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BECOMING AN ENERGY GIANT: AN OVERVIEW OF GAZPROM EXPANSION INTO EU ENERGY UTILITIES AND NETWORKS SECTOR

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ABSTRACT

The paper offers an overview of the Gazprom expansion into European market of utilities, power generation, and energy networks – the most recent and most debated tendency of the gas giant. This expansion is a long-term commitment of Gazprom investment into gaining full-scale access to the end use customers across EU and Eastern European countries supported by the established partnerships with largest German, Italian and French gas companies. The main focus of the paper is to provide an analytic outline of contemporary dynamics of these tendencies, to show the most heated points as they are being discussed in the EU and USA. Attention is also given to the existing situation of EU gas supply and distribution as they relate to the ongoing debate on restructuring EU energy market along the Energy Charter. Final sections of the paper contain discussion on potential short- to mid-term scenarios and discussion of the most likely challenges that Gazprom will encounter in implementing its expansion strategy in Europe as well as solutions, alternatives, and business models with which to address the challenges.

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1. INTRODUCTION

One of the most interesting companies on today's world energy stage is Gazprom. In 2005, Alexander Medvedev – one of its public top-managers – stated the company's strategy for the upcoming decade is not only being a gas giant, which it was already but "to become the largest energy company in the world" (Gazprom 2006). Quite an ambitious goal, to which Gazprom started moving quickly ever since.

Relatively young Russian companies have launched a massive offensive of mergers and acquisitions in the markets that have long been dominated by European and US capital. While in the CIS and Eastern Europe, their interest and financial successes have been seen as quite reasonable, given the long standing tradition, proximity, and ties that has been developed during the post WWII era. Western European heartland countries, such as France, Italy, UK, and others have long been seen as a last resort of true capitalism with Western-originated money.

As it looks now, this is not true anymore. The last 5 years have seen a dramatic rise of Chinese, Indian and Russian capital movement into Western Europe and North America, not only in terms of goods and services, but what is more important, in terms of acquiring US, EU-rooted, large, and long-established corporations.

Gazprom strategy has evolved significantly over the last decade. The main difference has been visible particularly during the Vladimir Putin administration when Gazprom was first, secured as a state-controlled company and given the monopoly to manage all gas transmission networks, and second, when it has been destined to perform with the mainline political line, which has been concerted by the state administration. As a result, Gazprom moved from a prominent gas supplier to a key global energy market player which has visible support from the state.

European Union's strategy over gas has been shaped significantly by the recent gas conflicts, which took place in 2005 and 2006 between Gazprom and several neighboring countries – Ukraine and Byelorussia, that have – since the dissolution of the Soviet Union in 1991 – long enjoyed heavily subsidized gas prices. The most important thing is the fact that these two countries serve as key transit states for Gazprom gas and during the dispute; several Western European countries were impacted. This raised serious concerns in the EU regarding security of supply and stability of gas shipping from Gazprom. The main accent of following debate has been to alleviate dependency on Gazprom and Russian gas by promoting alternative routes of gas pipelines as well as looking to alternative sources of energy.

The aim of this paper is to first, outline the major trends and facts in Gazprom movement from a supplier company to energy multinational, which seeks to establish European presence not only in terms of long-term gas supply contracts, but expanding its ownership to downstream assets such as the distribution networks, electricity generating utilities, et cetera. Secondly, I would like to explore the general reaction and response from EU companies, authorities, and general business media and public towards such a movement.

It has, for a long time, been a tradition that EU and US business to seek targets in other countries. We are now seeing a returning movement towards large-scale investors from resource-rich regions coming to developed markets, such as EU, willing not only to buy, but also to establish a long term business and gain direct customers for their products. Gazprom may serve as quite an outstanding example of such strategy, supported by the originating state.

2. CURRENT STATE OF EU GAS DISTRIBUTION NETWORKS IN WESTERN EUROPE: AN OVERVIEW

The current state of gas distribution networks in EU is characterized by a mainstream tendency toward deregulation and liberalization, which provides a potential for both domestic and foreign investment in developing infrastructure and networks. For a long time, the energy sector has been – and still is – considered to be too important to sell it out to the unpredictable market dynamics (Eurogas 2006; Honore 2004; Mahan 2005, 2006).

Examples from Anglo-Saxon economies, such as the US, UK, Australia and Canada has shown that the process is far from easy and often brings about crisis (Eurogas 2006). Deregulation, however, is the main goal of EU strategy to ensure that effective competition exists on the energy market, traditionally considered strategic state asset. Regulation certainly stays in the picture as the state continues to implement rules and laws on the energy environment.

The changes that are being considered concern the value chain and its players. Instead of one integrated value chain state-controlled or unilateral monopoly, array of competing companies across sub-sectors of respectively: production-transmission-distribution-storage-marketing, come into play. To be more specific the chain of production in terms of how EU sees it is this:

> **Gas Production** – which can be further broken down into the exploration, drilling, extraction and processing of gas. A few OECD countries import gas in liquid form (known as LNG), which is subsequently re-gasified and distributed by a pipeline network.
> **Gas Transmission** – the high-pressure transportation of gas to high-volume customers such as distribution companies, large industrial customers and power stations.
> **Gas Distribution** – the low-pressure distribution of gas to small and medium-volume gas customers.
> **Gas Storage** – the smoothing of the flow of gas through the transportation network by pumping gas into holding facilities at off-peak times, and withdrawing the gas at peak times.
> **Gas Retailing or Marketing** – the provision of services of contracting with production, transmission and distribution companies on behalf of gas customers and associated billing and metering services.
> (OCDE 2000)

Each of the components is equally important to the overall gas business, which is often compared with electricity and railroads because of its major transmission route – the pipeline.

Returning to the liberalization of EU gas market, the ultimate goal of deregulation is to decrease costs and improve economic performance. Analysts indicate several forms of liberalization/deregulation:

- Privatization
- Introduction of third part access to gas supply infrastructure
- Demonopolization of regulations / laws

> **In the European Union**, governments are revising the regulatory framework of their gas industry, in the context of the EU Natural Gas Directive 98/30 on gas market opening. The Directive establishes some common rules for the transmission, distribution, supply and storage of natural gas. The gas market is to be opened to competition progressively, during a 10 year period, to reach in 2008 at least 33% of total gas consumption. The first stage had to be implemented by 10th August 2000, opening the markets to competition for consumers representing at least 20% of the gas market. Degrees of liberalization vary among countries, being United Kingdom the most liberalized market and France the least liberalized one, as for June 2001 (UNCTAD 2007).

Most of the EU countries have just started the process so ownership status has not changed significantly yet. The majority of transmission networks belong to the domestic companies or state monopolies, which will very soon change in light of new legislation introduction.

The UK has been always seen as a successful case for de-regulation of the gas market and unbundling of gas supply, transportation, marketing, etc. of the gas value chain to optimize the use of network. The UK gas unbundling, however, has been recently analysed and convincingly debated and counter-argued by SERIS research (2006). Centrica, the largest gas transmission network, and formerly integrated part of British Gas is at the center of this argument (also has been a target for potential takeover from Gazprom or Gaz de France). SERIS found that:

> **Full ownership** unbundling of British Gas which involved (a) the demerger of the previously internally unbundled supply function into Centrica plc in 1997, and (b) the demerger of transportation into the Lattice Group in 2000, was not driven by the objective of 'optimizing the use of the network' but by purely commercial considerations.

> **The empirical evidence** of full ownership unbundling in the UK does not support any assertion that gas network ownership unbundling 'significantly changes the behaviour of the transport undertaking' or that 'a fully unbundled Transportation System Operator will focus on optimizing the use of its network.' (2006)

Among the key vectors in EU gas policy on internal markets has been the so-called Energy Charter, which promotes competition between the players and places limitations on ways in which gas producers may go into monopolizing the chain of gas production-distribution-marketing. Main objectives of energy policy as indicated in the Energy Charter signed by most EU countries include: «*economy, security of supplies, environmental compatibility, quality control and consumer protection. There is a policy move in many countries to encourage a greater use of natural gas within the total energy mix. Environmental and security concerns may result in legislation encouraging an increasing use of natural gas because of its clean-burning properties in relation to other fossil fuels. Natural gas plays an important role for energy diversification*». (UNCTAD 2007)

Natural gas policies are also needed to promote investment and development of natural gas supplies, to facilitate construction of natural gas infrastructure and to develop domestic and cross-border natural gas transport as well as markets for natural gas products and services. Main argument of the energy policy of EU is:

> - **most electricity users** cannot switch to gas in the event of a drop in the relative price of gas;
> - **natural gas** is almost always transported from the point of production to the point of consumption over a pipeline network. There is a scope for competition in transmission pipelines, depending upon the density of the network and the physical location of gas producers and gas consumers. In most cases there is also significant scope for competition between gas producers.
> - **allowing competition** between gas producers (and between transmission pipelines, where possible) enhances incentives for efficiency in production and enhances the quality of the regulation of the pipeline network.
> - **where rival gas producers** are ensured access to an existing pipeline network, there must exist a system for rationing the capacity of the network at peak times. This could be achieved through a system of peak-load charges for the use of the network, but in practice it is often easier to auction the capacity of the network at peak times.
> - **in the case of a country** which is highly dependent on imports from a single foreign supplier unilateral liberalisation might remove a countervailing power, enhancing the market power of the foreign supplier, to the detriment of domestic consumers (OCDE 2000: 19).

There is a certain level, at which the unilateral liberalization can be done, since there are other markets, except for EU, which suppliers can chose to switch or a direct dealing by supplier and a single EU member (Germany, France, Italy, Denmark, etc.) which imports gas and wants guarantees of stable supply based on long-term contracts. There is also a joint venture approach but this is only possible on political grounds since most suppliers regard their oil and gas capacities as strategic resource that is heavily regulated in terms of foreign investment and possible format of involvement.

3. CURRENT POSITION OF GAZPROM IN EU

Gazprom has been supplying gas to EU countries for several decades. First as the USSR Ministry of gas and lately as a state-controlled open joint stock corporation Gazprom. Most volumes of gas are going to Eastern and Central European countries; however, several projects that have been undertaken by the company in the recent years show clear signs of expansion towards the Western part of the continent. Among the most visible ones are Blue Stream to Turkey, which will be extended to southern parts of the EU, as well as Nord Stream which is destined to supply gas directly to Germany, with possible extensions to Denmark and Scandinavia.

Despite the obvious task of secured and continuous supply of gas to its existing customers at home and abroad, Gazprom's short- and mid-term strategy includes development and further launching of new gas fields in the far North and offshore fields such as Shtokman. The main long-term strategy is highlighted by the ambitious goal of becoming global energy (note, not only gas, but 'energy') company, - "a global energy leader, providing secure deliveries of natural gas and other fuels and raw materials to the world and domestic energy markets as well as promoting the Company value growth in the long term" (Gazprom 2007).

Most of the new gas fields that are accessible in short- to mid-term range are those located in the Yamal peninsula, namely Zapolyarnoye field as well as the Aneryakhinskaya and Kharvutinskaya areas of the Yamburgskoye field, both of which are promised to be online by 2010. Other fields include those nearby the ones being exploited already (Yuzhno-Russkoye field, Valanginian deposits of the Zapolyarnoye and Pestsovoye fields, Achimov deposits of the Urengoyskoye field). All of these fields will utilize the infrastructure already built for larger fields in the vicinity. The second line of strategy is to utilize and secure as much of Central Asian gas as possible. This will allow Gazprom to optimize investment flow going to development of new fields in the North while maintaining volume of gas supply. Among other potential direction Gazprom claims:

- Setting up an integrated gas production, transmission and supply system in Eastern Siberia and the Far East
- Exploiting Russian Arctic shelf resources
- Exploiting hydrocarbon resources abroad
    - Uzbekistan
    - Kazakhstan
    - Turkmenistan
    - India
    - Vietnam
    - Iran
    - Venezuela
- Investments in power generation (Gazprom Business Strategy, in Gazprom 2007)

Conventionally, it is possible to speak of four groups of potential expansion of Gazprom business in the world. First is to reunite or re-establish its networking and extraction-supply chain on the outdoors of former Soviet Union to ensure stable and growing customer supply for both domestic and international sales of gas volumes. This includes Ukraine, Belorussia, Armenia, and Near-Caspian states. Securing and reinforcing the Turkmenistan gas deal is a key to the process.

Second is the process of acquisitions in Eastern Europe and expansion of existing traditional markets it has in Western Europe. This includes long-established partners in Germany, France, France, and Finland, which already are in part influenced by Gazprom business. Third is expansion into new markets and market segments in EU countries as a whole. In other words, buying up downstream assets across EU and participating in building new pipelines in Western and Southern Europe

Fourth is expansion into the new global markets that Gazprom has never been to such as the Middle/Near East, Far East, South America, and Africa. This investment has high potential given the recent dynamics of business.

Discussing first two groups is a key to understanding the Gazprom strategy in downstream assets acquisition in EU. Central Asian gas from former the Soviet republics of Turkmenistan and Kazakhstan constitute the essential part of internal Russian Federation consumption, which allows exporting much of Russia's own gas to the EU to take advantage of higher prices. Ukraine and Byelorussia serve as important transit states through which pipelines to the EU lay. This format of transit is commercially and politically secure in three possible scenarios:

1. Pipelines belong or are being controlled by Gazprom,
2. Transit countries are very stable politically, economic allies of Russia and are favorable to Gazprom,
3. Gazprom has alternate routes to export gas without being entirely dependent on potential political and economic turmoil in transit countries.

Therefore, to resolve this task Gazprom - although certainly relying on heavy support from the state in necessary cases – similar to other large companies in the world of big business and politics (let's look into Dick Cheney and American oil corporations or BP and its relations to UK political and economic elite) – cannot rely on scenario number 2. It can only survive as viable and reliable multinational company in scenarios 1 and 3. Naturally, these come into conflict of interests with both transit countries (see Osipov 2007b) as well as developing EU energy politics that emphasize competition and alternative routes of fuel (both gas and oil) supply.

Once Gazprom established effective management in the beginning of 2000 and received unequivocal support from the official administration, the company started expansion into the external market. It is important to understand though, that this expansion has been in line with the general business scenario which is actively progressing across the globe. Enlargement of companies, mergers and acquisitions has been the case in resource industries everywhere due to rapid globalization. Small firms give space to larger vertically oriented corporations. In these terms, Gazprom has little choice but to follow the logic of globalizing business, similar to its rivals in North America, Europe, China and India as well as other markets. Recent analysis from the Economist Intelligence Unit on the rapid expansion of Russian business on the global scale indicated that

> **The rapid rise** in Russia's outward investment is driven in part by global consolidation pressures, which are especially strong in the natural resource industries and the telecommunications sector. "We have to participate in the process of acquisitions, or else we will be reduced to a minor player in our industry," says Severstal's Mr. Veraszto. "We are either going to be an active acquirer or will be acquired. We decided to be the acquirer." … During the Soviet era, Russia's huge state-owned enterprises acted much like vertically integrated multinationals, enjoying almost complete control of the supply chain across the network of satellite states… As a result, one of the major challenges facing Russian companies ever since transition began has been how to restore the value chain and how to find new markets to utilise their vast excess capacity. The energy companies quickly moved abroad to restore their markets and improve their pricing power, taking control of distribution channels across the CIS and Eastern Europe. Indeed, until 2000, Gazprom and Lukoil, accounted for around 90% of Russia's assets abroad (RUSAL 2006).
>
> **"Russian companies** in the energy and metallurgy sectors have used up growth opportunities at home," says Rusal's Mr. Bulygin. Global acquisitions are now part of a complex strategy of securing raw materials, expanding capacity and opening up access to new customers. Two significant constraints on export growth have also encouraged large Russian companies to also encouraged large Russian companies to invest abroad. First, they face far higher barriers to trade in developed markets than the major global players due to Russia's continuing economic isolation. Although talks are ongoing, the country is still not a member of the World Trade Organisation (WTO), and companies are hampered by quotas and antidumping restrictions from expanding rapidly in the lucrative EU and US markets. The best way to bypass those is to acquire strategic assets in the countries they export to. Secondly, Russian companies were generally stuck at the bottom end of the market, making low-price, low-tech commodities. The fat margins were going to foreign companies, which focused on processing or delivering Russian export commodities to upper end producers (RUSAL 2006).

Moving ahead with its strategy Gazprom has done several steps:

1) Created (or is creating) possible alternative routes (Blue Stream, Nord Stream) directly to large consumers eliminating the "middleman" factor
2) Instead of having middleman and a single consumer at the end of the pipeline, Gazprom is negotiating storage and distribution "hubs" across EU. In return, countries that are becoming such hubs provide the company with direct access to the distribution networks.

Most of the news related to the Gazprom investment have been spread during the last two years (2006-2007) with most of the acquisition news related to this year. The hub strategy has been tested twice – first has been the Nord Stream project which is under active development. The hub will be obviously Germany. Second has been recent news from Belgium, where in March 2007 Gazprom has been offered a potential deal (Socor 2007).

Belgian Prime Minister Guy Verhofstadt indicated that he would have "no objection if Gazprom should decide to acquire infrastructure from the Belgian gas distribution company Distrigaz. We are structuring the market so as to avoid unhealthy monopolies. Liberalization and diversification are key today, and this does not depend on the presence or absence of Gazprom or any other company," Verhofstadt told Interfax in Moscow:

> **The French energy company Suez**, controlling owner of Belgium's Distrigaz, faces a requirement by EU competition authorities to divest itself of Distrigaz as a consequence of the Suez-Gaz de France merger. Thus, parts of Distrigaz will be up for sale and Gazprom is a likely buyer. The other big distribution company in Belgium, Fluxys, plans to team up with Gazprom to build a large-capacity underground gas storage site at Poederlee for distribution of Russian-delivered gas to Belgium and nearby countries. From the perspective of Gazprom's expansion plans, Fluxys is attractive due to its direct links with the pipeline networks of several West European countries. Moreover, the project envisages laying a pipeline on the seabed of the North Sea from Zeebrugge in Belgium to Britain for Gazprom (Socor 2007).

Belgium currently consumes some 16.5 billion cubic meters of gas annually. Gazprom first entered the Belgian market in 2006 with a small volume that will likely grow rapidly through these projects. Using a tactic it has recently tried in Hungary and Germany, Gazprom offers to make the targeted country a "regional hub" for storage and transit of Russian-delivered gas, demanding portions of the would-be "hub" country's infrastructure in return for that favor. (Interfax 2006a)

3) Generated mergers and business partnerships (on a shareholder basis) that can lead to entering new markets by building new pipelines or entering as a shareholder in the existing pipelines.

This latter strategy has not been easy for Gazprom. First of all, the EU has now moved quicker to make its energy-related anti-monopoly legislation (neobxodimym) for all countries. One of the clear signs of uneasy entrance into the EU market have been the statements from European Commission on plans to force the Russian gas giant to sell its gas transportation network. This will fall into the mainstream direction of unbundling gas transport and sales companies. The reference is towards a

BASF and Gazprom's joint venture Wingas that owns a large number of German gas networks. (Interfax 2006b)

Similarly, the UK has also pulled the trigger on Gazprom's interest towards Centrica, which owns the largest distribution network with millions of customers in the UK. The BBC reported that "any moves by Gazprom towards Centrica would face "robust scrutiny" since "security of energy supply to the UK's consumers is paramount". Meanwhile, Gazprom entered the UK market by acquiring a small gas distribution and marketing company PNG (BBC 2007b) and has just purchased another small gas related company, which resides next to PNG in the same office building. The aim of the acquisition is, most likely, an acquaintance with UK gas market.

Several other countries have expressed their interest in striking direct deals regardless the empty political claims for the united EU and US position on 'diversification' and 'unity' in all energy matters – Denmark and France concluded contracts until 2025-2030 for gas supply to their customers, which provides Gazprom a necessary ground for potential investment into the utilities and transmission business, once a credit history is established. Gaz de France is a long standing partner for Gazprom. (BBC 2006)

Making its way into other energy sectors such as generation is also a target, (another reason is that electricity can be generated with Gazprom's gas, which in some parts of the world represents clear commercial sense, especially in the absence of middleman in gas supply to the generating facility). Soteg SA, a Luxemburg company, and Gazprom struck a deal to build an 800 Megawatt electricity generating facility in Eisenhuttenschtadt. Investment will be nearly 400 million USD and the facility will be able to sell electricity across several EU states, given the optimal location on the borders of several EU member states. Most of the proposed electricity will be sold to long-term industry contracts and the rest will be distributed by SOTEG and Gazprom UK arm Gazprom Trade and Marketing. (Tsyrlina 2007a).

Together with finding bids in Europe, Gazprom continues thoroughly gathering gas-related assets across former Soviet Union – which was once a united gas system crossing all 15 republics of USSR. 2007 moves include a 80% buy out of Armenian largest gas company ArmRosGazprom and a long-debated deal in buying 50% of the shares in Belorussia Transport Gas (BelTransGaz), which ships almost all Gazprom export volumes to Northwestern Europe. Armenian authorities have not objected to the Armenian deal (Tsyrlina 2007b, TodayAz 2007), while it took many years to come to an agreement with Belorussian authorities. Gazprom has plans to purchase 12.5% of the BeTransGaz company annually during 2007-2010. The final price for the 50% package is 2.5 billion USD. In 2007, Gazprom will transport 45,8 bln m3 of gas through Belorussia.

Securing assets back at home and with immediate neighbors is essential in Gazprom's strategy to enter and lead gas market in the EU in the long run. Realistically, there is little alternative, except for LNG, of other stable and continuous gas supply that that of Central Asia and Russia. The fact sheet has grown extensively over the last two years and especially during 2007 and now includes:

Country	Project
Austria	Opportunity to gain a share in transporting hub OMV and entering into gas storage joint venture.
Belgium	Creating a joint venture with Distrigas and Fluxys, potential pipeline projects, gas storage facilities in northern regions of the country
United Kingdom	Plans to gain 10% of British market by 2010 году, interest towards gas fields in Northern Sea, gas storage projects.
Baltic States	Gas storage projects (Lithuania)
France	Plans to exchange pipeline gas to LNG with Gaz de France and Sonatrach. July 13, 2007 Gazprom signed agreement with Total to enter joint venture with 25% of Shtokman field development.
Germany	Gas-fed electricity generation facilities, direct sells to end customers through transmission networks and "Nord Stream", gas storage projects.
Hungary	Extension from "Blue Stream" into Hungary
Italy	Project "South Stream" pipeline delivering gas directly to Italy and Southern Europe, opportunity to enter into Nabucco project capital (Near East - Italy)
Netherlands	Exchange of shares in pipeline projects with Gasunie
Poland	Extension of transit pipeline capacity
Turkey	Opportunity to buy shares in gas distributing companies, plans to transit gas to Israel.

Source: Reuters, as cited in Tsyrlina 2007b.

So far, Gazprom has little to show for its efforts - a 50 percent share in GWH and 25 percent in Centrex, both in Austria, and offers from German companies BASF and E.On to swap some of their assets to be allowed to participate in gas exploration in Russia. (Kovalev 2007).

4. POTENTIAL DIRECTION AND PERSPECTIVES

Gazprom imports, to a large extent, depend on availability of gas supply to internal Russian market from the CIS countries, such as Turkmenistan. Therefore, one of the most important tasks for Gazprom is to ensure availability of gas supply from CIS countries, and namely from Turkmenistan. This task has become of critical importance since the launch of Baku-Tbilisi-Ddjeikhan oil pipeline, which has attracted a lot of attention from both Kazakhstan and Turkmenistan. Both countries, although exercising a long term attempt of multi-vector politics, want to break out from Russia-owned Transneft pipeline system, which operates gas and oil distribution downstream networks on the entire territory of the former Soviet Union.

To address these concerns, Turkmenistan and Kazakhstan have started discussion of a TransCaspian gas pipeline route which was immediately reacted to by Russia with an offer to build a Near-Caspian gas pipeline route as a counteroffer. As the situation worsened, Vladimir Putin spearheaded a very successful effort to advocate the Near-Caspian route during the spring-summer of 2007, which resulted in three countries' Presidents' gathering in Ashkhabad to sign Near-Caspian Pipeline Agreement. This agreement has been reported as one of the most important successes of Russian politics in the CIS territory over the last decade. The effect this event will have on EU-Russia relation in the energy sphere can be hardly underestimated (Kolesnikov 2007).

Another important trend that has become clear in the last year is the strengthening relationships with Latin America, which traditionally has been dominated by the US business. With active counter measures against the monopoly of US business and economic interests, which several South American governments undertaken, Russia and China in general, and Gazprom in particular have become a natural business partner that some of S. American countries turned to. For example, Hugo Chavez, one of the fiercest critics of US politics, has invited Gazprom to invest in the country's gas development and become the operator of gas fields in the Orinoco delta (Walsh 2006).

On North American side, it has been reported to me by several Inuvik officials that during initial phases of McKenzie Delta Pipeline project Gazprom indeed sent a delegation to explore the opportunity. Results of it are yet to be clarified. In general, however, Canadian view on potential of Gazprom expansion to North American projects lies in the milieu of the quite cautious tendency in some of the European-originated opinions, focused on the fact that Gazprom is still a state-controlled company. Steven Kerbel, Account Executive in Extractive Industries, EDC, one of the key experts in Russian oil and gas industry in Canada, kindly outlined this view:

> **With respect to potential** Gazprom expansion into North America, and in particular Canada, this evokes some very deep-seeded feelings within Canadian government and industry. The main concern is of course Canada ceding control of its oil & gas reserves to another state or government. Gazprom is not only *de facto* a Government owned entity (with 50%+ Russian Government ownership), but it is also viewed by many as a vehicle of the Government of Russia to effect oil & gas markets to its benefit. While Canadians are more or less open to seeing foreign private companies invest in its resources to maximize exploration and production, that same tolerance will be unlikely to transfer over to a foreign government entity. This position will therefore be worth watching to see if it effects the ability of Canadian (and other North American) companies to partner with Gazprom in Russia on various projects (Kerbel, personal communication, October 2007).

African/Near Eastern expansion has also been a significant movement in the last two years. Algeria, Egypt, and Qatar contacts has intensified significantly, both on the grounds of gas OPEC as well as joint projects with Gazprom, opening up new page in the history of the gas giant expansion. Altogether, international initiatives provide Gazprom with important legacy of true international business presence and diversity of new supply in addition to the enormous fields the company already has in Russia.

Returning to the EU scene, three key directions will play the most significant role in the Gazprom expansion in EU in the years to come:

- Building direct pipeline links to the customer and acquiring shares in other pipelines.

- Building gas-fueled power generation facilities across the economic allies in EU, such as Germany and Belgium.
- Building gas storage facilities which allow countries in which they are built to become a local and, most importantly, regional re-distributor of gas supply in the EU market – an offer that few can refuse due to both the demand for gas as well as elimination of the middleman and the influence of gas distributor.

Threats to the strategies utilized by Gazprom mainly lie in the stereotypical post-Cold war attitudes towards Russia in general and the Russian corporations in particular. These will continue to shape the business landscape in the strategic asset markets, of which energy sector has become the critical one. The Economist Intelligence Unit has researched this issue at length arriving to the same conclusion, based on opinion of more than a 100 executives of the largest businesses. Among the main challenges noted have been a) reputation legacy from the 1990's and b) Post-Soviet Cold war prejudice. These two are greatly reinforced by the US and EU media in the all-too-common image of the Russian Bear. Among the strengths the Economist Intelligence highlights are a) emerging markets know-hows, b) financial strength (liquidity/cash-flow) and c) strong but flexible structures with high concentration of ownership (EIU 2007, RUSAL 2006).

Another threat, which is probably more vocal but less likely to be exercised in full is the EU deregulation of energy market. As serious as it sounds, the politics of deregulation have triggered several questions and counter movements in EU. First of all, it is the fear that by inviting more competition and diversity on the market results in less stability of supply as well as less certainly against the energy defaults which North America and EU have recently seen. Industry and suppliers want long-term contracts, which is impossible to make with smaller or middleman companies, which cannot adequately respond to risks of energy markets as opposed to vertically integrated giants with their own end-to-end solutions from development to customer distribution, both EU- and CIS-based.

Therefore, the most likely scenario is that deregulation will be buried in the internal politics of EU countries, much like the EU Constitution, as non of the large suppliers will allows their strategic companies to get rid of their networks and to open up to risks of uncertainly in the energy sphere. Germany, France and several others states have already vocalized their rejection of the newly formed EU policy on deregulation which is developed by Anrdias Piebalgs and EU energy commission. Energy will always be a critical sovereignty issue for nations of EU, and the battle for deregulators is unlikely to be won, at least in the near future.

As a result, Gazprom is likely to continue successfully expanding its business with its German, French, and Italian partners, especially in the field of pipeline building, gas storage and gas power generation facility buildings. The most difficult direction which will certainly continue to trouble the expansion plans will be distribution network acquisition, which will be regulated heavily not only by EU but most importantly by the respective countries themselves, given the very delicacy of providing end-to-end presence of foreign distributor. The possible outcome of this is a negotiation of shares that Gazprom may take in such networks together with its partners (non-control one), much like the model currently used in Russia for foreign energy companies willing to enter energy sector (see Osipov 2007a).

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