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Andrei V. Belyi and Andreas Goldthau

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Abstract

Gazprom, Russian's prime state owned gas producer, is facing severe pressure stemming from international gas market dynamics, EU regulation and the Ukraine crisis. Slowing gas demand coupled with shifting pricing models and a persisting transit issue pose significant challenges for Gazprom's business going forward. Domestic pressure emerges from competition arising from private companies, mainly Notatek, but also state owned rival Rosneft, and is reinforced by governmental moves toward more market oriented Russian gas sector organization. Gazprom's options include pivoting to alternative markets, notably China; reverting to international legal bodies and market principles to counter EU regulatory pressures; and to depoliticize gas trade in order to generate long term expectations on its prime market - Europe. We pose that neither of these options is likely to fully solve Gazprom's dilemma, whose competitive position will arguably further weaken both domestically and internationally. We believe that Gazprom's best option would be to aim for depoliticizing gas trade, by way of giving up its de facto monopoly on gas exports to Europe.

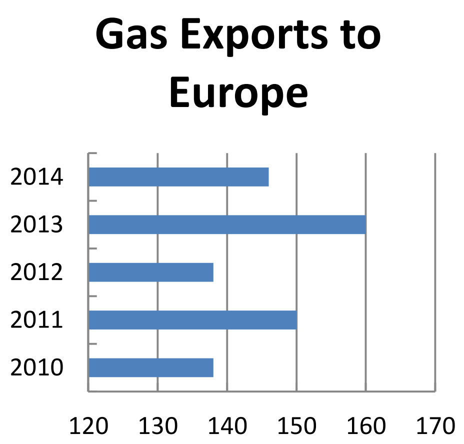
Keywords

Energy security, gas markets, Gazprom, European Union, regulation

1. Introduction: Gazprom's perfect storm*

Increasing tensions between the EU and Russia, declining world oil prices and accelerating dynamics in transnational gas markets have put severe pressure on Gazprom, Russia's prime state owned company and the world's largest gas producer. Gazprom's production levels fell by 5 % in 2014, to a long-time low of 430 bcm a year[1]. Export dynamics also slowed down, and have been especially weak in the second part of the year 2014 and early 2015[2]. Observers therefore estimate a drop of 60% in year-on-year net profits in the last quarter of 2014[3].

Figure 1: Gas Exports to Europe, 2010-14, bcm



Source: Gazprom Export and East European Gas Portal

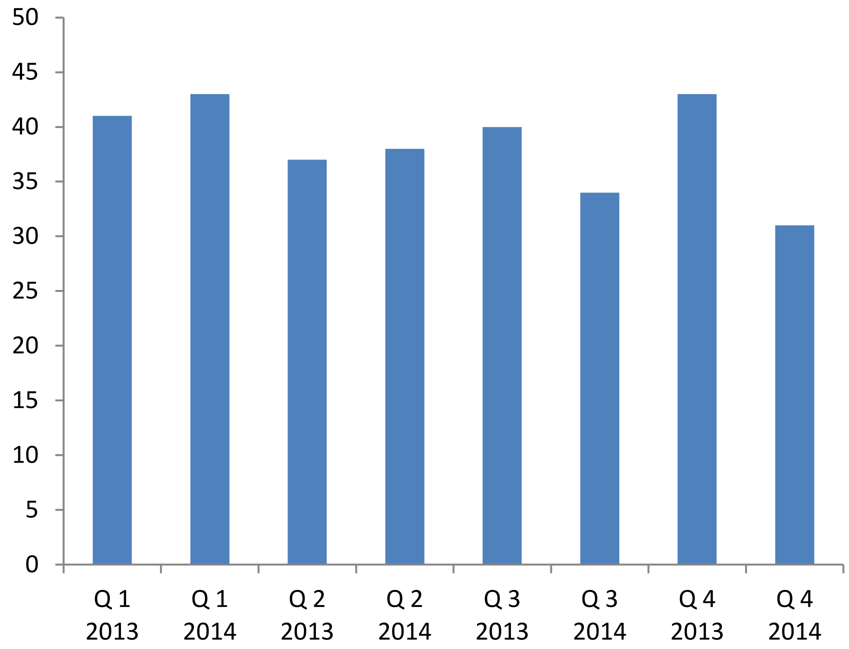
* The authors gratefully acknowledge the support of the EU FP7 large-scale integrated research project GR:EEN Global Re-ordering: Evolution through European Networks, European Commission Project Number: 266809.

1 For details on most recent trends in gas supplies from Russia to European states, see J. Stern, S. Pirani and K. Yafimava, *Does the cancellation of South Stream signal a fundamental reorientation of Russian gas export policy?*, Comment of Oxford Institute of Energy Studies, January 2015, available on URL: http://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/01/Does-cancellation-of-South-Stream-signal-a-fundamental-reorientation-of-Russian-gas-export-policy-GPC-5.pdf (last accessed 5 February 2015)

2 For details, see Platts data, 22 January 2015, available on http://www.platts.com/latest-news/natural-gas/london/analysis-russias-jan-gas-flow-to-west-europe-26989784 (last accessed on 5 February 2015)

3 World Street Journal, 29 January 2015, available on http://www.wsj.com/articles/gazprom-profit-falls-on-ruble-ukraine-1422518057 (last accessed pn 4 february 2015)

Figure 2: Gas exports to Europe, 2013-14, bcm



Source: Gazprom Export and East European Gas Portal

Arguably, a warm winter season had its share in faltering sales. Yet, the main reason lies in Gazprom is facing important challenges in Europe and in Ukraine. What is more, Gazprom also increasingly has to deal with competition in its home market, arising from Russian gas producers gaining strength. Finally, the Ukraine crisis keeps on impeding the company's operations and impacts on its options. Among others, the crisis pushed Gazprom to make stronger commitments to the Asian market, where China increasingly gains market power. Taken together, these trends pose significant challenges for Gazprom's business going forward. In fact, if unchecked, they may amount to a perfect storm for the gas major.

It would be easy to discard Gazprom's dilemma as a domestic Russian affair. Yet, analyzing Gazprom's perspective in the international gas conundrum is of high relevance for European consumers and its gas industry. Indeed, Gazprom, holding Russia's export monopoly, supplies about 30% of the EU's gas consumption and the share is as high as 100% in some countries of Central Eastern Europe. There, is a persisting lack of cross-border interconnections that makes Russia a crucial player. Obviously, interconnections are being constructed but a declining demand and a lack of competition rather makes these investments doubtful. In this context, Gazprom's gas remains one of the most competitive gas suppliers in Europe, not the least because the pipeline infrastructure, put in place by the Soviet Union at the time, has been amortised. As we will demonstrate here, Euro-Russian divergences rather stem from institutional and political dimensions. Gazprom therefore plays a pivotal role in European markets and their energy infrastructure, including its asset swap agreements with the largest European gas undertakings (eg, Italian Eni, French Gaz de France, German Eon), its participation and leadership in large-scale pipeline projects such as Nord Stream, and its direct involvement in gas trading via Gazprom International Operating and Trading Ltd and Gazprom Germania GmbH[4]. Besides, the Russian gas major invested in the power sector in some European

4 For details on European affiliates of Gazprom, see http://www.gazprom.com/about/subsidiaries/list-items/ (last accessed on 4 February 2015)

states and even entered the electricity trading business through acquiring Germany's Envacom[5]. Understanding Gazprom's options and assessing its strategies therefore becomes imperative for European energy security going forward. Last but not least, Gazprom's corporate debt to international banks - and particularly the European financial sector - exceeds 300 bln USD, hence its economic interests and strategies cannot be ignored.

This policy brief highlights the key challenges Gazprom has come to face at both international and domestic levels. It assesses Gazprom's options in this context and poses that neither strategy - pivoting to China, fighting EU regulatory pressures and (so far unconvincing) attempts to depoliticize European gas trade - will offer a silver bullet to Gazprom's woes. Gazprom's strategy reflects a complex combination between contradicting institutional features, which combines protecting its monopoly structures on one hand and adapting to changing market dynamics on the other. The objective of this brief is to sketch Gazprom's situation and to assess possible policy options the company could purse.

2. Shifting market fundamentals: from shortfall to oversupply

European gas markets, the largest and most profitable in Gazprom's customer portfolio, have been in deep transition towards more competitive structures by at the same time being experiencing over-supply and a declining demand. In the early 2000s most of the European gas importing utilities expected a projected gas supply deficit while at the same time European gas demand was expected to rise[6]. Keen on closing the perceived gap and eager to secure supplies in a growing market, large gas companies from Germany, France and Italy hurried to conclude long term contracts (LTCs) with Gazprom by allocating to the latter new long term guarantees of gas purchase and sweetened by granting access to downstream. Gazprom struck long term deals with Eni, Gaz de France and Eon Ruhrgas on supplies up to 2030-35, which include the opportunity for Gazprom to directly sell small quantities to the respective downstream markets in Italy, France and Germany. In addition Gazprom engaged in an asset swap agreement with Germany's chemical giant BASF, which owns gas trader Wintershall[7].

The preference of European gas companies for long term agreements with Gazprom changed[8] as the market started to shift by the end of the decade, which was triggered by soaring LNG inflows into Europe and sluggish demand in the aftermath of the 2008 financial crisis, and resulted in a surplus in gas supplies[9].

5 Itar Tass, 15.11.2012, http://itar-tass.com/en/archive/664529 (last accessed on 5 February 2015)

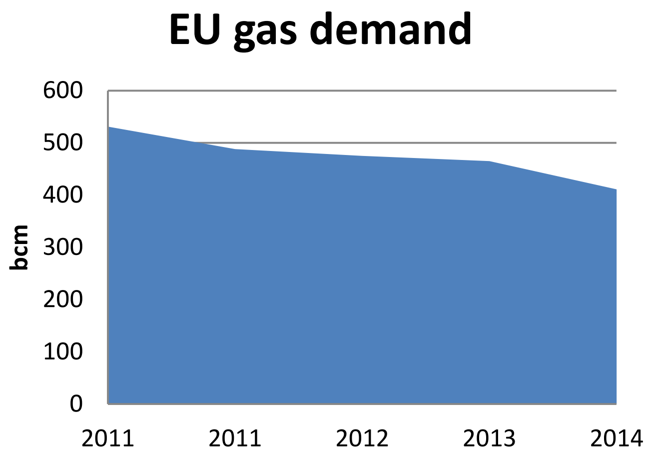
6 Among others, in 1999 Finnish company Fortum was forecasting a gas deficit of about 100 bcm per annum for the period starting from 2015, see Fortum, *Northern Dimension Gas Study,* Helsinki, 1999

7 For more detailed overview of Gazprom's long term contracts in Europe see J. Stern, "The Impact of European Regulation and Policy on Russian Gas Exports and Pipelines", in J. Henderson and S. Pirani, *The Russian Gas Matrix: How Markets are Driving Change*, Oxford: University Press, 2014, pp. 82-107

8 Among others, in 1999 Finnish company Fortum was forecasting a gas deficit of about 100 bcm per annum for the period starting from 2015, see Fortum, *Northern Dimension Gas Study,* Helsinki, 1999

9 T. Mitrova, Issues and Challenges in the EU-Russia Energy Relationship, *Natural Gas Europe*, 09 July 2012

Figure 3: EU gas demand trends



Source: Eurogas

Moreover, available short term supplies of natural gas stimulated transactions and churn on natural gas hubs in Europe, making the price gradually decouple from oil. Bilateral contracts with Gazprom, by contrast, mostly kept the indexation. Between 2011 and 2014, therefore, the oil-indexed price at times was some $2 per MBTU higher than hub traded prices.[10] The difference gave rise to serious disagreements between the Gazprom and European companies over the pricing formula for long term Russian imports. Declining demand made European companies take off less gas than agreed in the LTCs. What is more, companies started to buffer short term (i.e. daily or monthly) demand hikes by additional purchases on gas hubs. Gazprom criticized this growing re-orientation toward hub-based pricing and, especially, short term transactions for creating strong uncertainty for upstream investments with long pay back periods of 10-20 years. They argued that whilst the suppliers kept their responsibility in providing the commodity, consumers profited from a switch to lower prices, effectively breaching long term agreements. Yet, producers would still need to commit to long term financial obligations (i.e. bank loans), commitments which were concluded in advance and on the basis of existing contractual terms pertaining to price and volumes.[11]

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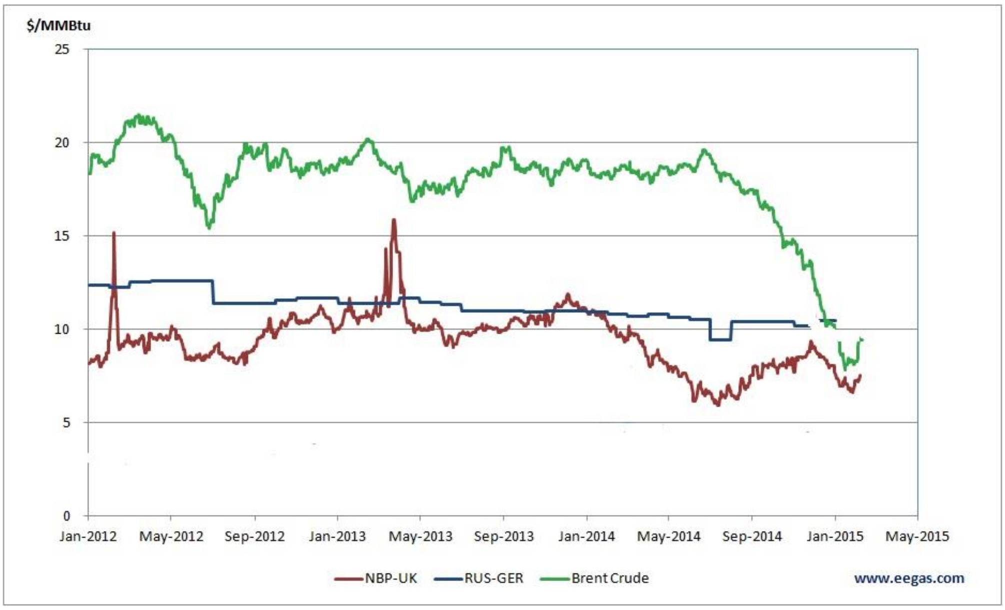
[10] For the gas price comparison, see International Energy Agency, available at URL: http://www.iea.org/newsroomandevents/graphics/2014-11-04-will-asian-gas-prices-come-down-from-their-heights.html (last accessed on 4 February 2015)

[11] See a more detailed comment on the European norms for Access to capacities and subsequent considerations by Russian experts by V. Feigin and A. Konoplyanik, Comments on Capacity Allocation on European Gas Transmission Networks Pilot Framework Guideline (Ref: E09-GNM-10-05, 10 December 2009); A. Konoplyanik, "A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)" in K. Talus, P-L- Fratini, *EU-Russia Energy Relations,Brussels:* Euroconfidentiel, 2010

Figure 4: Oil and Gas price dynamics in Europe



Source: East European Gas (adapted), 2015

Arguably, however, the recent decline in oil prices may contributes to making the gas price issue less politicized: Gazprom's price curve will follow oil, due to an oil indexation that still pertains to around 50 percent of the gas imported from Russia. A softening oil market will exert its impact on gas prices with the typical time lag of about half a year. The difference between oil indexed and gas hub prices might therefore diminish in the long run, and European energy retail companies might therefore become less attracted by hub-based pricing, whereas Gazprom may become less keen on maintaining the oil indexation.

3. EU legal frameworks: increasing competitive pressure

Adding to Gazprom's woes, European competition policy has an increasing impact on the company's long lasting business practices. In addition, during the first decade of 2000s, transit flows were then exempted from the EU liberalization scheme. In many central and eastern EU states, Gazprom did either have shares in transmission operators or concluded agreements where 100% of gas transpo rt capacity has been booked for the Russian supplier. Gazprom typically reserved all of its transit capacity to fulfil its gas supply agreements. This has been justified by the need to respond to the demand volatility. However, the EU's Third Energy Package of 2009 and particularly its Regulation 715/2009 and subsequent Network Code for Capacity Allocation Mechanisms introduced a number of provisions aimed at enhancing market practices in pipeline use, which also apply to transit contracts. In particular, the Package opposes the booking of transport capacity without actual using it[12]. What is more, whilst during the first decade of 2000s transit flows were then exempted from the EU liberalization scheme, this came to an end as well.

In the context of a new gas over-supply, the change in EU legal frameworks meant significant risks for Gazprom's operations. According to the new European regulation on pipeline capacity,

[12] For more details on the EU gas market regulation and functioning, including access to networks and charges mechanisms, see M. Hallack, „Opening a Market for Gas Flexibility" in J-M. Glachant, M. Hallack, M. Vazquez, *Building Competitive Gas Markets in the EU*, Edward Elgar, 2013, pp. 77-110.

Transmission System Operators (TSOs) have to open networks for both daily and hourly exchanges[13]. Hence, Gazprom would enter competition with other suppliers without the ability to reserve an entire pipeline capacity as it used to be done before. Gazprom's concerns regarding Third Party Access (TPA) has mainly been related to short term transport capacity agreements, which do not reflect long term supply obligations. Gazprom therefore argues that this will lead to a 'supply-capacity mismatch' between supplies committed in a long term contract and available pipeline capacity. According to European legal practice, the capacity reservation for long term supplies by a dominant player should not exceed 50 percent. Gazprom as well as some European companies considered this an inadequate measure to ensure imports and investments[14]. Noteworthy, similar concerns related to the necessity to match supply contracts with transport capacity were mentioned during negotiations of the Transit Protocol of the Energy Charter Treaty. At the time Russia, certainly influenced by Gazprom's interests, requested the right of first refusal for existing supply contracts ensuring capacity agreements.[15]

In addition, the EU Network Codes on Capacity Access Mechanisms do not address the issue of new infrastructure development, which remains a crucial concern for any large gas company, including Gazprom. At various discussion fora, including the EU-Russia Gas Advisory Council, Russian experts advocated for a need of stable long-term capacity access mechanisms as incentives to invest into new infrastructures.[16] Among others, Andrey Konoplyanik, advisor to Gazprom Export, argues that auctions are not suitable for putting in place new infrastructure capacity because of the high capital costs entailed and related investor uncertainty. Instead, he says, new infrastructure capacity should reflect the financial capabilities of investors, be organized through Open Season and revert to auctioning only for remaining capacity.[17] Still, the Network Codes, elaborated by Agency for Cooperation of Energy Regulators, give a strong preference to auctions.

In order to ensure an adequate investment pay-back, a new pipeline infrastructure can be subject to exemption from TPA requirements[18]. The rationale behind this is to grant pipeline constructors a certain time period so that their investments amortizes before allocating the capacity to potential competitors. Among others, TPA exemption has been still pending so far for the German onshore branch of Nord Stream pipeline OPAL[19]. Gazprom did not book pipeline capacity during the Open Season, a procedure required by European legislation. By contrast, Gazprom viewed long term supply agreements as automatically leading to capacity reservation. Eventually, Gazprom and the European Commission reached an agreement that would allocate 50% of the network capacity to Gazprom and earmark another 50% for auction. In the meantime South Stream, Gazprom's major project rivaling EU sponsored pipelines in the Southern Corridor, had to comply with the afore-mentioned capacity

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[13] See Articles 8, 11 and 12 of Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council, Official Journal of the European Union L 273/5

[14] In this context, EU and Russia established a Gas Advisory Council, which aims at resolving the supply-capacity mismatch. Conclusions of the Gas Advisory Council (2013) on this issue are available on http://ec.europa.eu/energy/international/russia/dialogue/dialogue_en.htm (last accessed on 5 February 2015)

[15] A. Konoplyanik, "A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)" in K. Talus, P-L- Fratini, , *EU-Russia Energy Relations,(Brussels:* Euroconfidentiel, 2010)

[16] See a more detailed comment on the European norms for Access to capacities and subsequent considerations by Russian experts by V. Feigin and A. Konoplyanik, Comments on Capacity Allocation on European Gas Transmission Networks Pilot Framework Guideline (Ref: E09-GNM-10-05, 10 December 2009)

[17] A. Konoplyanik, presentation at „Energy Transitions", Joensuu, 26 February 2015

[18] For details see T. Van Der Vijver, "Commission Policy on Third Party Access Exemption for New Gas Infrastructure" in M. Roggenkamp and U. Hammer (eds), *European Energy Law Report VI*, Cambridge: Intersentia, pp. 115-129

[19] ICIS Newsletter, 30 October 2014, available on URL: http://www.icis.com/resources/news/2014/10/30/9833701/brandov-natural-gas-cross-border-capacity-in-demand-as-opal-decision-delayed/ (last accessed on 4 February 2015)

mechanism because the consortium did not send a request for an exemption from third party access. Arguably a long pending decision on OPAL enhanced Gazprom's distrust into the European exemption model and its operationalization. In addition, investors and financiers dislike the idea of exemption-based decisions as they generate uncertainty on long term frameworks: projects become dependent on bureaucratic decisions, which may increase transaction costs. The issue provoked controversy between Gazprom, the Commission and EU member countries hosting parts of the South Stream pipe, which eventually led to a cancellation of the project in December 2014. Throughout the controversy, Russia argued that intergovernmental agreements with the EU member states shall prevail over the EU law, hence the TPA would not be applicable.

In aftermath of the South Stream cancellation, Gazprom proposed a new project via Turkey - Turkish Stream - which may imply a change in the company's strategy to access EU markets. The design of the new project, delivering gas to the Turkish-Greek border, would among other avoid TPA issues and Gazprom would decrease its participation in and exposure to the downstream sector[20].
Another area of dispute is related to investment into the European networks, and surrounds what has been nicknamed the "Gazprom clause". At its very core, EU law permits restrictions for non-European suppliers to invest into EU energy networks. In addition, national regulatory authorities have a right to refuse the certification of non-European companies, in case there is an issue of supply security. The certification issue has so far not proven problematic for Gazprom. Still, the company considered itself targeted because the Directive's provision remains vague on the definition of "security".

Reacting on the 'Gazprom clause', Gazprom lobbied the Russian government to file a case against the EU at the World Trade Organization against the afore-mentioned investment restrictions. When making the case, Russia's argument will mainly center on discriminatory and anti-market practice pertaining to EU regulatory practices.

In spite of the mounting competitive pressure on EU markets, Gazprom remained hesitant to change its contractual practices for capacity booking in Central and East European states, nor its incumbent business model. Consequently, the EU initiated an anti-trust monitoring procedure against Gazprom in 2012. With it, the European Commission addressed contractual practices of companies, mostly of Central and Eastern Europe, involving either Gazprom subsidiaries or close business partners. The European Commission objects three elements of Gazprom's practices, which might run counter to EU law: market partitioning as a consequence of alleged de facto destination clauses, barriers to supply diversification through hoarding of pipeline capacity, and unfair pricing based an opaque oil indexation mechanisms[21]. Unlike in other cases, the European Commission addressed the issue of pricing[22] which triggered criticism on behalf of Gazprom. In particular, Gazprom accused the European Commission of an attempt of an artificial control of prices[23]. Ironically, therefore Gazprom operates with similar arguments as the officials in Brussels, arguing for non-interference in market practices.

In all, however, Gazprom's incumbent business model, based on LTCs and oil price indexation coupled with control over pipeline infrastructure has come under severe pressure. With the crisis in Ukraine unfolding, the European Commission decided to postpone the anti-trust monitoring. However,

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[20] J. Stern, S. Pirani and K. Yafimava, *Does the cancellation of South Stream signal a fundamental reorientation of Russian gas export policy?*, Comment of Oxford Institute of Energy Studies, January 2015, available on URL: http://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/01/Does-cancellation-of-South-Stream-signal-a-fundamental-reorientation-of-Russian-gas-export-policy-GPC-5.pdf (last accessed 5 February 2015).

[21] N Sartori, The European Commission vs. Gazprom: An Issue of Fair Competition or a Foreign Policy Quarrel , IAI Working Papers 13 | 03 – January 2013, available on http://www.iai.it/pdf/DocIAI/iaiwp1303.pdf (last accessed on 4 February 2015)

[22] K. Talus, *EU Energy Law and Policy* Oxford: University Press, 2013

[23] J. Stern, „Russian Responses to Commercial Changes in European Gas Markets", J. Henderson and S. Pirani, *The Russian Gas Matrix: How Markets are Driving Change*, Oxford: University Press, 2014, pp. 50-81

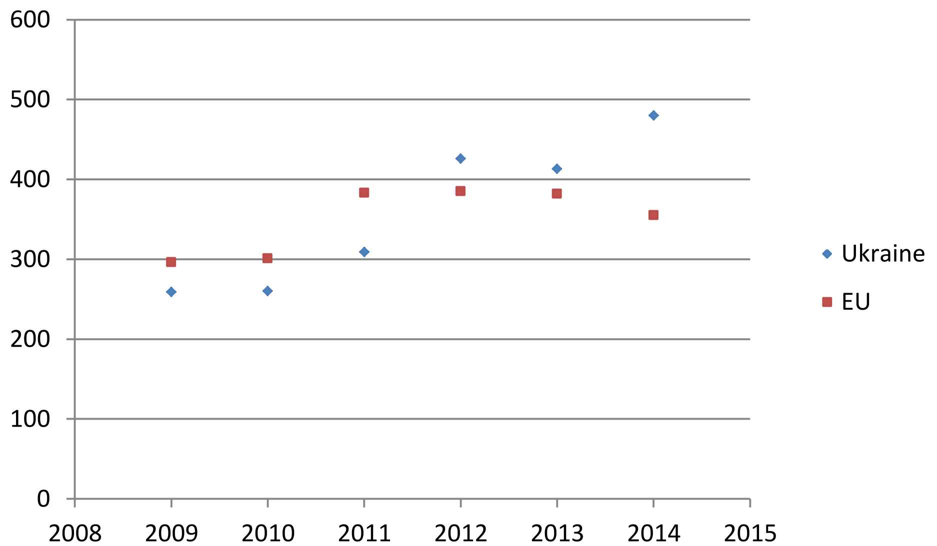
the link between the two issues - Russia's contractual practices in Eastern Europe and the Russia-Ukraine gas dispute - remain weak. Hence, one can assume that legal implementation of the European law can indeed be subject to political compromises and accords. In the meantime, political uncertainty creates additional economic risk for both Gazprom and its European partners and creditors. Interestingly, European gas companies voice similar points of critique against EU competition policies in the sector, irrespective of their own disagreements with Gazprom on pricing and contracts.

4. Ukraine crisis: further politicization of European gas trade

A third element complicating Gazprom's operations in the European gas sector are the recurring disputes with the Ukraine, and in particular the most recent crisis that started in 2014. In short, the disputes spurred the politicization of Russian gas supplies. Arguably, when it comes to supply and pricing, Gazprom willingly became a political instrument in the Kremlin's foreign policy. After a short supply cut to Ukraine during the 2006 gas crisis, the 2009 dispute, in which Gazprom decided to halt all gas supplies via Ukraine, strongly reinforced a negative image of Gazprom among European partners, and contributed to a growing perception of a politicization of EU-Russian gas trade. Clearly, this post-2009 environment was not taken into account by Gazprom officials later, when the conflict in Ukraine unfolded. Instead, similarly strong rhetoric toward Ukraine was utilised even by Gazprom's top officials.

Although the agreement of 2009 aimed at connecting the gas price to oil indexation, the new pricing arrangements did not align Ukrainian with EU border prices. Because of various discounts to European retailers, resulting from compromises over afore-mentioned disagreements, Gazprom's estimated price to Ukraine has often been higher than the EU border price marker. Hence, the connection to international pricing remained vague in spite of the declaratory objective to introduce market mechanisms.

Figure 5: Estimated gas price to Ukraine vs EU border price



Source: Vedomosti, 28 July 2014

Since the conflict of 2014, Gazprom has been trapped in the territorial dispute between Russia and Ukraine, which translate into a gas dispute. Its roots can be found in the Kharkov agreement of 2010.

At the time, then President Yanukovich obtained a $ 100 per tcm[24] price reduction from Gazprom in return for the Black sea fleet being stationed in Crimea. However, in aftermath of Yanukovich being ousted of power in February 2014, Russia annexed the Peninsula and unilaterally revoked the Kharkov agreement. As argued by Moscow, since Crimea no longer is under Ukrainian sovereignty, the Kharkov agreement is nil. In turn, and as a consequence, the 2009 gas price of $ 450 was back in place. However, Ukraine disagrees with this interpretation and considers that Kharkov agreement as still valid. Therefore, Ukraine disputed the new gas price and refused to pay until an agreement on gas was found. Paradoxically, the new Ukrainian authorities defended the price agreement of late 2013, which had been concluded by their main adversary Yanukovich and stipulated $ 265 per tcm, as legitimate. Among others, Ukraine therefore reimbursed additional transit fees to Russia as they were not corresponding to the $265 per tcm gas price. As the transit fee is proportional to the price of the delivered volumes, Ukraine's calculation of transit fee results in a smaller amount compared to Gazprom's figure. This demonstrates how deeply the new tariff dispute is linked to the territorial dispute.

Adding to this, a regulatory dimension in the shape of the EU energy regime come into play. Since 2010, Ukraine has been a contracting party to the Energy Community Treaty, which aims at expanding the European energy market acquis to non-EU states. Such membership would therefore require the unbundling of Naftogas, the state owned Ukrainian national oil and gas company, and the creation of market-based anti-hoarding mechanisms for transit pipeline capacity. Distance-based tariffs for transit should then phase out and a new entry-exit method will be in place. Although these requirements were bound with difficulties when it came to implementation, they also constituted a barrier for a potential Gazprom-Naftogas consortium, which was lobbied for by Russia in 2011-13. Since 2014, and against the backdrop of a more pro-western political orientation of Ukraine, the implementation of the Treaty was accelerated. Ukraine now plans to introduce new entry-exit tariffs for pipeline capacity, which replace the existing distance-based tariff linked to Russian supplies. At the end of the day, Naftogaz' import monopoly is ought to be abolished and any Ukrainian trader will be allowed to import Russian gas. For Gazprom, the new system would mean selling gas at the Russia-Ukraine border instead of the EU border.

In turn, a success of the planned Ukrainian gas hub will arguably not be functional with a strong dependence of Ukraine on Gazprom's supplies. Existing interconnections with other states have been built for transiting Russian gas to Europe and underground storages have been also filled with Gazprom's gas. Therefore, reverse gas flows, which were organized by Central European states to Ukraine, faced the issue of being reliant on one-directional infrastructure and full dependence on Gazprom's supplies. For instance, when Gazprom reduced gas supplies to European costumers in September 2014, this happened within contractual terms[25]; yet, the reduction was sufficient to make some countries (in particular Hungary) halt gas flows to Ukraine. Although the supplies from Hungary, Slovakia and Poland were often called "reverse flows", they operated in different pipeline networks from Soviet-era inherited trunk pipelines. The desire of creating Ukrainian gas hub and connecting it to the Central European market may therefore hit the harsh realities of path dependencies in post-Soviet supply-transit structures.

Finally, the Ukraine crisis has arguably been the tipping point in shifting Gazprom's export strategy, and has given rise to additional pipelines via the Black Sea - the above mentioned "Turkish Stream". Gazprom's decision to re-route exports comes against the backdrop of an already existing

[24] Russian statistics use the volumes for price benchmark in thousand cubic metres (tcm), which differs from international trading systems, where the price of gas is taken out of its calorific value, BTU. The conversion between the two is done via a generic consideration of 1 thousand cubic feet (tcm) = 1 thousand BTU. Considering 35 cubic feet in one cubic metres, a conversion would then be 1 cubic metre for 35 thousand BTU. Hence, a price of $ 100 for tcm is equivalent to $ 2.85 MBTU. For conversions analysis, see S: Bhattacharyya, *Energy Economics, Heidelberg:* Springer 2011

[25] See data of ICIS report, *Heren European Gas* Market, 30 September 2014, p. 17

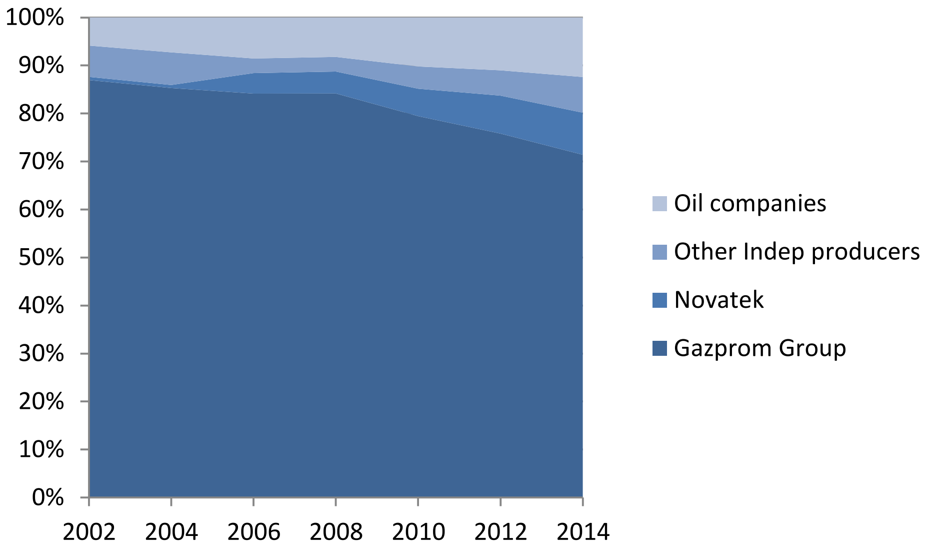
over-capacity in Russian export pipelines to Europe, which include the Ukrainian network, the Yamal-Europe pipeline via Poland and Nord Stream. This merits the question how of over-capacities of networks compare to gas export volumes. The pipeline network via Ukraine amounts to almost 150 bcm of annual capacity, which adds to 33 bcm of Yamal-Europe (via Poland), 55 bcm of Nord Stream to Germany (through the Baltic Sea) and finally 15 bcm of Blue Stream to Turkey (through the Black Sea). With Turkish Stream projected to 63 bcm per annum, Russian export capacities will almost double compared to the exceptional peak in exports of 2013. Since there hardly is an economic rationale for this move, it is arguably the Ukraine nexus that drives Gazprom's new strategy. Finding alternatives to Russia-Ukraine route is primarily of interest of south-eastern Europe, a region which still suffers from lopsided infrastructure options. Also, contrary to official statements, Ukraine cannot be entirely circumvented as most of Gazprom's LTCs stipulate delivery points in Central Europe and hence necessitate the use of the Ukrainian network at least until current LTCs expire in 2030-35. This comes against the backdrop of Ukraine's strong dependence on Gazprom. All of this suggests that both Russia and Ukraine would find it difficult to significantly reduce their mutual exposure in the energy sector in the next years to come.

5. Domestic Russian market: pressure from within

A final challenge for Gazprom emerges on its home market. In fact, and counter to widespread perception, the market paradigm is nothing new to the Russian gas sector. Already in 2002, the Ministry of Economy tabled a number of reform proposals aimed at restructuring Gazprom. Although Gazprom managed to resist fundamental change, it has now become subject to market regulation, including provisions on non-discriminatory access to pipelines for independent gas producers[26]. However, Gazprom controls all the trunk pipelines and typically feeds gas from non-Gazprom sources into its networks only after having purchased it. Yet, third party access to pipelines has been especially promoted by Russia's Federal Anti-Monopoly Service. Over the past years, independent Russian gas producers therefore started to gain access to networks without losing the ownership over the commodity they were feeding into the grid. In addition, the gas flaring reduction plan of 2009 incentivized oil companies to entered the gas condensate market. Consequently, Gazprom's share in Russian natural gas production declined from almost 95% in early the 2000s to less than 80% in 2014. This share keeps on declining since. This trend coincides with the rise of Novatek, a gas company that emerged in the late 1990s and whose owner, Gennady Timchenko, allegedly has built strong ties with the Kremlin. In addition Rosneft, the second major state owned energy company, increased its gas stakes, especially since the acquisition of assets owned by Anglo-Russian company TNK-BP in 2011.

[26] A Decree on non discriminatory Access was adoped in 1997, for details on Gazprom regulation see J. Stern, *Future of Russian Gas and Gazprom,* Oxford: University Press, 2004, A. Bely and C. Locatelli, „State and Markets in Russia's Hydrocarbon Sectors: Domestic Specificities and Interrelations with the West" in A. Belyi and K. Talus, *States and Markets in Hydrocarbon Sectors*, Palgrave Macmillan, 2015, pp. 103-121.

Figure 6: Structure and dynamics of Russia's gas production



Source: TEK, Russia's Gas Statistics, 2014

Subsequently, the creation of a wholesale Russian gas market gained a political support at the governmental level. Already in 2006-08, a market platform was set to trade gas between Gazprom and independent gas producers. However, trade activities calmed down with the wake of the financial downturn of 2009, and Russia's government brought back the idea only in 2010. Eventually, a new wholesale market platform is in operation since October 2014, albeit with so far limited volumes and churn[27]. Experts observe only limited interest in the market platform on part of Gazprom[28]. Moreover, for most of Russian domestic gas consumption tariff and price regulation remains in place[29]; however, governmental plans to introduce market pricing are being discussed. In all, therefore, there has been growing competition between various gas companies, particularly for customers in the Russian power sector[30]. Gazprom's main fear consists in losing the most profitable stakes in Russia's power market. Therefore, Gazprom already acquired about 16% of generation capacity in the country. However, competition with Novatek is becoming more fierce for the electricity market.

Gazprom's challenge in both domestic and export markets consists in the amounting over-investment. As discussed, it is especially export pipelines to Europe that exceed supplies sent west going forward. Turkish Stream complicates the situation even further, and the new pipeline might still face similar challenges related to declining European gas demand and third party access requirements once the pipeline crosses the territory of the Energy Community space.

Domestic changes also affect external regulation. Both Novatek and Rosneft lobbied for repealing Gazprom's export monopoly in LNG, an effort that was successful and signed into law in December 2013. However, the access to domestic trunk pipelines remains under Gazprom control. Rosneft

27 A short overview of the Russian wholesale gas market, see Gazprom's Press Release, available on URL:http://www.gazprom.com/about/marketing/russia/ (last accessed on 4 February 2015)

28 T. Mitrova, „The Political and Economic Importance of Gas in Russia" in J. Henderson and S. Pirani, *The Russian Gas Matrix: How Markets are Driving Change*, Oxford: University Press, 2014, pp. 6-38

29 Cf decree of the Federal Tariff Service of Russian Federation on Gas Tariffs of 9 July 2014, available in Rossiiskaia Gazeta, No. 163, 23 July 2014.

30 J Henderson, 'Evolution in the Russian Gas Market – The Competition for Customers', (Oxford Institute for Energy Studies 2013) http://www.oxfordenergy.org/wpcms/wp-content/uploads/2013/01/NG_73.pdf (last accessed on 5 February 2015)

therefore requested access to Gazprom's pipelines to connect its planned LNG facility (operated jointly by Rosneft and ExxonMobil) in Sakhalin to the transit network. Interestingly, Russia's Federal Antimonopoly Service made Gazprom comply with provisions on non-discriminatory access to its pipelines, which Gazprom wanted to defend in front of courts.[31] Gazprom therefore faces a ironic situation in which another state-owned company, Rosneft, challenges its positions, and in which two state owned companies compete for domestic market shares. There is an interesting twist, Rosneft's leadership, which represents the most conservative and statist wing of Russia's elite, openly uses competition arguments to fight Gazprom, similar to those presented by the European Commission. Adding insult to injury, Novatek managed to conclude a 10-year contract of 2 bcm of annual gas deliveries to Germany.[32] Precisely because this violates Russia's long-standing practice of Gazprom maintaining an export monopoly, this move confirms the general trend that the gas giant is about to lose is overly dominant position both on the domestic market and in external trade.

Gazprom's response to the situation consisted once again in over-investment. Among other, Gazprom initiated two LNG terminal projects, one in Vladivostok and one in Baltics, both located far from resource-base and both requiring additional investments into trunk pipelines.

6. Assessing Gazprom's options

Overall, Gazprom faces challenges related to its traditional business model on the European market, notably because of the European regulatory model and an increasing politicization of gas trade. Adding to that, Gazprom faces mounting pressures domestically, both regarding market share as with a view to its fading export monopoly. Squeezed between a rock and a hard place, what are Gazprom's options? Here, we present a critical assessment of existing strategies and will carve out possible policy options.

6.1 Diversify customer base: the China pivot

A first option for Gazprom consists in divesting from a lopsided dependence on the European export market, and turn to Asia. This would diversify its customer base and the company could build on its existing strength in the upstream and export segments. A structural argument backing this strategy consists in the fast growing Asian gas demand which contrasts with a slowly declining share of gas in Europe. In fact, since the mid-2000s Russia's Gazprom and China's CNPC had been negotiating the possibility of a gas pipeline from Siberia to China[33]. Apparently, however, negotiations were stuck due to disagreements over the price. Although the details remained confidential, Gazprom allegedly aimed for a European price level, which China was not ready to agree on. It was only in early 2011 that China and Russia came to an agreement on the political level, leaving details to be agreed by the gas operators. Russia declared to be ready to supply up to 60 bcm (slightly more than a third of exports to the EU) to China.

Still, it was only in the wake of the Ukraine crisis that Russia's Eastern strategy gained momentum. In May 2014 Russia and China agreed on gas trade of 32 bcm annually from 2018 onwards. The agreement provides a political ground for a long term orientation of Russian supplies to the world fastest growing energy demand state. Many pointed out a difficult task in implementing the project as new pipeline infrastructure must be built to China. For instance, capital costs for exploration in

[31] Up to now, the two companies found an agreement to dispatch the supplies Russian Companies news, RBC TV, 20 November 2014

[32] Bloomberg, Nov 2012, available on URL http://www.bloomberg.com/news/2012-08-15/novatek-s-german-contract-price-seen-at-18-above-spot-at-alfa.html (last accessed on 4 February 2015)

[33] P Andrew-Speed, *The Long Road to the China-Russian Gas Pipeline Deal: The End of the Beginning*, Commentary, available on URL: http://www.andrewsspeed.com/index.php/permalink/3276.html (last accessed 10 December 2014)

Yakutia, from where gas supplies to China will be provided, are estimated at $ 70 billion in capital costs only. This should be complemented with transportation costs and operational costs[34]. Hence, the economic gain for Gazprom might be questionable. Gazprom expected to receive a pre-payment from China for building the necessary new pipeline infrastructure. In turn, China considered the pre-payment a loan and hence demanded interest on it. As the agreement on financing the pipeline remained pending, Gazprom started the project with own capital expenditure.

Later on, another pipeline direction from west Siberia to western part of China (so-called western route) was discussed for another 30 bcm of gas supplies. In this case, Russia-China agreement aims at a long term increase of volumes from Russia to China, which would deviate parts of the gas designated to Germany. However, up to now, parties did not agree on the exact terms for the “western route” to China.

Yet, China plays hard to catch and might need smaller volumes from Russia. China’s incremental gas demand by 2020 is expected to be about 120 bcm, and China has increased its commitments for LNG imports from the Asia-Pacific and tightens ties with Turkmenistan. For instance, in May 2014, right before the deal with Russia, China concluded an agreement with Turkmenistan to supply 62 bcm of gas from 2016 onwards, two years earlier than Russia. That way, Beijing indirectly demonstrated to Moscow that it does not vitally need Russian gas, whereas Russia would more urgently need to diversify supplies away from Europe. Furthermore, it is not necessarily Gazprom that will emerge the winner in Russia's efforts to pivot to China. In fact, Gazprom pivoting to Asia triggered new competition between Gazprom and Russia's independent gas producers. Among other, Russia’s government agreed to co-finance new pipeline projects from East Siberia to Russia. This would imply that Gazprom might eventually lose its export monopoly toward Asia to independent producers. This would certainly fall in line with the more general pro-competition trend in Russia’s domestic regulation.

China its, finally, a country that still prefers long term bilateral agreements, became a market changer for Russian gas. For China, bilateral agreements remain the more secure option compared to a volatile oil-indexed Japanese gas market, at least for the time being. In this context, Gazprom might need to improve domestic efficiency of investments and might hence reconsider its investment commitments. For instance, the Vladivostok LNG terminal will be located remotely from the resource base and hence would require additional investments into trunk pipelines. This may become tricky against the backdrop of alternative pipelines being constructed into China and tightening competition for China’s market.[35] Japanese import prices declining by nearly 50% in the last months may also put in question the expansion of LNG facilities in Sakhalin, which are jointly operated with Shell. For the same reason, Gazprom might not need to fear Rosneft's desire to acquire a market share in Japan with its own project in Sakhalin. At the same time, it is highly likely that Rosneft and Novatek will demand access to Eastern pipeline infrastructure. Hence, Gazprom would feel pressure from both domestic and international competitors willing to access China’s markets.

6.2 Fight fire with fire: resort to international law

A second option for Gazprom is to take on the legal challenge on its European market. In fact, despite deteriorating political relations, a number of contractual controversies with European companies and states have recently been resolved via various arbitration procedures and pre-arbitration compromises.

[34] M Krutikhin, RusEnergy Consult. See, M Krutikhin, ‘Arithmetic, an Enemy of Gazprom’ *Natural Gas Europe*, 11 June 2014 available on URL: http://www.naturalgaseurope.com/china-russia-gas-deal-arithmetic (last accessed 10 December 2014).

[35] For details on economics of Vladivostok LNG terminal, see T Mitrova, “Russian LNG: The Long Road to Export”, Paris: Institut Francais des Relations Internationales, December 2013, No 16,5www.ifri.org/downloads/ifrimitrovalngengnov2013.pdf4 (last accessed 4 February 2015)

Compromises have been struck between Gazprom and European companies particularly with a view to implementing more flexible contractual commitments for gas supplies and pricing. Gazprom's most complex dispute was with Lithuania, involving a long range of issues, from Vilnius' decision to sell Gazprom's network assets in order to implement the third energy package to even covering gas transit to Russia's enclave of Kaliningrad. Disputes were successfully resolved within arbitration and Gazprom agreed on selling its assets in transport networks in the Baltic country. In the meantime, transit of Russia's gas to Kaliningrad has been secured so far and operates with a significant over-capacity in networks from Lithuania to Kaliningrad. Hence, Gazprom never faced a capacity-supply problem in the region.

Still, the "Gazprom clause" and the full ownership unbundling remain important barriers for Gazprom's economic activities in Europe. As indicated, in an attempt to defend its cause in Europe, Gazprom made the Russian government file a case against EU investment restrictions in front of the WTO. That way, Gazprom, as a major international company, is using international legal mechanisms to protect its positions outside its home country. Choosing WTO procedures arguably is only second best compared to operating on the basis of the Energy Charter Treaty (ECT). For instance, the Energy Charter investment provisions could have been used in defending Gazprom's investments in Europe.[36] The WTO does not entail a similar investment protection regime. Instead, direct state-investor dispute settlements have usually been covered by either Bilateral Investment Treaties or (for energy) the ECT. Yet, Russia does not have a Bilateral Investment Treaty with Estonia, a country which also implemented full ownership unbundling. In this case, the Energy Charter could have been a valid framework for Gazprom in its potential arbitral case with Estonia. Yet, since the Kremlin rejected the ratification of the ECT in 2009[37], its instruments might not be available to Gazprom. The company is now forced to look for more indirect ways of access to arbitration. It is important to note that although Gazprom could have been benefited from the multilateral energy treaty, Russia's rapprochement with the Energy Charter is highly unlikely, especially with a view to the Yukos case.[38] The approach towards the WTO has been different so far, although Gazprom can participate only indirectly by lobbying through the Russian government. Though time-consuming, litigation will still require significant efforts before any decision will take place.

6.3 Adaptation to Markets: give in to new realities

A third option for Gazprom consists in adapting to new regulatory realities on European markets, in order to keep its long term market position. In fact, Gazprom has made steps toward accommodating requests by its European customers. For instance, Gazprom agreed to amend existing contracts with Eni, Eon and other European utilities to include hub-based pricing elements. Adapting to market realities would also allow reducing over-investments.

Yet, although Gazprom seems to be flexible in finding compromises with European companies, it remains reluctant to comply with the EU's regulatory environment. Compared to adjustment through arbitration, which is on firm level and allows Gazprom to maintain its interests, adjustment to EU rules would amount to a fundamental change in the company's business model. Making matters worse,

[36] For a detailed legal analysis of the ECT, see C. Blamberger and T. Wälde, 'The Energy Charter Treaty' in M.Roggenkamp, C. Redgwell, I. del Guayo, A. Rønne, Energy Law in Europe, Oxford University Press, 2007, 145–195

[37] On Russia's position regarding the ECT process see A. Belyi, S. Nappert and V. Pogoretsky, "Modernizing the Energy Charter? Road map and Russian Draft Convention on energy security", Journal of Energy and Natural Resource Law, 2011, Vol 29 (3), pp. 205-224

[38] Based on the ECT provisions the International Arbitration Court in the Netherlands ruled that former shareholders of the defunct company were to be to be compensated by Rosneft with 50 billion USD, for details see M. Dietrich Brauch, "Yukos v Russia: issues and legal reasoning behind $50 billion awards", 4 September 2014, Investment Treaty News, available on URL: http://www.iisd.org/itn/2014/09/04/yukos-v-russia-issues-and-legal-reasoning-behind-us50-billion-awards/ (last accessed 4 February 2015)

formal attempts to consult with the Commission started only in 2011, two years after the Third Energy Package was put in place. This drives the point home that Gazprom often under-estimated the EU's legal and procedural requirements, as well as its intent to enforce them (as became apparent in the cases of OPAL and South Stream). Gazprom's contracts in Central and Eastern Europe also remain opaque and politically shaped, which spells conflict with EU regulators and the European Commission. Anti-hoarding mechanisms for the pipeline contracts, finally, might gradually expand to Central and Eastern European as well as Ukrainian networks.

In this context it is important to appreciate that Gazprom's gas supplies will remain crucial for European markets in the long term, for the sheer lack of economically viable alternative supply options.[39] Gazprom might therefore be able to convince the EU to adopt a certain degree of regulatory flexibility to facilitate Russian gas imports. The issue of supply-capacity mismatch, for instance, should certainly be discussed within various policy, expert and industry frameworks. Also, Gazprom's infrastructures has been mostly amortised which gives Gazprom an opportunity to keep on granting select price discounts. Lithuania's recent construction of an LNG terminal, for instance, which comes with a purchase contract with Statoil, presents a challenge for Gazprom's positions in the tiny Baltic market. However, Gazprom remains in a position to exert price leverage. By the end of 2014, Gazprom allocated a price discount to Lithuania's gas company, which makes Russian gas about 10% cheaper than Statoil's LNG cargos. All of this suggests that Gazprom may have opportunities in adapting to new market realities.

6.4 Depoliticize the business model: create long term expectations on European market

A fourth option for Gazprom will be to work toward depoliticising gas sales in Europe. This may prove difficult but may in the long term work toward Gazprom's favor. Presently, against the backdrop of the ongoing crisis in Ukraine, the European Commission decided to postpone the pending anti-trust monitoring against Gazprom. What is more, the EU-Russian Gas Advisory Council, established in order to tackle key issues of concern on both sides, has been inactive, as no major political decision might to be taken during the crisis. Further, the EU presently seems to adopt an approach of 'non-decision' towards Gazprom: neither do they move forward on anti-trust monitoring nor are there steps toward solving issues surrounding the supply-capacity mismatch. This keeps Gazprom in a limbo, and the persisting political uncertainty creates an additional economic risk for Gazprom. Finally, sensitivity levels in Europe toward Gazprom are high. Disputes over gas supplies to and transit through Ukraine is likely to further deteriorate Gazprom's image in Europe, which might translate into further choices in the spheres of regulatory policy and when it comes to negotiating future supply contracts. This may impact on Gazprom's long term position on its most profitable market. Therefore, and regardless of European concerns centering on supply security, the increasing politicization of gas supplies clearly also plays against Gazprom.

Depoliticizing gas trade would require two main elements. First, Gazprom would need to give up on its export monopoly. Arguably, Russian oil exports, which are entirely demonopolized, are not considered a security issue in Europe. By contrast, Gazprom's dominant position on the European market supports European perceptions of the company as the Kremlin's foreign policy arm. Demonopolizing gas exports would come with various advantages: It would balance out current over-capacity in Russian export pipelines to Europe and growing domestic production capacity from non-Gazprom producers; resulting competition would push Gazprom, the incumbent, to take strategic choices on new projects and increase the company's overall efficiency; and it may even stabilize its European market share, as the historical case of Statoil suggests. Indeed, the demonopolization of Statoil's exports was accompanied by an increase of the market share of Norway in Europe.

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[39] See Andreas Goldthau, Can Europe survive without Russian gas? Maybe, but it should not have to. GMF Policy Brief, 2015 (forthcoming).

Admittedly, abandoning the de jure export monopoly - despite the challenge that Novatek et al present - remains politically sensitive in Moscow, and Gazprom enjoys persistently strong political support. However, demonopolization would arguably strengthen Gazprom's hand in the long run. Existing flows, which constitute the basis for Gazprom's LTCs, could continue to receive priority access to Russia's export networks under the right of first refusal principle. New supply contracts, concluded by either Gazprom or its competitors Novatek and Rosneft would get their share in exports to Europe and hence increase liquidity and competition on European hubs. As old contracts will phase out over time, new gas flows will gradually dominate exports, as does a new export regime. Such a move would not only fall in line with EU regulation but also decrease political tension and reduce the politicization of Russian gas exports. In fact, it is not inconceivable that Gazprom agreeing to forego its export monopoly could become a bargaining chip in the context of the European Commission's anti-trust case against the company.

The second element would consist in the Europeans acting quid pro quo and adopting appropriate steps on their part. This not only includes consultations on the discussed supply-capacity mismatch, which is important not only for Gazprom but also for the European gas industry. Such a move would allow the EU to maintain its liberal paradigm in energy policy. This paradigm has increasingly come under pressure due to an ongoing securitization of gas supplies, in the context of discussions on common purchase vehicles, and because internal market integration was lagging. It should be noted that a constructive relation between the EU and Russian gas suppliers would contribute to creating a competitive gas market. In this context, the needs of investors, especially regarding new trunk pipeline infrastructure, have to be taken into account to reflect market realities.

7. Conclusion: Gazprom weathering the perfect storm?

Gazprom has options, but they require tough choices. At present, however, Gazprom's strategy appears inconclusive. On one hand, recent moves taken by Gazprom's leadership suggest that the company is committed to fostering the China pivot, despite the presently poor economic fundamentals of this 'Eastern Strategy'. Yet, the China pivot hardly amounts to a strategy nor does it necessarily solve Gazprom's problems, which consist in a soft international market environment, rising competition domestically and abroad, and an increasing politicization of gas trade in its still most important export market. Re-routing EU supplies through Turkey, on the other hand, point to a re-orientation of Gazprom's export strategies, as a reaction to the ongoing conflict in the Ukraine, past transit disputes with the country, and EU policies effectively stopping South Stream. Statements have also been made to the effect that the company would completely withdraw from the European downstream market. All of this suggests that Gazprom aims at diversifying away from the EU market and the regulatory regime governing the European gas sector. Gazprom seems confident to keep the current EU market share.

To be sure, pivoting to Asia and defending market share in Europe are not mutually exclusive strategies, and can be the result of diversification efforts coupled with measures toward higher compliance with EU regulatory frameworks. Yet, arguably, this is not what Gazprom pursues. To the contrary, Gazprom's strategy is very much driven by concurrent and contradictory dynamics within the company. Parts of the company that represent post-ministerial structures still regard Gazprom as a tool for Russian (external) power. Related political discourses clearly stem from Gazprom's historical legacies, even though these discourses more often than not mismatch reality. At the same time, Gazprom's participation in hubs, compromises on contracts and prices and attempts to use international legal instruments for dispute settlements demonstrate that parts of the leadership are willing to de-politicize the gas business. These two contradicting approaches at times become even evident inside Gazprom's affiliates.

It remains to be seen which camp within Gazprom ultimately retains the upper hand. Among all options outlined above, Gazprom should aim at de-politicizing gas trade by way of de-monopolizing exports. While the company would see growing competition from domestic competitors Rosneft and Novatek it would in turn see the support of the European Commission in liberalizing export regimes and in fostering gas-on-gas competition. Such a move would arguably also soften the EU's attempts to put additional political, economic and monetary resources behind checking Russian market power - notably in the shape of the planned 'Energy Union'.

Such an adaptation process would not necessarily imply that the company foregoes its interests. Although Gazprom will have hard times 'fighting fire with fire' it will still be able to use legal instruments for defending its rights and interests in Europe. The challenge will be to keep disputes in the legal sphere and at lower levels of politicization. Here, Gazprom will find support in Europe. Clearly, Europe has not gained from the politicization of gas trade. A negative effect of the securitization of international energy governance has been, for instance, Russia's rejection of the Energy Charter Treaty, which the EU has pushed for two decades. This has arguably decreased predictability and planning security in international energy relations. And, in spite of differences on prices (which become again less relevant in the context of lower oil price), both the European gas industry and banking sector have an interest in Gazprom weathering the perfect storm.

For European regulators it might be worth considering infrastructure regulation, a concern voiced not only bay Gazprom but also the European energy industry. New pipelines entail long lead times, require a stable investment climate and will hardly be built based on a traditional pro-market regime coupled with rather arbitrary exemptions. Closer consultations between European regulators and the energy industry, including Gazprom, would help to depoliticize the context.

Still, it is mainly on Gazprom to take the right steps. Short of that, new spirals of gas trade politicization are likely to make security agendas dominate over the market logic, both in Europe and Russia. The result would be further demand destruction in Europe and even more unclear export prospects for Gazprom. It is on Gazprom to make the right choice.

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