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Working Paper

Trust and European-Russian Energy Trade
The Case of Natural Gas Partnerships

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Abstract

This study argues that, in addition to political and economic factors, the level of trust in interpersonal relations influenced outcomes in European-Russian energy trade. Drawing on selected cases of natural gas partnerships, it examines the impact of trust on energy trade. The findings are the following. First, trust mitigated suspicion and encouraged cooperation between the commercial and political actors. Second, when trust was present, conflicts of interest were more easily overcome while in its absence, a spiral of litigation and attempts at political coercion ensued. Third, the development of trust was partially determined by pre-existing political and economic conditions. At the same time, actors had the option to make decisions that either contributed to building trust or suspicion, the opposite of trust.

Introduction

Much academic attention has recently focused on the causes of conflict plaguing energy trade between European and Russian partners. The question usually posed is whether Russia aims to use its oil and gas resources as a tool to exert political influence or maximise profits. Does politics precede economics or vice versa? There is, however, a critical determinant missing from the discussion, one that, along with political and economic factors, influences outcomes, trust.

Drawing on selected cases of European-Russian natural gas partnerships, this paper examines the role of trust and its impact on energy trade. The findings are the following. First, trust mitigated suspicion and encouraged cooperation between the commercial and political actors. Second, when trust was present, conflicts of interest were more easily overcome while in its absence, a spiral of litigation and attempts at political coercion ensued. Third, the development of trust was partially determined by pre-existing political and economic conditions. At the same time, actors had the option to make decisions that either contributed to building trust or suspicion, the opposite of trust.

In addition to measuring the effects of trust, this study investigates the conditions and policies that encouraged the development or erosion of trust. The first case is the British-Russian joint venture, TNK BP, established in 2004 between British Petroleum (BP) and investment group, Alpha Access Renova (AAR). The second set comprises German-Russian partnerships between Gazprom, E.on Ruhrgas (Eon), and BASF. Two German-Russian partnerships will be examined as one case because they eventually merged, and the history of one influenced the development of trust in the other. Between the two groups, trust was a determining factor insofar as it coloured the preferences of actors, which influenced their decisions at critical stages of the partnerships. It influenced the choice of commercial partners, the handling of disputes, and the resolve to continue a partnership despite more attractive

alternatives. In general, trust between the German and Russian actors explains the high level of cooperation compared to the British-Russian case.

This study comprises three sections. The first examines why the issue of trust became relevant to understanding current trends in European-Russian energy trade. It includes a commentary on the academic discourse and a working definition of trust. The second assesses the impact of trust on decision makers at two critical stages of the partnerships, the formation of a joint venture and the first conflict. The third identifies how trust was developed or eroded and compares the role of trust to political and economic conditions that influenced decision makers. And finally, it poses implications of the findings on wider debates concerning energy trade and trust in commercial and political relationships.

Although the study references other partnerships, the two primary groups of cases are German-Russian and British-Russian joint ventures because they display strong variation of trust levels between Western and Russian parties and consequently, the causal relationship between trust and outcomes are more apparent. Information sources are both primary and secondary including journals, periodicals, publicly available trade data, and interviews conducted by the author with experts and current or former employees. The time frame is from the first interaction of the parties through to the present. The geographic scope is limited to joint ventures between Russian and West European joint ventures because historical circumstances in the east of Europe, namely the legacy of the Cold War, create a different geopolitical orientation to Russia. Issues such as nationalism and an entrenched suspicion of Russia make for a different starting point for Russian joint ventures in Eastern Europe and are beyond the scope of this analysis.¹ The commodity of focus is natural gas because there are

¹ Russia's 'near abroad' refers to the bordering countries that used to be part of the Soviet Union. The dynamic between these states and Russia is conditioned by the experience of being former Soviet republics and, as such, are different from relations with other former communist states in Eastern Europe. With respect to natural gas, this difference manifests in price. Ukraine, for example, has paid Gazprom significantly less for natural gas compared to Poland, because of legacy trade relations among Soviet republics. Although this is changing, the 'near abroad' states can not be treated in the same way as other European states. For further information on this regional variation, see Trenin, Abdelal, Haslam, and Goldmann.

several features of the industry that make it particularly useful in the examination of trust and international energy trade. The restricted modes of transportation by either pipeline or liquefied natural gas (LNG) and the high degree to which Russia protects this industry necessitate both political and economic participation in order to build partnerships. Although the majority of TNK BP's dealings are in oil, it began as an oil and natural gas company, and its inability to actively enter the natural gas market is partly explained by trust.

Trust and international energy trade

In all of the complexities that an energy partnership entails, why would one explore the issue of trust? First, the actors themselves attribute the success or failure of joint ventures to a question of trust. As former BP CEO, Lord Browne of Madingley articulated, 'All oil companies will now struggle with the issue of trust ... building trust will become even more important as permission is sought to 'develop' oil found in ever more challenging environments...' ² Those interviewed brought up the issue of trust to explain the relative success of German-Russian partnerships versus British and American ventures with Russian partners. Therefore, to the extent that actors' perceptions construct their reality, trust, ipso facto, becomes relevant.

The second reason concerns the nature of the international state system. In international energy trade, there is no central authority or enforcement mechanism to govern trade. Unlike consumer goods, which fall under the auspices of the World Trade Organization (WTO), there is no comprehensive multilateral trade regime for natural gas. An explanation of why this is the case is beyond the scope of this analysis, but suffice it to say, most consumer states treat energy trade as a security issue because both their economies and military forces depend on access to natural resources. Even supplier countries typically become dependent on

² Sir John Browne, *Beyond business* (London 2011), p. xiii.

revenues generated by natural resource exports. Consequently, natural gas trade is negotiated by and large bilaterally.

And finally, trust is relevant to understanding international energy trade because it reveals regional variation in the conditions that shape preferences among decision makers. These conditions may include geopolitics, historical suspicions, business-government relations, and established interpersonal networks. Yet, they are typically overlooked in academic and policy analyses concerning European-Russian energy trade.

Trust as a subject of academic exploration

One of the challenges of approaching an issue like trust is the conceptual disagreement among scholars on a working definition. Most admit that the issue is problematic from an analytical perspective, yet the level of academic interest speaks to its analytical significance in understanding social phenomena.

There are, however, aspects of the various scholarship that are evident in the European-Russian case. For example, trust as the opposite of risk, as many economists have employed, was clearly evident in the cases of TNK BP, Eon, BASF and Gazprom. Furthermore, the expectation that partners would adjust their policies to account for each other's preferences, resembling Keohane's definition of 'cooperation', was also evident.³

Based on what actors understood trust to mean and the behaviour that it encouraged, this study will define trust as the belief that the counterparty will fulfil expectations based on mutual interest, previous observed behaviour, and associations while acting in a manner that demonstrates the counterparty's interests. The opposite of trust is, therefore, suspicion, a state in which the party doubts the intentions of the other and expects the counterparty to fail in either fulfilling articulated commitments or act in a manner that demonstrates her/his interests. This two-part definition allows for a measurement of trust insofar as articulated expectations,

³ Robert O. Keohane, *After hegemony: cooperation and discord in the world political economy* (Princeton, 1984), p. 12.

the fulfilment thereof, and signalling behaviour that demonstrates interests are apparent in the interactions of the actors. An example of how this might be applied is a breach of contract because it represents an unfulfilled expectation, thus eroding trust in subsequent interactions. Another illustration characteristic of interactions at TNK BP was the articulated indifference of the American CEO, Robert Dudley, to his counterpart's suggestions.⁴ Often times, however, the actors attributed trust by name to outcomes, and when possible, these references will act as guiding posts throughout the analysis.

This study makes no attempt to incorporate Putnam or Fukuyama's societal dimensions of trust, such as 'social capital', because the unit level of this analysis concerns corporate executives and politicians. Contrary to Fukuyama's distinction between 'high' and 'low trust' societies, all of the actors, from British, American (in the case of TNK BP CEO, Robert Dudley), German and Russian backgrounds displayed similar behaviour resulting from a presence or absence of perceived trust.⁵ Thus the national culture, per se, did not influence the likelihood of actors to trust or distrust; however, the national history, particularly stereotypes and suspicions originating from historical antagonisms, was a factor that constrained the development of trusting relations in some instances.

Cases

To ground the analysis and isolate the causal relations of trust to outcomes, the cases are divided into two stages when actors faced critical decisions. The first was the decision to enter into a contractual relation. Why choose to work with one party over another? The second was how to handle a dispute. These decision points are common to most joint ventures, and thus, the lessons may be applied to multiple international joint ventures. The cases illustrate that trust, in addition to political and economic factors, influenced the preferences of actors to initiate cooperative relations, mitigate the effects of disputes and

⁴ Tom Bower, *The squeeze: oil, money and greed in the 21st century* (London 2010), p. 448.

⁵ Francis Fukuyama, *Trust: the social virtues and the creation of prosperity* (London 1995), p. 225.

breaches of contract, and swayed preferences to deepen their cooperation over time. As a reference, Table 1 illustrates the chain of events of the more detailed case studies.

Stage 1 – Contract formation

In the first stage of the contractual relation, partners typically undergo a selection process. Although there is a formal approach, which includes an economic analysis of factors, such as the financial status of the company, in recent years, political risk has also become an integral component. But, as the cases demonstrate, there was a trust dimension in making the final decision. It was during informal meetings between actors that trust influenced the decision to form a contract, in the case of BP and AAR, and remove trade barriers in the German-Russian case.

There were three factors leading to the first contracts. First, commercial incentives were the impetus to explore a trade and investment. Next, the political climate, which in both cases had been an historical barrier to trade, was removed. Finally, in the process of the interactions among the actors, the development of trust shaped their preferences to join with the specific partner over other possible options.

In the case of Eon and Gazprom, German energy companies had a pre-existing interest in trade with Russia. For example, leaders of Eon's subsidiary, Ruhrgas, were intent on securing a long term energy contract. The political barrier was the Coordinating Committee on Multilateral Export Controls (CoCom), a policy of Western bloc states to refrain from trading with the eastern bloc states. In reality, the U.S. was the main proponent of this policy, and until the 1970s, Germany more or less adhered to CoCom.

However, the interest in oil and gas trade with Russia became more acute by the oil crisis of 1973. The Federal Republic of Germany (FRG), with an export driven industrial

economy, wanted to secure stable deliveries of energy resources for its industries.

Commercial executives also wanted to open new markets for their products in the east.⁶

With a change of party leadership from Christian Democratic (CDU) to Social Democratic (SPD) in 1972, the prospect of engaging trade with the Soviet Union emerged. The newly elected chancellor, Willy Brandt, wanted to initiate a direct dialogue with the Soviet Union. The new policy was called, *Ostpolitik* or eastern policy. It had two purposes, the promotion of trade between the FRG and the communist states of the Eastern Europe and a political rapprochement with the Soviet Union and German Democratic Republic (GDR).⁷

Under *Ostpolitik*, trust began to emerge at the highest level of politics between the two states. At its beginning, Chancellor Brandt and General Secretary Brezhnev opened a back channel of communication through the West German foreign minister and Soviet intelligence officers. This channel was highly secretive, but at a relatively early stage, both sides articulated their intentions to develop open and honest communications. This backchannel was the beginning of trust and resulted in the first trade negotiations. As Brandt's foreign minister, Egon Bahr, explained, 'this honest communication laid the foundations for what developed into a trusting relationship...and for the rapprochement of our two countries through trade, [the relationship] worked fabulously.'⁸

Concerning the second German-Russia partnership, BASF and Gazprom, arrived at their first agreement in another political shift between the two countries. BASF was introduced to Russia through a consortium of German banks organised by Federal Ministry of Economics and Technology (BMW) under Helmut Kohl. The Soviet General Secretary Mikhail Gorbachev was attempting to reform the Soviet economy under *perestroika*, a policy designed to liberalise certain sectors of the Soviet economy.

⁶ Schürmann, Heinz-Jürgen Dr. Former Chief Energy Correspondent, [Handelsblatt](#). Interview took place by telephone on June 17, 2011.

⁷ Westdeutscher Rundfunk (2010), 'Geheimoperation Ostpolitik', <http://www.youtube.com/watch?v=EHTFGHedVIg>, last accessed on 27, June 2011.

⁸ Ibid

Helmut Kohl saw an opportunity to move towards German reunification in exchange for aid and technical assistance. At a meeting that took place at Gorbachev's *dacha* in southern Russia, they agreed to a commercial package that comprised financial loans and manufactured goods amounting to DM 15 billion. In exchange for Germany's assistance, Kohl sought access to the Soviet market for West German products and Gorbachev's approval for the German reunification. Thus politics was intertwined with BASF's entrance into Russia.⁹

While the development of trust at the political level removed trade obstacles, trust between managers at the organisational level influenced Gazprom's choice of partner in the FRG. Herbert Detharding, the new head of BASF's natural gas subsidiary, Wintershall, had recently joined Wintershall after 20 years of experience in Russia at Ruhrgas.¹⁰ Detharding already had existing relations with heads of the appropriate Soviet ministries. This explains Gorbachev's curious decision to offer a field development contract to BASF, a chemicals company, over companies that were far more expert such as Exxon or Chevron.¹¹

Thus, the role of trust, which had been developed between Gazprom's predecessor and BASF over a 20 year interaction with another German company, played a decisive role in the choice of Russian decision makers to engage BASF through its subsidiary, Wintershall, over any other foreign energy company.

In the case of BP and AAR, the starting point was quite different. BP had no experience or contact with Gazprom until after the collapse of the Soviet Union. Much like the German-Russian case, the removal of political barriers, namely the emergence of democracy and privatisation, made investing in Russia possible. There were several economic factors that influenced Browne's decision to engage invest in Russia. The first was BP's

⁹ Bower, *The squeeze: oil, money and greed in the 21st century*, p. 106.

¹⁰ 'Raushalten, fertigmachen' *Der Spiegel*, 4 (1994), 84.

¹¹ Bower, *The squeeze: oil, money and greed in the 21st century*, p. 106.

stagnant level of oil and gas reserves. When Browne first assumed the post of CEO, BP itself had recently been privatised and, consequently, under pressure from investors to grow. Establishing itself in Russia would immediately raise oil and gas reserve levels.

However, BP eventually came into conflict with AAR over their first joint venture, Sidanco. Unbeknownst to Browne, one of the investors, the oligarch, Mikhail Fridman, had a standing dispute with one of Sidanco's investors. To recover the investment, Fridman began a bankruptcy filing for a portion of Sidanco, the assets of the company belonging to BP. This was a common procedure to acquire state assets at the time, well known to locals but not to BP.

It is important to understand the background of BP's first interaction with its Russian partners in order to make sense of Browne's decision to reengage Fridman for TNK BP. BP was still intent on doing business in Russia for all the previously mentioned reasons. After the Sidanco dispute, Browne sought to make a major investment to make up for the loss of its assets, not to mention saving face with his board of directors. Browne finally made the decision to invest in TNK after a series of face-to-face meetings with Fridman, Khodokovsky, and Putin.¹² Based on these personal interactions, Browne's confidence in Fridman grew while his suspicions of his hitherto first choice, the president of Yukos, Khodorkovsky, were confirmed by Putin. Although Yukos was the largest oil company in Russia, the concern lay with Khodorkovsky's political ambitions. As Putin told Browne at the mention of Khodorkovsky, 'I've had to eat too much dirt from that guy'.¹³

On the Russian side of TNK BP, there were two sets of decision makers. The first was BP's commercial partner, the investment group AAR led by Mikhail Fridman.¹⁴ Economic incentives for AAR were paramount. It needed investment to modernise TNK's production and refining facilities. Moreover, the most lucrative markets for its natural gas asset, the

¹² John Browne, *Beyond Business*, (London 2011), p. 145.

¹³ *Ibid* p. 145.

¹⁴ *Ibid* p. 144.

Kovytko field, lay in Europe and Asia. In order to access these markets, AAR needed financial investment and technical expertise for the construction of a pipeline.

At first glance, the development of trust with BP did not appear to play a decisive role on AAR's choice of partner. AAR did, however, have aspirations of expanding beyond Russia and believed it would need to earn the trust of western business partners and their governments in the future. To this end, a partnership with BP, a respected international energy company, would help build credibility for a foreign audience. Thus building trust with a western audience was one of the factors influencing AAR's decision to engage with BP.

The second Russian group involved in TNK BP was political, notably President Putin and the Russian minister of energy, Igor Sechin. BP's willingness to assume an equal rather than controlling stake alleviated the suspicions of the Russian politicians who were concerned about foreign control over Russia's oil and gas industry.¹⁵ BP also agreed to commit to a series of goals, both commercial and social, that helped reassure Putin.

Stage 2 - Disputes and breaches of contract

The second stage of analysis investigates the decisions of actors when different interests or breaches of contract emerged. When this occurred, actors chose to either cooperate and find a compromise, or retaliate through litigation and coercion. With TNK BP, diverging interests coupled with personal conflict between the leaders led to coercion and an exploration of alternative partners. In this case trust played a dominant role because the economic factors were clearly in favour of collaboration. On the other hand, two instances of supply disruptions, technically breaches of contract, brought about an increase in cooperation through further joint investments. Economic interdependence can explain why Germany chose not to defect from the relationship, but it does not explain why other energy options,

¹⁵ Ibid p. 146.

such as LNG, nuclear, and coal, were not actively pursued. The outcomes begin to make sense only when one factors trust into the analysis.

At TNK BP, the first contract lasted four years, from 2004 to 2008. During this period, the parties were required to maintain existing management structures and could not opt out of the contract by selling their stake in the joint venture. The dispute began when the leaders of the AAR group voiced concerns about staffing issues and the firms BP appointed CEO, Robert Dudley.¹⁶ Fridman and his Russian partners perceived BP to be intransigent to their suggestions on management issues, such as expatriate staffing, and the development of ventures outside of Russia.¹⁷ The initial contract did not rule out activities beyond Russia, but it did stipulate that both parties had a veto in that decision, both used that veto.

Shortly after the formation of the company, the relations between the BP appointed CEO, Robert Dudley, and AAR's appointed chairman, Mikhail Fridman, began to sour. Both had different ideas about how the company should be staffed. Dudley brought 146 expatriate staff from BP into the joint venture.¹⁸ AAR thought most of these positions were redundant and an unnecessary expense to the company. Some Russian managers also believed the presence of expatriate staff who could not interact with the other employees had a demoralising effect on Russian staff.¹⁹ Eventually, personal interactions between Fridman and Dudley degenerated such that Dudley began to miss scheduled board meetings, which effectively halted executive decision making. When the conflict became public, both expressed personal criticisms of one another.

The second issue concerned business interests and the geographical boundaries of the partnership. AAR was intent on collaborating with BP outside of Russia through the joint

¹⁶ Bower, *The squeeze: oil, money and greed in the 21st century*, pp. 450, 462.

¹⁷ Ibid p. 448.

¹⁸ Ibid p. 463.

¹⁹ Interview with Konstantin Kovalenko. Former Manager, Upstream Operations, TNK BP. Interview took place in Moscow on November 26, 2010.

venture TNK BP.²⁰ They regularly presented business opportunities to Dudley, and when proposals were rejected, Fridman attempted to make the case to BP headquarters in London. BP, however, viewed TNK BP as a subsidiary and had no interest of collaborating outside of Russia.²¹

What ensued was a very public dispute where both parties resorted to coercion through the press and political channels. First, to address the staffing issue, AAR appealed to the Russian Ministry of Energy to exert pressure on Dudley and British expatriate staff. As foreigners, they were required to renew their working visas every year. Many of BP's staff were also not paying Russian taxes because they were officially registered in the United Kingdom. As a result, the working visas of expatriate staff, including the CEO, were cancelled. Dudley and his staff were forced to leave Russia, where he managed TNK BP thereafter from London.²²

Reacting to AAR, BP launched its own campaign to exert pressure on AAR. Browne appealed to political channels in the U.K. and U.S. At his request, both Prime Minister Blair and President Bush wrote letters to Putin on behalf of BP.²³ When these letters went unanswered, Browne appealed to the US State Department. He knew that AAR had submitted a loan application with the United States Agency for International Development (USAID) programme to fund various projects in Russia. The application for U.S. \$400 million was ultimately rejected.²⁴

At this point, the interactions between BP and AAR had reached a point where BP began to look for other options in Russia. The newly appointed CEO of BP, Robert Dudley was in talks with Gazprom to form a partnership which would allow it to develop and market

²⁰ Robin Pagnamenta (2008), 'TNK-BP dispute triggered by Iraq oil project row', *The Times*, 27 June 2008, http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article4221694.ece, last accessed on 29 June 2011.

²¹ Bower, *The squeeze: oil, money and greed in the 21st century*, p. 451.

²² Ibid pp. 452, 461-3.

²³ Ibid p. 456.

²⁴ Browne, *Beyond Business*, p. 141

gas from the *Kovytko* field to customers in Asia. This included discussions on the construction of a new pipeline. BP had also initiated discussions with Rosneft. Likewise, Fridman and AAR continued to explore projects outside of Russia and had even begun negotiations with the Regional Authority of Kurdistan.

The role of trust in explaining the outcomes of the dispute is particularly poignant at this stage because economic and political factors were in favour of collaboration. First, TNK BP was a highly profitable company. BP had invested U.S. \$8 billion into the joint venture and extracted fourteen billion in profits from 2004 to 2009.²⁵ By all accounts, collaboration between the two companies had been successful, and there was no reason why the two companies could not earn profits on new projects. Politically, there were also compelling reasons to collaborate. In a partnership with Rosneft and Gazprom, it is likely that BP would have a lower share of any joint venture and assume a passive role. First, the natural gas industry is a highly protected sector of the Russian economy, and with the exception of German and Italian companies, working with Gazprom entailed risks. BP's rival, Shell, had just learned this lesson when it was forced out of another joint venture with Gazprom, Sakhalin II.

Despite compelling reasons to collaborate, BP decided against it. The tone of the interpersonal interaction reflects the degree of distrust. As the then British Ambassador described, 'this had turned into a war, and AAR won this round'.²⁶ Thus, the interactions became a 'zero-sum' game. A compromise or win-win outcome which would have made better economic sense was out of the question. Rather than cooperating, the actors attempted to enforce their will through political coercion. Robert Dudley was eventually transferred to a different post in BP and replaced by a Russian speaker. The dispute, however, has yet to be

²⁵ Ibid p. 146.

²⁶ Interview with Sir Anthony R. Brenton. Former Ambassador of the United Kingdom to Russia, 2004-2008. Interview took place in Cambridge on May 2, 2011.

resolved. The effects of this ongoing dispute will be explored in the third stage of the case analysis.

Contrary to TNK BP, there were no significant diverging interests between the German and Russian partners that could lead to a dispute. There were, however, two breaches of contract lasting several weeks when Gazprom cut supplies of natural gas to Germany, in 2005 and 2009. Recalling that Eon and BASF, ‘place a premium on stable and consistent deliveries’, these disruptions could have led to a dispute, or even litigation, as is currently underway between another German energy company and Gazprom, RWE.²⁷ The reason for the supply disruptions was a dispute between Gazprom and Ukraine’s Naftogaz. Because Gazprom currently transports natural gas to Europe through Ukraine, the dispute affected several countries in central and Eastern Europe. The reaction from the German side was to seek a resolution to the conflict. First, Schröder in 2005, and then Merkel in 2009, mediated the disputes. However, there was no penalty, per se, to Gazprom for the disruptions. Rather, what followed was a deepening of commercial relations between the two sides. At this stage, trust rather than economics or political factors explains the decision to increase the level of interdependence.

After three decades of collaboration, the German-Russian partnerships were no longer commercial transactions, both of the economies of Germany and Russia had become interdependent. Defecting from this relationship, although within the boundaries of the original contract, would have had substantial economic consequences. Germany depends on Russian gas for 40 per cent of its total supply. Natural gas makes up 23 per cent of German power generation demand and 40 per cent of its total energy consumption.²⁸

²⁷ ‘Ungültige Vertragsklausel ermöglicht jederzeit Kündigung’ (2010), *Strom Magazin*, http://www.strom-magazin.de/gasmarkt/ungueltige-vertragsklausel-ermoeglicht-jederzeit-kuendigung_28926.html, last accessed on 29 June 2011.

²⁸ Eurostat (2007). ‘The European Union and Russia: statistical comparison’. <http://epp>, last accessed on 29 June 2011.

However, there were other options for the long term. Although Germany is dependent on Russian gas, a portion could be supplanted by other sources such as coal, nuclear, and LNG. Yet, the number of operating nuclear plants, even before the recent earthquake in Japan, was scheduled to be reduced. Since the 2005 gas disruption, there has only been one LNG regasification plant constructed whose purposes is to introduce new supply to the spot market, not the long term contract market that Russian gas currently supplies.

If politics, in the form of energy security were dictating the outcomes of the disruptions, one would also expect an effort to find alternatives to Russian gas. Instead, what ensued was a deepening of energy dependence. Both Eon and BASF recently signed new long-term contracts with Gazprom to replace the current contracts set to expire in 2020. In the case of BASF, the new contract will raise deliveries of natural gas from 140 bcm to 180 bcm annually through 2035.²⁹ Likewise, Eon and Gazprom have jointly invested in energy companies in Germany and Eastern Europe.

In sum, economic considerations, namely interdependence, played a role in influencing decision makers on both the German and Russian sides not to respond immediately to supply disruptions, however, economic interdependence and energy security do not account for events that followed. Rather than seeking alternative sources to Gazprom such as coal, nuclear, or LNG, both sides chose to further entrench their commercial relations. Where distrust accounts for BP's decision to seek alternative partners that were economically unjustified, trust explains why the German and Russian partners, in response to disruptions, sought to deepen engagement rather than finding alternatives. The new contracts, lasting 30 years, expose German industry to a high degree of risk, but as the board director of BASF explained, 'the partner (Gazprom) addresses our needs for long term energy security, and these long term contracts would only function on the basis of absolute trust'.³⁰ This sentiment

²⁹ Ralf Neubauer, 'Gazprom gibt in Deutschland weiter Gas' Leipziger Volkszeitung, 11 November 2011, p. 9.

³⁰ Ibid

was confirmed by multiple sources interviewed for this research project to explicate the formation of these contracts.³¹

Summary

To summarise the findings of the cases, trust, among political and economic factors influenced decision makers toward cooperation rather than defection. With respect to the first contract, it pushed decision makers to select one partner over another. Although the dispute between BP and AAR originated from different interests, a break down of trust exacerbated the dispute leading to litigation and eventually an attempt to defect from the relationship. By contrast, the presence of trust between the German and Russian parties mitigated a potential dispute when Gazprom twice breached its contract with Eon and BASF. Despite compelling energy security and economic barriers, German actors attributed the decision to deepen their partnerships with Gazprom to trust. Thus, the degree to which trust influenced outcomes varied at each stage of the partnerships, depending on interactions between the two companies and changing political and economic conditions. The next chapter explores the factors that assisted in the development of trust.

Trust determinants

The examination of the natural gas partnerships provides insights into what trust-promoting conditions are actor-determined versus pre-existing. With respect to pre-existing factors, this study identified six. In order of proximity to the actors, they included a perceived social contract, ideological legacy, stereotypes and associations, the nature of transactions, degree of interdependence, and transportation infrastructure.

First, the perception of the firm's responsibilities to society were more aligned in the German-Russian cases than at TNK BP. Second, ideological legacies, particularly among Russian politicians contributed to suspicions that BP had to overcome when entering Russia.

³¹ Interviews with Jörg Kirsch, Dr. Heinz-Jürgen Schürmann, Dr. Ralf Horlemann.

Third, stereotypes and associations encouraged the development of trust between the German and Russian parties while raising suspicions and causing friction between BP and AAR executives. Fourth, the nature of transactions as an investor versus a customer-supplier influenced trust. As an investor, BP was always under scrutiny from Russian authorities suspicious that it would pull resources out of the Russian economy. By contrast, Germany was Russia's largest customer and as such, a financial contributor to the state's budget. Fifth, the deep degree of interdependence between the German and Russian parties necessitated repeated interactions, which contributed to building trust over time. Finally, the transportation infrastructure, namely the pipelines connecting Russia and Germany are 'ties that bind', creating a structural interdependence between the supplier and consumer.

Concerning actor-specific factors, the cases point to five determinants. In order of proximity to the actor's degree of control of the decision, they include networks, interpersonal relations, language, signalling interest, and fulfilling expectations.

Both the British and German cases show how networks were used to select a partner and build confidence with other parties. BASF used relations through a German trade promotion organisation and recruited executives from another German company with existing relations at Gazprom. Likewise, BP was introduced to AAR through a financial network with relations to the oligarchs.

Developing interpersonal relations resulted in a deepening of trust between organisations. Schröder and Putin spent vacations together with their families, and the relationship took on a personal dimension, which reinforced their official interactions. Likewise, regular social interactions between Russian and German staff at Wintershall contributed to building trust between the two partners, BASF and Gazprom. The TNK BP case stands in contrast to the German-Russian cases in this respect.

Language posed either an advantage or disadvantage to building trust. On both the German and Russian sides, decision makers in the companies and politicians were more likely

to be proficient in the other's language than at TNK BP. This allowed for easier communication and actors generally felt more at ease in interactions when no interpreter was present. By contrast, the language barrier prevented the TNK BP CEO from interacting with Russian staff outside of the board room. This developed into one of the primary sources of conflict between AAR and BP.

Signalling interest became important for BP in developing trust with the Kremlin. It did so by committing to meet both social and business goals. Browne met several times with Putin to reinforce BP's long-term interests in order to develop trust. Likewise, Gazprom's decision to resume deliveries to its German customers despite not having resolved its dispute with Naftogaz demonstrated interest to its partners.

Related to signalling interests was fulfilling expectations. German executives and politicians repeatedly articulated their trust in Gazprom owing to a long history of contract fulfilment. At the heart of TNK BP's dispute was an unwillingness to fulfil expectations in collaborating within Russia and abroad.

Implications

The findings of this study have implications on broader questions of trust and energy trade. The following is an exploration of two possible applications. The first represents a pattern exhibited by the development of trust. In both cases a high or low degree of trust became fixed over time.

Economic cooperation did not necessarily lead to trust. Trust was developed or eroded at the interpersonal level through interactions in the first stage. If it developed, preferences of actors deepened economic interactions and likewise, interdependence. At this point, interdependence and trust became self-enforcing, which made the relationship more stable. By contrast, when trust eroded at the interpersonal level, actor preferences worked against the

relationship leading to discord. Judging from the two cases, it appears that the trajectory of the development or erosion of trust is established during the first stage.

Another implication concerns energy trade and security. Currently, most natural gas contracts are long term and negotiated bilaterally. Unlike consumer goods, energy is treated by most states as a security issue, which explains the absence of a multilateral trade regime for energy, such as the WTO.³² In this environment, the two cases reinforce Lord Browne's assessment of the primacy of trust with local actors as a determining factor for energy companies. Most of the world's oil and gas reserves are under control of state-owned companies. Private energy companies such as BP account for eighteen per cent of the world's oil and gas reserves, and consequently, the need to develop trust with not only commercial partners but also political leaders becomes more acute. These individuals, as in the case of Russia, have preferences conditioned by a variety of factors, of which efficient and profitable hydrocarbon production is only one. Although it is well known that geopolitics and commerce affect energy trade, an analysis of trust speaks to the importance of human interaction as another determining force. Economic cooperation and the development of trust between the actors reinforced cooperation, which then reinforced trust. The results of this analysis point to trust as a critical determinant for stable international energy trade. If the interest of states is to establish energy security, it need not be opposed to interdependence, as the German-Russian case attests.

This has particular relevance to energy trade in the E.U. where the development of a common energy policy has remained elusive for decades. In the absence of a regional energy regulatory framework, member states are left to their own devices in securing energy supplies. This mirrors the failure of previous attempts to create a multilateral trade regime for energy in

³² Daniel D. Yergin (2006), 'Ensuring energy security', *Foreign Affairs*, 85, 2, pp. 69-82.

the international system. The International Energy Agency (IEA), for example, was intended to coordinate supply distribution among its members in case of disruption.

Without a common energy policy, the E.U. Energy Commission's current approach to dealing with energy security has two elements. First, it has incrementally encouraged cooperation among regulatory agencies through divisions, such as the newly formed Agency for the Cooperation of Energy Regulators (ACER). It has also established broad new regulation to discourage monopolies in the natural gas market through unbundling companies with monopolistic positions. Gazprom is often cited as an example. Second, it has financially supported projects designed to raise energy security in states deemed as vulnerable, particularly to Russia. In the case of natural gas, this means financial support for new pipelines, such as Nabucco, and LNG regasification terminals. But despite efforts, these projects create market distortions, namely over supply. They can also exacerbate animosities, thus lowering trust, between member states. A recent row between Germany and Poland over the construction of an LNG facility is one case in point.³³

Ultimately, this study illustrates the broad variation of company and country factors in Western Europe, a region thought to have similar market characteristics. Because interpersonal relations, as the cases demonstrated, exert their own pressures on energy cooperation, the development of trust among political and commercial leaders needs to be an integral part of a stable and long term E.U. energy plan.

³³ In response to the announcement of the German-Russian Nord Stream pipeline, which effectively bypasses transit pipelines through Ukraine, Belarus, and Poland, a Polish consortium of companies supported by the E.U. Energy Commission began construction of Poland's first LNG regasification terminal at Swinoujscie. This project was delayed by environmental complaints raised by the German government in the European Parliament. In the end, Poland was allowed to proceed with construction, however, gas delivered to this terminal still faces the challenge of distribution. Through which pipelines will this new supply be delivered, and where will it be stored? The main pipelines connecting local pipeline infrastructures are effectively controlled by a partnership between Gazprom and the Polish company, PGNiG. Therefore, without support from Gazprom and Polish energy executives who are part of legacy professional networks, the new supply may be blocked from delivery to its primary consumers in Poland. Other LNG projects in the Baltic states, for example, face similar obstacles.

Limitations of study

Limitations of this study include the size of the sample set and availability of information. Concerning the first, the focus on just two European-Russian joint venture cases limits what can be said about European-Russian energy trade in general. However, this was mitigated by selecting cases that represented extreme circumstances among a variety of examples available, cases where trust was clearly developed and influenced economic and political outcomes and likewise, where it was, for the most part absent.

The availability of data about the interaction of company executives and politicians was another constraint. Energy companies the size of BP, BASF and especially Gazprom are fortresses. Their decisions can have consequences on entire economies, and, as such, staff members are typically bound by protocol not to discuss company matters with outsiders. However, because these cases are so high profile, there has been extensive media coverage. This study has benefited from considerable journalism and previous analysis that includes comments from those privy to discussions and interactions between company executives and politicians. Additionally, interviews with those close to the events grounded information from secondary sources. The result is a tapestry of the interactions and articulated intentions of the executives and politicians that affected the development of trust, which in turn influenced their preferences.

Conclusion

In conclusion, this study has argued that trust, along with political and economic factors influenced the outcomes of the two cases between British-Russian and German-Russian companies. The findings are the following. First, trust mitigated suspicion and encouraged cooperation between the commercial and political actors. Second, when trust was present, conflicts of interest were more easily overcome while in its absence, a spiral of

litigation and attempts at political coercion ensued. Third, the development of trust was partially determined by pre-existing political and economic conditions that decision makers could not alter. At the same time, they had the option to pursue policies that assisted in building trust or encouraged suspicion, the opposite of trust. Thus, trust has the potential to exercise an independent force in overcoming political and economic obstacles that confront energy partnerships.

In the first British-Russian case, there was an antagonistic dynamic, which led to increased transaction costs in the form of litigation, curbed transportation of supply which limited overall sales of the supply to the highest paying market, stagnated operations, and the inability to pursue new projects that would have benefited both parties. In the German-Russian case, the trust relationship created an environment where litigation was avoided when breaches of contract took place, the deepening of economic cooperation, and the relatively stable fulfilment of contractual obligations. Politics played a role to varying degrees in both instances, but in general, politics was used as a tool to penalise partners at TNK BP, while in the German-Russian case, it was used to mediate disputes and organise financing for new projects.

The development of trust had certain characteristics or determinants, some that were pre-existing while others actor-determined. The impetus was aligned mutual interests. Trust developed over time through repeated fulfilment of expectations and signalling interest. Language, networks and interpersonal relationships were also determining factors to building trust.

Finally, this study posited two implications. The first concerned a pattern from the cases that may apply to other natural gas partnerships. Once trust was established, it appeared to become stable. Actors would prefer to cooperate rather than defecting from the relationship despite economic and political pressure to do so. With respect to energy security and the prospects for a common E.U. energy policy, the current approach of the E.U. Energy

Commission is likely to face obstacles because it targets only market regulation and company structures. This study points to the need for a more sophisticated approach that incorporates the individual energy trade circumstances of each state.

Appendix

Table 1

Eon, BASF, and Gazprom	TNK BP
<p>Stage 1 – contract formation</p> <p><i>Ostpolitik</i> and end of Cold War removes political barrier to trade</p> <p>Ruhrgas (E.on) lobbies government to open talk with Soviet Ministry of Energy</p> <p>Trust is developed at political level.</p> <p>BASF introduced to Gazprom through Ruhrgas (Eon) and political networks.</p>	<p>Stage 1 – contract formation</p> <p>End of Cold War removes political barrier to trade.</p> <p>BP reengages AAR after dispute over Sidanco.</p> <p>AAR director, Mikhail Fridman, tries to make amends with Browne.</p>
<p>Stage 2 – dispute or breach of contract</p> <p>Gazprom stops supply deliveries in 2005 and 2009 as a result of dispute with Ukrainian Naftogaz.</p> <p>Gazprom resumes deliveries under pressure from German partners</p> <p>Schröder and Putin develop close relationship.</p> <p>Both sides discuss how to avert future disruption.</p>	<p>Stage 2 – dispute of breach of contract</p> <p>Dispute emerges over CEO position and geographic scope of business.</p> <p>Both sides use political channels for coercion.</p> <p>BP looks for other options in Russia. Engages talk with Rosneft and Gazprom.</p> <p>AAR explores new project in Iraq and Vietnam against stipulations of contract.</p>

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