneft and Novatek, on the other, don't seem to be competing with the same intensity. Rather, Gazprom is not fiercely defending its positions as a monopolist – all its actions are more retaliatory than pro-active.

Therefore, one could suggest that the changes in Russia's gas exports policy are primarily driven (or at least, supported) by the Kremlin. The scheme and the objectives of such a "liberalization" are not clearly defined, though.

By advancing a hypothesis that the "de-monopolization" does not really aim at giving more power to the independent gas producers and suppliers, this paper will look more in detail at the changes implemented in order to cast light on gas-export liberalization "à la russe".

| Rosneft and Novatek: new challengers to Gazprom?

Gazprom's monopoly has largely resulted from its Soviet era heritage as well as low gas prices during the 1990s: as a government-managed corporation, it was the only one able to guarantee large-scale gas production while two other market players – ITERA and Novatek – could hardly compete[3].

With the gas price boom in the early 2000s, Gazprom's positions have become even stronger: the 2006 Federal Law on Gas Exports established Gazprom's export monopoly limiting the independent gas suppliers activities to Russia's domestic market. In other words, if a decade ago it was mainly the market situation that didn't favor the emergence of new and independent gas market players, the 2000s have seen this situation fixed by federal law. As a result of such a 'centralization' Gazprom has been left with no challengers at all as far as Russia's foreign markets are concerned.

1. CIA, *The World Factbook, Natural gas-production*, URL: https://www.cia.gov/library/publications/the-world-factbook/rankorder/2249rank.html.
2. Balashov S.V., Shtilkind T.I., *Gazprom and the Independent Gas Producers* ("Газпром и независимые производители газа") URL: http://www.unece.org/fileadmin/DAM/ie/se/pdfs/RTG_Balashov_R.pdf.
3. Bochkarev Danila, *Liberalization of Natural Gas Exports to Help Russia Restore Positions on the European and Global Markets*, Russian International Affairs Council, August 01, 2013. URL: http://russiancouncil.ru/en/inner/?id_4=2182#top.

Left with the sole option of expanding on the domestic market, Russia's IGSs have shown some good dynamics, though: their share has become more important with growth of almost 5% during 2000-2012 (from 9,9% to 14,6%, to be more specific). This sudden (but still modest) rise could partly be explained by the IGS's strategies focused on the minimization of production costs, as some analysts suggest[4].

The best results have been shown by Rosneft and Novatek. The rise of the two most productive Russian IGSs during this period largely resulted from an active M&A strategy (Novatek bought shares in a number of independent gas producing companies – SeverEnergy, Sibneftegaz, Northgas – as well as took control over some gas distribution businesses – Mezhregiongaz Chelyabinsk, for instance; Rosneft purchased Itera and TNK BP). Apart from this, the new players were expanding their client base intensively: Rosneft has signed two major contracts with Inter RAO[5] and Fortum[6] while Novatek sealed a deal with Sibur[7].

Even though Rosneft's and Novatek's growing influence on the domestic gas market during the 2000s could hardly have been neglected, it would be fair enough to note that neither the former, nor the latter has tried to compromise Gazprom's monopoly on gas exports. On the contrary, all legislative moves (2006 Federal Law, most notably) were reinforcing this *status quo*. The changes started as soon as Vladimir Putin was elected President for his third term in 2012 and Igor Sechin was nominated as Rosneft's CEO: the second most powerful man in Russia[8] seems to have outreached Gazprom's CEO Miller as a lobbyist for his company. That is the time when the very notion of the gas exports de-monopolization appeared in political discourse. But was it a bid for a real de-monopolization or Rosneft's and Novatek's attempt to enter the market by creating a new monopoly of three?

| LNG exports: new rules of the game

In April 2013, Rosneft's president Igor Sechin said that the company's target was to assure production of up to 100 bln. cbm of natural gas per year by 2020[9]. It would allow the company to control about 19-22% of Russian gas market, according to Rosneft's vice-president and head of Rosneft's gas business unit Vlada Rusakova, who used to work for Gazprom as a head of its strategic development department[10].

These declarations came some months prior to the bill on LNG Exports Liberalization passed and ratified by the State Duma. Although breaking Gazprom's hegemonic position, the amendments to the Federal Law didn't allow many new players to step in: in fact, only Rosneft and Novatek were de-facto permitted to export gas.

At the same time, even for those two companies, the progress was important, but so far, minor. That is to say, today in Russia there is only one LNG plant, and it is controlled by Gazprom: the project "Sakhalin-2", the capacity of which reaches 10 mln tons per year and which started operation in 2009. The construction of the plant's second line is expected to be launched in late 2014. The co-owners of the project are Shell, Mitsui and Mitsubishi Corporation, but Gazprom holds a majority stake.

The other Russian LNG project that is currently under way is "Yamal SPG": the plant controlled by Novatek, CNPC and Total (60%, 20% and 20%, respectfully) is set to reach a total capacity of 16.5 mln tons of liquefied natural gas per year. The operation is planned to start in 2016[11]. According to RIA Novosti News

4. *Ibid.*
5. JSC Inter RAO is Russia's major energy holding company, that specializes in power generation, energy supply, engineering, etc. Inter RAO is one of the largest public energy companies in Russia.
6. Fortum is one of Russia's major energy companies specializing in power generation.
7. OAO SIBUR Holding is one of Russia's top gas processing and petrochemicals company.
8. "The World's Most Powerful People List – 2014", *Forbes*, November 05, 2014. URL: http://www.forbes.com/powerful-people/list/#tab:overall.
9. "A sevenfold increase in gas production by Rosneft", *Forbes*, April 23, 2014. URL: http://m.forbes.ru/article.php?id=238157.
10. "Rosneft to give Gazprom a dare" («Роснефть» бросает вызов «Газпрому»), *Vedomosti*, April 24, 2013, URL: http://www.vedomosti.ru/companies/news/11486901/rosneft_posopernichaet_s_gazpromom.
11. *The Development of a World LNG Market: Challenges and opportunities for Russia*, Moscow School of Management Skolkovo, Energy Centre, October 2013, URL: http://energy.skolkovo.ru/upload/medialibrary/07c/SEneC_Global_LNG_Eng.pdf.

agency, in April 2014, Novatek's co-owner Leonid Mikhelson said that about 75-78% of planned production had already been subject to a contract (he did not reveal any details, though)[12]. As for Rosneft, it plans to launch an LNG plant in 2018-2019 in cooperation with ExxonMobil.[13]

The development of LNG production in Russia has largely been a result of the liberalization bill, it seems. But at the same time, one should take into account that LNG as a proportion of Russia's total gas exports is still very small: according to forecasts, by 2017 LNG' share in Russia's gas exports to Europe will not exceed 3%.[14]

Russian officials, however, seem to be more optimistic about the LNG initiative. According to a statement made by Russian deputy energy minister Kirill Molodtsov, Russia should increase its share in the world LNG market from the current 4% to 10-13% by 2025. "The objective regarding the development of LNG exports was attained due to legislative efforts: a bill passed through the State Duma in November 2013 allowing the suppliers like Rosneft and Novatek to export LNG directly to their clients. But it's not the end point. Today we are looking forward to a share of 10-13% in the world market by 2025 instead of the current 4% ensured by the Sakhalin projects", - Molodtsov said[15]. No details on how such an ambitious plan is to be brought to life were given though: it is to note, that research conducted by the Skolkovo Business School has shown that in the most positive scenario Russia's part in the world LNG market will not exceed 6% by the year 2020; if the Sakhalin project remains the only operational LNG plant by then (which is possible given the current international situation), Russia's share will drop to 2%.[16]

The initiated liberalization has therefore resulted in some new LNG projects in Russia but hasn't had any far-reaching implications for the Russian gas exports market. However, a system that seemed to be well anchored and not subject to any transformation was shattered. By changing the *status quo* a precedent was set enabling new initiatives to break Gazprom's monopoly.

| Rosneft: tracking the way to Russia's gas export

On 4 June 2014 during the session of the Presidential Commission on the fuel and energy sector Rosneft's president Igor Sechin outlined a plan according to which Russia's IGSs should be given access to pipeline export capacities as well as the right to build their own infrastructure. Sechin's suggestion was supported by the Ministry of Energy and Novatek. During the meeting, Vladimir Putin did not openly support Igor Sechin's plan but stressed that the cost of using the pipeline transportation system should be equal for all market players. Besides, Vladimir Putin declared that the Government intended to give Gazprom unprecedented backing regarding its recent contract with China – the contract would help finance new infrastructure projects such as the gas pipeline "Sila Sibiri ("The Power of Siberia")" which could cost up to $25 bln and account for more than ¼ of all Gazprom capitalization: once implemented, this plan could allow the Government to have influence over granting access to the new pipeline. [17]

The first reactions to the plan came as soon as in July 2014 when Andrey Belousov, aide to the President of Russia, said that Gazprom will keep its monopolist position. As for the independent gas suppliers, the only option left was selling their gas to Gazprom at a netback price: the decision seemed to be driven by the

12. "Russia should assure 13 % of the world LNG market by 2025" ("Минэнерго: Россия должна занять до 13% мирового рынка СПГ к 2025 году"), *RIA Novosti*, April 23, 2014, URL: http://ria.ru/economy/20140423/1005143684.html.
13. *Ibid.*
14. *The Development of a World LNG Market: Challenges and opportunities for Russia*, Moscow School of Management Skolkovo, Energy Centre, *op. cit.*
15. "Russia should assure 13 % of the world LNG market by 2025" ("Минэнерго: Россия должна занять до 13% мирового рынка СПГ к 2025 году"), *RIA Novosti*, *op. cit.*
16. *The Development of a World LNG Market: Challenges and opportunities for Russia*, Moscow School of Management Skolkovo, Energy Centre, *op. cit.*
17. "Sechin wants to call off Gazprom's monopoly on gas exports" ("Сечин призвал отменить монополию Газпрома на экспорт газа"), *RBC Online*, June 4, 2014, URL: http://top.rbc.ru/economics/04/06/2014/928535.shtml; and "Ransoming the Monopoly" ("Выкуп за монополию"), *Kommersant*, June 5, 2014. URL: http://www.kommersant.ru/doc/2486604.

recent agreements with Chinese partners – according to Russian officials, the strategic nature of the deal implied having a single Russian company as a supplier to China[18].

However, just as Raiffeisenbank analyst Andrey Polischuk suggested back in July 2014, Rosneft will most likely get access to the pipeline in the end.[19] Russian Ministry of Energy (which often supports Rosneft's initiatives) has drafted a plan on granting the IGS access to the pipeline and presented it to the Government in September 2014[20]. No reaction has so far been heard from the Cabinet, but it seems that as soon as all options are examined, Rosneft's plans on boosting its extraction up to 45 bln cbm per year by 2030 using its Eastern Siberia and Far East fields will be brought about[21].

Apart from seeking access to Sila Sibiri, Rosneft is also trying to obtain an export license for its "Pechora SPG" LNG project: the 2013 de-monopolization bill includes the limitation that only plants with export licenses obtained by January 2013 were granted export quotas. Rosneft's intention was to change the timeframes to August 2014 so that "Pechora SPG" could fulfill all the requirements set by the bill: the amendments were proposed by MP Valeriy Yazev, but the Government's resolution on Yazev's initiative was "neutral" – in the official document issued by the Cabinet it was stated that "further liberalization of gas exports should not take place until the results of the first package of amendments are thoroughly examined"[22]. Such a move could be regarded as a Rosneft defeat, but given that some time ago sources in Vedomosti from the Ministry of Energy as well as the Ministry of Economic Development and Gazprom all agreed that the Government would adopt an unfavorable resolution on Yazev's initiative, the "neutral" decision seems to be a small success as opposed to a setback.

Besides, Rosneft has recently asked for an unprecedented loan of 2,4 trln roubles ($ 48 bln) from the National Wealth Fund: Rosneft's bid accounts for all the Fund's assets reserved to invest in Russian companies. That is to say, once approved, Rosneft's loan could seriously undermine the entire system of supporting national business, which in light of the current economic situation – declining real wages, oil prices hitting their low, Rouble's slide, problems within the pension system, etc. – could pose risks for the domestic economy. It seems, however, that despite all this, Rosneft's bid will be approved (with some slight modifications as far as the total loan amount is concerned). Another Rosneft's initiative, according to the sources of RBC in the Ministry of Economic Development, would allow the company to monopolize oil and petroleum supply to all Russian government structures[23].

To sum up what has been said, Igor Sechin's company perseveres in establishing more and more control over the Russian energy industry. This is mainly due to the fact that Rosneft benefits from various leverages granting influence over decision-making process, which, combined with company's steadfast diversification strategy, leads to surefire results. Hence, there are no real challengers to company's strategy – that is why the recent developments are not seen as a conflict between Rosneft and Gazprom or a conflict between Rosneft and the Ministry of Finance, but rather as a consistent reconfiguration of the Russian gas market.

18. "Belousov: Gazprom will maintain its gas export monopoly" ("Белоусов: Монополия «Газпрома» на экспорт газа остается незыблемой"), *Vedomosti*, July 23, 2014. URL: http://www.vedomosti.ru/companies/news/29340591/belousov-monopoliya-gazproma-na-eksport-gaza-ostaetsya#ixzz3HAcWS27l.
19. "Gazprom Will Keep its Monopoly on Natural Gas" («Монополия на экспорт природного газа в России останется за «Газпромом»), RBC Daily, July 24, 2014, URL: http://www.rbcdaily.ru/industry/562949991960001.
20. "Russian Ministry of Energy Has Drafted Plans on the Access to the "Sila Sibiri" Pipeline" ("Минэнерго представило в кабмин предложения по доступу к "Силе Сибири"), *RIA Novosti*, September 29, 2014, URL : http://ria.ru/economy/20140929/1026058817.html.
21. Today Rosneft's total gas production reaches 1,6 bln cbm per year.
22. "The Final decision on the "Pechora SPG" Project Will Be Taken by Putin" ("Решение по проекту «Печора СПГ» примет Путин"), RBC Online, October 6, 2014, URL: http://top.rbc.ru/business/06/10/2014/542ed64fcbb20fe29870b629; and "Government issues a neutral resolution on the access to "Pechora SPG" exports" ("Правительство дало нейтральный отзыв на законопроект о доступе к экспорту «Печоры СПГ»"), *Vedomosti*, October 14, 2014, URL: http://www.vedomosti.ru/companies/news/34687261/pravitelstvo-dalo-nejtralnyj-otzyv-na-zakonoproekt-o-dostupe.
23. "Rosneft to become Government's sole supplier" («Роснефть» попросила статус единственного поставщика для государства»), *RBC*, October 30, 2014, URL: http://top.rbc.ru/business/30/10/2014/545253e9cbb20fba881e52b3#xtor=AL-%5Binternal_traffic%5D--%5Brbc.ru%5D-%5Bmain_body%5D-%5Bmain_item%5D-%5Btitle.

| Conclusion

All in all, Russia's gas industry is changing its rules, but the demonopolization efforts don't seem to favor the emergence of any new market players. The initiative is reinforcing the positions of Russia's top IGSs (Rosneft and Novatek), but the new market disposition is far from what one defines as a liberalization.

What is more, the "independent" status of Russia's two major IGSs is to be questioned. It seems that the very term has long been used to separate Novatek and Rosneft from Gazprom, the key government-controlled operator on the Russian gas market: with regards to Rosneft, however, one should take into account that in spite of its primarily oil-market-oriented activities the company is still a government-owned corporation.

As for Russia's European consumers, in short and, most probably, in the medium term all gas issues will still be covered by Gazprom: Rosneft's and other IGS' initiatives are primarily focused on the domestic market and potential eastern partnerships (like "Sila Sibiri") while the LNG exports are not important enough to rival traditional pipeline supplies to EU countries. Therefore energy relations will more depend on the success of the Russia-EU-Ukraine gas negotiations. The way parties are tackling the problem is a good example of how a purely economic issue of gas exports could become a political one: although the pre-winter series of talks involving Gazprom and the EU has become a tradition, the current developments in Ukraine are really undermining the chance that the parties will agree upon any far-reaching compromise any time soon. With all the financial problems Kyiv is actually facing, the deal signed on October 30, 2014 is more of a makeshift than long-term solution.

Another important factor is the general conjuncture of Russia-EU economic relations, which now heavily rely on further decisions regarding economic sanctions. The new atmosphere of mistrust between Russia and the EU has had some serious implications not only for the energy sector (its high level of politization is understandable), but for other areas of economic cooperation as well. And Rosneft could be playing a central role as far as Russia's economic policy towards the West is concerned: according to some sources, recently, the company has offered the Kremlin a plan for anti-sanctions measures – the scheme involved, for instance, the possibility of introducing a 100-percent prepayment for gas supplies to the EU[24]. However, both Igor Sechin and Dmitry Peskov, spokesman for the President of Russia, denied there was any anti-western plan proposed by Rosneft.

Finally, the current changes and especially the rise of Rosneft are to be followed by foreign investors to the Russian energy industry: recent developments caused by the Russia-EU and the Russia-US sanctions could affect joint projects featuring among others those with France's Total and the US' ExxonMobil[25].

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24. "Rosneft offers Kremlin its own set of anti-sanctions measures", *Russia Beyond the Headlines*, October 29, 2014, URL: http://rbth.co.uk/international/2014/10/29/press_digest_rosneft_offers_kremlin_its_own_set_of_anti-sanctio_41001.html.
25. "Sechin: Rosneft Will Find New Partners Should ExxonMobil Withdraw" («Сечин: "Роснефть" найдет партнеров в случае отказа ExxonMobil»), *RIA Novosti*, October 30, 2014, URL: http://ria.ru/economy/20140930/1026227056.html.