

Gazprom, Eni Plan New Gas Pipeline to European Union (Update3)

By Adam L. Freeman and Yuriy Humber

June 23 (Bloomberg) -- OAO Gazprom, the world's biggest natural-gas producer, and Eni SpA may build a pipeline from Russia to the European Union, bypassing neighbors that have threatened to block supplies on existing routes.

The 900-kilometer (558-mile) South Stream pipeline could go under the Black Sea to Bulgaria and then split in two, Eni Chief Executive Officer Paolo Scaroni told reporters in Rome today. The project will now go through feasibility studies, and construction may start as early as next year, he said. It will carry gas equal to as much as a third of German demand.

State-controlled Gazprom, seeking to bolster European sales and cut transit risks, has announced three new pipeline projects in 12 months. Neighbors including Ukraine and Belarus are used as transit countries for Russian gas sales to EU nations and both have threatened to block supplies because of pricing disputes.

``Gas is a political commodity nowadays; economically speaking, this project is not really justifiable," Vladimir Matias, managing partner of Asset Capital Partners, said today by phone from Vienna.

The new pipeline will provide a direct route into Italy and Austria and mirrors Gazprom's project with E.ON AG and BASF AG to build the Nord Stream pipeline to Germany. South Stream will avoid the need to send gas through Ukraine and Belarus, while Nord Stream bypasses the Baltic states, which often have tense political relations with Russia.

Gazprom, based in Moscow, already supplies a quarter of Europe's gas needs. The company's profitability depends on exports since state-set gas prices in Russia are about a fifth of those in Europe.

Russian Control

Russia is seeking to regain control of energy assets and has pressured foreign investors into relinquishing their projects in the country. Royal Dutch Shell Plc ceded control of its \$22 billion Sakhalin-2 project to Gazprom in December, while a unit of BP Plc yesterday announced the sale of its 63 percent stake in a Siberian gas deposit to Gazprom.

For Eni, Europe's fourth-largest oil company, the pipeline would secure gas supplies for Europe's third-largest gas market behind the U.K. and Germany. Italy buys 86 percent of its gas from abroad, mainly Algeria and Russia. The new pipeline may carry as much as 30 billion cubic meters of gas a year.

``Building South Stream is the most audacious plan in the history of gas pipelines and in our sector," Scaroni said. ``It aims to meet the gap between Europe's gas supply and demand."

Eni, based in Rome, agreed in November to let Gazprom build up retail sales in Italy and extended its purchase contracts with the producer to 2035 in return for joint access to oil and gas reserves in Russia and Africa.

Gas Exports

Today's agreement ``underlines that Italy is playing ball with Russia" to secure future gas supplies, Asset Capital Partners's Matias said.

Gazprom has exported gas to Italy via Eni since 1974. Gazprom is already supplying about 25 billion cubic meters of gas a year to Italy, making it Gazprom's second-largest country client after Germany.

Still, Eni's existing dominance of the Italian gas market may make winning regulatory approval for the southern route more difficult. Only one of the two proposed pipelines within Europe may be built and the northern route has a higher priority, Scaroni said on the sidelines of the briefing.

The new proposed pipeline also carries political risk, some investors said.

``The gas will have to cross through eastern European countries and east Europe hasn't reached the level of political stability that makes for a good investment environment," said Giorgio Mascherone, chief investment officer at Deutsche Bank SpA in Milan, who helps manage 32 billion euros (\$43 billion).

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