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Bear Paw in the Honey Pot
Russian Oil and Gas Investment in Central Europe

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Eastern and Central Europe are highly dependent on Russian gas supply. During the last few years, Moscow has assertively sought to extend its leverage using the "energy weapon" in the region. As a further step to increase this dependence, Russian energy giants are ready to invest in Eastern and Central European oil and gas firms as the latest purchase of shares in the Hungarian company MOL by Russian owned Surgutneftegas demonstrates.

Financial investment or strategic expansion?

On March 30, Hungarian MOL's – one of Central Europe's biggest oil and gas companies – leadership learnt through press coverage that 21.2 per cent of the firm's shares had been sold to the Russian company Surgutneftegas by the Austrian company, OMV. MOL, as a Public Limited Company, is registered on the Budapest stock exchange. The company's ownership structure is divided among smaller investors, including foreign financial investors and a few strategic partners (e.g. the Czech energy concern CEZ, with 7.3 per cent of the shares). Until the latest transaction, OMV had been the largest shareholder. The unexpected event has opened a new chapter in the Hungarian company's history, but more importantly it could redraw the balance of power in the oil and gas business in Eastern and Central Europe, where Russian leverage has already been significant.

MOL, which has remarkable influence over the Croatian and Slovakian oil market through its subsidiaries Slovnaft and the Croatian INA, had been struggling with OMV's hostile takeover attempts since 2007. The Austrian oil and gas company had over a period of time bought up 21.2 per cent of OMV's shares on the stock exchange, and publicly offered a remarkable price for the rest of the firm. However, the acquisition, opposed by both the Hungarian political elite and the European Commission, was unsuccessful. The latest transaction between Surgutneftegas and OMV signifies that the Austrian firm has given up its intention to be affiliated with MOL, but has created a situation where Russia could gain excessive influence over the region's oil and gas market.

The transaction would seem to have been extremely advantageous for OMV, which received 1.4 billion Euros for the shares, or 19,200 Hungarian Forint per share, almost double that of the 9960 Forint quarterly closing price of the firm. The current low price on the stock exchange is due in large part to the financial crisis which is hitting the Hungarian economy very hard, providing a window of opportunity for hostile takeover actions through the undervalued share prices. Nevertheless, the importance of the share prices is insignificant compared to the strategic advantages Moscow could gain through MOL.

First of all, if a Russian state-connected entity takes over MOL, the latter's participation in the EU's Nabucco gas pipeline project, which is planned to transport gas from the South Caucasus and Central Asia (and potentially Middle Eastern countries) through Turkey to the European market via the Balkans and Hungary, will become more than doubtful, thus it could lose not just one of its six partner companies and a financial supporter, but also Hungary as a transit route. At the same time, the investment could facilitate the Moscow-backed South Stream project, the Nabucco project's Russian rival, increasing the region's already significant dependence on Russian gas imports. In addition, through MOL and INA, Moscow could gain leverage over the planned liquefied natural gas (LNG) terminal on the Adriatic, a possible alternative gas source for the region.

Reactions to the acquisition

According to Surgutneftegas and its Director General Vladimir Bogdanov, the firm's MOL acquisition is a "vertical integration" which could create a "productive and long-lasting relationship" and also brings "maximum proximity to end users of the oil products," thus portraying the investment as an average market transaction. By contrast, MOL's management places emphasis on the fact that there had not been any kind of cooperation or prior consultation between the Russian company and MOL, "therefore, the intention of Surgutneftegas formulated in its statement, is not clear. The Board of Directors of MOL considers Surgutneftegas to be a financial investor, and does not comment on transaction between ordinary shareholders."

The Hungarian government was more forthright in its response to the acquisition, summoning the Russian ambassador to the Ministry of Foreign Affairs to provide an explanation of the transaction and also used diplomatic channels to inquire about the lack of prior notice from the Austrian government. The Hungarian frustration is in particular understandable because a few weeks before the deal, then Prime Minister Ferenc Gyurcsany and a large MOL delegation had visited Moscow to sign a bilateral agreement on the South Stream project and the building of a more than 1 billion cubic meter capacity gas storage site in Hungary. In spite of the fact that the Hungarian prime minister had met high ranked Russian officials, including President Dmitry Medvedev and Prime Minister Vladimir Putin, the Kremlin concealed any information concerning the acquisition. It is hardly conceivable that the Russian and Austrian governments were not aware of the deal taking place between the partly state-owned OMV and the biggest fuel supplier to the Russian army, Surgutneftegas. Moreover, Surgutneftegas has an opaque ownership structure, and is so close to the Kremlin that it is believed to be directly controlled by Russia's political leadership.

Worthy of note is that the negotiations between the Hungarians and the Russians in Moscow were not smooth. According to *Kommersant*, Putin at a press conference publicly lectured the Hungarian prime minister about the difference between the Nabucco and South Stream projects in favor of the latter, while Gyurcsany expressed his concern over the excessive Hungarian dependence on Russian gas, and the advantages of the Nabucco project. In Hungary, some journalists claim that the Russian investment in the MOL is nothing but a punitive action for Hungarian involvement in the Nabucco project. In other words, Moscow is flexing its muscles to show how important it is to maintain a good relationship with the Kremlin.

Budapest has been trying to steer a careful course between the two rival gas pipeline projects for a while now, hosting an international Nabucco conference in January 2009 and signing a bilateral agreement on building the South Stream's Hungarian section. This policy is mainly due to the high proportion of gas – more than 40 per cent – in the country's primary energy consumption (double that of other EU member states) and the fact that the overwhelming majority of households directly or indirectly use Russian gas imports for heating their homes.

Possible developments and alternatives

Long before the recent acquisition, certain business analysts in Hungary had suspected Russian influence behind OMV's share purchases in MOL. Such conjecture has now been given new impetus, considering the transaction – and the overpayment to OMV – as an attempt by Moscow to torpedo the Nabucco project and persuade the Austrian government and OMV to support the South Stream project, even if Gazprom is unlikely to have the necessary capital to finance the project due to the recent economic crisis. However, MOL is a hard nut to crack even for a Russian energy giant. During the last few years, the oil company's leadership has developed an efficient legal defense with the active help of the political parties both in the government and opposition in the Hungarian Parliament, which adopted the so-called Lex-MOL, resisting hostile takeover attempts by OMV. A possible Russian attempt to take control over the firm will certainly face further legal difficulties.

In the light of the enormous Russian leverage over gas and oil imports in Eastern and Central Europe, and the Ukrainian-Russian gas controversy that led gas supplies to much of Europe being blocked for several weeks during the coldest winter month, it is vital for the European Union to increase cooperation in the field of energy security, and furthermore to closely watch the internal energy market, hindering any attempts to build a monopoly or hampering the implementation of flagship EU projects, such as Nabucco. As far as MOL is concerned, it is still an open question whether the Russian company intends to buy further shares on the stock exchange to try to take over MOL, or whether it will keep its profile as merely a financial investor.

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