

Shutting Off Gas Supplies to EU Would Be Huge Blow to Gazprom

By [The Moscow Times](#)

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A specialist works in the main control center of Latvijas Gaze's underground gas storage facility in Incukalns, Latvia.

LONDON — The unspoken threat to leave Europeans shivering in the cold next winter may be Moscow's trump card in its confrontation with the West over Ukraine.

But for both technical and financial reasons, the world's biggest gas exporter would be badly hurt by any decision to cut off its main customers in Europe.

Twice in the past decade, Moscow responded to natural gas price disputes with Ukraine by cutting off supplies, affecting its European clients further down its pipelines. As tensions between the West and Russia have escalated in recent weeks, the EU has begun drafting emergency measures to brace itself for another potential energy supply crisis.

Only President Vladimir Putin can decide whether another cut-off will take place, sources

at Russia's giant energy monopoly Gazprom say. But they also say the company would face unprecedented difficulty if it were to cut supplies to Europe for a prolonged period of time.

For technical reasons, the gas has nowhere else to go but out to customers: It is impossible to severely scale back extraction volumes at Gazprom's giant fields in Siberia, nor could such huge amounts of gas be safely flared off.

On the financial side, Russia's second most indebted company would face big challenges in servicing its debt were export revenues to plummet. Economic sanctions against Moscow have already caused new lending to dry up, meaning Gazprom has little alternative besides steady income from exports to pay its day-to-day bills and the wages of its half million workers.

"Another gas cut would be a huge financial blow. But operationally it would be a disaster too. You just can't turn the taps on and off on the fields — it ruins them," one veteran Gazprom source said.

Another source at the firm said it could no longer easily absorb losses like those it sustained the last time its supplies were cut off to Europe five years ago.

"Back in 2009, Gazprom had all lending options in the world at its disposal and could lose a billion here and a billion there. Today the lending is shut so money will run out quickly."

A company spokesman said Gazprom wasn't working on a scenario for a potential supply cut: "Our focus is to continue stable gas deliveries to our customers."

Cuts

Gazprom supplies a third of Europe's gas and for many EU countries it is the main source of heat for homes and power for cities and industry.

Until 2011, when Moscow opened the new Nord Stream pipeline on the Baltic Sea floor, nearly all of that gas was pumped over Ukraine, leaving the supply to Europe vulnerable to disputes between Moscow and Kiev. Today, thanks to the new pipeline, only about half the gas for Europe transits Ukraine, but halting it would still be enough to cause disruption in peak cold months.

In January 2006, Moscow halted the flow over a price dispute with Kiev and accusations that Ukraine had stolen gas. The cut-off lasted for just a few days but prompted the European Union to accuse Moscow of using gas for political intimidation.

Three winters later, Putin personally ordered a second halt over the same issues. This lasted longer, resulting in a major drop or a total shut-off in gas supplies to most EU members for more than two weeks. It cost Gazprom over \$1 billion in lost revenues.

This year, when Ukraine's pro-Russian president Viktor Yanukovich was toppled in February, Moscow swiftly demanded a much higher price from Kiev for gas. In June, with fighting escalating between Ukrainian troops and pro-Russian rebels in east Ukraine, Moscow cut off Ukraine's gas, citing overdue payments at the higher price.

So far, through the summer season of reduced demand, cutting off Ukraine has not affected supply to Europe. Kiev has even allowed Gazprom's European shipments to continue to transit its territory, while burning gas stored in its own reserve tanks.

But with the cold months coming, little sign of agreement between Moscow and Kiev, Europe ratcheting up its sanctions against Russia, and Moscow running out of other ways to retaliate, some European governments clearly fear that Moscow could use the threat of a gas cut-off to exert leverage.

Despite the existence of the alternative Nord Stream route, the likelihood of a shut-off for Europe is still greater as long as Russia is withholding gas from Ukraine.

Moscow says it fears Ukraine, short of gas for winter, will start stealing from transit pipelines if it fails to reach a new deal. Kiev says Russia is planning to shut off Europe's gas and use allegations of Ukrainian theft as an excuse.

Europe has worked behind the scenes as a mediator, hoping to resolve the price dispute so Russian gas supplies to Ukraine can resume. But although the gas talks are officially separate from the conflict in Ukraine's east, it is hard to see how it can be resolved with the two countries on opposite sides of a war.

Limited Options

In the long run, Putin hopes to wean Gazprom off its reliance on sales to Europe by cultivating China as a new customer for natural gas.

In May, Putin presided over Gazprom's first big agreement with Beijing, to supply \$400 billion worth of gas over the next decades. But it will take at least five years to build a new pipeline for the shipments.

"Without this pipeline you won't know what to do with gas this winter if both Ukraine and Europe are cut off," one Gazprom source said.

For now, Gazprom's sales to Europe generate between \$60 billion and \$70 billion a year or 60 percent of its total revenues, with the rest mainly from domestic Russian customers and the former Soviet republics. The share of revenues from exports is rising as sanctions have driven down the ruble, reducing the value of domestic sales.

For now, Gazprom needs steady sales to meet expenses. Even though Gazprom itself has so far not been named as a target in Western sanctions lists, international lenders have already mostly cut off its credit.

Big U.S. fines this year against banks for thwarting sanctions elsewhere in the past have made financial institutions worldwide more reluctant to deal with companies in sanctions-hit countries, even if the firms themselves are not targets.

This week, the EU is considering extending a ban on raising capital in its markets — now applied only to Russia's state banks — to all Russian state firms, which would include Gazprom.

"Lending options are very limited. In addition to U.S. and European [banks], you now have Asian banks pulling back from lending. A lot of projects will have to slow down or stop," one Gazprom source said.

Gazprom requires annual investment exceeding \$25 billion to maintain its output levels, develop new Arctic fields, build new pipelines and gas liquefaction plants in the Pacific and the Baltic, and construct its vaunted new pipelines to China.

It generated a profit of \$33 billion last year, but with a total debt of around \$50 billion it has to divert a lot of resources on debt servicing.

Russia's other big energy firm, oil company Rosneft, enjoys tens of billions of dollars in credit lines from China. But since Gazprom will not be supplying China with gas for years, Beijing has not been as generous toward it with financing.

An initial plan under which Gazprom would get a \$25 billion prepayment has yet to materialize.

"It has been very quiet on the prepayment front," one of the Gazprom sources said. "China will not lend anything cheap."

Of course, whatever happens to its customers or its credit, Gazprom would be unlikely to go broke if Putin were determined to divert state resources to keeping it afloat. He has suggested lending Gazprom \$55 billion from state coffers to help fund the Chinese projects.

But since that suggestion was floated in June, many other contenders have stepped up seeking state funding from Moscow. Rosneft is looking for \$42 billion in aid.

Moscow's gold and forex reserves, the world's fourth largest, have already shrunk by \$42 billion since last year to \$466.9 billion, mostly due to Central Bank intervention to curb the ruble's fall since the Ukraine crisis erupted.

Even Russia, the world's biggest exporter of gas and second biggest seller of oil, has finite wealth. Ultimately, it relies on Gazprom to pay into the treasury not take money out.

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