Gas Politics Take Center Stage In Ukraine Crisis

Russia’s annexation of Crimea has renewed concerns in Europe about the future of an energy mix that relies heavily on what decision-makers on the continent see as a capricious regime in Moscow. Russia is by far the single largest supplier of gas to continental Europe and Turkey, providing 30% of all gas consumed, and a cessation of its volumes would pulverize an already hard-pressed economic recovery. Across the pond in the US, liquefaction advocates have seized on the Crimean crisis to push regulators in Washington to expedite export approvals as a form of energy deterrence to Russia’s geopolitical gas weapon. But political wrangling has so far left European gas markets untouched (see related article above). For Ukraine, there is almost certainly going to be a move away from Russian gas and further deterioration in economic and diplomatic ties with its powerful neighbor. Although this will not be easy, it could mean a renewed push for a maiden LNG import scheme in the Black Sea. For others in the Baltic trying to reduce Russian gas dependence, the crisis underscores the importance of already fledgling import projects.

Since the 2006 and 2009 gas crises, when Gazprom turned off flows to Ukraine in disputes over unpaid bills, the prospect of a sudden stoppage from Russia has hung over European buyers. Now the situation in Crimea has returned these concerns to the fore. Yet while Russia’s military entry and annexation of Crimea combined with saber-rattling from President Vladimir Putin towards critics in the West has the political world up in arms, the gas markets have remained sanguine. The UK’s National Balancing Point has barely budged since the start of the crisis. At $8.90 and $9.05/MMBtu, respectively, the prompt and the front month contracts are below levels prior to Russia’s Crimean adventure. While Russia does not directly supply the UK, markets in Northwest Europe are sufficiently connected that continental concerns would still feed through to NBP. Compared to early 2013, when temporary engineering problems with the UK-Belgium Interconnector and one of the Norwegian gas pipelines into the UK saw prices spike well above $20/MMBtu, markets have been remarkably calm.
Buyers have likely shrugged off the crisis as political posturing, and the fact remains that Russia has always been a reliable supplier of gas to a vast majority of Europe. The main argument that European gas users have with Russia is over contract structure and price, not the dependability of its volumes. So far, gas flows through the Ukraine pipeline network to Europe, and flows to Ukraine itself, have not been affected. Politics aside, Putin’s government is heavily dependent on hydrocarbon revenues to keep the state afloat. Stopping or drastically reducing exports to Europe would hurt Russia more in the long run than it would Europe. For its part, Ukraine has long been a difficult partner for Russia’s gas exports. For years, Ukraine siphoned off gas from the pipelines and prevaricated over its bills. Moscow has threatened to raise the price of gas to Ukraine because a discount Kiev received for letting Russia use the Crimean port of Sevastopol no longer applies. Russia claims its neighbor owes $11 billion in unpaid gas bills and Prime Minister Dmitry Medvedev says Ukraine owes another $2 billion to Gazprom and an additional $3 billion that it lent to Ukraine during a bail out last year.

Around 160 Bcm of Russian gas was sent to the European Union and Turkey last year. Around two-thirds of this could be diverted through non-Ukrainian network routes – Nord Stream, Yamal-Europe and Turkey’s Blue Stream pipelines. The diplomatic impasse between the two sides has halted talks on Gazprom’s proposed South Stream pipeline and on opening up the Opal pipeline in Germany, where limitations currently confine Nord Stream to just 70% of its operating capacity. In one way, not much has changed: European buyers remain over-dependent on Russia for their gas and are considering ways to find alternatives. But there is a new urgency to act, especially in eastern Europe. Alternative sources of supply are limited, however. North African gas exports are constrained by growing domestic demand. Azerbaijan’s Shah Deniz 2 will provide new supply through the Trans-Adriatic Pipeline into Italy from 2018-19, although less than 20 Bcm/y a year. Prospects for massive new inflows from Iran and Kurdistan are real – and still a long way off. In the short term, there is no reason for LNG imports to rise, given that pipeline flows through Ukraine are steady and local gas hubs have not risen. One observer suggests LNG exports could even fall further, if Russia attempts to show how reliable it is and softens contract prices or boosts pipeline flows.

The Baltic countries are already building their own terminals, so the import project most likely to be directly impacted is the one in Ukraine itself. Excelerate Energy signed a deal to supply a floating storage and
regasification unit to Yuzhny near Odessa in the Black Sea last year before Russian promises of cheaper pipeline gas drained momentum from the project – as was, no doubt, the intention. But there are now calls for the new government to fast-track the FSRU proposal once again, practically the only way for the country to source non-Russian gas. The possibility of reverse-flowing some gas from Europe east into Ukraine exists, although not in the necessary quantities or schedule Kiev needs. Sourcing affordable LNG and bringing it through the Bosporus will be challenging enough. And there could be more stumbling blocks. The preliminary deal was signed with the heavily compromised Yanukovych regime, and it was already moribund. It is uncertain whether the interim government has the mandate to move the project forward before elections in May, while Ukraine’s credit rating and foreign currency holdings have nosedived.

Washington backs the new leaders in Kiev, and advocates of a faster approval process for applications to the Department of Energy to export LNG to countries that do not have Free Trade Agreements with the US have seized the opportunity to make political hay. They claim expediting approvals would undermine Russia’s gas supply leverage against Ukraine. Tom Barrasso, a Republican senator from Wyoming, attempted to include an automatic LNG export approval from DOE for North Atlantic Treaty Organization countries plus Ukraine, which is not a member of the regional security alliance, in a Senate aid package. Barrasso’s proposal was shot down in the Foreign Relations Committee on March 12 before it reached a wider vote. Colorado Republican Cory Gardner introduced legislation that would broaden DOE’s threshold for automatic approval from just 18 FTA countries to the 159 nations participating in the World Trade Organization. “The turmoil in Ukraine underscores the problem with DOE’s unnecessarily sluggish LNG export approval process,” Congressman Fred Upton said in support of Gardner’s bill. Mary Landrieu, a Democratic senator from Louisiana, held a Senate Energy Committee hearing on March 25 with the topic of LNG exports taking center stage.

The hearing, the third this year on LNG in the upper house, occurred a day after DOE gave its blessing to the Veresen-sponsored Jordan Cove LNG project in Oregon for 6 MMt/y of non-FTA exports. Advocates pointed out that DOE can move relatively quickly when it is pressured to act, spurred on this time by calls for a political counterweight to Russia. It took DOE only 41 days to issue the order after Cameron LNG received its consent on February 11. But even if DOE granted licenses to all 20 plus applicants still waiting, it won’t change the timeframe for first LNG exports...
from the US. These will be sourced from Sabine Pass Liquefaction, which is under construction for commissioning at the end of 2015. The next two projects are aiming for startup in 2018 and 2019 and the US is not expected to be a substantial exporter until after 2020. DOE only mentions Russia once in the 158-page Jordan Cove order and this pertains to the country’s own LNG exporting ambitions. Instead, it stressed that the total amount of non-FTA capacity approved – now at 9.3 Bcf/d – is within the 6-12 Bcf/d band that would still return a net economic benefit to the country, pointing to evidence in the 2012 study undertaken by NERA Economic Consultants.

US-led sanctions on Russia have brushed up against one of the sponsors behind Yamal LNG in northwest Siberia. The US Export-Import Bank has retracted its interest in financing the project and abandoned a recent financial review. Its exit falls squarely on Gennady Timchenko, a 23% shareholder in Yamal’s lead developer Novatek, who appeared on Washington’s post-Crimea economic blacklist because of his direct ties to Putin. Timchenko also owned nearly 45% of Gunvor, the oil and LNG trader, but some timely financial dealings allowed him to offload this share to keep the firm out of the firing line. Ironically, the sanctions have emboldened Russia’s eastern energy push. Rosneft’s CEO Igor Sechin sought support in Tokyo this month for his firm’s 5 MMt/y Sakhalin 1 project with ExxonMobil, as well as additional oil and gas assets in Siberia. Sechin also teamed up with India’s Oil and Natural Gas Corp for future energy sales into the country. Gazprom said it aims to finalize the much-anticipated 38 Bcm/y pipeline gas deal with China in May, and continues to prioritize Vladivostok LNG in Far East Russia.

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