

Gas Industry

Gazela is among the last company-financed gas pipelines: this kind of venture is too risk-fraught

★ Interview

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Today is the opening ceremony for the Gazela gas pipeline at Pšimda. Russian natural gas will enter the Czech Republic which flows into Europe across the bottom of the Baltic Sea. "This is the most important project of the past 30 years", says Thomas Kleefuss, CEO of Net4Gas, the company who built the pipeline, in the interview with us. Net4Gas is a subsidiary of RWE. "Completing Gazela was the No. 1 priority of the Czech gas industry", seconds Jiří Gavor, executive at ENA, an analyst business. According to them, the Czech Republic will no longer be dependent on the political situation in Ukraine, and a recurrence of the 2009 gas crisis is thus impossible.

HN: In your view, how can the Czech Republic benefit from the Gazela gas pipeline?

This is a very important project, one of the greatest of the past 30 years. This was the last chance for the Czech Republic, and for Net4Gas, to continue with the transport of Russian natural gas. Because the alternative was to bypass the Czech Republic and instead to extend the German OPAL gas pipeline up to Waidhaus.

HN: And what about a gas pipeline from Ukraine across Slovakia?

Yes, certainly. Indeed, the route across Ukraine is the most efficient for both Russian and Caspian natural gas. But at least for another three to five years, things will be complicated.

HN: Why so?

Because of the political situation. I want to believe that both sides took away their lesson from the 2009 gas crisis, and that the relations between Russia, the EU, and Ukraine re-consolidate. But we will never be able to completely rule out another crisis.

HN: Didn't the construction of Nord Stream to some extent involve side-stepping the EU? This was strictly speaking an understanding between Germany and Russia.

Oh that's the spin Poland puts on it, more or less. But look and see how today's market works: to the extent that the Russians deliver gas, they do so for Europe in its entirety - as soon as the gas is made available for trading at one of the commercial hubs, anyone can buy it, the Poles included. Ten years ago, this wouldn't have been possible - you need to look at it from the vantage point of today's market.

HN: Why, then, is Gazela so important? Strategically? Economically?

There are three main reasons. Firstly, we have a new transport route from Russia to the Czech Republic and beyond. These are not necessarily gas deliveries exclusively designated for Czech consumption; the gas can travel further, to Bavaria, and vice versa. Secondly, huge amounts of capacity are set free in the existing pipelines. During the 2009 crisis, we could see how the insufficient capacity meant that there was no way how to get gas to the Czech Republic, and from there to Central Europe. In other words, Gazela translates again into increased security of supply. And thirdly, this is an economically extremely favorable deal. We expect annual revenues around 2.5 billion crowns.

HN: Did you manage to stay within the projected budget of 10 billion crowns?

In fact, we built the gas pipeline for a little less. In other words, we delivered on time, and without a price hike. That's not too common these days.

HN: What were the biggest problems you faced? There was talk of issues concerning the building land. That was definitely the most difficult part. The last time a gas pipeline was built in this country, thirty years ago, there was but one landowner: the

state. Compared to 1035 land owners today with whom we had to sort it out in negotiations. This was decidedly not an easy task. Nor was it easy to deal with the public authorities; in fact, the Building Code was amended several times during the project. We had unequivocal support on the level of the national government, true - but we had to take it to the regions, to townships, and in the end to the individual owners.

HN: There was also a lot of talk about property speculation regarding the land across which the pipeline should be routed.

It was exasperating! We secured around 80 per cent of the land without trouble. People approached the topic along the lines of "this is a great project, I'll get compensation, I have no issues with it". Around twenty per cent required more involved talks and explanations. And then, sadly, there were around twenty individuals who tried to make money off our project. And when you have no recourse to a functioning eminent-domain procedure, and these people are often quite chummy with the local officials... It was an ordeal, but in the end, we sorted it all out.

HN: Could you be more specific? Did you have to take people to court?

Yes, we did. But in the end, we always reached an agreement anyway.

HN: Did this have an impact on the final price for the project? Kilometer for kilometer, the Nordstream pipeline extensions were cheaper than Gazela.

The published prices were only estimates. For 470 kilometers, they paid a billion euros in Germany - that is two million euros per kilometer and then some. In our case, we have 166 kilometers for approx. 330 to 340 million, plus the costs of the Brandov transfer station of around 30 million euros, so we are just as expensive as they are - in fact, I would say we probably are a bit cheaper in the end.

HN: To what degree did Czech firms contribute to the construction of Gazela?

One key supplier was, above all, Pardubice-based Plynostav, of course alongside many subcontractors. CEPS, for instance, for pressure test, various cable work, and others. The project management was in the hands of Russian Stroytransgaz and a Belgian-Austrian consortium: Denis Alpin. All told, about two third of all jobs went to Czech firms.

HN: You've mentioned earlier that Gazela was the only gas pipeline paid for by a private business. What does this mean?

Today, this is one of a precious few projects funded by the transport operator. And we won't see many of these in the future either - if at all. There are no transport operators, aside from shippers-cum-producers like Gazprom, who are willing to invest billions over a period of ten, twenty years without long-term transit contracts. The markets are much more liquid than in the past, and traders want more freedom. In the past, large companies said, we have a long-term contract for gas from Russia or Norway, and that's why we also need a long-term transport contract. But look at new players like ČEZ. ČEZ buys at the drop of a hat, whenever it can buy cheap gas and get it to the Czech Republic somehow. They don't give a hoot for long-term contracts. Which means that investments into key infrastructure are becoming ever more difficult, and that we need new rules for financing. Before you tie up money in an investment of 20, 25 years, you need certain guarantees.

HN: Could this jeopardize the building of such projects?

Well, take a look at the efforts to make the transition to carbon-free energy sources. Where is the rub? In the transmission grids. You produce solar power in Moravia, but the consumption is in Prague or Pilsen. Gas



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has always been transported over larger distances. But today, you need much greater flexibility. You don't need huge gas pipelines, you need smaller, flexible routes. In the Czech Republic, we already have reverse-flow mechanisms. But five years back, this was impossible; in the end, the money came from the European Union, in the wake of the 2009 gas crisis. Often, it is not the customers in the Czech Republic, but the customers in Slovakia or Austria who need better pipelines and bigger capacity. And if the latter do not want to foot the bill for pipelines abroad, then the European Union must step in with a solution.

HN: Is this the same problem as in the case of Germany's insufficient power grid, with German electricity transmission destabilizing the Czech system?

Exactly. Why should the Czechs pay for transit, if Germany doesn't? A mechanism of some sort for re-allocation between countries will have to be stipulated, or be created by the European Union.

HN: You've had plans for a number of additional pipelines. What is their fate, if future investments are not worth it?

In Moravia, a gas pipeline runs be-

Gazela Gas Pipeline

10
BILLION

The 166 kilometers of the new Gazela pipeline, and the Brandov transfer station cost 10 billion crowns. RWE expects a return on the investment by 2035.

56
MILLION

56 million cubic meters: the daily transport capacity of Gazela, or roughly twice the daily consumption of countries such as Slovakia or Austria.

tween Břeclav and Ostrava which right now leads further into Poland. However, it already operates at full capacity, and you therefore cannot add any new customers. You can't just up the capacity somehow, but you have to build a completely new gas pipeline. That's why we prepared the Moravia project. But who is going to pay for it? The customers in Ostrava won't scrape together five billion crowns. This price must be distributed across the customer base in the Czech Republic as a whole. There you have it - the market wants a gas pipeline, but we don't have the money to make an investment which is not backed up by a guarantee.

HN: But wasn't this the kind of problem the liberalized market was supposed to resolve? Isn't this simply a matter of valuing the transport so highly as to ensure a return on the project?

But the market does not take care of it. Because the only players are traders, and their thinking is short-sighted.

HN: Doesn't this mean that the attempt to open the energy market was foolish?

You've got to differentiate between separate concepts here. Unbundling infrastructure from trading is primar-

ily not a bad idea. But we have a mixed system of market forces and regulation today, and that's why we need guarantees and exemptions.

HN: What is the current state of progress of the Moravia project?

We are waiting for a consensus regarding the financing. We have been working on this project for about three years already, and the EIA study has just now passed muster. We hope to reach a financing agreement with the Regulator (ERÚ), so that they will allow us to reflect the investment in the gas tariff. If everything goes well, we would like to complete this project by 2017. The mileage is similar to the Gazela pipeline. Next up among our plans are the connections to Slovakia and Austria.

HN: Is Moravia a part of the project to connect the LNG terminals in Croatia and Poland?

Allow me to rectify one oversimplification of which you journalists are sometimes guilty: clearly, "connecting" is what one does to bring a source to the market, rather than bringing two sources together. That being said, countries clearly want flexibility, want to have a source up north and in the south. We already have an east-west connection. Thanks to Gazela, we now transport up to 56 million cubic meters of gas per day, which is twice the Slovak or Austrian daily consumption. This is why a north-south connection is now being contemplated: aside from greater security, it would also yield greater commercial flexibility. However, Poland is not a very advanced country in the area of gas - it is a large country, and hooking up all its regions is a complex endeavor. Does it make sense today to buy LNG in the Baltic Sea? After all, the ships come in from the Mediterranean, and the transport up north has a price tag. In commercial terms, I doubt it is worth it, especially from the Czech perspective. At the same time, the Poles certainly want a second source aside from Russian gas, but I don't want to comment on this. As for an LNG terminal in Croatia? Ten years ago, this was a fantastic project in an ideal location. I believe they missed the boat, though. As soon as another gas pipeline, be it Nabucco or South Stream, delivers gas to Italy, another terminal becomes entirely pointless.

HN: So there won't be a north-south route?

Connecting Poland to the Czech Republic, and the Baumgarten trading hub in Austria, might turn out to be more important. In Western Europe, the gas market is already fully liquid, and now we have this liquidity in the Czech Republic as well. The gas price is no longer ordained by Russia, but determined in the German market just like the price for electricity.

HN: Aside from Moravia, what other plans are on the table?

We are in negotiations over gas pipelines with Slovakia and Austria, and also over a connection with the western part of Austria. The gas pipeline would be routed around České Budějovice towards the Austrian and German borders. This would give us two gas pipelines which connect to Austria, which makes e.g. transits between Prague and Salzburg easier. However, this project is in its early stage.

HN: RWE has offered Net4Gas for sale. How is the process coming along?

The idea is to solicit binding offers in the first quarter; the sale should be closed in the second quarter. Note, however, that the negotiations are about us - we are not the seller. I cannot comment on what seller and buyer might agree upon.

I want to believe that both sides took away their lesson from the 2009 gas crisis, and that the relations between Russia, the EU, and Ukraine re-consolidate. But we will never be able to completely rule out another crisis.