ENERPO NEWSLETTER

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The Week in Review

Investment Troubles in the Era of Low Energy Prices: The Case of the North Sea

The article discusses the impact of low oil prices on the highly expensive extraction costs of North Sea oil production. It notes that while production is increasing this year because of investments during periods of high oil prices, that investment in new development is grinding to a halt. Over the next few years several billion fewer pounds sterling of annual investment are expected. Additionally, many North Sea players are dumping or attempting to dump their assets such as Total of France. Furthermore, direct and indirect job losses are already estimated at 70,000 and are expected to rise as investment drops. The slowdown in investment is not really a shock. Analysts have been waiting and tallying which oil players would be first to blink in the face of the current production glut.

Stacy, Kiran, 2015. Plunge in North Sea Investment Predicted. Financial Times, 9 September.

The Arctic Race: Budget for Icebreakers

Over the last 2 years, the Russian efforts to ramp up its icebreaker activities, develop its northernmost regions, and move forward with the Arctic shipping lanes to the Far East have been highly criticized by Western journalists and analysts. Many have claimed Russia's Arctic ambitions were absurd and lacked any real potential; however, as the article points out, there exists glaring deficiencies in the U.S. Arctic policy that Russia has or is already in the process of developing. These items include ice breaking potential (the U.S. has only 2), satellite systems, deep water ports, aviation assets, and navigational aids. The article details the lack of interest in funding these types of programs in the U.S. despite the huge mineral potential of the Arctic region and echoes President Obama's recent call on Congress to find the funding necessary to speed U.S. Arctic goals.

Conley, Heather A, 2015 To Build or Not to Build and Icebreaker? That is the $1 Billion Funding Question. Center for Strategic Studies, 1 September.

Indonesia to Rejoin OPEC

The number of OPEC's member-countries may rise to 13 by the end of year. Indonesia submitted official letters for its readmission to the organization after seven years. Indonesia's request has been already circulated to OPEC members for approval, and formalities for reactivation of its membership will be carried out in next OPEC's next meeting on December 4.

Clarke, David, 2015. UPDATE 1-OPEC says Indonesia to rejoin oil group after 7-year break. Reuters, 8 September.

Novatek's Access to Funds, the Upcoming Decision by Sberbank to Affect Yamal LNG

Due to the sanctions after the Crimean crisis, Novatek's access to Western funds has been limited; French oil major- Total's ability (that holds a 20% share of Yamal LNG) to finance part of the Yamal LNG project in Russian Arctic has been affected by Western sanctions. Russian Sberbank will decide on financing terms of the deal for Novatek-led Yamal LNG project by the end of September. Novatek also expects to get more than $10 billion from Chinese banks to finish the project by 2017. Total investment needed for the project is $27 billion.

Kobzeva Oksana, Golubkova, Katya, 2015 Russia's Sberbank says to decide on Yamal LNG financing terms by month-end. Reuters, 8 September.

Gazprom Bows to Brussels by Holding First European Gas Auction

There has been a long-running battle over the shape of the European gas market between EU and Russia. Russia supported LTC while the EU pushed creation of a liberalized gas market. Finally, Gazprom launched its first public auction for spot gas supplies in Europe making a concession to Brussels. Although the volume of gas involved in auction during this week is small, it represents Gazprom's shift in strategy and may help parties to reach a settlement. If auctions are successful, it will also help Gazprom to resolve problems with Opal without violating EU regulations.

Farchy, Jack, 2015. Gazprom bows to Brussels by holding first European gas auction. Financial Times, 7 September.

New Round of Cooperation between Iran and Azerbaijan

While under Western sanctions, problems arose between Iran and other littoral states over exploration of some disputable oil and gas fields in the southern part of the Caspian Sea. Now, the situation has become different: sanctions are on the way to being lifted, and Iran is more willing to cooperate with other coastal players. The National Iranian Oil Company and Azeri SOCAR commenced a new round of cooperation in oil and gas in the Caspian Sea. This cooperation will boost economic ties and expand relations in the energy sector between two neighboring countries.

Mehr News Agency, 2015. Iran, Azerbaijan commence new round of oil cooperation. Mehr News Agency, 10 September.

Ukraine Seeks to Become a Part of a Gas Hub With European Partners

Ukraine wants to join the gas hub that is now being developed by Poland, Romania, Hungary and Slovakia, which will meet all criteria and requirements of TEP and provide free gas flow among cited countries. A memorandum was signed for the construction of a gas interconnector (10 bcm) between Ukraine and Poland. Realization of this plan will contribute to Ukraine's energy independence.

Caspian Energy News, 2015 Ukraine seeks to become a part of a gas hub with European Partners. Caspian Energy News, 10 September.

Why Vladimir Putin Won't Be Helping OPEC to Cut Oil Production

The hot topic of the week following a surge in oil prices based on speculation of cooperation between Russia and OPEC on cutting production levels. The article details how these types of speculation have happened before, but that Russian and former Soviet leadership has never agreed to any quotas with the Saudi-led oil cartel. There are several reasons for this noted in the article such as the difficulty of "shutting off the pumps" in harsh climate areas in Russia, the pro-USA stance of Saudi Arabia, and the ability of the Russian economy to function despite lower oil prices as compared to many of OPEC's members.

Mazneva, Elevan, Khrennikova, Dina, 2015. Why Vladimir Putin Won't Be Helping OPEC to Cut Oil Production. Bloomberg Business, 11 September.

Gazprom Signs Key Nord Stream-2 Deal with EU Companies

Huge news on the pipeline front and it is a binding agreement that includes the major gas players from Europe. Gazprom will have the controlling stake; E.ON, BASF/Wintershall, OMV, and Royal Dutch Shell getting 10% each. Engie will get the remaining 9%. After the EU and US helped kill the South Stream pipeline that would have benefitted Bulgaria and Southeast Europe for transit, this deal will place Germany in the role of transit master and bypass the troubled Ukrainian route. The U.S. and EU leaders are expected to come out against the pipeline, but as in the past, Germany's eastern policies will likely prevail.

Barsukov, Yury, 2015. Gazprom Signs Key Nord Stream-2 Deal with EU Companies. Russian Beyond the Headlines, 8 September.

Price Weakness, Construction Costs Cast B.C. LNG Projects into Doubt

The article discusses how the glut in LNG and regulatory approval are hampering the completion of 20 proposed LNG projects in Western Canada. Many analysts including Peters and Co., a Canadian investment dealer, are predicting that only 3 or 4 of the projects may actually be completed. Several major gas production companies such as Chevron (USA), Woodside (Australia), and Petronas (Malaysia) have major stakes in the development of their projects near British Columbia. The LNG export projects were started with the expectation to compete for contracts in Japan, South Korea and China. However, they have faced resistance from Native American groups, environmentalists, and regulators in moving forward quickly.

Jang, Brent, 2015. Price Weakness, Construction Costs Cast B.C. LNG Projects into Doubt: Report. The Globe and Mail, 10 September.

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Energy News Blog

The Future of the EU's Gas Market: A Roundtable Led by ERIRAS' T.Mitrova and V.Kulagin

– Michael Camarda

On Monday, September the 14th, the Higher School of Economics at the National Research University hosted a roundtable discussion on the Future of the EU's gas market. Tatiana Mitrova, the head of the Oil and Gas Development Department at the Energy Research Institute of the Russian Academy of Sciences (ERI RAS), and Vyacheslav Kulagin, the director of the Centre for International Energy Market Studies at ERI RAS, gave a dual presentation on the topic.

Their presentation was based off an in-house, 86 page report entitled, **The Gas Market of Europe, Lost Illusions and Timid Hopes**. Their presentation was divided into six parts: Demand of Gas in Europe; Price Formation; Regulation and Energy Politics; Domestic Production and Infrastructure; Level of Competition; and Russia's Niche. Kulagin tackled the first, third, and fifth topic, while Mitrova addressed the second, fourth, and sixth topics, making for a tag-team style presentation.

Through graphs, charts, and maps the duo drew a sober picture of Russia's position in the coming ten years in Europe (excluding Turkey). While they most addressed the likeliest case of flat to slightly decreasing demand for gas, their presentation allowed for many scenarios, ranging from high to low demand. An interesting note that was only later addressed in the question and answer session at the end is that all of their forecasts included the current geopolitical environment, including the sanctions regime placed on Russia by the US and EU, remaining in place for the foreseeable future. Most predictions extended as far out as the next decade.

There were several topics that piqued the interest of the audience, which included energy reporters and researchers at other Russian institutions. Firstly, the future prospects of hub pricing as the chief mechanism of pricing gas in Europe and whether Gazprom's historic resistance to this and reliance on long-term contracts would hold over the next decade. Secondly, the future of LNG, in which Mitrova highlighted the fact that LNG hasn't grown over the last 3-4 years, but would see great growth by the years 2025, a phenomenon she described as "a bomb for global markets."

Thirdly, the rising level of competition led Kulagin to describe the potential for a major drop in pricing due to an overabundance of suppliers (to the potential exclusion of Russia) as the most interesting slide of the presentation. He even stated that he wouldn't be surprised if American LNG producers sell at below marginal cost rates in order to secure European market share, at least initially.

The presentation ended with a detailed, multi-scenario, multi-contingency future of Russia's niche. While some of the worst case scenarios of low European demand and high increase in competitors actually drew blank expression from some of those in the audience, Mitrova underscored that Russia, despite being degraded in EU energy policy from "strategic partner" to just another supplier, still occupies a strong position, and if Russia markets its energy correctly, it can maintain a leading position as the EU's energy supplier.

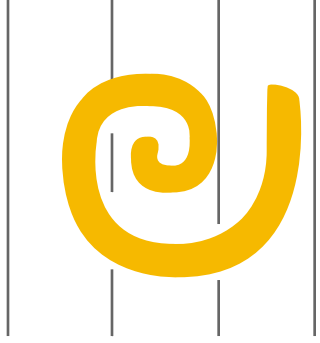
Editor's note:
The ERIRAS' report ultimate aims to provide with analysis of developments in the European gas market; it is published in Russian and targeted at the Russian audience. Another publication with similar subject, but different perspective, was published during the same week by James Henderson of the Oxford Institute of Energy Studies and Tatiana Mitrova of ERI RAS. ***The Political and Commercial Dynamics of Russia's Gas Export Strategy*** *looks at Russian approaches to new economic realities in the European gas markets and is targeted at the European reader. We will make sure to write a review in one of the upcoming issues of the ENERPO Journal.*

What are the Ramifications of the Nordstream-2 Deal? Gazprom's Latest Deal May Provide More Questions Than Answers

– Jerry Byers

The deal recently reached by Gazprom and Western European majors to begin the Nordstream-2 pipeline has left a plethora of policy makers, analysts, and buyers with a wide array of reactions and questions.

According to the deal reached at the recent Eastern Economic Forum in Vladivostok, the proposed Nordstream-2 pipeline should be completed by the end of 2019. The stakeholders in the project include E.ON, BASF, Shell, OMV, and Engie. Gazprom will reportedly hold a 51% stake in the pipeline. The other shareholders will each take a 10% stake with exception of Engie (receiving only 9%). The routing of the pipeline will follow Nordstream-1 from St. Petersburg through the Baltic Sea to Germany, and could have the capacity to deliver 55 bcm of natural gas annually to European markets.



Additionally, Gazprom completed asset swaps with BASF that provides it with additional storage capacity in Europe, and OMV, receiving assets in the value chain.

What are the consequences for the key engaged players?

There are clear justifications for pursuing the deal for Gazprom, who will have more flexibility in meeting existing obligations for gas deliveries to Europe. Furthermore, an exclusion of the often volatile transit states in the process will provide more energy security for countries at the end of the value chain, with Germany seen as a much more stable and reliable transit partner. Moreover, additional supply capacity via Nordstream, the recent auction conducted by Gazprom earlier this month, and acquisition of assets through agreements with BASF and OMV may be a telling glimpse of Gazprom's plans for adaptation to EU gas market liberalization.

For the Western partners, additional supply capacity will also reduce price risks in the event that European demand for gas rebounds in the next few years. Few alternative suppliers have been secured in Europe's attempts at diversifying away from Russian gas. The additional pipeline also solves the problem of unreliability of transit.

There has been significant critical response to the deal from the Eastern European transit states, namely Ukraine, Poland and Slovakia, who could be subject to reduced transit revenues. Leaders from the transit states have publicly complained about betrayal by the EU and the lack of solidarity. Their arguments have some traction in the media as Western Europe once more benefits at the expense of its EU brothers in the East and South. The prevailing theme in EU policy coming from the Western members seems to be, "Do as we say, not as we do."

On the cross-regional scale, the addition of Nordstrem-2 (which, combined with other supply options, surpasses current and foreseeable European demand) seems to successfully undermine the perspectives of Nabucco-like ideas, which began to be voiced again after the cancellation of the South Stream in December 2014.

Overall, despite critique from the Eastern European parties, there are high chances that the project will actually be implemented, since it falls within the strategic priorities of participating companies.

There are still some problematic issues, however.

There are two questions about the role of Nordstream-2 in Gazprom's strategy. Firstly, what effect will Nordstream-2 have on other planned pipeline activities for Gazprom, namely in the south? The cancellation of South Stream was announced with the caveat of a Turkish Stream instead. The stated plan is to drop gas deliveries on Europe's southern border via Turkey. Is that still the plan or can we attach "RIP" to yet another pipeline adventure in the south? Secondly, what about the two proposed pipelines to China? The Power of Siberia is isolated from these developments, because it relies on green fields in East Siberia, but the proposed Altai pipeline would rely on the same fields that have been earmarked for Europe. Can Gazprom secure enough volumes to meet both or does Altai make another return to the scrap heap?

One of the biggest remaining questions is to what extent the Third Energy Package (TEP) will be a problem for the Nordstream-2. According to the TEP provisions, pipeline operators on the EU territory have to reserve part of their capacity to be used by third parties, and this has created problems for OPAL – an onshore pipeline that connects to Nordstream in Griefswald (Germany) and runs to Poland. As a result, OPAL, and consequently Nordstream-1, have not been utilized at full capacity. If the TEP is effectively blocking the full use of existing lines, then how is a twin line going to circumvent this problem? How this will be resolved, again, remains to be seen, and will certainly be a topic for discussion over the next several months.

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This issue brought to you by

Irina Mironova Editor-in-Chief (imironova@eu.spb.ru)
Aaron Wood Managing Editor (awood@eu.spb.ru)
Michael Camarda ENERPO Program Associate Director (mcamarda@eu.spb.ru)
Jerry Byers ENERPO Journal Associate Editor – online edition (jbyers@eu.spb.ru)
Fatma Babayeva ENERPO Student (fbabayeva@eu.spb.ru)

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If you have questions or comments about the ENERPO Newsletter or are interested in contributing, send us an email at imironova@eu.spb.ru or awood@eu.spb.ru