

# South Stream Pipeline Viable, but Legally Risky

By [The Moscow Times](#)

December 16, 2013

**The**  **Moscow Times**

BRUSSELS/LONDON — Russia's South Stream pipeline project for transporting gas to southern Europe is economically viable, despite its price tag of \$45 billion, but legal issues with Brussels risk derailing the entire endeavor.

In a sign of the strategic but tense relationship between Russia and the European Union, state-controlled Gazprom this month opened a new office in Brussels, taking up two floors of a city center property.

In town for the opening, Gazprom deputy chairman Alexander Medvedev called in at the European Commission, the EU executive, and offered concessions to try to settle an EU investigation into charges it has priced gas unfairly.

The Commission has yet to decide whether the undisclosed measures are enough for Gazprom to avoid a multi-billion euro fine.

Despite the uncertainty and a host of other legal problems, Gazprom is pressing ahead with the massive South Stream route into southern Europe, which bypasses the traditional transit route through Ukraine and would have an annual capacity of 63 billion cubic meters of gas.

"South Stream would be profitable from day one. We expect to return investments during 15 years of its work," Gazprom said, adding that it would also provide "protection against the transit risks."

The 2,400-kilometer pipeline, which Gazprom says will be fully operational by 2018, would be able to supply almost 15 percent of Europe's annual gas demand.

Some industry sources question whether South Stream will be completed. They dismiss the project as part of Russia's grand-scale bargaining over influence in Ukraine or say that only a reduced version of it would be built if Gazprom could secure control over Ukraine's pipelines.

Yet Gazprom has already begun construction of South Stream, and the price starts to look less alarming when compared with the costs associated with shipment via Ukraine.

Feasibility studies carried out for Gazprom and seen by Reuters show that the cost of pumping Russian gas through South Stream would be 10 percent cheaper than sending it through Ukraine, which charges a transit fee.

Gazprom says it has found buyers for all of the gas that would flow through the pipeline, including customers for gas currently shipped through Ukraine.

Ukraine has been the focus of both EU and Russian anxiety for years, but especially since 2009 when a pricing dispute with Russia led to a cutoff of gas supplies to EU customers.

Russia has said it lost about \$2 billion during that three-week interruption of supplies.

Since then, Europe has sought new suppliers and to bring Ukraine into its orbit, while Russia has been building alternative supply routes to safeguard deliveries to its European customers, which provide 80 percent of its revenue.

Moscow has also succeeded in persuading Ukraine's government to maintain its political links with Russia, albeit it at the cost of popular protest. Brussels is continuing talks to try to persuade Ukraine to sign a partnership deal with the EU instead.

Nord and South Stream's combined capacity would all but eliminate Ukraine's role as the main transit route for shipping Russian gas to Europe, carrying more than 100 bcm per year at its peak.

### **Commercially Viable**

South Stream's total costs are comparable with Gazprom's annual profits and amount to about 10 times the annual transit fee through Ukraine, where huge investment also is needed to upgrade its aging gas infrastructure.

"If you look at the required cost to modernize Ukraine's pipelines and factor in the political

risk, then spending money to avoid Ukraine by building South Stream to cement your dominant position in your core market seems viable," one adviser to Gazprom said on condition of anonymity.

The documents say gas through South Stream could be marketed at an equivalent of \$9.50 to \$11.50 per million British thermal unit, or mmBtu, including a 30 percent export duty.

Those levels are comparable with expected prices for future Azeri pipeline supplies and U.S. LNG exports to Europe, and are cheaper than East Mediterranean gas expected to come to Europe toward 2020.

With the exception of Azeri gas, South Stream does not compete geographically with the new sources of supply.

U.S. LNG, for instance, is likely to go to markets with Atlantic access such as Britain, Belgium, and the Netherlands.

Meanwhile, Italy's Eni is trying to reduce its reliance on gas from unstable North Africa and is one of Gazprom's main partners in South Stream, along with France's EDF and Germany's Wintershall.

Italian Undersecretary for Economic Development and Energy Claudio De Vincenti in Brussels last week said Italy, as a supporter of South Stream, was willing to work as a broker between Gazprom and the Commission.

## **Legal Battle**

Analysts say Russia would be rash not to respect European law, and they see legal issues as the project's biggest risk.

Sympathy from individual EU member states, they say, is not enough, and bilateral agreements signed between nations along the pipeline route and Russia are no protection if they flout EU law.

EU rules, designed to promote competition, require a separation in ownership between energy suppliers and transit routes, meaning Gazprom would need a special exemption to ship gas through a pipeline it largely owns.

South Stream's defiance of EU anti-monopoly law has prompted a barrage of warnings from officials, who say it will not be allowed to operate unless it respects EU rules.

"If it goes ahead without an exemption, it is taking a major risk on issues such as tariffs and capacity allocation," said Jonathan Stern, chairman of the Oxford Institute for Energy Studies.

Nord Stream, Russia's already operating route into Germany that avoids Ukraine, applied for an exemption, the details of which are being finalized within the Commission.

Nord Stream, comprising two 27.5 bcm pipelines, was built by Gazprom and its partners E.ON, Wintershall, GDF Suez and Gasunie and delivered its first gas in 2011.

EU officials say South Stream's legal irregularities are a much bigger problem than the case of Nord Stream because of the number of EU nations that South Stream passes through and because Gazprom has yet to even apply for an exemption.

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