

The Polish-Russian Deal on Natural Gas Supply: The Incapacity of the EU Energy Policy

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On October 29, 2010, Poland and Russia signed an agreement on the supply of Russian natural gas until 2022 (with an option to extend the agreement until 2037). The agreement stipulates that in 2010 the Russian natural gas company *Gazprom* will supply 9.7 billion cubic meters of gas to Poland, and from 2011 it will supply 11 billion cubic meters of natural gas annually¹. An agreement was also reached on the transit of Russian natural gas to Western Europe through the Yamal-Europe natural gas pipeline² section in Poland's territory until 2019 (with a possible extension of the transit of natural gas until 2045). This agreement between Poland and Russia on Russian natural gas supply could be considered a unique continuation of the improvement of bilateral relations between these two countries in the energy area that is not very favourable to Lithuania for a number of reasons.

Firstly, this deal in a way is a mutual compromise that Poland and Russia have arrived at, which formally conforms to the legal norms of the EU's 3rd Energy Package (on the unbundling of extraction, supply and distribution of energy resources); however, it inevitably increases Poland's energy dependence on Russia. *Secondly*, the improving Polish-Russian relations in the energy sector in short and medium terms create conditions for further penetration of Russian capital into the energy sector of Eastern and Central European countries (Poland, the Baltic States and others).

¹ To compare, the annual Polish gas demand amounts to 14-15 billion cubic meters of gas, 70% of this amount is imported from Russia. - *Author's Note*

² Russia supplies natural gas to Germany and Poland through the above mentioned pipeline with the capacity of 33 billion cubic meters of natural gas per year. Joint Polish and Russian company *EuRoPol GAZ* controls the 684 kilometre section of the pipeline that begins in Russia, goes through Belarus and Poland to Germany. 48% of *EuRoPol GAZ* shares belong to *Gazprom* and Polish gas and oil company *PGNiG* and 4% of shares are controlled by joint Russian and Polish company *Gas-Trading S.A.* The Yamal-Europe natural gas pipeline in Poland's territory is separated from the national gas supply system. - *Author's Note*

Furthermore, the development of energy ties between Poland and Russia becomes a distinctive means of manipulating the Polish foreign policy to influence problematic relations between Lithuania and Poland, for example, in solving the problems of the Polish ethnic minority living in Lithuania. In order to assess the recently intensifying development of the Polish-Russian energy ties, it is necessary to evaluate the importance and possible consequences of the Russian-Polish natural gas supply deal, signed on October 29, 2010, on Central and Eastern European countries.

The Circumstances of the Signing of the Agreement on Gas Supply between Poland and Russia

Signed on October 29, 2010, Poland-Russian agreement on Russian natural gas supply could be regarded as a certain mutual compromise, based both on unique motivation of the two countries and their attempts to mitigate the European Commission's (EC) pressure to make the deal conforming to the legal norms of the EU's 3rd Energy Package.

Russia's motivation. Russia chose Poland in order to test the efficiency of the EU's energy policy. Moscow selected Warsaw for several reasons.

Firstly, in 2006, when Russia suspended gas supply to Ukraine, Poland began actively promoting the importance of the diversification of the EU's imported energy resources in its foreign policy. If Russia successfully implemented its intentions in Poland, the obvious incapacity of the EU energy policy would be revealed and a precedent for other opaque Russian energy transactions with the individual EU member states would be set.

Secondly, in the beginning of 2009, in their energy ties, Russia and Ukraine got rid of the nontransparent mediation scheme (mediation services of *RosUkrEnergo*), which had served as a basis for the bilateral relations between Russia and Ukraine in the energy sector since 2004. On the other hand, after the Russian-Ukrainian energy relations scheme had been changed and *RosUkrEnergo* had been eliminated, Poland lost more than 2.3 billion cubic meters of natural gas per year, the purchase of which had been agreed with *RosUkrEnergo*. In addition to this, in 2010, Ukraine banned natural gas exports from third countries to Poland through its territory, until Poland reached an agreement with Russia. These circumstances resulted in more pressure on Poland to negotiate with Russia on the additional amounts of natural gas supplies through the Yamal-Europe gas pipeline.

Russia did not view the contract on additional volumes of gas supply only as a purely commercial transaction, but was seeking the new contract to increase Poland's energy dependence on Russia. The Russian natural gas company *Gazprom* agreed to sign the new contract for the supply of natural gas only if Poland fulfilled the following conditions³:

³ *Siguranta Energetica*, Vladimir Socor, *Russian-Polish gas negotiations testing EU's energy policy*.

- The new agreement on Russian natural gas supply to Poland must be tied to the intergovernmental Polish-Russian agreement, signed in 1993 and regulating the transit of Russian natural gas via Poland and natural gas supplies to Poland until 2022. At Russia's request, the natural gas supply to Poland was to be extended until 2037 by the new agreement.
- Russia demanded the joint Polish-Russian company *Europol Gaz* to be granted the exclusive rights to use and control the Yamal - Europe gas pipeline until 2045 and to be allowed to retain the rights of the pipeline's ownership and operation.
- Poland's state company *Gaz-System S.A.*, fulfilling the functions of the natural gas transmission operator, should become only a technical operator of the Yamal-Europe gas pipeline with duties limited to providing services. In other words, *Gaz-System S.A.* will not perform the role of an operator independent of a gas supplier.
- Significant discounts for the transit of Russian natural gas through the Yamal-Europe gas pipeline are to be kept.
- Poland is not allowed to re-export the surplus of Russian natural gas to third countries. If Poland violates this provision, Russia's *Gazprom* will reserve the right to cut gas supply to Poland unilaterally.
- Finally, Russia demanded that provisions of the EU's 3rd Energy Package not apply to the Yamal-Europe gas pipeline for three reasons:
 - 1) the pipeline was built earlier than the EU adopted the EU's 3rd Energy Package, thus, these provisions should not be applied to this pipeline;
 - 2) the EU's 3rd Energy Package cannot be in effect in Russia, which is not an EU member state, as there is only one access to the Yamal-Europe gas pipeline – through the territory of Belarus, and any companies other than *Gazprom* will not be able to supply natural gas through the pipeline;
 - 3) the provisions of the EU's 3rd Energy Package shall be binding on Poland only from 2012, thus EU requirements should not be imposed on the Polish-Russian contract, concluded in 2010, (in fact, Russia has overlooked the fact that the agreement for natural gas must be concluded for at least a decade).

Poland's motivation. When Russian-Ukrainian relations in the energy sector changed at the beginning of 2009, Poland felt the need to secure additional 2.5-3 billion cubic meters of natural gas annually. It is vitally important for Poland to secure additional amounts of natural gas in the short and medium terms as alternative energy projects (such as the construction of a liquefied natural gas terminal by 2014, the exploration and production of shale gas, the construction of a nuclear power plant by 2022 and etc.) that could reduce Poland's energy dependence on Russia are yet to be implemented. On the other hand, the previous agreement for the supply of natural gas between Poland and

<<http://www.sigurantaenergetica.ro/russianpolish-gas-negotiations-testing-eus-energy-policy.html>>.

Russia expired on October 20, 2010, thus in order to avoid possible losses for the industry during the cold season, Poland was forced to obey Russia under some conditions.

It should be noted that before the deal for the supply of natural gas was inked on October 29, 2010, Poland experienced a lot of pressure not only from Russia but also from the European Commission (EC), which urged the new agreement between Poland and Russia to strictly comply with the provisions of the EU's 3rd Energy Package.

For example, on July 14, 2010, the European Commission told Poland that all the existing arrangements between Poland and Russia for the supply of Russian natural gas ignored the EU's internal market rules. Poland is guided by the provisions of the contract with the Russian gas company *Gazprom* which prohibit the re-export of Russian natural gas surplus to third countries and forbid the access of the companies from other EU countries to the Yamal-Europe pipeline. The European Commission has claimed that these provisions violate the EU's antitrust laws and warns Poland that it may lodge a complaint against Poland to the European Court of Justice within two months, unless the agreement on Russian natural gas supplies is revised.

It should be noted that Poland's ruling coalition had differing views on the securing of the country's energy interests and the pressure from Russia and the European Commission. Polish Foreign Minister Radoslaw Sikorski backed Poland's closer relationship with Russia on the condition that the EU legal norms were not sacrificed for the development of these relations. Meanwhile, Waldemar Pawlak, Poland's chief negotiator with the *Gazprom* company and Polish deputy prime minister, supported by Polish Prime Minister Donald Tusk and the company *PGNiG*, did not object to Russia's demands and tried to compromise between the EU and Russia, for example, by downplaying the importance of the contract at the EU level⁴. Finally, after nearly two years of negotiations, in order to coordinate the EU and Russia's demands, Poland and Russia agreed on a compromise agreement with certain exceptions.

Compromise deal. The provisions of the gas supply deal, signed by Poland and Russia on October 29, 2010, largely mirror the two countries' compromise agreement which complies with the requirements of the EU's 3rd Energy Package:

- The Yamal-Europe gas pipeline operator's functions were transferred to the Polish state company, *Gaz-System*, which runs all the Polish natural gas transmission and distribution networks. On the other hand, it should be noted that the independent technical operator does not have a very substantial role in the operation of the Yamal-Europe gas pipeline. The Russian natural gas company *Gazprom*, in fact, maintains the natural gas

⁴ *The New York Times*, Judy Dempsey, *Europe Seeks to Block Polish Gas Contract*. <<http://www.nytimes.com/2010/10/11/business/energy-environment/11gazprom.html>>

monopoly, and third-country natural gas suppliers will be allowed to use the Yamal-Europe gas pipeline only if the volumes of Russian natural gas supplies fall (if the Russian gas supply does not use the technical capacities of the pipeline fully). The Yamal-Europe pipeline is scheduled to operate at its full capacity until at least 2035, thus, third countries will continue having only formal access to the pipeline (which is laid down in agreements only, but not put in practice).

- The fees for Russian natural gas transit through Poland will be imposed by the Polish energy regulatory office *Urzad Regulacji Energetyka (URE)*, but the transit fees will further be set by *EuRoPol GAZ*, in which *Gazprom* will hold a 50% stake, while the other 50% will be owned the *PGNiG* company. So far, Poland and Russia have not reached an agreement on natural gas prices and transit fees in 2011⁵.
- Poland demanded a 10% discount for natural gas prices from Russia in the event of exceeding the volume of natural gas to be purchased that was laid down in the contract in exchange for allowing *Gazprom* to retain its monopoly position in the Yamal-Europe pipeline. Although the Russian natural gas company *Gazprom* was not inclined to make any concessions, Russia finally offered Poland a 3% discount if the purchased supplies of natural gas exceeded 75% of the supplies laid down in the contract. Russia also agreed to a discount of 10% on the condition that the discount would be applied to 25% of the volume of natural gas at most when Poland bought no less than 100% of the natural gas volume agreed in the contract.⁶
- Poland and Russia agreed on the annulment of the provision prohibiting Poland to re-export Russian natural gas surpluses to third countries⁷. However, many experts doubt whether lifting the said clause would give any practical benefit to Poland for several reasons. *First*, Poland will simply not have any natural gas surplus to re-export in the short and medium term because of the load of the Yamal-Europe pipeline and the country's energy needs. This means that *EuRoPol GAZ* decisions will not be adopted until they are agreed on by all the shareholders (*Gazprom* and *PGNiG*). Decisions on the issues related to the Yamal-Europe gas pipeline will not be taken unilaterally. On the other hand, the principle of unanimity may block the decision-making in *EuRoPol GAZ*, if *Gazprom* and *PGNiG* fail to agree on any matter, such as conditions for re-exporting natural gas to third countries.⁸

⁵ *Kommersant*, Наталья Гриб, Российский газ разложили по пакетам. <<http://www.kommersant.ru/doc.aspx?DocsID=1530288&ThemesID=290>>.

⁶ *Kommersant*, Наталья Гриб, Газ расширяется при потеплении. <<http://www.kommersant.ru/doc.aspx?DocsID=1532442&NodesID=5>>.

⁷ *EurActiv*, Polish-Russian gas treaty receives EU blessing.

<<http://www.euractiv.com/en/energy/polish-russian-gas-treaty-receives-eu-blessing-news-499415>>.

⁸ *Kommersant*, Наталья Гриб, Анна Занина, В Europolgaz введут единоегласие.

Effects of Polish-Russian gas supply agreement on Central and Eastern European countries

Poland and Russia signed a contract for Russian natural gas supplies and transit via Poland, while managing not only to satisfy the EC requirements formally, but also further strengthen the Russian gas company *Gazprom's* monopoly on Central and Eastern European energy markets due to several reasons:

- As Poland and Russia agreed on the use of the Yamal-Europe gas pipeline, Russia gained additional leverage in exerting pressure on Ukraine, whose territory sees the main Russian natural gas transit flow to Europe. Currently, 80% of Russian natural gas for European countries is carried through Ukraine. The importance of the Yamal-Europe pipeline, which bypasses Ukraine, for the transit of Russian energy supplies to European countries allows Russia to push Ukraine more for privatization of its natural gas transportation system (see *Eastern Pulse* No. 5 (33)).
- The said natural gas deal between Poland and Russia created a precedent as the parties to the agreement formally confirmed that the contract complied with the EU energy regulations and secured EC support for the deal, thus, they neutralized the practical effect of EU norms.⁹ For example, an independent operator would be able to grant the access to the Polish-Russian Yamal-Europe gas pipeline to third countries only if the total capacity of the gas pipeline was not used up and etc.
- The contract on natural gas supplies and transit via Ukraine, signed by Poland and Russia on October 29, 2010, in principle, further increased Poland's energy dependence on Russia, despite the formal compliance in its provisions with the EU's 3rd Energy Package. It is likely that *Gazprom's* monopoly position in the short and medium term (from 2011 till 2022) may affect not only the implementation of Polish alternative energy projects (shale gas exploration and production, the construction of a liquefied natural gas terminal in the Baltic sea coast, etc.), but also to lead to increasing dominance of the Russian capital in the Polish energy market.¹⁰

<<http://www.kommersant.ru/doc.aspx?fromsearch=0f7a22c3-1202-418e-80f2-0802c88b0foc&docsid=1536887>>.

⁹ On November 4, 2010, EU Energy Commissioner Günther Oettinger confirmed that the 29 October Polish-Russian agreement on natural gas supply complied with EU law. – *Eubusiness, Russia, Poland Gas Deal in Line with EU Law*. <<http://www.eubusiness.com/news-eu/poland-russia-gas.6tj>>.

¹⁰ For example, Russia is particularly concerned that in the short and medium term Poland would not develop shale gas field exploration, which is being carried out in Poland by such U.S. companies as *Exon, Chevron, Conoco-Philips, Marathon Oil* and others having the latest shale gas exploration and extraction technologies. The Polish government has issued a total of several tens permits for Western companies for shale gas exploration and production in Poland. According to U.S. companies' estimates, from 1.4 to 3 trillion cubic meters of gas could be extracted from the shale in Poland. As reported, Poland's annual demand for natural gas stands

The natural gas supply contract, signed by Poland and Russia on October 29, 2010, may be viewed as a unique Polish-Russian consensus on energy as it is reflected by their coordinated positions on the EU and Russia's involvement in joint energy projects with Poland. On October 29, when signing the said agreement, Russia invited Poland to take part in the construction of the nuclear power plant in Kaliningrad Oblast. Also, Poland and Russia discussed Poland's potential participation through the Russian capital by privatizing the Polish oil concern *Lotos Group*, which owns the Gdansk oil refinery and the second largest chain of petrol stations in Poland. *Lotos Group* is eyed by such Russian companies as *Gazprom Neft*, *Rosneft* and *TNK-BP*. As the Polish government announced its plans to privatize *Lotos Group* (the government holds a stake of 53% in the oil concern) on October 30, it is likely that the concern will be sold¹¹ precisely to a Russian company for several reasons:

- Russia's investment value in *Lotos Group's* privatization increases as the Gdansk oil refinery and an oil terminal at the port of Gdansk are especially dependent on Russian oil imports. To create favourable conditions for Russian investors for *Lotos Group's* privatization, Russia may reduce its oil export volumes to Poland or even stop the oil supply to the country altogether. In other words, in the case of Poland, Russia could use its experience with the Baltic States (the disrupted supply of Russian oil at the port of Ventspils in Latvia in 2002 and at the Lithuanian oil refinery *Mazeikiu Nafta* in 2006).
- On October 22, the Russian state-owned oil transport company *Transneft* announced about the completion of the second pipeline in the Baltic Pipeline System (BPS-2).¹² Eventually, the BPS-1 and BPS-2 oil pipelines, running from Russia's Bryansk oblast along the border between Russia and Belarus to the Russian Primorsk and Ust-Luga ports, should make the shift of Russia's oil exports flow from an old Druzhba pipeline, which runs through East and Central European countries (see Figure 1), to sea routes possible. The re-orientation of oil exports will allow Russia to increase oil export performance (in addition to the existing oil pipeline BPS-1 with the capacity of 75 million tonnes of oil per year, the BPS-2 oil pipeline is expected to reach the capacity of 30 million in 2011 and later up to 50 million tonnes of

at 14 billion cubic metres. If the U.S. company forecasts prove right, Polish gas reserves would be sufficient for from 100 to 200 years, and in the future Poland could reduce its dependence on Russia to zero and focus on gas exports to other states. - *PKN Orlen, Shale Gas: Basic information*.

<http://www.orklen.pl/EN/PressCenter/Publications/Documents/orklen-shale-gas_ENG.pdf>.

¹¹ By February 18, 2011, the Polish government is to select several foreign companies to negotiate *Lotos Group's* privatization - *Warsaw Business Journal*, Alice Trudell, *Lotos Privatization Gets Underway*

¹² The Jamestown Foundation, Vladimir Socor, *Russia Targeting Oil Assets in Poland and Lithuania*.
<[http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=37146&tx_ttnews\[backPid\]=7&cHash=142cf9a297](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=37146&tx_ttnews[backPid]=7&cHash=142cf9a297)>.

oil per year). On the other hand, Russia's ability to switch the direction of its oil exports to Europe may lead to Russia's additional pressure on East and Central European countries when privatizing their energy infrastructure. In Poland's case, it would be the privatization of *Lotos Group*, in Lithuania's case - the possible sale of *Orlen Lietuva* to Russia, etc. It should be noted that changes in the direction of Russian oil transit in principle will not affect the West European countries which receive the Russian oil supplies by sea.

Figure 1. Druzhba pipeline, BPS-1 and BPS-2 routes¹³.



¹³ Source: *European Dialogue*, Druzhba Pipeline Map, (Follow the link for larger view: <http://eurodialogue.org/Druzhba-Pipeline-Map>).