

Cross border Pipelines: How to Meet Stakeholder's Interests - a View from Russian side (an exporter & long-term supplier perspective)

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**Presentation at Round Table 1 "Cross border Pipelines:
How to Meet Stakeholder's Interests",
20th World Petroleum Congress, Doha, Qatar, 04-08.12.2011**

Russian Gas Export to Europe: on-border Sales and Transit Arms

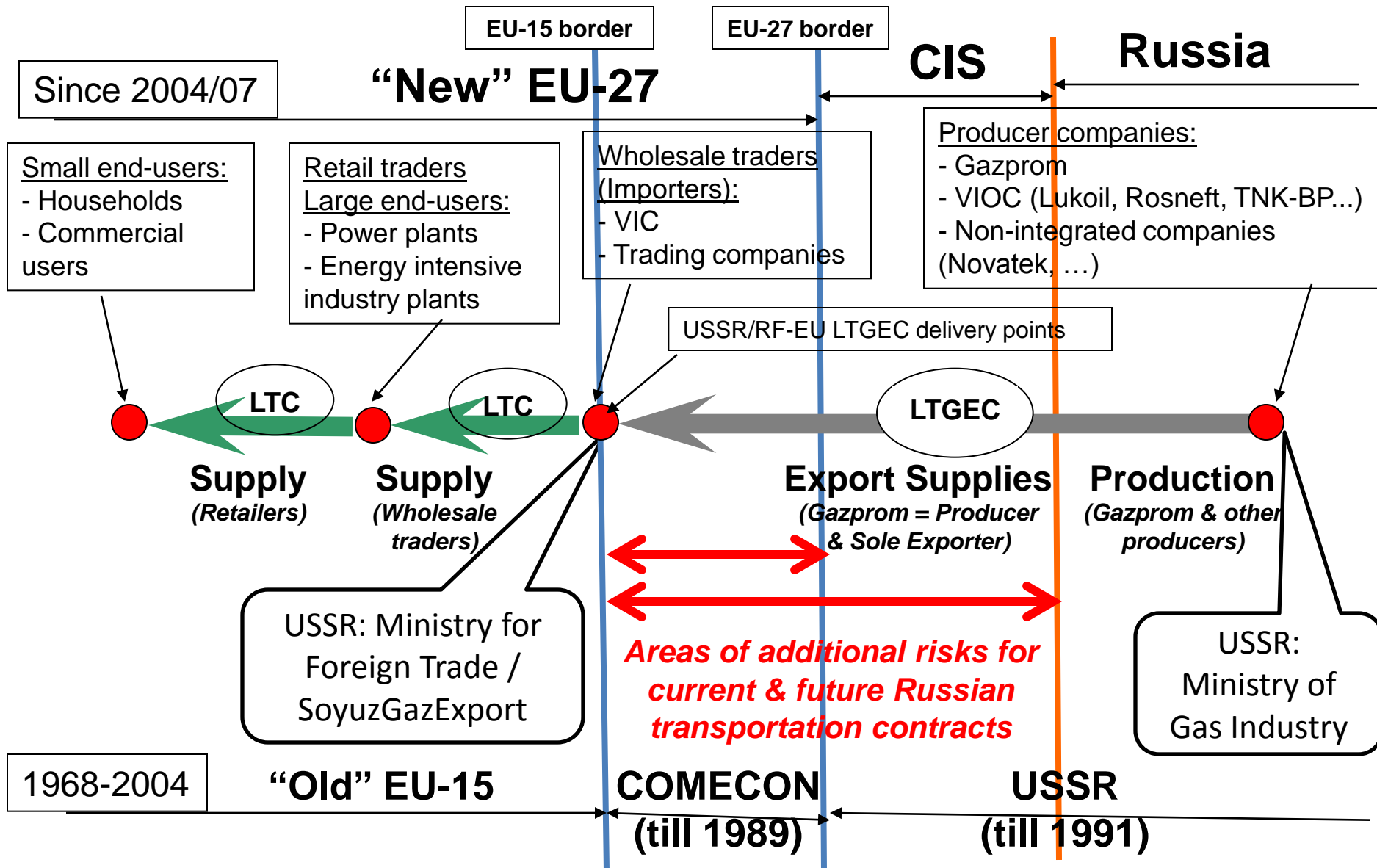
Map source - IEA



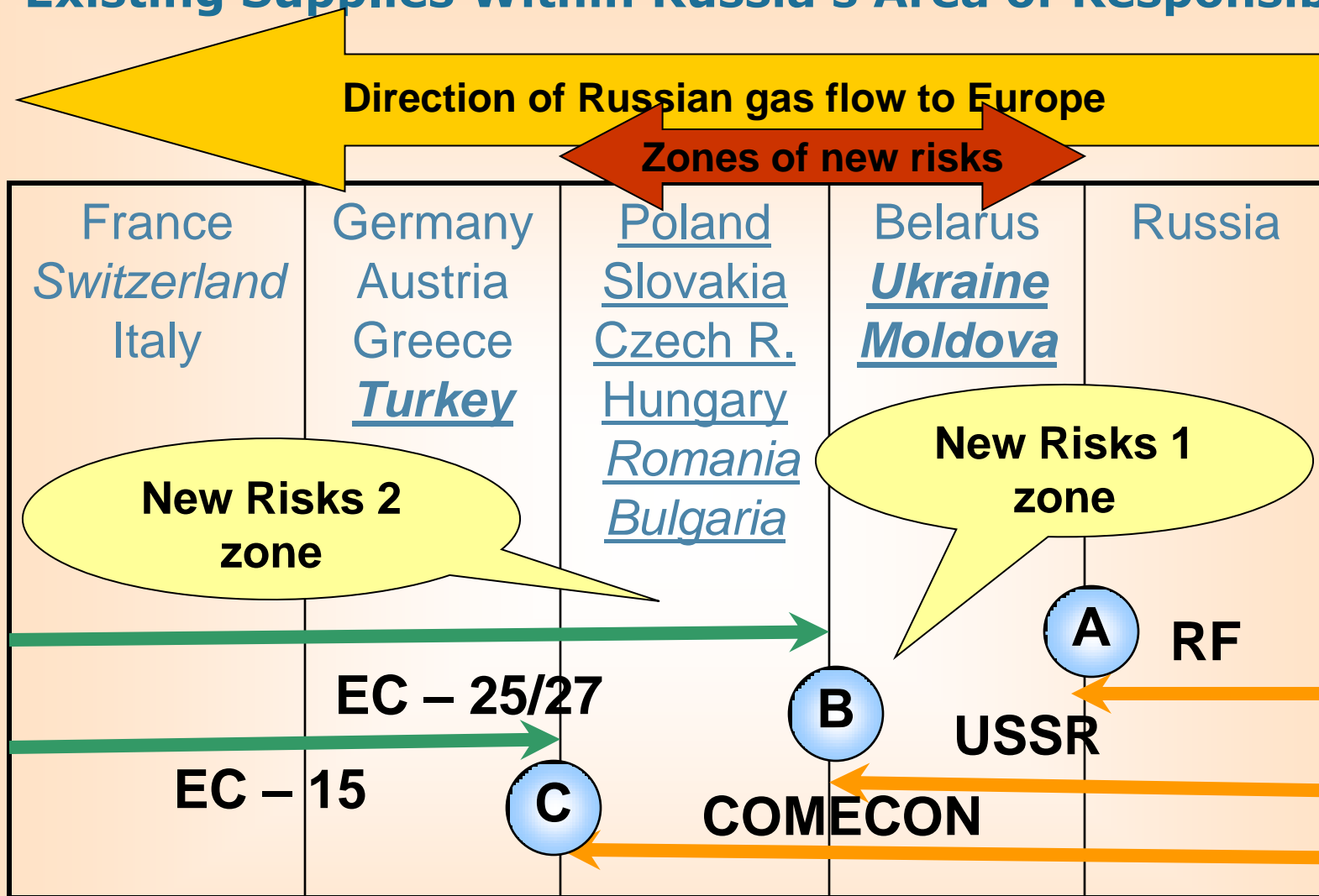
Russian LTGEC to EU:
A, B, C – points of change of ownership for gas and/or pipeline;
for gas and/or pipeline;
C – delivery points to EU



Russia-EU gas value chain: three-step LTC structure since 1968 till nowadays



Russian Gas Supplies to Europe: Zones of New Risks for Existing Supplies Within Russia's Area of Responsibility



Normal – EU states; *Italic* – non-EU countries; new EU accession states: underlined – since 01.05.2004, underlined + italic – since 1.01.2007; **underlined + italic** – Energy Community states; A, B, C – points of change title of ownership for Russian gas and/or pipeline on its way to Europe (see slide 2)

Russia's Gas Supply to Europe: New Cross-Border Risks – Which, When and Where

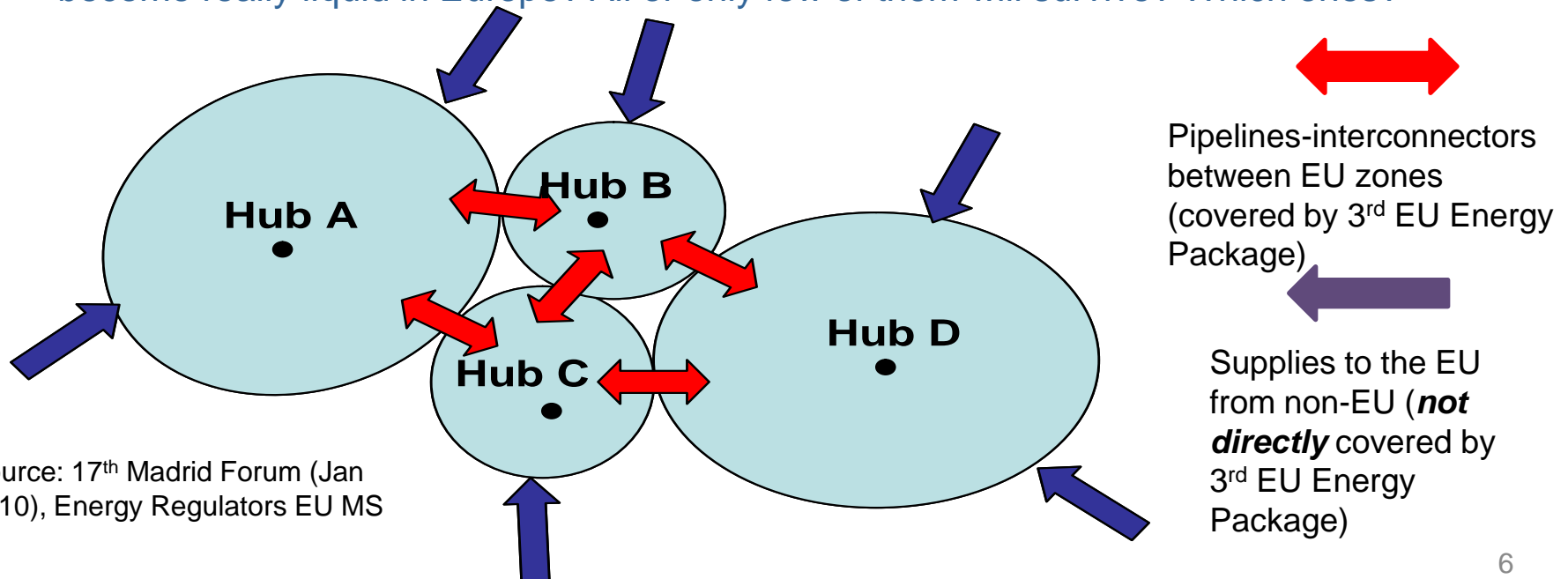
- **Since 1989/1991:** upstream to delivery points, within f.COMECON/FSU
 - COMECON/USSR dissolution => new sovereign states on-route => new transit risks
- **Since 2002/03:** + at delivery points
 - Tri-lateral solutions on destination clauses = “package deals” but whether they were balanced? (e.g. capacity allocation procedure at TAG Dec'05 auction, etc.)
- **Since 2004/07:** + upstream to delivery points, within enlarged EU-25/27
 - combined result of EU expansion + EU gas market liberalization (2nd EU Energy Package/2003) => new transit / transportation risks (unbundling + MTPA)
- **Since 2009:** + upstream to delivery points, within EU-27
 - 3rd EU Energy Package (03.09.2009): new EU gas market architecture + “third party clauses”
- **Since 2012:** + upstream to delivery points, within CIS
 - Ukraine & Moldova joined Energy Community Treaty & to transpose 2nd EU Energy Package/2003 into national laws => new transit risks (unbundling + MTPA)

Future organization of internal EU gas market: 3rd EU Energy Package = radical change of wholesale market architecture

- No single (homogenous) internal EU gas market in the near future even as economic model
- All market areas to be organized as **entry–exit zones** with **virtual liquid hubs** => Towards uniform capacity allocation ("**bundled products**") & gas pricing ("**spot & exchange pricing**") mechanisms; still open questions (continued debate) on, *inter alia*:

(1) **Capacity allocation:** **short-term** vs. **long-term**? At zone borders? At hubs? How to overcome uncertainties of 3rd Package for cross-border pipelines ("long-term": transportation = 1 year+, supply = 10 years+ => risk of "contractual mismatch")? Whether auctions as uniform capacity allocation mechanism is appropriate solution ?

(2) **Gas pricing at hubs:** on **all** or just on **portion** of gas supplies? When gas hubs will become really liquid in Europe? All or only few of them will survive? Which ones?

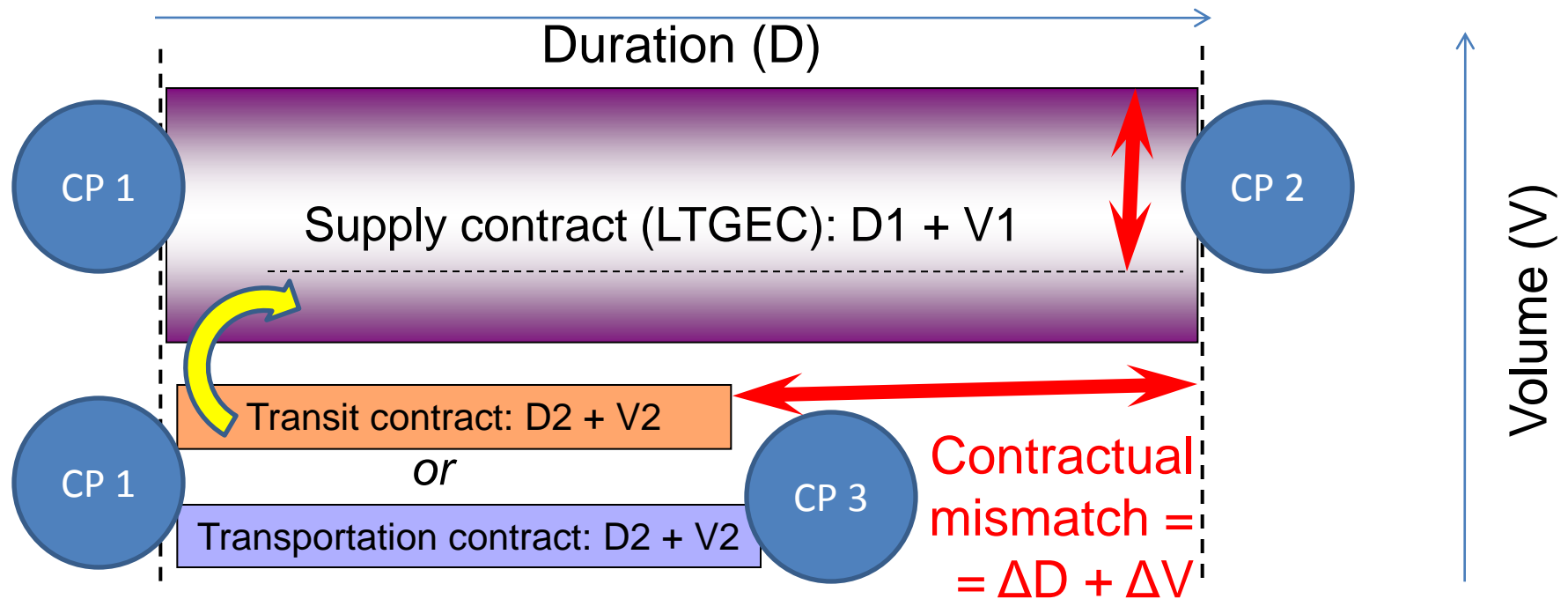


Source: 17th Madrid Forum (Jan 2010), Energy Regulators EU MS

Post-2009 New Gas World is more risky & uncertain, incl. for cross-border pipelines

- **Demand-side:** economic crisis + decarbonisation combined effect => demand uncertainties => CAPEX pay-back? => investment decisions are postponed
 - **Supply-side:** multiple competitive supplies (pipeline gas, LNG, shale gas, ...) => oversupply? => throughput capacity utilisation (EU 70% ?) => CAPEX pay-back?
 - **Institutional:** Third EU Energy Package = Anglo-Saxon model in European gas? But Continental Europe & Eurasia radically differs from US & UK => marketplaces & paper gas market = short-termism; + IRR upper limit (FRG: 6%)? => CAPEX pay-back?
 - **Political:** effects of Russia-Ukraine/Belarus/CA gas crises, etc. => perceptions converted in investment decisions both on consumer & producer side => extra CAPEX => CAPEX pay-back?
- => **In result:** Investments in cross-border pipelines are more risky => multilateral investment-protection decisions needed => ECT, etc.

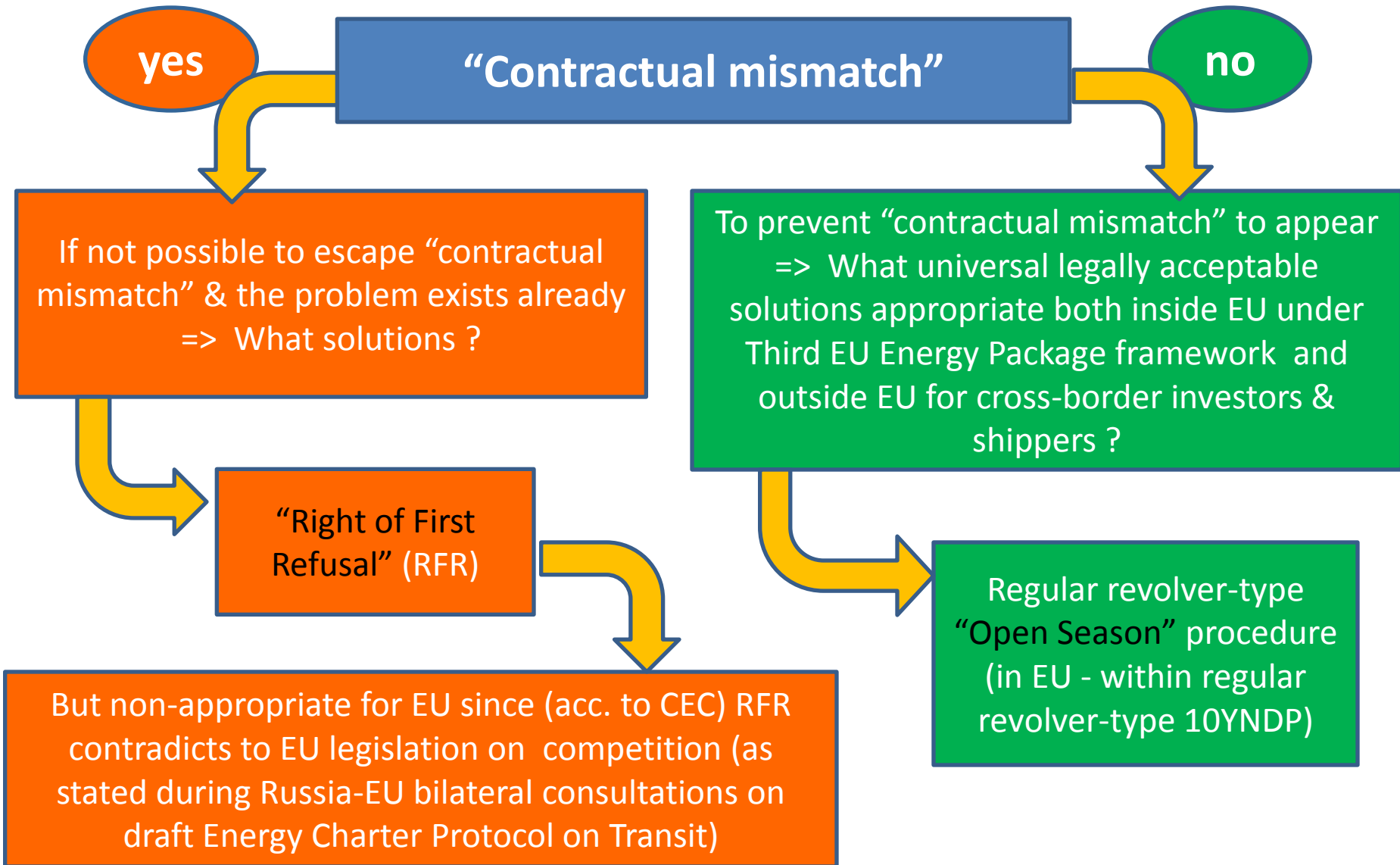
EU institutional problem: "Contractual Mismatch"



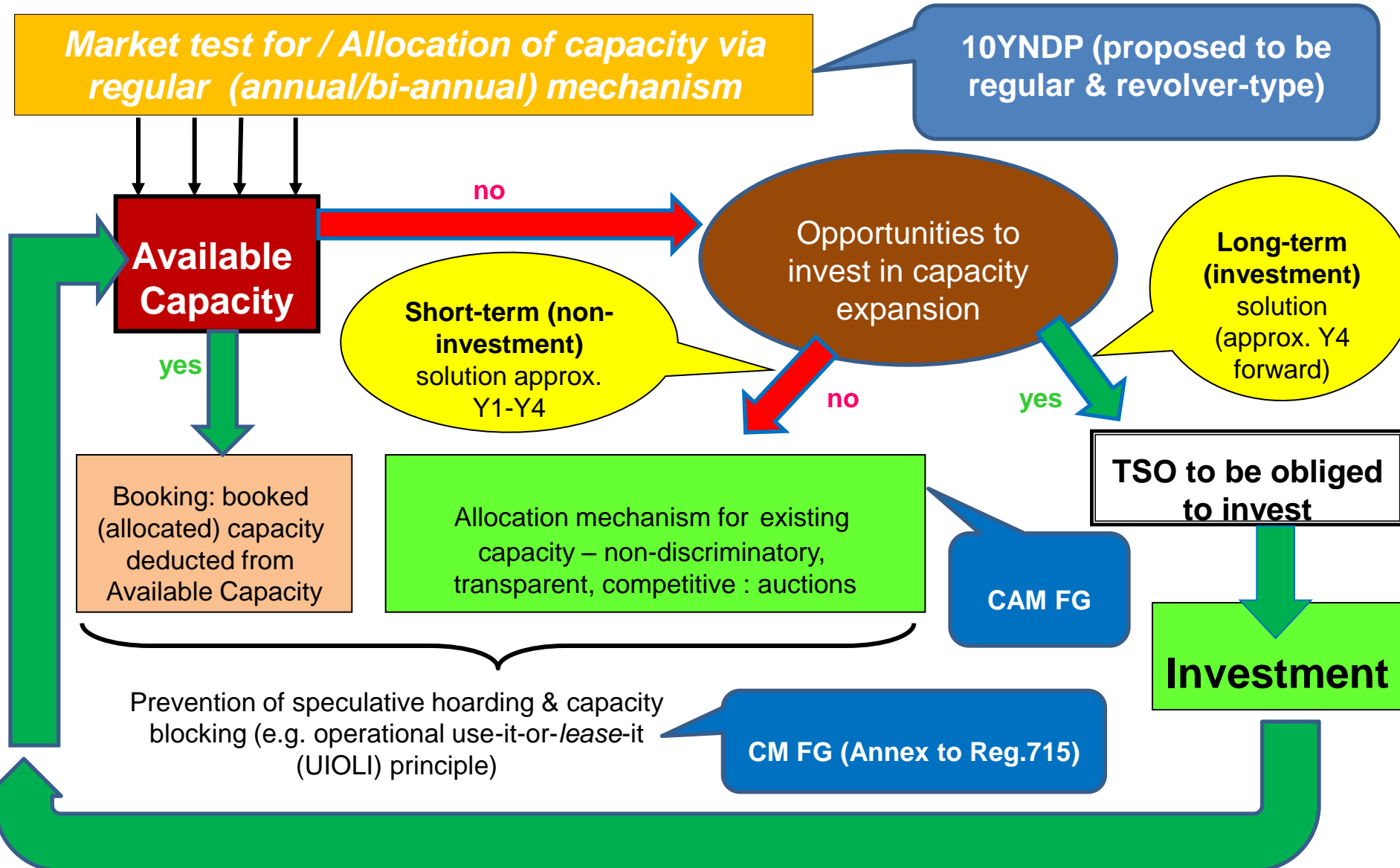
Contractual mismatch: resulted from unbundling + MTPA; correlation needed between duration/volumes (D/V) of long term supply/delivery contract (LTGEC; CP1-CP2) and transit/ transportation contract (CP1-CP3); the latter is integral part to fulfill the delivery contract => risk of non-renewal transit/ transportation contract => risk of non-fulfillment supply/delivery contract.

Core issue: guarantee of access to/creation of adequate transportation capacity for volume/duration of long term contracts

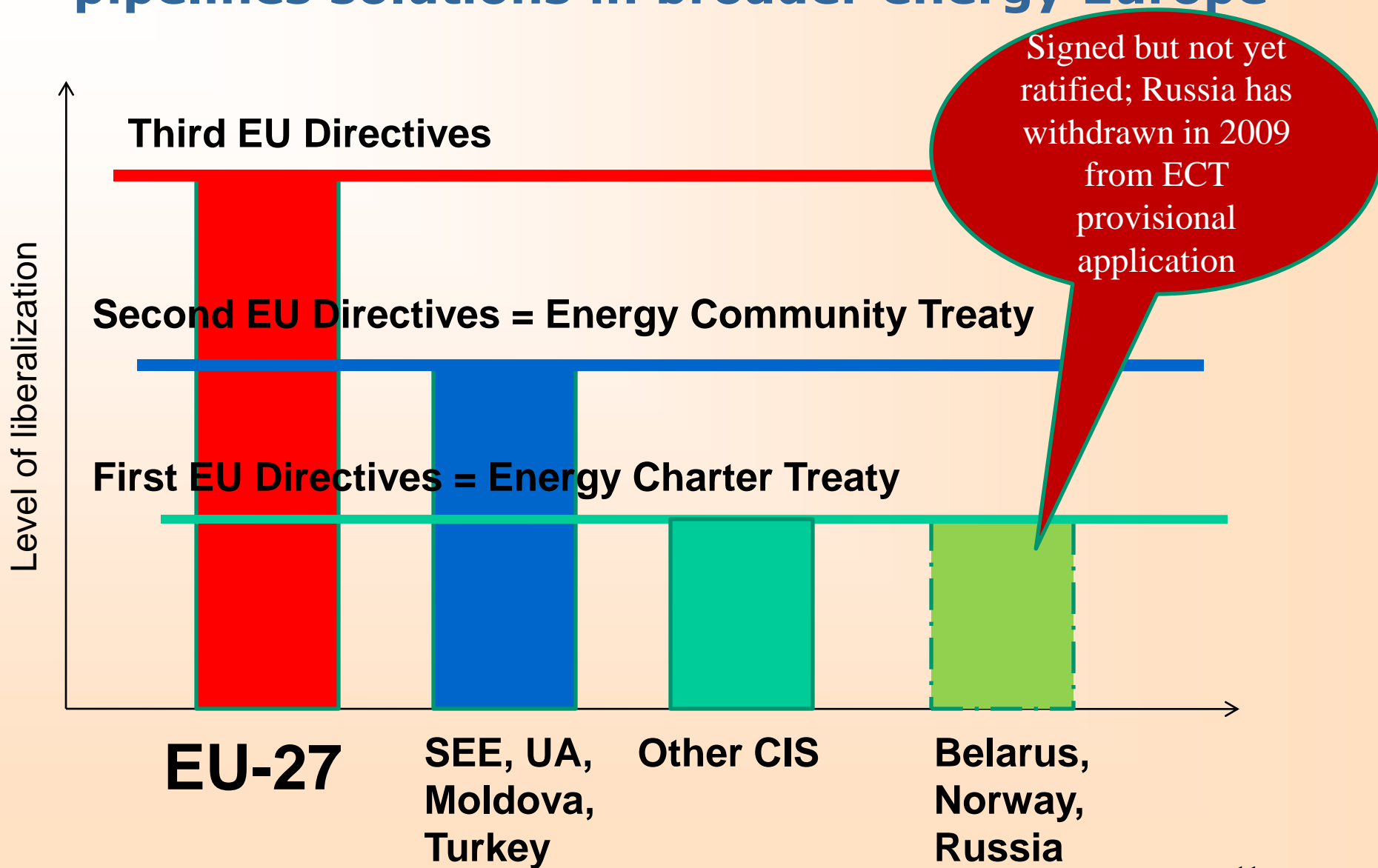
“Contractual mismatch”: from “Right of First Refusal” to regular revolver-type “Open Season”



Open Season as Universal Mechanism of Long-, Medium-, and Short-Term Allocation of Capacity (draft proposal of Russian experts to the EU)



ECT – a common denominator for cross-border pipelines solutions in broader energy Europe



ECT new role? Russia to return...

- **Early 1990-ies:**
 - ECT aimed to diminish cross-border risks related to consequences of USSR & COMECON dissolution
 - **Nowadays:**
 - ECT to diminish cross-border risks related to post-2009 multi-facet uncertainties in gas in “broader energy Europe”?
 - ECT as protection tool against cross-border risks (firstly: against investment risks) resulted from further liberalization of internal EU gas market (EU *acquis communautaire* vs. ECT = EU domestic vs. EU international obligations)
 - adaptation of the Energy Charter process aimed at further protection cross-border energy flows (Russia *should* return in full to the ECT family => WTO a good restarting point)
- => challenging agenda for new SG ECS !!!

Thank you for your attention !

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