

From concentration to competition: The struggle for power between the Kremlin and Gazprom through the study of TNK-BP and South Stream

Paolo Sorbello & Ludovico Grandi

Introduction

In 2004, after granting the state a majority stake in Gazprom, Putin compared the Russian gas giant to Saudi Aramco and American ExxonMobil. He emphasized the necessary role of Gazprom as a multinational company “representing the interests of the Government both domestically and internationally”.¹ This was accompanied by a declaration of Gazprom’s officials that: “The strategic goal ... is to become a global vertically integrated energy company occupying a leading position on the world market”.² Many academics and Western newspapers regard Gazprom and Rosneft as new diplomatic actors acting on behalf of the Russian state.³ Although a causal question may arise (is it the state’s interests that are represented by the companies, or vice versa?), it is true that the two hydrocarbon giants have a say in Russian foreign policy decision-making.⁴

¹ Jonathan P. Stern, *The Future of Russian Gas and Gazprom*, Oxford Institute for Energy Studies, Oxford University Press, New York, NY, 2005, 219

² *Ibidem*.

³ Peter Rutland, ‘Oil, Politics and Foreign Policy’, in David Lane (Ed.), *The Political Economy of Russian Oil*, Rowman & Littlefield, Lanham, ML, 1999, 163; Nina Poussenkova, ‘Lord of the Rigs: Rosneft as a Mirror of Russian Evolution’, Working Paper for the joint project by the James Baker III Institute for Public Policy at Rice University and Japan Petroleum Energy Center, *The Changing Role of National Oil Companies in International Energy Markets*, March 2007; Vladimir Milov and Boris Nemtsov, *Putin i Gazprom: Nezavisimyi Ekspertnyi Doklad*, Novaya Gazeta, Moscow, 2008; Amelia Hadfield, ‘Energy and foreign policy: EU-Russia energy dynamics’, in Steve Smith, Amelia Hadfield, and Tim Dunne (Eds.), *Foreign Policy: Theories, Actors, Cases*, Oxford University Press, Oxford, 2007; Alexander Visotzky, *Double-Edged Sword: Russia’s Use of Energy as Leverage in the Near Abroad*, VDM Verlag, Saarbrücken, 2009; Steven Wöhrel, ‘Russian Energy Policy toward Neighboring Countries’, in Martin T. Pohler (Ed.), *Russia’s Energy Assets: Security and Foreign Policy Issues*, Nova, New York, NY, 2009.

⁴ Leigh Hendrix, “Russian Energy Policy: Exploring the Efficacy of a Resource-Dependent Economy and Foreign Policy”, University Honors Thesis defended at Wittenberg University, Springfield, OH, 2008, 25. Available at:

Since our goal is mainly to depict power relations, we picked two issues to exemplify our argument. Far from a simplistic approach, these cases for oil and natural gas represent paragons for the whole post-Soviet energy sector as seen from Moscow. Other authors prefer to take into consideration the Yukos affair (see below), others Gazprom's monopolistic role in the foreign realm. Instead, our goal is to analyse concentration and competition where the flow of power bottlenecks: our work sheds a light on two of the latest controversial cases: TNK-BP, with its strong connections in the Kremlin, and Gazprom's activity with regards to the South Stream gas pipeline.

After having taken into careful account the energy power structure in Russia – particularly with regard to oil and gas – our effort is directed towards the study of each case, in terms of power. First, we consider the early struggle of TNK-BP to gain a domestic leadership in oil production and the subsequent policy change on the Kremlin's part that essentially translated to hoarding every venture that had gained a strong position through shady privatisation practices in the Nineties. Second, we focus on the free-floating activity carried out by Gazprom for the prospective construction of the South Stream pipeline, which at times marks a drift from Moscow's foreign policy stance. We conclude that, although different and diachronic, the oil and gas sector present analogous dynamics in terms of power relations with the Kremlin.

Russian Energy Power Structure

The Ministry of Fuel and Energy (*Mintop*) replaced the old Soviet structure upon the collapse of the USSR and was only granted limited and regulatory duties. The real heirs of the Soviet oil industry were the 'Production Associations', taken over by private companies that supplemented the work of the *Mintop*. In 1995, the first ministerial 'Energy Strategy' was published, shortly before the launch of the 'loan for shares' program.⁵

To illustrate the role played by energy, it will suffice to outline the 'energy intensity' in the Russian economy. The share of value added produced by oil and gas in Russia's total GDP has averaged 20% for the past ten years and the exports in the

http://etd.ohiolink.edu/view.cgi?acc_num=wuhonors1242245813 (Last accessed on 15 January 2011).

⁵ 'This is how [so-called 'oligarchs' like] Mikhail Khodorkovsky (owner of Menatep Bank) came to purchase the former Siberian portion of the state-owned Rosneftgaz, which became known as Yukos. Following this model, in 1997 Mikhail Fridman (owner of Alfa Bank) bought Tyumen Oil, another Siberian asset, better known as TNK. Potanin himself (owner of OneksimBank) used the same method to take control of Norilsk Nickel (now the largest non-ferrous metal conglomerate) and the Sidanko oil company, for one tenth and one fifth of the real value respectively.' Paolo Sorbello, *The Role of Energy in Russian Foreign Policy towards Kazakhstan*, Lambert Academic Publishing, Saarbrücken, 2011.

oil sector amount to roughly 50% of crude production. Exports of raw materials since 2005 are consistent as a percentage of total exports, constituting a share higher than 60%.⁶ The substantial participation of the State in the Russian energy companies favours the coordination of central political intents and peripheral – or foreign – business actions. Vice versa, the business sector retains a relevant and collaborative role in shaping policies to be adopted by the ministries.

The oil industry was privatized at a slower pace compared to the gas sector. Furthermore, the Kremlin has allowed the existence of non-threatening independent companies only in the oil sector, such as LUKoil and, initially, TNK-BP. On the gas side, Gazprom has captured and retained the lion's share of the Russian market, leaving the crumbs to 'independent producers',⁷ who play, in fact, cameo roles and benefit little from the domestic sale of gas.

Oil Sector

During the Nineties the oil industry witnessed the vertical integration of a number of operators, Vertically Integrated Companies (VICs). VICs were involved in each stage of the supply chain, from upstream to downstream. A significant share of formerly state-owned energy assets went to companies that spun off from Rosneftegaz: Surgutneftegaz (1992), LUKoil (1995), Yukos (1995), Sidanko (1995), Sibneft (1995), and TNK (1997). The remnants of the former Soviet Ministry of the Oil Industry that remained in the hands of the state after privatization in the Nineties were just Rosneft, Onako and Slavneft. In 2009, Russia surpassed Saudi Arabia and became the largest world producer of crude oil, with an estimated production capacity of 9.9 million barrels per day (bbl/d). In the same year, its domestic consumption was *only* 2.9 million bbl/d. Thus, Russian oil exports amounted to about 7.7 million bbl/d.⁸

Today, oil production is completely controlled by domestic operators. The only exceptional feature emerged in 2003, when BP and TNK joined forces to create a new major oil producer. This market operation remains unique since subsequent attempts by foreign operators to enter in Russia's oil production were unsuccessful. After Yukos' collapse, the state-run company Rosneft acquired most of its assets and challenged LUKoil as the largest oil producer of the country.⁹

⁶ Russian Federal Statistics Service (ROSSTAT), *External Economic Activities* (chapter 26), 2010, available at: www.gks.ru (last accessed: 14 March 2011). In the first quarter of 2011, the share of oil and gas in Russian export revenue hit a record 68.2%, according to Louis Skyner, "Revising Russia's Energy Strategy", *Chatham House Briefing Paper*, October 2011.

⁷ Jonathan Stern, 2005.

⁸ Elvira Oliva and Paolo Sorbello, "Energy Fact Sheet: Russia", *Energy Policy Studies*, Portal on Central Eastern and Balkan Europe, November 2011, available at www.pecob.eu

⁹ Rosneft finally overtook LUKoil as the largest petroleum company in Russia in 2007.

It is important to point out both Yukos and Rosneft's peculiar trajectory in the past decade. Since the incarceration of Mikhail Khodorkovsky and Platon Lebedev, Yukos became the prey of an opaque judicial operation, which induced a few oligarchs to step down from their energy thrones and a few companies that retained strong links with the Kremlin to concentrate under their wings most of the Russian energy sector. As Yukos's doomed fate materialized, Rosneft collected the spoils and led the new wave of energy nationalism that some analysts labelled 'Kremlin Inc.'¹⁰ Igor Sechin, an early member of the Kremlin administration under Putin's first presidential term, was appointed chairman of Rosneft in 2004, becoming the Kremlin's representative in what had become the strongest oil company in Russia. LUKoil's primacy in terms of output and revenue was not contested directly, however, the discretionary behaviour that both the legislative and the judiciary powers demonstrated were the showcase of Rosneft's all-round strength.

Gas Sector

Gazprom was born from the Soviet-era Ministry of Gas, which was restructured and converted into a "Russian" joint stock company (the Russian acronym is RAO) in 1993. Viktor Chernomyrdin acted as a natural gas *factotum* for half a decade before being appointed to various government positions by Yeltsin, during the height of the economic crisis of the Nineties. Throughout Rem Vyakirev's chairmanship, Gazprom underwent a period of transformation, chiefly represented by the reincorporation into an open joint stock company (OAO).¹¹ Such transformation remarkably came after the restructuring of the oil industry and kept high the participation of the state, which retained 38.37% of the company's shares. Rosgazifikatsiya, a company born in the Nineties for the gasification of the Federation, owns 0.889% and continues to have strong ties to the management of both Gazprom and Transneft.¹² In 2005, state-owned Rosneft' purchased 10.74% of the privately owned stocks in order to give the majority "sceptre" to the Kremlin.

This last period, with the appointment of Alexei Miller at the head of Gazprom, which might be called 'the recapture of Gazprom by the state', was now personified by the energy-conscious Putin. Between 2003 and 2006 the shift was clear: the CEOs of the major Russian energy companies used to participate in the decision-making process at the governmental level by lobbying, however, when Putin strengthened his position in the Kremlin, he made sure that the businessmen he had

¹⁰Adrian Dellecker, "Kremlin Inc.", Policy Paper for the *Institut Français des Relations Internationales*, January, 2008; Catherine Belton, "Rosneft Considers Kremlin Board Purge Order", *Financial Times*, 5 April 2011.

¹¹ For a legal distinction between "open" and "closed" JSCs, see Ichiro Iwasaki, "Legal Form of Incorporation", in Tat'yana Dolgopyatova, Ichiro Iwasaki, and Andrei Yakovlev (Eds.), *Organization and Development of Russian Businesses*, Palgrave MacMillan, Basingstoke, UK, 2009, 66.

¹² Nataliya Grib and Dmitry Butrin, 'State Can't Take Control of Gazprom', *Kommersant*, 1 August 2006.

to deal with were men under his thumb, thus utilizing state-owned energy companies as the operative branch of the Ministry of Energy. At the end of 2008, ‘11 of 18 members of Gazprom’s board had worked in the St. Petersburg administration or the FSB during the Nineties’.¹³

The evolution of the gas industry followed the basic political principles laid out by Putin during his studies. He subscribed to the concept of ‘natural monopoly’ and took it further to the level of ‘national champion’. The state-owned energy company not only retained ‘natural’, i.e. inherent, monopolistic rights due to the fact that the energy extracted from the subsoil was property of the Russian Federation, in addition, the company had to champion the herald of the nation on a global scale. In Putin’s own words, the role of Gazprom was to be that of a multinational company ‘representing the interest of the Government both domestically and internationally.’¹⁴ In 2006, a law was passed to give Gazprom exclusive rights for gas trade abroad,¹⁵ which was paired with the transportation monopoly over pipelines held by Transneft. This strategy designed by Moscow further strengthened Gazprom’s position as the biggest natural gas company in the world.¹⁶

The National Conundrum: TNK-BP

Partnership in the Russian energy sector has historically been a challenging venture. Since Putin’s rise to power, several foreign companies saw the terms of their Product Sharing Agreement (PSA) revised.¹⁷ Many pundits and analysts tend to associate these events with the rising presence of the State in the industry. Under the sways of energy nationalism, the interests of the Russian Federation have increasingly been associated with those of its ‘national champions’, Gazprom and Rosneft,¹⁸ especially in high prices conjunctures. As simple and straightforward this narrative may sound, there are several cases in which this logic does not apply to foreign investors.

The prime example of this is the case of BP’s joint venture with a group of Russian oligarchs. The aim of this chapter is thus to outline why Kremlin’s designs do not always correspond to the interests of its state owned companies. The consortium known as TNK-BP was born at the beginning of 2003, resulting in what would have later become one of the world’s top ten energy operators in terms of oil output.¹⁹ Its

¹³ Vladimir Milov and Boris Nemtsov, 2008.

¹⁴ Putin in 2004, cited in Jonathan Stern, 2005, 219.

¹⁵ Tobias Buck and Neil Buckley, “Russian Parliament vote Backs Gazprom Export Monopoly,” *Financial Times*, 16 June 2006, 8.

¹⁶ Pol-Henry Dasseleer, *L’idéalisme européen à l’épreuve du réalisme russe*, L’Harmattan, Paris, 2009, 15.

¹⁷ *The Economist*, ‘Russian Arm Twisting’, 22 June 2007.

¹⁸ Marshall I. Goldman, *Petrostate: Putin, Power, and the New Russia*, Oxford University Press, Oxford, 2010, 3.

¹⁹ See TNK-BP Website: <http://www.tnk-bp.com/en/company/>, (last accessed: 13 March 2012)

successes were the result of BP's know-how (and capital availability) next to the key assets controlled by AAR (Alfa Bank, Access Industries and Renova). The oligarchs controlling AAR are Mikhail Friedman, Len Blavatnik and Viktor Vekselberg. In them, BP had found the right connection to the Kremlin, as well as a consolidated industrial group controlling substantial assets such as the giant gas Kovykta field. On the other end, to AAR, BP represented those badly needed financial resources and exploration/extraction experiences so crucial to operate in the Russian business environment.

The TNK-BP board of directors was composed of 4 AAR and 5 BP representatives. The ownership was divided on a 50–50 scheme, and Robert Dudley was appointed as CEO.²⁰ Finally, a clause granted the consortium with the right of pre-emptive veto in case of future energy projects in Russia and Ukraine involving its two components. The inaugural ceremony of the biggest foreign investment in Russia since 1917²¹ was held in London and attended by both Tony Blair, then British prime minister, and Putin, in his first term as president of the Russian Federation.²² However, as Putin predicted during a conversation with Lord Brown (BP's former CEO), the equal control in terms of shares and the unbalanced representation in the board of directors was inevitably lead to future contrasts in TNK-BP's management.²³ Moreover, the events following the establishment of TNK-BP brought BP into a defensive position. The Yukos affair (and its later acquisition by Rosneft) led the British company to think that the business climate was changing in favour of state-owned enterprises.²⁴ In fact, Khodorkovsky, the former CEO of Yukos, attempted to form a venture similar to that of TNK-BP, by selling stakes to Exxon Mobil and merging its assets with Sibneft.²⁵ The acquisition of Sibneft by Gazprom in 2005 further reinforced this belief.²⁶

From that moment onward, a misunderstanding of the business environment led BP's Russian venture into an increasing unpredictable discontinuity in its activities, together with major international trials. Whenever AAR proposed to expand the scope of TNK-BP's activities, BP would use its majority in the board of directors to prevent it. This was the case when Alfa tried to gain control of four refineries controlled by Venezuela's national oil company, PDVSA.²⁷ BP's attitude stemmed from the belief that a low business profile would have reinforced its position

²⁰ A. Cemal Ekin, Thomas R. King, 'A Struggling International Partnership: TNK–BP Joint Venture', *International Journal of Strategic Business Alliances*, Vol.1 n. 1, Inderscience Enterprises Ltd., 10 March 2009, 95.

²¹ *Corporate Europe Observatory (CEO)* and *PLATFORM*, 'BP and the Russian Bear: A Case Study', 2009, 3.

²² Marshall I. Goldman, 2010, 126.

²³ Daniel Yergin, *The Quest: Energy, Security and the Remaking of the Modern World*, The Penguin Group, London, 2011, 38.

²⁴ *The Economist*, 'Mixing Oil, Gas and Politics', 20 June 2005.

²⁵ *The Economist*, 'Divorce Me, Darling', 18 December 2003.

²⁶ *The Economist*, 'Russia's Energetic Enigma', 6 October 2005.

²⁷ *The Moscow Times*, 'Alfa to Buy Venezuelan Oil Refineries', 25 December 2003.

in a continuously evolving business environment, and helped protect its assets from being seized by Russian national companies.

Although this approach may sound understandable since BP was the only foreign company controlling more than 49% in a Russian energy company, Putin was nurturing other designs. Not only did he initially present the consortium as the perfect example of how safe the Russian business environment had become, but in his quest for the rationalisation of the Russian energy industry, he later opposed BP and Gazprom's designs. In fact, when BP started to negotiate an alliance with Gazprom with the aim of replacing AAR in the consortium in 2007, the fear of an unmanageable and excessive power concentration in the hands of Gazprom led the Kremlin to oppose the venture.²⁸ One of the consequences of such a deal would have been to question Rosneft's role as one of the leading Russian oil producers, unbalancing the delicate equilibrium designed by the Kremlin to rationalise the oil and gas industries. Not surprisingly, Igor Sechin (Rosneft's CEO) strongly opposed the deal.²⁹

Gazprom's successful attempt to seize control of the Kovykta gas field from TNK was in line with the rationalisation of Russia's energy sector.³⁰ Furthermore, when BP made a second attempt in 2011 to replace AAR from the consortium through a partnership with Rosneft over the Arctic explorations, not only AAR felt confident enough to sue BP according to the already mentioned clause on the consortium's exclusive agreement with BP (thus challenging Rosneft's designs), but Sechin walked out of the talks.³¹ The fact that the TNK-BP consortium is still in place and well performing³² (even if with a different CEO)³³ is a clear statement that AAR's ties with the Kremlin are strong enough to resist assaults from either Gazprom or Rosneft. Thus, the Kremlin's interests do not simply coincide with those of its proxies. As this brief chapter outlines, the stances expressed by private Russian and foreign companies have sometimes prevailed³⁴.

²⁸ Shamil Yenikeeff, *BP, Russian Billionaires, and the Kremlin: A Triangle that Never Was*, The Oxford Institute for Energy Studies, Oxford University, 2011, 8.

²⁹ C. Belton, S. Pfeifer, 'Putin Ally Delivers Connects with the West', *The Financial Times*, 16 January 2011.

³⁰ *Reuters*, 'Gazprom Gets Licence to Develop Kovykta Gas Field', 7 October 2011.

³¹ *The Economist*, 'Dancing with Bears', 3 February 2011.

³² *Reuters*, 'TNK-BP Net Profit Hits \$ 9 Bln in 2011 on Strong Output', 29 February 2012.

³³ *The Economist*, 'Moscow Calling', 27 June 2010.

³⁴ This article was completed in the summer of 2012. Later on, BP decided to sell its 50% stake and quit its partnership with TNK. Rosneft was resolute in its decision to purchase what was available on the market. The continuous developments of the issue force us to restrict our analysis to the period preceding the sale (2003-2011). The events occurred in October do not, however, substantially modify our assumption that the oil sector alternatively swings between concentration and competition, according to both economic and political reasons. Our aim in this paper is simply to outline this dynamic, not to go deeper in the analysis of the single case.

The International Tug-Of-War: South Stream

The complicated domestic relationship between Gazprom and the Kremlin is also evident in the purely international sphere. Here, we take the South Stream natural gas pipeline project as paramount example³⁵. Such an angle allows us to describe what has become a paragon of the tug-of-war between the gas giant and the Russian government for the past five years. In June 2007, Alexey Miller, Chairman of Gazprom's Management Committee, flew to Rome to sign a memorandum of understanding with Paolo Scaroni, CEO of the Italian energy company (ENI), for the construction of a pipeline from Russia to Austria and Italy. ENI and Gazprom had closely collaborated in pipeline construction since the Blue Stream feasibility study, performed in 1999, after the signing of an intergovernmental agreement between the Russian Federation and Turkey. Like the Blue Stream³⁶, South Stream would be laid at the bottom of the Black Sea³⁷. However, the newer project is much more challenging: instead of re-emerging 396 kilometres south in Durusu, Turkey, South Stream will be stretching for 900 kilometres from the Russian to the Bulgarian coast³⁸.

Due to the variety of countries that would be involved in the completion of the project, Gazprom and ENI lobbied and engaged with European governments and

³⁵ This is only one among many energy issues that are carried on by the companies rather than the central government. For reference, the example of Rosneft in the Kurmangazy offshore field in the Caspian Sea, (Gawdat Baghat, 'Prospects for Energy Cooperation in the Caspian Sea', *Communist and Post-Communist Studies*, vol. 40, nr. 2, 2007 and the Rosneft web page on the Kurmangazy offshore field at http://www.rosneft.com/Upstream/Exploration/international/kurmangazy_kazakhstan/, last accessed: 14 March 2012) and the entire Central Asian gas market, which only responds to Gazprom's commands in terms of price and quantity (Simon Pirani, *Central Asian and Caspian Gas Production and the Constraints on Export*, Oxford Institute for Energy Studies, December 2012, available at: <http://www.oxfordenergy.org/2012/12/central-asian-and-caspian-gas-production-and-the-constraints-on-export/>, last accessed, 14 December 2012).

³⁶ The Blue Stream project was completed in 2003, when gas started flowing. 'Blue Stream gas starts flowing', *Upstream Online*, 20 February 2003, available at: <http://www.upstreamonline.com/live/article33319.ece> (last accessed: 14 March 2012).

³⁷ As this article went to press, the final agreement on the pipeline was being signed and the start of the construction was celebrated with an inaugural ceremony in December 2012. In this article, however, we only consider the period until the summer of 2012 for our arguments.

³⁸ The four pipes that will be laid in the offshore section are technologically new and have a large diameter (LDP) that will allow the flow of the projected amount of natural gas of 63 bcm every year. These LDPs are Vysota 239, manufactured in Russia. *LNG World News*, 'Gazprom Says Large Diameter Pipe Purchases to Rise 30 Percent in 2011', <http://www.lngworldnews.com/> 22 September 2011 (last accessed: 28 April 2011)

national companies, to sell shares, bargain for the best transit tariffs, and ensure the most feasible routes (both technically and politically). In fact, after its journey through Bulgaria, the pipeline will split into at least two branches. The southwestern pipe will supply Greece and possibly the prospective Interconnector Turkey-Greece-Italy (ITGI), ending up in the Adriatic and purposely avoiding the Albanian territory. The northwestern branch will run through Serbia and Hungary to Austria. This branch is likely to split into several smaller branches to feed in many directions.

Land connections are nonetheless a simpler task. For the offshore leg, the question involves the much-sought bypassing of Ukraine. Gazprom accused Kiev of stealing gas and fuelled the crises of 2006, 2008, and 2009. This has been the main reason for pushing forward routes that circumvent the Soviet-built network that brings gas from Russia to Europe through Ukraine. Both *Soyuz* and *Bratstvo* ('Union' and 'Brotherhood') follow comparable/similar routes and were used as weapons during the above-mentioned crises. Nord Stream, bypassing the Baltic States, came on line in the summer of 2011, while South Stream would eventually run South of the exclusive economic zone pertaining to Ukraine in the Black Sea. Interestingly, these two pipelines carry names that are evocative of the Russian effort to emancipate its natural gas from the transit in Ukraine: both *streams* are north and south of the 'peripheral country'³⁹.

'Nobody can win a gas war: all parties lose'⁴⁰. Perhaps this consideration is the main driver for Gazprom to seek for alternative routes instead of insisting on its claims of unpaid gas bills or pipeline siphoning from Kiev. As one spokesman at Gazprom told the press in February 2012, with Nord Stream already on line, once South Stream is completed 'Ukraine's transit role for the export of Russian gas will be equal to zero'⁴¹. Gazprom's assertiveness against Ukraine is not necessarily matched by the same strong political antagonism from the Kremlin. *Nametkina ulitsa*⁴² has often released strong and unequivocal declarations that have put Putin's attempts to build friendly relations with the Ukrainian government in jeopardy⁴³. If Gazprom's interests were the same as Russia's such a competition would hardly emerge.

In this respect, Gazprom has been described by many political, academic, and journalistic figures as a 'weapon' in the hands of the Kremlin, used for the fostering of Russian foreign policy abroad. As described below in section 5, this is not necessarily

³⁹ Ukraine's prior name was *Malorossiya*, "Little Russia", later turned into Ukraine, from *u krai*, "extreme edge".

⁴⁰ Jérôme Guillet 'How To Get a Pipeline Built: Myth and Reality', in Adrian Dellecker and Thomas Gomart (eds.), *Russian Energy Security and Foreign Policy*, Routledge GARNET series: New York, 2011.

⁴¹ Gazprom's Sergei Kupriyanov is quoted in the article "Gazprom's pipeline projects to reduce Ukraine's transit role to zero – Kupriyanov", *ITAR-TASS*, 23 February 2012.

⁴² Gazprom's headquarters in Moscow are located at nr. 16, *Nametkina ulitsa*.

⁴³ This problem was outlined by Alexei Khaitun during his interview with Mikhail Gusev, "Nord Stream and South Stream inefficient for Russia", *RIA Novosti*, 26 September 2011.

the angle one should look at such events. Gazprom has followed its own market strategies and has garnered the trust of several other multinational energy companies in order to obtain a strong position in the so-called “near abroad”⁴⁴ and in Eastern Europe, both representing gateways to energy-thirsty Western Europe. Taking into account the analysed case of South Stream only, ENI, MOL, Bulgargaz, and Srbijagas are in business with Gazprom for the administration of the national and offshore sectors of the pipeline. Moreover, national companies from Romania, Croatia, Austria, Greece, and Slovenia, are involved in the setup of transit agreements in terms of both legislation and supply. Romania and Croatia, in particular, have decidedly changed their position from a more western-oriented support for the Nabucco project, to one that pays lip service to the business interest of their respective national companies, Transgaz and INA, who have greatly improved their relations with Gazprom⁴⁵.

What has become evident is an opposite *competitive* trend, with Gazprom acting more freely in the international arena, gaining influence primarily through and for business. Gazprom needs to secure customers downstream, preferably via long-term contracts because the sizeable cost for the construction of the pipeline is judged between 19 and 25 billion USD. For Gazprom, to break into the European market with yet another pipeline is more important than finding the 63 billion cubic metres (bcm) of natural gas that would go through South Stream yearly⁴⁶, because the key goal is to gain a foothold in highly rewarding markets. European customers are willing to pay an inflated price for Russian energy, as there few other options.

The favourable scenario that Gazprom is laying out for its own profits duly influences the Kremlin foreign policy options. Having judged the prospective configuration as advantageous for the Russian budget, Putin was personally involved in the high-level meetings that gave birth to the abovementioned agreements. His participation represented the official seal on the foreseeable success of the project. Investors and analysts were sceptical up until the central government began employing every means to support Gazprom. However, endorsement came at a cost, as the Kremlin has recently tried to counter Gazprom’s plans to raise domestic prices for natural gas, which would be extremely harmful for the newly formed Duma and for Putin’s new term as president.

⁴⁴ In this case, we employ the narrower definition of *near abroad*. While it is often used to describe the entire post-Soviet area, with the exception of the Baltic States, most academics and politicians use the phrase when referring to the three Newly Independent States located to the east of Russia: Moldova, Belarus, and Ukraine.

⁴⁵ On Romania, see John Lough, “Russia’s Energy Diplomacy”, *Chatham House Briefing Paper*, May 2011. On Croatia, see the article signed “MarSz” in the Center for Eastern Studies’ (OSW) *EastWeek*, issue 9 (202), 3 March 2010, Warsaw, Poland.

⁴⁶ The figure of 63 bcm/yr was originally as low as 30 bcm, according to Nicklas Norling, “Gazprom’s Monopoly and Nabucco’s Potentials: Strategic Decisions for Europe”, *Silk Road Paper*, The Central Asia – Caucasus Institute, 2007. The figure gradually surged to 63, which is the latest available on the project’s official website: www.southstream.info (last accessed on 14 March 2012).

From Concentration To Competition

The first decade of the Twenty-first Century could be viewed as a *concentration* period in terms of governmental control of the Russian energy sector. Through the appointment of Putin affiliates in key positions as ‘national champions’ and the exclusion of players unwilling to subdue to the Kremlin's design, Moscow managed to reorganize both the gas and oil industries in a vertical pattern designed to keep political control over national strategic assets in the hands of the presidential clique. At the same time, Gazprom's desires are not necessarily dictated by the Kremlin. Over time, the company has built relations of its own, ranging from international projects such as South Stream, to national policies on pricing, supply, and exports. The ‘decade of concentration’ has unleashed a multiplicity of power poles, whose interests collide and converge according to the continuously evolving energy environment in which the players interact.

Competition, in particular, has come to the surface during the last few years, as the power held by energy companies consolidated within the Russian power struggle. Domestic energy prices are one of the many examples that could be taken to outline how the Kremlin and those that used to be its proxies are competing for setting the agenda. Prices are of paramount importance to understand how Gazprom and Moscow's interests diverge. On the one hand, the Kremlin prefers to keep them as low as possible in order to maintain a wide popular consensus and subsidise the industrial sector.⁴⁷ On the other hand, Gazprom would like to increase them, turning the Russian market from a source of losses into a profitable outlet. Traditionally, in fact, the company concentrated its profits on hard currency from foreign markets to cover for the losses from the internal sale, with prices set far below production costs.⁴⁸

The dimension of the quarrel overlaps with the consideration of Gazprom as a national champion, therefore entitled to privileged access to internal markets and monopolistic grip on exports. As noted by many academics and experts, Gazprom's budget is highly reliant on foreign currency and the company has retained little interest in seizing entirely the unprofitable domestic market. Moreover, the Kremlin's concessions to third companies for the sale of natural gas have become the poster child for Russia's application to the World Trade Organization and, in general, for the friendliness of its business environment. Not considering the US-born ITERA, which maintains an insignificant share of the market, Novatek is the only competitor-on-paper for Gazprom. Still, Gazprom keeps its grip on the transportation system and on processing plants and the internal markets bear little profits both due to subsidised prices and because of the common practice of non-payment⁴⁹. Not surprisingly, Novatek's existence is preserved through strong ties with the Kremlin and can only be considered a competitor when the two centres of power in Moscow disagree. As it has become evident, Gazprom has grown ‘too big’ to be just a tool in the hands of the

⁴⁷ Kevin Rosner, *Gazprom and the Russian State*, GMB Publishing, London, 2006, 9.

⁴⁸ *The Economist*, ‘In a Bear Hug’, 18 December 2006.

⁴⁹ Jonathan Stern, 2005, 198.

Kremlin, especially abroad, where the state cannot control business and lacks puppet competitors like the domestic ones.

Concentration has been the recent trend in the oil industry, backfiring from the permissive liberalisation policy of the early Nineties. Besides the better known Yukos affair, the case of TNK-BP has shown an interesting dynamic in relation to the Kremlin's actions. Moscow directed all its energies to restructuring Rosneft into a national champion and therefore opposed any manoeuvre that undermined this goal. Acting on behalf of the Kremlin, Rosneft tried to secure a partnership with BP for the joint exploration of offshore Arctic fields in 2010. The international lawsuit that followed, prompted by TNK-BP stakeholders, struck a blow against the flourishing role of Rosneft as an internationally recognized and reliable business partner. However, the principle of the rule of law had to be protected, and no further retaliations took place. It can be argued that the Yukos lesson was learned – although another precedent still looms in TNK-BP as non-Russian board members were prevented from entering Russia for a brief period in 2008, until BP agreed to let Mikhail Fridman be the CEO of the joint venture.

Although maintaining an intimate connection with regard to energy, the central government in Moscow and the *Nametkina ulitsa* Gazprom offices in Moscow have had numerous rows, challenging the mainstream idea of coordination which has circulated for the past ten years among scholars and experts in Russian energy politics. The representation of Gazprom as a tool in the hands of the Kremlin for the dominance of the domestic energy market and for the fostering of Russian foreign policy objectives abroad is undermined by several examples of the frictions between the two centres of Russian power. It is more a tug-of-war between concentration and competition in terms of sheer power, rather than economic profits.

Boris Barkanov judges the 'change in state authority' as 'the causal explanation for the shift in the industry management'⁵⁰ while energy analysts at CERA have explicitly stated that 'the Russian state is becoming the industry itself'⁵¹. Petersen recently went as far to declare that 'energy policy has become such a central and consuming plank of Russian foreign policy that the two are practically one and the same'⁵². It is reported that Putin meets 'Gazprom's CEO more often than the majority of ministers in the Russian government'⁵³ and unsurprisingly, at the end of

⁵⁰ Boris Barkanov, "From Apprentice to Mercantilist: Transformation of State Identity and Russian Energy Charter Treaty Policy" (forthcoming), paper presented at the annual convention of the Association for the Study of Nationalities held at Columbia University, NY on 13-14-15 of April, 2010.

⁵¹ Cambridge Energy Research Associates, *Russia at a New Crossroads: Can Expanding State Companies Deliver Energy Supply Growth?*, CERA, Cambridge, MA, 2006.

⁵² Alexandros Petersen, *The World Island: Eurasian Geopolitics and the Fate of the West*, Praeger Security International, Santa Barbara, CA, 2011, 99.

⁵³ Stanislav L. Tkachenko, "Actors in Russia's Energy Policy towards the EU", in Pami Aalto, *The EU-Russia Energy Dialogue*, Ashgate, Aldershot, 2008.

2008, ‘11 of 18 members of the energy giant had worked in the St. Petersburg administration or the FSB during the Nineties’⁵⁴.

The federal government in Moscow has ‘tightened the grip on Gazprom, considerably expanded its involvement in the management of the oil sector and reinforced its monopoly over oil and gas export pipelines’⁵⁵ since Putin took power in 2000. To honour these intents, Russia’s official strategic documents put in printed characters multi-faceted energy policies that often mirrored multipolar foreign policy ‘doctrines’⁵⁶. Personal ties and proximity to the Kremlin have taken the place of the tycoonish attitude of the oligarchs, so as to seal Putin’s victory against such behaviour and individuals. In spite of this, the competition on the surface of the energy component of the Russian economy masks a concentrating effort that is likely to provoke more volatility in the near future, as Gazprom tries to emancipate its destiny from the Kremlin’s.

Conclusion

With this paper, we sought to individuate the power dynamics between the central government and the “national champions”, particularly those controlling the energy sector. Economic and political decisions are made both by the heads of the power cabinets (so called, *siloviki*) and by the companies’ CEOs, who frequently meet and plan policy options together. Furthermore, the paper aimed to show how opposite trends stemming from decisions in Moscow influence the Russian energy sector, both in its structure and in its business endeavours. Without being explicitly codified, trends of competition and concentration reflect the degree of resource nationalism circulating in the Kremlin rooms. Strategic energy policy documents, together with foreign policy doctrines, pave the way for certain behaviours towards and within the business sector. However, sometimes, as seen above with the case of Gazprom in the international arena, a competing thrust might emerge. On the internal stage, the struggle over domestic prices has reached a peak recently⁵⁷ and is likely to show cracks in the nearly perfect structure that Putin’s policies have contributed to build.

The recent turn from a trend of increasing concentration to one of open competition, domestically and internationally, needs not to divert the researcher’s attention from the real stakes that the Kremlin still holds in this confrontation: Gazprom remains ‘property’ of Russia, in that the government retains more than 50% of its shares; Gazprom is not jeopardising the Moscow’s strategic interests either at home or abroad; the failure of Gazprom’s recapitalisation has shown a weakness from *Nametkina ulitsa* that can become a weapon in Kremlin’s hands; and, lastly, the personal ties between the Kremlin and the key figures in the energy sector remain solid and strong.

⁵⁴ Vladimir Milov and Boris Nemtsov, 2008.

⁵⁵ Louis Skyner, 2011.

⁵⁶ Paolo Sorbello, 2011, 95-102.

⁵⁷ Isabel Gorst, ‘Gazprom: feeling the squeeze’, *Financial Times*, 26 March 2012.

The key findings from the analysis of the TNK-BP and the South Stream cases are the recognition of multiple power poles that join hands and collide without a clear pattern. Historic and personal rivalries have played a relevant role in the unravelling of the events that led to the failure of the concentration effort. On the other hand, the apparent freewheeling attitude shown by Gazprom in its international ventures is counterbalanced by a contingent convergence of interests with the Kremlin. Should the circumstances vary, the approach by Moscow, Gazprom, and the other Russian energy giants might follow a different path from the present one. The described cases are to be considered a paragon for the general behaviour in the energy sector. Above the chessboard of Russian energy the pool of players is so diverse and numerous that it becomes hard to predict beyond one or two moves.