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Strategy's implementation**

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The South Stream project, first hurdle of European Energy Security Strategy's implementation

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On June 24, 2014, Austria's OMV and Russia's Gazprom sealed a deal for building the Austrian branch of the controversial South Stream² project. This agreement was signed just two days before the European Council meeting which took into discussion the European Energy Security Strategy, which calls for the suspension of South Stream. The European Commission succeeded in halting the work on South Stream's Bulgarian section by launching infringement proceedings against Bulgaria on the grounds regarding the breach of internal market rules. The outcomes of OMV-Gazprom agreement are significant, as on short run the deal considerably restrains the European Commission's room of manoeuvre towards South Stream and on medium- and long run can take Ukraine out of the European energy game and prevent the developing of the Southern Gas Corridor.

European Energy Security Strategy calls for South Stream's suspension

On June 27, 2014, the European Council discussed the European Energy Security Strategy (EESS), which was drafted by the European Commission one month before. The European Council welcomed the EESS in its official conclusions and asked the Council of the European Union (EU) to further analyze other measures to enhance EU's energy security, based on EESS. An integral part of the 2030 policy framework for climate and energy³, the EESS proposes actions regarding the completion of internal energy market and acceleration of

¹ Note: This paper represents the views of the author, not the position of The Center for International Relations Studies (CEFIR).

² With a total length of 2,500 km, the South Stream pipeline is going to become operational at end of 2016 and to achieve full capacity at the end of 2018. The pipeline will have an offshore section (running 900 km under the Black Sea waters, through the exclusive economic zones of Russia, Bulgaria and Turkey) and an onshore section, which will cross Bulgaria, Serbia, Hungary and Austria. The project may cost nearly 16 billion euros and it is projected for an annual capacity of supply of 63 billion cubic meters. The project's stakeholders are: Gazprom (Russia: 50 percent share), Eni (Italy: 20 percent share), EDF (France: 15 percent share), Wintershall Holding GmbH -BASF Group (Germany: 15 percent share). South Stream bypasses Ukraine, which opposes the project, because it will lose its status as main transit country of Russian gas towards Europe. Ukraine proposed Russia to build South Stream through its territory instead of Bulgarian territory, arguing that this decision would make the pipeline five times cheaper than the current price. Once fully operational, the South Stream project will substantially reduce the volume of the gas transported through Ukrainian gas-transport system, which will lessen the prospects of country's gas-transport system modernization and will considerably lower Ukraine's gas transit revenues.

³ COM (2014) 15.

interconnection targets⁴, the diversification of supplier countries, the increasing of energy efficiency and indigenous energy production, the developing of new solidarity mechanisms for natural gas and gas storage facilities. Welcoming the calls for an Energy Union⁵, the strategy calls for “speaking with one voice in external energy policy”⁶. The EESS emphasizes also that Member States should inform each other and the Commission prior of defining and adopting national energy policies and strategies as well as intergovernmental agreements with third countries, as those agreements must be fully compliant with EU legislation. In this regard, the EESS states that “the South Stream project should be suspended⁷ until full compliance with EU legislation is ensured and re-evaluated in light of the EU’s energy security priorities”⁸. The necessity of compliance with EU’s market and competition rules for significant energy infrastructure is stated in the aforementioned European Council conclusions as well. However, unlike EESS, the European Council conclusions do not explicitly mention the South Stream—most likely for strategic and political reasons. Though, the document does make an indirect reference, as it states about “relevant energy infrastructure investments, including those involving third countries”⁹.



European Council meeting, June 27, 2014. Credit: Photographic Library of Council of EU.

⁴ Currently, the average interconnection is nearly 8 percent. The European Commission aims to extend the interconnection at 10 percent by 2020 and 15 percent by 2030.

⁵ In April 2014, Polish Prime Minister Donald Tusk sets out, in an article published in Financial Times, the blueprint of EU’s Energy Union. Tusk’s proposals referred to developing mechanisms for jointly negotiating energy contracts with Russia, guaranteeing solidarity among Member States and building energy infrastructure for breaking the dependency on Gazprom as single supplier of at least 10 EU’s Member States.

⁶ COM (2014) 330, p. 17.

⁷ In December 2013, the European Commission already had announced that the intergovernmental agreements concluded for the construction of South Stream between Russia, Bulgaria, Serbia, Hungary, Greece, Slovenia, Croatia and Austria are not in the compliance with EU law and should be re-negotiated.

⁸ COM (2014) 330, p. 20.

⁹ EUCO 79/14, p. 9.

The internal market rules succeeded in halting the Bulgarian section of South Stream

The European Commission succeeded in influencing to suspending the construction of Bulgarian section of South Stream on June 8, 2014 after a series of warnings were previously addressed to Bulgarian government. Moreover, on June 2, 2014, the Commission launched infringement proceedings on the grounds that internal market rules, particularly those related to the procurement, were breached. The Commission's concerns regarded mainly the procedures under which the South Stream's construction was awarded¹⁰. Though, the government ordered the suspension of the South Stream's construction only after a meeting in Sofia between the Prime Minister Plamen Oresharski and three American senators: the Republicans John McCain and Ron Johnson and the Democrat Christopher Murphy.

Prior to that, on April 4, 2014, the Bulgarian parliament helped the South Stream project to circumvent the EU legislation by passing amendments to the Bulgarian Energy Law which redefined South Stream not as pipeline, but as "gas grid interconnection" and stated that the offshore pipeline section entering Bulgaria's territorial waters is not actually "crossing European territory". Those legislative artifices aimed at avoiding the obligation under EU's "Third Energy Package"¹¹ of providing third-party access to the South Stream project.

Bulgaria has one month to answer the European Commission's concerns regarding the breach of internal market rules. Given the US sanctions faced by Sroytransgaz Company, the government in Sofia has only one option left out: that of taking into account the European Commission's concerns. Most likely, a new bidding for the construction of South Stream's Bulgarian section will be re-launched but that will not prevent Gazprom of controlling the South Stream project in Bulgaria-and eventually blocking third-party access to the project- unless the aforementioned legislative amendments will be removed.

Nevertheless, despite European Commission's opposition towards the South Stream, the project received an important political impetus from Austria.

"No one tells me why ", says Austrian President

On June 24, 2014, Russian President Vladimir Putin paid a one-day visit to Vienna, invited by Austrian President, Heinz Fischer. The same day, the Austrian OMV and Russian

¹⁰ The South Stream Bulgaria, a 50 % - 50 % joint venture between the Bulgarian government and the Russian Gazprom, announced, on May 27, 2014, that the bidding procedure for the construction of Bulgarian branch of South Stream was won by Sroytransgaz consortium. The consortium is made up by two companies, Russian Sroytransgaz and Bulgarian Gasproekt Jug. Sroytransgaz is controlled by billionaire Gennady Timchenko, a close ally of Vladimir Putin. Following Crimea's annexation, several companies owned or controlled by Timchenko-including Sroytransgaz Holding and Sroytransgaz Group- are subject of US sanctions.

¹¹ COM (2007) 529.

Gazprom sealed the deal on South Stream by agreeing to create a 50%-50% joint venture company which will build and operate the 50-kilometer of pipeline's Austrian section. The Austrian branch of South Stream is set for commissioning late 2016 and its annual transport capacity will be up to 32 billion cubic meters.

The deal between OMV and Gazprom was concluded two days before the European Council meeting which discussed the EESS. In Vienna, though, the realpolitik calculations prevailed upon the European Commission's concerns and aims. "No one can tell me why... a gas pipeline that crosses NATO and EU states can't touch 50 kilometres (31 miles) of Austrian territory"¹², said the Austrian president, whereas Vladimir Putin put the blame for South Stream's difficulties on "our American friends...(who) want to supply Europe with gas themselves. They do everything to derail this contract..."¹³. It's difficult to say whether or not Austrian government had informed EU's Member States and European Commission, as the EESS puts forward, prior to decide on going ahead with the South Stream project. But it is not difficult to assess the consequences of such decision.

Consequences of Austria's decision

Firstly, Austria's decision puts the European Commission in a difficult position, as it significantly restrains its room of manoeuvre for asking not only the re-negotiation of inter-governmental agreements linked to the South Stream but the project's suspension itself. Secondly, at least on the short run, it makes the EESS's calls for speaking with one voice in external energy policy and for coordination of Member States' energy policy decisions and strategies a dead letter. Nor it will help reducing EU's energy dependency on Russia as a whole and of some Members States in particular¹⁴.

Thirdly, by going ahead with the South Stream project, Russia will significantly decrease the volume of gas transited through Ukraine from 82 billion cubic meters¹⁵ yearly to up to 20 billion cubic meters yearly. That will not only cause considerable losses related to the transit gas revenues which will further affect country's economic stability, but it will reduce Ukraine to a marginal status within the European energy game.

¹² DEUTSCHE WELLE, "Austria defies US, EU over South Stream during Putin visit", *Deutsche Welle*, June 24, 2014.

¹³ *Ibidem*.

¹⁴ Bulgaria, Estonia, Latvia, Lithuania, Finland, Slovakia are wholly dependent on Russia for their gas imports. The Czech Republic and Austria also heavily depend on Russian gas supplies. Currently, EU imports nearly 65% of its overall gas consumption; about 39 % of gas imports came from Russia.

¹⁵ In 2013, Russia exported to the European market 155 billion cubic meters of gas. 82 billion cubic metres of Russian gas exports were transited through Ukraine.

Fourthly, it is still unclear if and to which extent the newly created OMV-Gazprom joint venture will comply with EU's "Third Energy Package" and will provide third-party access to the Austrian section of South Stream project.

Last but not least, the South Stream project has a strong and crucial geo-economic stake. The opening of a new outlet for Russian gas supplies will make further obstruction to the development of Southern Gas Corridor- already hurdled by numerous geopolitical and infrastructure obstacles-which, ultimately, will prevent EU to diversify its external energy supplies.

A first significant hurdle in EESS's implementation, South Stream also represents a serious test for EU to attain some specific objectives in the energy field.

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