

**Interview** Alan Riley

# A bad time for a pipeline?

| by Karel Beckman and Stefan Nicola



Photo: Kai Sanf

It was, more than anything else, the European Parliament who got Alan Riley, Professor at the City Law School in London, involved in Nord Stream. 'They asked me to look into this', he says. Riley wrote a highly critical paper on Nord Stream for the European Parliament Foreign Affairs Committee (Nord Stream: An Economic and Market Analysis of the North European Pipeline Project). In his paper he focuses on the economic rationale of the project. Riley, who has done work for the UK Defence Academy and has acted as an advisor to the Lithuanian government, is currently writing another paper for the European Parliament on another Russian pipeline project – South Stream.

## What have you got against Nord Stream?

I look at Nord Stream from an economic angle. Economically, the project is unfortunate. The costs of projects like this are extremely high and getting higher. It is a bad time to build a pipeline – any pipeline. Then, the liberalisation of the EU energy market increases the options of consumers. There are plenty of non-Russian gas sources available. That means if Nord Stream's cost base is higher than that of existing pipelines, they will have a disadvantage.

## To talk about the costs first, you have given an estimate of €12 billion.

Because of the high oil price, there is a huge demand for new exploration and production, and thus costs for steel piping and services have increased. We are seeing at least a doubling of costs in the oil and gas sector. Nord Stream has already admitted that costs for the pipeline have gone from €4 billion to at least €7 billion. But it doesn't stop there. The consortium has problems receiving environmental permits, resulting in yet another delay of the construction of Nord Stream. So according to my best estimates, we are now pushing in the direction of €12 billion. It will be very difficult for the companies involved to shoulder that, and of course the customer will feel that as well, because someone will have to pay for the extra costs. It's already a lot of money for Gazprom, but imagine the costs to the likes of Gasunie and the other companies involved. You also have to explain that to your shareholders.

## The company emphatically denies that costs could go anywhere near €12 billion. Its current estimate is €7.4 billion. Some 60% of the costs have already been accounted for, so how could costs get out of control?

Well, if they could build it today, they could probably hold it around this figure. But what if the project is delayed for another two years? Will they be able to enforce their contracts if the steel price goes up again? What will be the costs of dealing with possible environmental issues? I don't know where it will end up. I do know that the likes of BP are cutting back on projects because of spiralling development costs.

You have said that the underwater route is much more expensive than if they had chosen to build a pipeline over land. Again, the company denies this. It says the underwater route is 15% cheaper.

*‘The solution is not to build very expensive pipelines, but to create an effective transit system for Europe.’*

With the most generous interpretation, based upon the Ukrainian transit fee price, Nord Stream will give you a bonus of about \$1 billion a year, which is significant, but it is based on the pipeline being able to deliver 55 billion bcm of gas a year, and that’s not sure at all. The first of the two pipes relies on identified gas fields in Western Siberia. The problem is there are no identified gas fields connected to the second pipe. The best scenario is that the gas will come from Shtokman, but the problem is that work to explore Shtokman has hardly begun. And we are not talking about an easy field; Shtokman is 560 kilometres off the coast and 300 metres down. And if the Norwegians are taking several years to open an offshore field, how would Gazprom, which has no offshore experience, be able to open Shtokman any time soon? They are also claiming that operating an underwater pipeline is cheaper than operating a land pipeline because you don’t have to build and run compressor stations. I am amused at this argument. How on earth can that be right? Why don’t the Brits then build all their pipelines under sea?

**Even if you are right, isn’t this a problem for the companies only? How could this be a problem for consumers?**

If consumers have a choice, then, yes, it is more of a problem for the companies. You could argue that if they want to load up a lot of debt, let them.

**Why would the Russians want to build a pipeline that is not to their economic advantage?**

I am reminded here of what Churchill said about the Americans: ‘they always make the right decision, after first having made all the wrong decisions’. I have the same feeling sometimes about Gazprom. But don’t get me wrong. They do have a legitimate security issue connected to land pipeline delivery, especially through Ukraine. In 2001, the Deputy PM of the Ukraine admitted that they stole 8 billion cubic metres of gas, which in 2001 prices was worth \$1.5 billion; today it would be worth nearly \$5 billion. The Russians legitimately shouldn’t have to tolerate that. But the solution to that isn’t to build very expensive pipelines, but to create an effective transit system for Europe. It cannot be beyond the wits of man to do this. We should actually try to create a tougher transit regime with more powers to enforce regulations so transit across Europe is safe and secure – for both importers and exporters. That is my major point: let’s have a very strict transit protocol, that is strictly enforced, and that takes into account the legitimate interests of the Russians. Even if we fill Nord Stream and South Stream, we will still need to bring massive amounts of gas through Ukraine, so we still have the transit issue on the table. So let’s deal with the issue – we’re not doing it with Nord Stream.

**Of course it’s hard to pull out now for the companies involved – it would be embarrassing.**

They may have to. There is an issue about legal challenges on environmental grounds. One of the problems is that there are lots of environmental directives in the EU that may enable challenges from environmental groups. The concern is that someone will challenge it on EU law grounds and force a reference with the European Court of Justice in Luxembourg, and they won’t answer within years. If that happens, I think the Russians might walk away from the project. They might be glad to have an excuse to do so.

**Well, as a matter of fact, they not only want to build Nord Stream, they are planning to build another pipeline to Europe, South Stream.**

South Stream may look very strategic from the Kremlin’s point of view. They may be doing this to stop Nabucco. But I question whether it is really necessary. If you refurbish the Ukrainian system, you will probably have enough capacity. I think South Stream is a potential disaster for the Russians. In fact, I cheered up a Baltic audience recently when I said that.

**So what about Nabucco? Does Nabucco make economic sense in your view?**

I have problems with Nabucco as well. I have serious doubts about the Iranian gas supply. Iran has a huge population, they need a lot of gas. They are talking about importing gas from the Azeri’s. The second problem is Turkmenistan. The IEA has doubts about the scale of their available reserves. They tend to overstate them. It is doubtful whether they can fulfil their obligations both to Russia and the west. So all you are left with is Azerbaijan. That may be enough for the first stage of Nabucco, but no more.

**Nevertheless, the European Commission has designated Nord Stream as a project of European interest.**

That was done a few years ago. I can’t imagine they would do that if they had to do it now. The context has changed enormously. Aside from that, many governments in Europe disagree. They see this as a purely German-Russian project, also because there was very little consultation with the Baltic states beforehand. Governments in Scandinavia or the Baltics will say ‘you may call this an EU project but we don’t feel that this is an EU project at all.’ They should have really attempted to bring people into the project before and at the start. Essentially, Nord Stream is a PR disaster for Gazprom, Russia and Germany.

**So what do you think are the chances of Nord Stream getting built?**

I think the chances are 50/50. ■