



BULLETIN

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Russia's Expansion on the German Oil Market

Jarosław Ćwiek-Karpowicz

Despite Rosneft's ongoing financial problems associated with Western sanctions, the Russian oil behemoth succeeded in signing two agreements with Total and BP, allowing it to take control of a German refinery in Schwedt. If the German authorities approve the deal, Rosneft may significantly strengthen its position in eastern Germany, jeopardising the competitive balance among those energy companies already operating in the region. Additionally, Rosneft may become a serious challenge to Polish oil companies operating across the border. Such a scenario would inhibit energy sector cooperation between Poland and Germany.

During last week's economic forum in St. Petersburg, information about the purchase of a 16% stake in German refinery PCK, in Schwedt, went almost unnoticed. The largest Russian state-owned oil company, Rosneft, purchased the stock from French oil giant Total for about \$300 million. Additionally, there was an agreement concluded with BP on the distribution of assets in the joint venture Ruhr Oel. For the past four years Rosneft and BP have held a common stake in four German refineries—Gelsenkirchen (100%), PCK in Schwedt (37.5%), Bayernoil in Neudstadt (25%), and MiRO in Karlsruhe (24%)—effectively controlling one-quarter of the refining sector in Germany. Assuming German authorities accept the deal concerning the distribution of Ruhr Oel assets, BP will become the sole shareholder of the refinery in Gelsenkirchen, while Rosneft will hold all the others. Thus, through agreements with Total and BP, the Russian company will have control (with *de facto* 54% of its shares) over the strategically important refinery in Schwedt, which is in close proximity to Berlin and the Polish border. Currently, it is unclear how the reorganisation of Ruhr Oel will appear legally after the changes. It is possible that *de jure* the Russian company will continue to have at most half, rather than the entire lot of Ruhr Oel's stake in PCK Schwedt (18.75%), which together with the newly acquired Total shares (16.67%), would create a facade that Rosneft is still a minority shareholder (35.42%) and thus poses no risk to the German market.

The Importance of the Schwedt Refinery for Germany. The German refining sector is highly diversified. A major challenge for the operation of the plants is the falling demand for oil products in Germany, largely the result of its transition towards renewable and low-carbon energy sources (*Energiewende*). Even though the PCK refinery in Schwedt produces one-tenth of all oil in Germany (about 10–12 tonnes annually), it manages to meet the energy needs of almost the entirety of the Brandenburg, Mecklenburg-Western Pomerania, and Berlin regions. Its products are put on the market by major shareholders (in addition to Rosneft, other shareholders are Shell and ENI) using a developed distribution system: a quarter is supplied by pipeline to a storage facility in Seefeld, near Berlin; half is distributed by rail; and the remainder is delivered by road. The competitive advantage of the Schwedt refinery is derived from processing cheaper Russian REBCO oil rather than the pricier Brent crude from the North Sea, which allows the plant to achieve a higher profit margin than most plants operating in Germany. This is possible through a connection to the Druzhba pipeline, which was constructed in the 1960s to provide crude oil from the Soviet Union to its satellite states, i.e., Poland, Czechoslovakia, Hungary and East Germany. Currently, besides PCK Schwedt, the only plant in Germany to use raw crude from the Druzhba pipeline belongs to the French-owned Total refinery in Leuna. It is worth noting that both refineries specialise in processing Russian oil, effectively maintaining a competitive advantage over other German plants. This phenomenon has created a lack of convergence between oil pipeline systems in the eastern and western halves of Germany.

The strategic nature of the PCK plant in Schwedt lies in its location. In addition to being connected to the Druzhba pipeline, the plant can also receive raw crude by sea via a terminal on the port of Rostock, which is connected to the

processing plant through an exclusive 200km-long pipeline running from Rostock to Schwedt. The pipeline has limited capacity (about 7 million tonnes per year); however, there has been an effort to increase it. The chief problem is the limited port handling capacity in Rostock (about 9 million tonnes), which, so far can only handle tankers with a maximum capacity of 100,000 DWT. Without a major oil terminal expansion and deepening of the fairway, other Baltic Sea ports continue to be superior to Rostock.

The Polish port in Gdansk, with its oil terminal capacity (33 million tonnes), and the Polish oil pipeline system both act as safeguards for the German refineries in Schwedt and Leuna, hedging against a disruption in the supply of Russian oil. With the acquisition of the plant in Schwedt, Rosneft will most likely seek to better utilise the port in Rostock and employ its own direct supply routes. It is unclear how much the Russians will try to convince Germany that a significant expansion of the port of Rostock is needed, and whether it can become a Russian regional hub for crude oil delivered from two giant Russian oil ports on the Baltic Sea, Primorsk and Ust-Luga. Russia's Gazprom, though, has lobbied for expansion of the LNG gas terminal in Rostock. Undoubtedly, this scenario is attractive in terms of regional economic development in northeastern Germany; however, it is difficult to justify economically in the context of the existing method of transportation through the Druzhba pipeline, which also happens to be the cheapest.

Russia's Motivation. Along with obtaining control over the PCK Schwedt facilities, Russian authorities are overseeing the materialisation of a long-held plan: one in which they hope not only to sell raw crude but to gain access to refinery plants and gain entry to the high-priced West European markets. In addition, recently enacted changes to the Russian tax code also favour this scenario, as there has been an increase in taxing oil producers while lowering tariffs on exports. It is possible that Rosneft will manage to persuade the Russian tax authorities to drop its customs duties, reasoning that it is importing crude to its own refinery in Germany. If this scenario transpires, Rosneft has the chance to dramatically increase its profit margin and considerably expand its market share. It seems plausible that there will be synergy between the Rosneft plants on both sides of the Baltic while creating a precedent for greater German–Russian industrial cooperation.

The Russian side is also keen to acquire proven German know-how—along with advanced refining technologies—while developing its own transport network based on Baltic Sea infrastructure. For geopolitical reasons it appears the Kremlin wants to create a supply line independent of the current Druzhba pipeline that passes through Poland, Belarus, and Ukraine (southern line). Therefore, Moscow may be inclined in time to support construction of a Leuna–Litvinov pipeline, which would ensure that Russian oil bypasses the Druzhba and reaches not only the refineries in eastern Germany but also the Czech Republic, Slovakia and Hungary.

Implications for Poland. The acquisition of a German refinery by the Russian oil giant will undoubtedly pose serious problems for Polish refiners, which use up to 90% of Russian oil for their processing. The chief concern is predatory pricing, which is in breach of EU competition laws (Art. 101 and 102, TFEU). Polish authorities should actively monitor the Russian company and its activities on the German market, reporting any observed irregularities. Also, it is imperative to call attention to the recent deal, indicating to German authorities that it may pose a threat to free competition on the regional oil market. Consequently, a study should be conducted on the effects of the acquisition (for example, by Germany's Federal Ministry of Economy and Energy) to investigate such concerns. Furthermore, this indirect acquisition by Rosneft proves that it is worth strengthening the European Commission by amending Regulation 139/2004 (EC Merger Regulation) by including a clause regarding abuse of a dominant position by a minority shareholder. The recent transaction also restricts the strategic potential of the oil port in Gdansk and its prospects for greater development. The clear message for PKN Orlen and the Lotos Group should be to diversify their supply. Last but not least, the idea of a Moravia pipeline, linking Poland with the other Visegrad countries, is also worth consideration; it could be a catalyst in helping to transform the port of Gdansk into a petroleum hub for the entire region.