



BULLETIN

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Editors: Marcin Zaborowski (Editor-in-Chief) • Katarzyna Staniewska (Managing Editor)
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The “South Stream” Train Stops in the Balkans

Dariusz Kałan

The European Commission infringement proceedings against Bulgaria, in breach of EU law over the choice of constructor of the South Stream gas pipeline, shows the determination of the EU institutions in the implementation of anti-trust policy and the liberalisation of the energy market. However, even if Sofia—and also Belgrade—will move the start of construction, one should not expect that they will withdraw fully from this project. Also the commission has neither the will, nor the instruments, to completely stop South Stream, but it may still seek to change the terms of the investment, so that it is beneficial for the whole EU.

Bulgaria is the first country against which the European Commission has launched infringement proceedings, over the construction of a section of the South Stream gas pipeline. The 541 km connection, joining the Bulgarian Black Sea coast and the Serbian city of Zaječar, is a key part of the investment, and one of the most financially challenging. A terminal in Varna, three compressor stations with a total capacity of 300 MW, and a 59 km branch to a distribution hub in Provadia, which will supply Greece, Macedonia and Turkey, will also be built, in addition to the pipeline. The EC alleges that Sofia broke EU public procurement law in choosing its section's constructor without transparent procedures. After a six-month process, the tender, worth around €3.7 billion, was won by a consortium composed of Russian oil and gas company Sroytransgaz and a five Bulgarian firms, affiliated under the name Bulgarian Gazproekt Jug AD. The owner of the main shareholder in Sroytransgaz (63%), Volga Group investments, is Gennady Timchenko, who is on the U.S. sanctions list of oligarchs close to the Kremlin. The left-wing Plamen Oresharski cabinet has already announced its readiness to move the start of construction, scheduled for the end of June. This was due to pressure from both the EU and the U.S. (Oresharski made his decision after conversations with three American senators and the U.S. ambassador, who had earlier threatened to impose sanctions on firms cooperating with Sroytransgaz), and the junior coalition partner's threat that it would leave the government. Shortly thereafter, the possibility to suspend Serbia's part of the investment was mentioned also by some members of the government in Belgrade.

South Stream: A Long List of Legal Problems. The procedure against Bulgaria is associated with EU public procurement law, but the list of legal doubts regarding South Stream, the northern branch of which could deliver the gas from the Russian port of Džubga through the Black Sea to the countries of Central and Southern Europe from 2018, is longer. The EC has already pointed out that the project is inconsistent with anti-trust policy and EU energy market liberalisation rules (in terms of, amongst other things, violations of the principle of separation of transmission system operators and TPA rules). Therefore, in December 2013, the EC challenged the intergovernmental agreements signed by Moscow with the countries through which South Stream will pass; these contracts gave both parties a monopoly on the construction and use of the pipelines, and the exclusive right to determine tariffs. Due to the differences on this background the EC and Russia are in a legal dispute in the World Trade Organisation (on Russia's initiative, which indicates the superiority of international law over EU law). Proceedings against Bulgaria prove the intractable position of the EC, which thus widened the scope of its activities with completely new tools.

South Stream and the Crisis in Ukraine. After the crisis in Crimea, geopolitical doubts resounded, in addition to legal uncertainties. The annexation of the peninsula and engagement in separatist activities in eastern Ukraine have undermined the credibility of Russia as a predictable member of the international community, and helped to stiffen the

EC position. The EU Energy Commissioner spoke of the need to suspend investments in connection with the loss of confidence in Moscow, meanwhile the European Parliament adopted an amendment declaring that South Stream was unbeneficial to EU interests. The possibility to abandon the project was publicly considered by Italian company Eni, which besides Gazprom is the main shareholder in South Stream. At the same time, the EC has stepped up preparation of a new comprehensive strategy for energy security (this will be discussed at the European Council summit, 26–27 June). Russia's activity aimed, on the one hand, to undermine confidence in Ukraine as a reliable transit country (by threatening to introduce pre-payment terms on Kyiv, which, given of its inability to pay, would result in interruptions in the supply of gas to Europe), and on the other, to accelerate negotiations with EU Member States without participation of the EU institutions. By such means, Gazprom signed a memorandum with the OMV company in April, on the construction of the Austrian section of the pipeline in 2015.

The Interests of Bulgaria. The choice of Stroytransgaz also caused a stir in Bulgaria, among both the opposition, which demanded resignation of the Oresharski government, and the junior coalition partner, the Movement for Rights and Freedoms. Its leader has already proposed an early parliamentary election, which most likely will take place in autumn this year. However, even if there is a change in power in Sofia, a reversal in South Stream policy cannot be expected. On the Bulgarian political scene there is a factual consensus that not only is the pipeline needed but also that it can become a bargaining chip in negotiations with Moscow. The latter point was proved by the centre-right Boyko Borisov cabinet (2009–2013), which, although withdrawing from two key Russian projects (the Belene nuclear power plant and the Burgas–Alexandroupolis Transbalkan oil pipeline), subsequently supported South Stream, winning economic concessions in return (among others, a 20% reduction in gas prices). The eagerness of left-wing government was in turn so obvious that, in April, parliament discussed an amendment to the national energy law, to release South Stream from part of the EU legislation (the draft was suspended after the first reading). Previously, Gazprom had received tax relief, an option to determine tariffs, and the possibility for Russian companies to participate in the project. In August 2013, the EC pointed out that these points were incompatible with EU law.

Although South Stream has fostered already great dependence on Moscow, it is generally favourable for Bulgaria, as it allows the diversification of gas supply routes (currently 100% of Bulgaria's gas is provided via Ukraine) and strengthens the strategic position of the country as a regional transit hub. After the failure of Nabucco, Sofia was left with no alternative means of breaking Russia's monopoly. Neither the planned interconnectors with Romania, Greece and Turkey (prepared rather for emergency situations), nor an early stage project to purchase gas from Azerbaijan, can strengthen the country's energy security in the short to mid-term. South Stream will also bring benefits by creating about 7,500 jobs, and for energy companies, including the largest in the region, Lukoil's Neftochim petrochemical conglomerate, which controls the domestic refining industry. Preferential conditions proposed by Moscow (including credit for 22 years to cover 30% of Bulgaria's contribution at 4.5% interest, repaid from transit fees), helped to solve the problem of financing the project. Bulgaria may also receive further gas price reductions.

Conclusions. Disputes not only between the EC and Russia, but also between the EC and the Member States show, on the one hand, the determination of the EC to implement the EU liberalisation law, and, on the other, the effectiveness of Russia's divide and rule strategy, which involves bilateral talks with individual countries without the involvement of the EU institutions. Also, even if Serbia decided to suspend construction of its section, it is not expected that any of the countries in the region will withdraw fully from this project. For many of the Central and Southern European states that are dependent of Ukrainian transit, and which were affected to varying degrees by the 2009 gas crisis, South Stream remains the only real opportunity for diversification of gas supply routes. Governments thus prefer to increase the predictability of supplies at the cost of continuing energy and economic (also political) subordination to Russia. This perception will rather not be changed by EC warnings, or by the conflict between Ukraine and Russia. The latter has shown that the primacy of economic interests is more important than long-term geopolitical reshuffles, and this is why the region has generally distanced itself from EU sanctions, as well as from the Polish idea of an energy union.

The result of the EC procedure against Bulgaria will be a precedent and a reference point for further activity of the EU institutions. The EC has neither the will, nor the instruments, to halt construction of South Stream completely, but can try to change the terms of investment, so that it is beneficial for the whole EU, and remains in line with EU legislation. Therefore, despite the possible resistance of the big EU countries, whose companies are involved in the construction of the pipeline, the EC should continue, on the one hand, to mobilise Member States through the instruments of anti-trust law, or, at a later stage, the third energy package, while on the other hand putting pressure on Russia to renegotiate its intergovernmental contracts. Ongoing legal disputes also work to Moscow's disadvantage, because it is forced to bear the additional costs. Although the EC has to be prepared for a confrontational response from the Kremlin (the threat to limit gas supplies via Ukraine, or extension of the third and fourth lines of Nord Stream) due to its political and economic weakening by the Ukrainian crisis, the current restrictive policy should be maintained, even after the formation of the new EC.