Trends of Russia’s Gas Sector Regulation
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Trends of Russia’s Gas Sector Regulation

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Abstract
Russia’s gas sector represents a number of structural and institutional specificities, which stem from the command economy economic structure. The main gas company Gazprom has a structure inherited from Soviet Ministries. During the 1990s, Russian gas sector was practically exempted from a restructuring. The whole sector has been politically defined as a “natural monopoly”. A limited privatization has been accompanied by a restriction on foreign direct investments in Gazprom. Since 2005 a number of new legislative initiatives have been put forward: gas export monopoly, strategic sector law limiting national regime for foreign investments in upstream as well as a take-over of Gazprom by the State. Partial market opening as well as a strategy to set a market price has been also observed. Moreover, Gazprom needs to adapt to the evolving European markets. Subsequently, two opposite features of Russian regulation took shape: Gazprom remains a specific “natural monopoly”, but which attempts to become a global competitive company. On these grounds, the paper defends a hypothesis that two opposite trends of Russia’s gas market regulation may be accentuated with the EU internal market development. Structure of the paper includes two main parts, which address internal and external dimensions of Russian gas regulation.

Keywords
Gas, restructuring, tariff reforms, liberalization, Russia, European Union
Introduction

While addressing specificities of the Russian gas sector regulation, it is important to outline its historical development within a centralized Soviet command economy, as well as a robust economic structure of both production and consumption. Indeed, Russian gas sector has a geographical disadvantage because most of profitable markets are located far away from the production areas. Transport infrastructure comprise a wide network and the length of shipment renders the pipeline business quite uncompetitive. For instance, average shipment of gas in Russia is about 2000 km, which is significantly higher than in other gas markets.

In addition to that, institutional structure of gas regulation represents an unbalance towards Gazprom, which still plays a core role in Russian gas market regulation. Instead, Gazprom remains the main impacting factor of regulatory change, which leads to an unbalance between new challenges and the actual policy implementation. Although Gazprom’s policy documents demonstrate an objective to increase domestic and external competitiveness, monopolistic structure with tariff cross-subsidies still characterize the market. Moreover, availability of gas is still regarded as a right rather than a good or service and such access to cheap energy allowed the development of non-energy industries as well as contributing to overall GDP growth.

EU gas market liberalization constitutes an important impacting factor on Russia’s gas sector. Robust economic structure needs to adapt to the new challenges and to become more competitive. In addition to that, European regulators might exert a pressure on Gazprom for its monopoly structure.

On these grounds, the present paper will demonstrate that Gazprom has are two coexisting priorities:
- to keep a specific status inside Russia and
- to become a “normal” international major.

The view defended in the article consists to demonstrate that the first priority constitutes an important barrier to the second priority. In order to provide a short but comprehensive analysis of Russia’s gas regulation, it is important to distinguish between internal and external dimensions of Gazprom’s policies.

1. Domestic Dimension: Evolving Regulatory Structure of the Russian gas sector

It could be relevant to outline volumes of the Russian gas market, which is still the world largest in both terms of production and consumption. For the first decade of the twenty first century gas production rose from 620 bcm to almost 700 bcm a year. Noteworthy, Gazprom’s production rose less significantly and a total share of Gazprom in the national gas production decreased 92% to 78%. By contrast, independent gas producers (mainly oil companies, who produce both oil and gas) have increased their participation in the gas business.
All the pipeline networks belong to Gazprom, which constitutes an important advantage in the valuating energy assets. Nevertheless, networks also constitute an important financial burden. Currently, more than 27% of pipelines are older than 30 years and hence need a replacement & modernization investments. For example, between 2007 and 2010 expenses into pipeline reconstruction still accounts for more than 25% of total expenses in the sector [Gazprom official data 2010, Demakova & Gozdumirski 2011, Mitrova 2009].

Gazprom imports gas from Central Asia for its domestic use. Also, Gazprom exports parts of its gas on the accounts of Central Asian companies [Pirani et al, 2009]. Imports from Central Asia represent a huge volume of gas, which could be equivalent of gas imports of most of the European importers. By 2004, imports from Central Asia reached 100bcm already by 2004 [Stern, 2004].

Most of the produced and imported gas is used domestically. Domestic demand attains 500 bcm. Largest part of the domestic demand is focused on the power sector and which represents 38% of the gross domestic gas consumption. Direct consumption of gas by individual consumers as well as needs for heating occupy about 30% of domestic gas consumption [Gazprom statistics, 2011]. Significant amounts of heavy gasses are produced by oil companies. Often, ethane is supplied to petrochemical industry. Alternatively, oil companies flare the gas due to the lack of access to infrastructures. In mid 2000s, gas flaring attained up to 50bcm per annum [IEA, 2007].

EU markets represent the biggest and most profitable share in Russia’s exports. By 2007, gas exports to Europe bypassed 150 bcm. A slight decrease in exports occurred during the financial crisis. However, it remains unclear whether a decrease in Russia’s exports to Europe represents a structural or conjunctural trend. Nevertheless, Gazprom recognizes that exports to Europe provide up to two thirds of its annual profits.

This short statistical review demonstrate both complexity and scale of Russia’s gas sector. In addition, an evolving institutional structure should be highlighted. Three main institutional aspects represent the challenge of Russia’s gas sector regulation: reform of Gazprom, role of independent gas companies and tariff reforms.

1.1. Transition from command economy and Gazprom’s reforms

Once the process of transition from command to market economy started in 1992, a Joint Stock of the gas sector Gazprom was created and proposed for a partial privatization. The head of Gazprom at the time, V. Chernomyrdin refused to unbundle production from transport and insisted on the vertically integrated structure of the company. Curiously enough, when V. Chernomyrdin later became a Prime Minister, who carried out most of restructuring and privatization reforms in other economic sectors. Nevertheless, he firmly believed that the gas sector should be largely exempted from a restructuring from production, transport and supply.

Then, in 1992, Russian legislators introduced a concept of “natural monopoly”, which basically means a sector, where a competition is counter productive. Interestingly, all the gas sector then was defined as a natural monopoly. Such an approach would actually mean that natural gas
sector in general represents a segment of the economy, where a competition is unnecessary. Such a definition contrasts with a general definition of natural monopoly, where specifically networks, and not the sector as such, is considered as a natural monopoly.

In early 1990s, Gazprom was largely privatized, the State remained the largest relative shareholder with 36% of shares. Foreign (non Russian) investors participation was then limited to 10%. Therefore, a specific notion of control co-exists with the very specific definition of “natural monopoly”. In other words, the State exempts Gazprom from National Regime for foreign investors in order to keep control over the company. Gazprom maintained a vertically integrated structure from production to supply. However, in 1996 a transmission company MRG was established as a main wholesale gas supplier in Russia [Stern, 2004: 38]. MRG remains 100% owned by Gazprom and its management remains highly dependent on Gazprom. Retail sales has been concentrated within regional gas supply companies, which also belong to Gazprom.

In 2005 a new reform of Gazprom occurred. The State bought up to 51% of the shares, which leads to a total governmental control. At the same time, a limitation on foreign investments has been de jure abandoned. However, Russia introduced Strategic Sector Law, which practically allows a large exemption from National Regime in the upstream sectors. Russia’s recent Strategic Sectors Law places important restrictions on the rights of both foreign companies and Russian companies with any foreign investment (state-controlled companies such as Gazprom and Rosneft are exempted), regardless of the size of the investment, to what are termed “subsoil blocks of federal significance.” Amendments to the Russian Subsoil Law provide criteria to determine whether a particular subsoil block is deemed to be a subsoil block of federal significance. These include the type of reserves, the volume of certain reserves as registered on the state balance, and the location of the subsoil block. Decisions granting rights to deposits of federal significance are taken solely by the Russian government. If a subsoil user who is a foreign investor or a Russian legal entity with foreign equity investment makes a discovery of a deposit which is deemed of federal significance, the government may refuse to grant the right to use the deposit for exploration and production or, if the license is a combined license, may terminate the right to use the deposit for exploration and production, on the grounds of a threat to national defense and security.1 This legislation provides additional advantages for Gazprom in the allocation of upstream reserves [Demakova & Gozdumirsky, 2011].

In 2006, Russian legislators introduced another restrictive Law on gas export monopoly. The de facto monopoly on exports existed already before and was successfully exerted by Gazprom. Since 2006, all export of natural gas and even of liquefied natural gas (LNG) is a subject of full monopoly by either Gazprom or its daughter companies.

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1 Law of the Russian Federation on Foreign Investments in Companies Having Strategic Importance for State Security and Defense, No. 57- FZ (English translation, URL: http://www.fas.gov.ru/english/legislation/20300.shtml). A new and more restrictive draft of the Strategic Sectors Law and relevant amendments to the Subsoil Law are expected to be considered by the Duma in March 2011. Most significantly, the new draft would limit to 10% the unsupervised acquisition by foreigners of entities that own licenses to develop “strategic subsoil assets”. State-owned trading enterprises, such as Gazprom and Rosneft, would be exempt from these restrictions. – See The Daily Telegraph, 31 January 2011, URL: http://www.telegraph.co.uk/news/wikileaks-files/bp-wikileaks/8294139/NEW-DRAFT-OF-STRATEGIC-SECTORS-LAW-WOULD-TIGHTEN-RESTRICTIONS-ON-FOREIGN-INVESTORS.html.
Alongside with the Strategic Law, Gas export Law demonstrates that gas sector represents an important political dimension for Russian regulatory system. It could be then argued that Gazprom represents a major input to the whole regulatory structure of the gas sector. Nevertheless, the situation is more complex because of the pressure on Gazprom, which is exerted by independent companies to open up markets. At the same time, Gazprom faces difficulties in forging tariff reforms.

1.2. Gazprom and independent gas producers

Although Gazprom maintained its vertically integrated structure, Russian gas regulation includes a Third Party Access, which was introduced back to 1997, one year before the first EU gas Directive [Stern, 2004]. Nevertheless, Gazprom’s daughter company MRG usually limited an access to the networks either due to the of available capacities or due to the different calorific value of the gas produced by independent producers. Nevertheless, production capacities of independent gas producers as well as of the oil companies have significantly increased during the last decade. The largest independent gas company Novatek plays an increasingly important role in the gas supplies to the liberalized power sector. However, non-Gazprom production of natural gas concentrates mainly in the oil companies: Rosneft, Lukoil and TNK-BP. Only Rosneft has 2 trillion cubic metres of gas reserves, with the economic potential to produce up to 50 bcm per annum, or about 10% of total gas production in Russia [Troika Dialogue, 2008].

In 2007, Gazprom favoured a creation of an electronic platform within its daughter company MRG. Electronic platform creates a ground for exchange operations, which allows independent gas producers to commercialize natural gas. Electronic platform allows Gazprom to partly abandon domestic market in order to concentrate on export. However, volumes of the gas sold at the electronic platform remained quite limited. Initially, “5+5” formula has been applied, which means that Gazprom sells up to 5 bcm to the spot market, while independent producers sell another 5 bcm. Gas stock exchange stalled during the financial crisis of 2008-2009, but MRG announced further objectives of increasing gas market. In 2011 the company announced to increase domestic gas competition by 40bcm by 2014.

Because of the gas pipeline control most of the gas fields with immediate commercial significance are owned by Gazprom. New fields have little likelihood of commercialising because of the variety of reasons – location of the field, complex geology, and high investment requirement. Moreover, Gazprom holds all the pipeline networks with an opaque access regime, which clearly defavors a development of a competitive gas market in Russia. Therefore, the level of Herfindal-Hirschmann Index\(^2\) (HHI) is still about 7500 for domestic market. The figure demonstrates a high level of concentration, as the HHI for a competitive market is usually defined by the level of 1200.

Final restriction to competition lays in the structure of the tariff and access regulation by Russian authorities. Russia does not have an energy regulator, hence all the access issues (i.e.

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\(^2\) HHI demonstrates a level of concentration by a sum of squares of all market shares in the market. Hence, the highest level of concentration is 100*100, hence 10 000. The lowest concentration level is 1. Competitive level of concentration is usually considered to be 1200.
discrimination, non-transparency about available capacity in networks) is a competence of Federal Antimonopoly Service (FAS). Importantly, FAS played a significant role in pressuring Gazprom in opening up norms for access to networks. Nevertheless, the tariff formation is a subject of Federal Tariff Service (FTS), a separate agency from FAS. FTS tends to establish prices, which reflect social needs of the country on one hand and the average production costs on another hand. Tariffs for supply of gas are made in consultation with Gazprom. Hence, FTS may propose a tariff, which is still uninteresting for independent gas producers, although they can obtain an access to the market through FAS.

FAS has repeatedly accused MRG of blocking access to networks. As MRG does not have an independent management, most of accusation are addressed to Gazprom. Indeed, Gazprom usually does not allow an access without a transferring ownership of gas to the monopoly. One of the major complaints against Gazprom has been advanced by Transnafta, which operates gas business in Volga region in Russia. However, Gazprom convinced the company to sell its gas to Gazprom’s local subsidiaries, who got the access to MRG network [RBC, 2011].

Likewise, another State-owned major Rosneft often accused Gazprom of blocking access to networks. Interestingly. Rosneft wishes to get access to exports, which are monopolized by Gazprom. A contradiction between the two State-owned companies reflect a non-harmonious approach of the regulation towards access to network [RBC, 2011].

However, Lukoil has been able to obtain an agreement with MRG for 2012-2016 to ship up to 8 bcm per annum [RBC, 2011]. Therefore, access to networks is not fully monopolized by Gazprom subsidiaries. Nevertheless, its allocation remains opaque.

If the access to the market is formally ensured by FAS, tariff for gas shipment through networks is approved by another agency FTS through a consultation with Gazprom. For the gas shipment, FTS adopts a distance-based approach, which is often considered not to reflect the market, usually favourable to Gazprom. A specific regulation was adopted in 2007, which states that network segment should maximize the profit in order to attract further investments.

3 The tariff of gas shipment is done in accordance with the following formula:

\[ T_{n_{ij}}^{\text{asc}} = T_{n}^{\text{FTPC}} \times \left( \sum_{r=1}^{s} (K_r \times l_r) + K_s \times (l_{ij} - l_s) \right) \]

Where,
- \( T_{n}^{\text{FTPC}} \) - baseline tariff for connection and usage of pipeline (independent from distance);
- \( s \) – a number of connections between entry (i) and exit (j) points;
- \( K_r \) - coefficient for pipeline usage depending on distance;
- \( K_s \) - distance-based coefficient for all s-connections;
- \( l_{ij} \) - average distance between entry and exit points;
- \( l_r \) - upper limit of distance of gas shipment;
- \( l_s \) - low limit of distance of gas shipment.
Distance based tariff does not take into account neither volumes supplied nor time-use for shipment. In a market based system, tariff also depends on volumes and duration of the contract (i.e. short term contract, long term contract etc). The tariff does not include a possibility of trading of available capacity, which remains the major limit for both independent gas producers and oil companies for the market access. At the same time, a particular attention should be allocated to the tariff reform because most of the oil companies are uninterested to sell gas for lower prices.

1.3. Difficulties supply tariff reforms in domestic markets and FSU

Tariff reform remains a difficult issue for the Russian gas sector. In the domestic market cross-subsidies remained in aftermath of the collapse of the command economy. In turn, gas sector earned most of the revenues from exports to the European markets, where gas price has been indexed to oil prices in long term supply contracts. Domestically, the concept of “right” of gas supply remained highly active. Due to the climate, distances as well as inherited energy intensive consuming sector, Russia remains one of the world largest energy intensive economies. At the same time, a decrease of energy intensity by 34% since 2000 has been mainly conditioned by a decreasing weight of heavy industry level. Gas intensity has remained high. Likewise, greenhouse gas emissions from the gas sector have risen by 13% [IEA, 2009]. For those reasons, domestic inefficiency is mainly conditioned by a historically inherited gas supply structure, which is coupled with price cross-subsidies.

During the 1990s, Gazprom experienced significant non-payment problems. Lack of cash of the consuming sector (including residential) had lead to practical supply in credit. Non-payment reached then up to 80% of the sales. Consequently, Gazprom experienced a systemic lack of cash, which discouraged investments into production and transport [Mitrova, 2009: 17-18].

Then, with an economic recovery of 2000s, cash flow level increased, which also allowed a gradual price increase. In 2002, Governmental Decree established a FTS-based tariff regulation of the gas sales [Stern, 2004: 38]. Since then, a gas price significantly increased from 20$/tcm to 50$/tcm. In 2010, Gazprom declared an objective of the oil-indexed gas price: 120-150 $ per tcm. The tariff is calculated in accordance to the EU-based netback model, without transportation costs and export fees. High level of gas intensity highlights a problem of payment for gas losses in the production and transportation segments.

At the same time, prices at the electronic platform are significantly lower the Gazprom’s target, i.e approx 70-80$/tcm. The reason stems from the high level of gas availability and economies of scale at the demand side, which both are conditioning gas price decrease. Moreover, cross-subsidies incentivized a penetration of gas into domestic energy consumption. Most of the Russian regions favoured a policy of gas consumption in the residential and power sectors. A share of natural gas in the total primary energy supply passed from 55% in 2000 to 63% in 2010. In some industrial regions (i.e. Nizhnyi Novgorod, Urals) the share reaches 70%. High level of
gas share renders less fuel options for the consumers. Lack of fuel replacement possibilities in the power sector makes rigid the demand elasticity. In this context, Gazprom’s price target might involve quite an unpopular measure. Moreover, inelasticity of the gas demand with a low diversification level does also mean that gas price increase would not influence gas intensity level. It could be argued that apart of the tariff increase additional policy mechanisms would better influence gas saving measures.

In aftermath of the power sector liberalization, Gazprom took an opportunity to get involved into the generation sector. In its statements, purchase of OGK is also aimed at diversifying power supply structure by producing more coal. Such an objective enters in line with the Gazprom’s strategy to increase its participation in export markets, where it keeps a monopoly. Therefore, a difficulty (voir impossibility) of domestic gas reform highlights the importance of the external dimension of Gazprom’s strategy.

2. External Dimension: Uncertainties in FSU and European Markets

Gas export monopoly envisages that Gazprom becomes the only Russian player in both FSU and European markets. Although Gazprom has a positive past in terms of supply reliability, gas export monopoly is often considered by the importing States as a security problem. Moreover, a strategic dimension of Gazprom, which is stated at the domestic level, reinforce a mistrust towards Russia’s gas exporter. In turn, Gazprom attempts to make FSU markets more competitive. In the EU, main concerns are related to the changing contractual structure. In such a context, Gazprom needs to adapt a higher level supply flexibility, which is still difficult due to the robust transport structure.

2.1. Exports to FSU: challenging supply-transit transactions

In the 1990s, barter deals dominated exchanges gas transactions in the FSU area [Mitrova, 2009]. For example, energy-importing countries of the former Soviet Union paid for natural gas with industrial and agricultural products. A detachment from barter deals has been also noticed in the Russia-former Soviet Union gas relations. Since 2002, Gazprom has attempted to reshape these tariff-trade agreements to make them more profitable [Stern, 2004: 179-184]. In international practice, the gas tariff is linked to the oil products price which makes the calculation of the gas rent margin easier [Energy Charter Secretariat, 2007]. Transition to the new tariff methods casted a sharp light on the opaque practices of bilateral deals between Russia and Ukraine.

The first important gas crisis between the two countries occurred in January 2006 when Gazprom attempted to abandon the former tariff practice [Stern et al, 2006]. Naftogaz rejected new conditions and in response Russia exerted a supply pressure on Ukraine. In turn, Ukraine used its transit capacities as a political leverage against Russia and reduced gas flows to Europe. Moreover, Kiev presented itself as a victim country of the bigger eastern neighbor in order to get closer with Europe. None of the two used the ECT to resolve the conflict. Instead, Kiev and
Moscow preferred to find a political compromise with cosmetic changes to the already existing bilateral trade and transit governance.

The crisis of 2006 was resolved by a new agreement which led to the establishment of a new Joint Venture, RosUkrEnergo, which is jointly owned by Gazprom and Naftogaz. The aim of the new joint venture company has been to supply Ukraine with gas, while all transit to Europe remained under Gazprom’s competence. In spite of this apparent change in the relationship Russia and the Ukraine otherwise maintained similar general framework whereby tariffs were adjusted politically without oil product indexation, dispute settlement mechanisms remained unclear, and all issues related to volumes and supplies were still agreed by annual Protocols. The agreement concluded in 2006 maintained a very important feature inherited from the past which was that gas trade and transit relations remained mainly based on political accord between Moscow and Kiev.

Three years later a new and bigger crisis occurred. Indeed, by the end of 2008, the Ukraine was still unable, and unwilling, to adapt to the net-back tariff policy and continued to reject proposals regarding Gazprom control of the networks. Deep political divide emerged as a result of the lack of an agreed legal framework for energy trade, tariffs and transit [Pirani et al, 2009]. In addition, the Ukrainian political classes could not reach agreement about the energy issue, which further complicated the situation⁴.

Moreover, it should not be forgotten that the crisis in 2009 happened only a few months after the Georgia-Ossetia conflict during which Russia intervened deep inside Georgian territory. The fact that Russia is the main political peacekeeper in the region is not new as Russia had continued to exert its power and influence since 1994. However, the military operation of August 2008 was the first large action of Moscow within another sovereign State since the collapse of the USSR. This fact provoked shock in most of the former-Soviet Union states, particularly in Ukraine. The latter backed then Georgia against Russia in the meanwhile.

The political divide between these two countries has further deepened since Ukraine’s request to join NATO and since the Ukraine started to press Russian naval presence on the Ukrainian Black Sea coast. Energy governance became then conditioned by the hard security relations between the two countries. A compromise solution on the Black Sea was found in 2010, when Ukraine could have obtained 30% of price reduction for gas supply [Pirani, 2011]. Consequently, Gazprom has been rather used for general political purposes in expense to the company’s profits.

Nevertheless, already in 2011, Ukraine required to renegotiate the price. It demonstrates that Russia-Ukraine price formation is still conditioned by a political relation [Belyi, 2009]. It could be argued that various institutional factors contribute to the conflictual relation between Gazprom on one hand and Belarus and Ukraine on the other hand. For instance, territorial restrictions and export monopoly do not allow the countries to purchase gas from non-Gazprom producer. In the context of an absence of market conditions, the countries require politically based price reduction. In turn, Gazprom finds it unacceptable because the company needs to increase revenues from the FSU markets.

⁴ The main conflict occurred between the President Yushenko, who took a hardliner position, and the Prime Minister Timoshenko, who preferred a compromise with Russia.
Indeed, since the early 1990s, most profitable markets remained in European Union. Nevertheless, new process of market transformation in Europe creates a new challenge for Gazprom.

2.2. Facing new contractual relations in Europe

The present study is not aiming to address the EU liberalization process, which has been analyzed by a number of scholars. However, it is important to highlight that EU market transformation addresses incumbents and hence influence existing contractual structures. Since 1998, EU gas legislation has evolved into a new model, which consists of a separation of gas transport companies from supply companies in order to enhance competition between suppliers.

European Commission forges a view, according to which incumbents should not book capacity of transmission companies even if there is no ownership on the network. In other words, European jurisprudence requires incumbents to open up at least 50% of the network in order to ensure competition [Talus, 2011].

By contrast, Gazprom usually concluded long term export agreements, which include a 100% capacity booking. Contracts require from the European gas network companies to consult Gazprom prior to allocate the capacity to any third party. According to the European regulatory norms, if the capacity is not used, the network company should sell the capacity. In case of contracts concluded by Gazprom, a hoarding of capacity is often a normal practice.

Consequently, a contradiction between Gazprom’s contractual approach and the EU regulation is quite evident. Moreover, European Third Gas Directive [2009] allows a national regulator to apply a reciprocity principle on an external monopoly, who maintains a monopoly domestically. In the context of politicization of Gazprom export policy, Gazprom’s contracts may become subject of significant pressure by national regulators.

Moreover, the impact on Gazprom’s contractual relations goes beyond the EU borders. The new EU regulatory model also started to be exported to other countries. The most integrated regulatory commitment is the south-eastern Europe Energy Community Treaty, where non-EU European countries accept the _acquis communautaire_ in energy markets. Here, the EU is in the process of creating a wide-ranging energy community, extending beyond the borders of the Union and based on common rules and practices.

The Athens Memorandum signed in 2002, the Energy Community Treaty was signed 25th October 2005 between the European Community on the one hand and the non-EU countries of south-eastern Europe: Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Romania and Serbia on the other. Energy Community Treaty involves actual integration to the EU market rather than a new framework of cooperation [Prange-Gstohl, 2009:
Therefore, the Energy Community governance represents a coherent cross-border regime, which may marginalize other international energy fora’s.

The political role of the Treaty consists in exporting the EU liberalisation model to other non-EU European countries. A contrast with the initial stages of liberalization (between 1998 and 2003) can be observed, when the EU responded to the challenges of international energy markets. At later stage of liberalization, both deepening of competition-driven approach and its international expansion demonstrate the EU attempts to forge international energy (particularly gas) markets both inside and outside the EU.

A year after the afore-mentioned gas transit conflict of 2009, Ukraine became a contracting party of the Energy Community Treaty. Such membership implies the unbundling of the Ukrainian Naftagas, which was designed by recent legislation on natural gas in Ukraine for January 2012 [Gas Law, 2010; Art. 16]

In spite of the accession to the Energy Community Treaty, Ukraine preferred to play a middle game between Brussels and Moscow and considered Russian interests before accepting the EU offer. Moreover, in March 2010 Ukraine changed its Presidential administration, which, unlike the previous ‘Orange’ administration, aims to seek a more consistent dialogue with Russia. It would be premature to consider that Russia-Ukraine trade and transit governance will bypass the earlier contradictions. For instance, tariffs for gas supplies as well as the Russian monopoly of exports to Ukraine remain major concerns for the new administration. A balance between long-term supplies from Russia and Energy Community Treaty might become a source of new conflict of interests in the future.

A number of challenges affect Gazprom’s export contracts. In the longer term perspective, Gazprom’s relations with Ukraine may likewise be challenged. An overall structural difficulty is related to the impossible forecast of the long term investment needs [Locatelli, 2008]. In the context of the long distance between production and supply, new contractual uncertainties render the monopolistic segment of the Russian gas sector even more difficult. In the context, where Gazprom practically holds a monopoly over upstream projects and most of network management, economic risks of the EU market liberalization are mainly passed on Gazprom. Therefore, Gazprom is facing institutional challenges, which may address the very monopoly of the gas sector and revision of the access to upstream. Nevertheless, the issue of demonopolization remains still a remote hypothesis in the highly politicized context.

Conclusion

Gazprom presses domestic markets for higher competitiveness and indeed wishes to reinforce its international presence. However, its vertically integrated structure, robust economics of Russian network industries, political attitude towards access to upstream and access to pipelines render the priority of the competitiveness more difficult. Indeed, ever-evolving EU gas markets and their expansion through Energy Community Treaty create rather unfavorable conditions for Gazprom. Consequently, an analysis of perspectives should envisage both positive and negative interdependencies between Russian and European regulatory models. In case of positive
interdependency, Russian and European positions are getting closer and the interdependency positively contributes to energy governance. By contrast, negative interdependency is characterized by a continuous mutual avoidance. In the case of “positive interdependency”, Gazprom would lose export monopoly but gain a possibility to conclude direct contracts on European downstream market. Gradually, market share of independent companies in both domestic and export markets increase. However, in the case of “negative interdependency”, we could assume mainly negative impact of the EU policies on Russia. Russian gas exports to Europe decrease and investment dynamics can be affected due to the contractual changes in Europe. In this case, both Europeans and Russians would attempt to avoid each other through costly diversification projects. Up to now, both trends co-exist and certainly accelerate contradictions between various priorities of Russia’s gas sector regulation.

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