

Jerome Davis

**SPECIFIC ASSETS AND CONTRACTUAL TERMS
A PROPERTY RIGHTS APPROACH TO POTENTIAL RUSSIAN
NATURAL GAS MARKET DOMINANCE IN THE EU INTERNAL
MARKET**

Jerome Davis: Canadian Research Chair (Oil and Natural Gas); Dalhousie University
Henry Hicks AA Building Room 301A, 6299 South Street, Halifax, N.S. B3H 4H6
Canada, e-mail: Jerome.Davis@Dal.Ca

Overview

Analysing Gazprom's global natural gas strategy, it is often difficult to separate what might be termed political demands, posed by the Kremlin from the purely commercial interests of the firm. In the aftermath of the dissolution of the USSR, ownership of specific assets, here primarily transiting transmission lines, were transferred to the newly independent states. These have promptly commenced using these ownership rights to extract economic rents, and in some cases, have severely mismanaged the assets under their ownership. Gazprom's strategy of attempting to regain ownership of these assets in the last five years is on the one hand commercially based. On the other hand, given the nature of the political background behind some of these negotiations, it has been alleged that Gazprom has been acting politically on behalf of its Kremlin owners. The dual nature of this phenomenon can create problems for future EU policy. Under what conditions can Gazprom be said to be a commercial agent or is seen to be acting politically? This paper investigates the nature of this overlap.

Methods

The method to be employed is that characteristic of the Law and Economics School: contractual rights, specific assets, and economic efficiency. We commence with investigating the various contracts utilized in European natural gas trade, and from this basis explore the nature of possible Russian exporter domination of the European natural gas markets. Given the secretive nature of these contracts, the provisions of the contracts in this paper will be based on an assessment of how such contracts probably look, given the nature of what is known about them (and available contractual provision from elsewhere in the world). (See for example, information from Lapuerta and Moselle, 2005, and U.K. Department of Trade and Industry, 2005). Given Russian ownership of various assets both outside and within the EU it is intended to analyze the relationship between asset ownership and contractual provision to pinpoint areas of possible future Russian market dominance.

Results

Perhaps the most obvious Gazprom/Russian strategy to date can be seen in Gazprom's contractual negotiations with the Ukraine, Armenia, Georgia and Belarus. Here Gazprom, almost unnoticed in Western press coverage of these negotiation, has offered relief from higher export prices for natural gas for ownership of the specific assets (international transit lines, primarily) within each of these countries. Higher contractual export contractual prices were intended to 'lever' control of transmission lines in these cases.

The question remains however of how Gazprom can use its future status as prime supplier to other markets in the EU to achieve economic/political results there, particularly given their ownership or control of specific assets further downstream, particularly at the LDC end. To this end, it is intended to analyze how future revised export contractual provisions

can be 'engineered' to give market dominance additional leverage through achieving 'synergies' with EU-based assets under Gazprom control.

(Preliminary) Conclusions

What we have here is essentially a coordination problem between the various European transmission companies and the nature of their contractual relations with Gazprom. This problem, the nature of which will be described further in the paper, should be given high EU priority.

References

- Helm, D. 'Energy policy: security of supply, sustainability and competition, ' Energy Policy, 30(2002), 172-184.
- Lapuerta, C. and B. Moselle, 'Convergence of non-discriminatory tariff and congestion management systems in the European gas sector' (The Brattle Group, September ,2002)
- U.K. Department of Trade and Industry, 'Conditions for truly competitive gas markets in the EU' (Report by Energy Markets Limited, volume one, November 2005).
- Von Hirschhausen, C. B. Meinhart, F. Pavel 'Transporting Russian Gas to Western Europe- A Simulation Analysis' The Energy Journal 21,2 (2005) pp. 49-68