

Changes of regulation and market structure in the EU and their impact on Russian gas exports to the EU

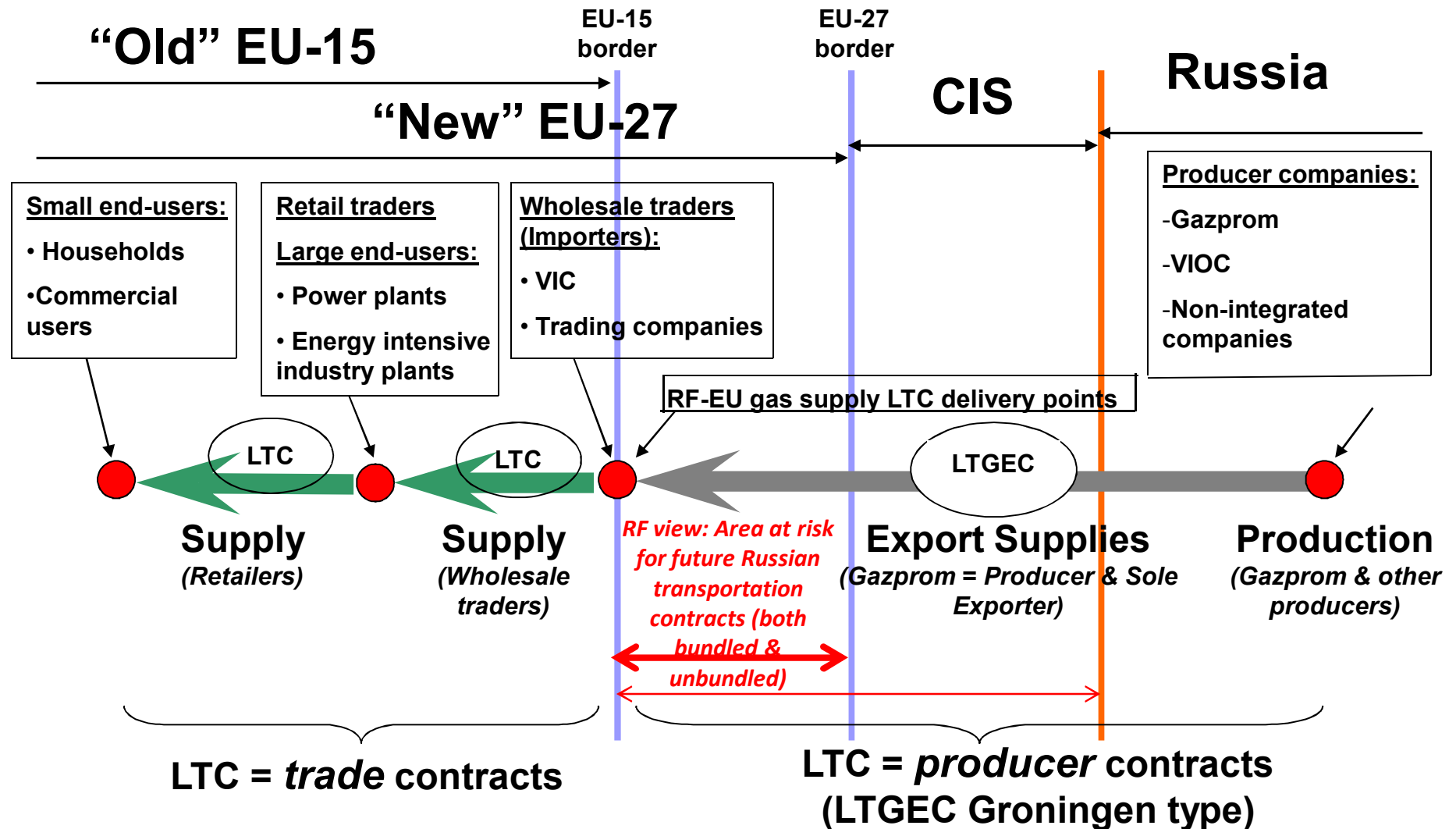
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Presentation at the Worldwide Independent Energy Network (WIEN) meeting, Moscow, FIEF, 25.05.2011

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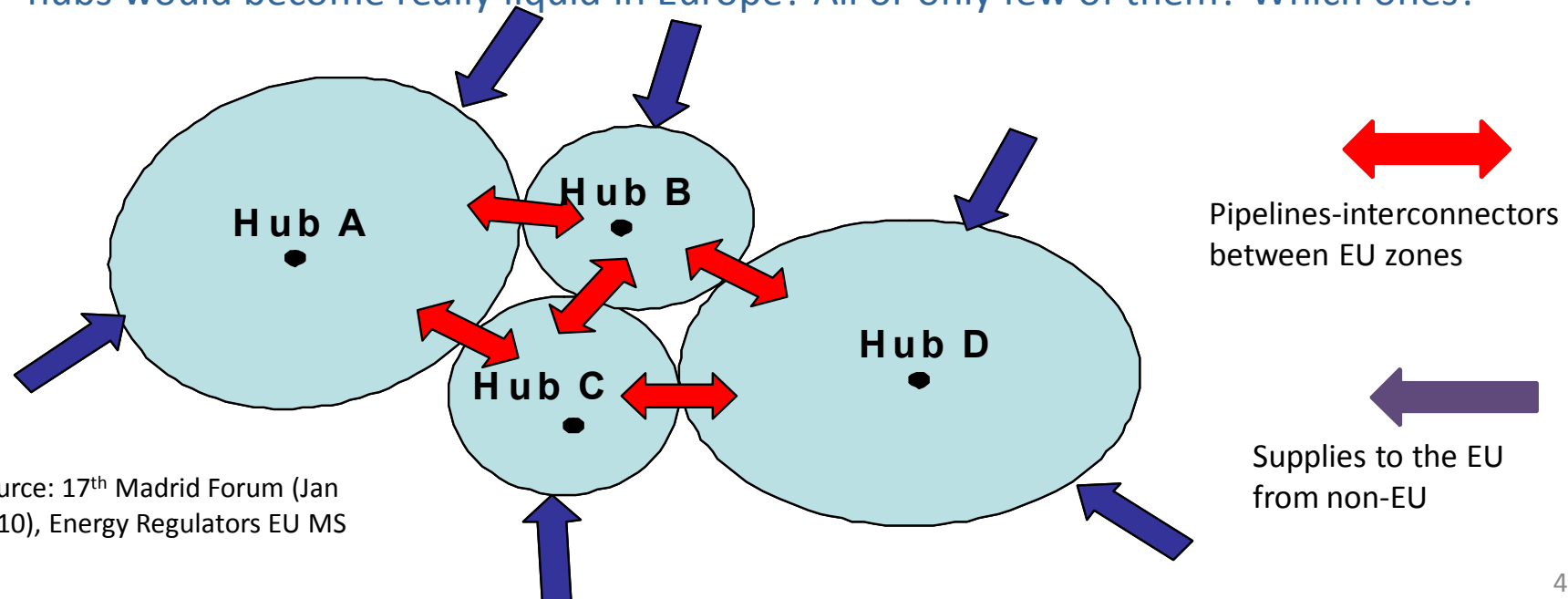
RUSSIA-EU GAS VALUE CHAIN: DIFFERENT TYPES OF LTC



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

- No single (homogenous) internal EU gas market in the near future even as an economic model
- All market areas to be organized as **entry–exit zones** with **virtual hubs** => Towards uniform capacity allocation mechanisms (“**bundled products**”) & gas pricing mechanisms (“**liquid hubs**”), but:

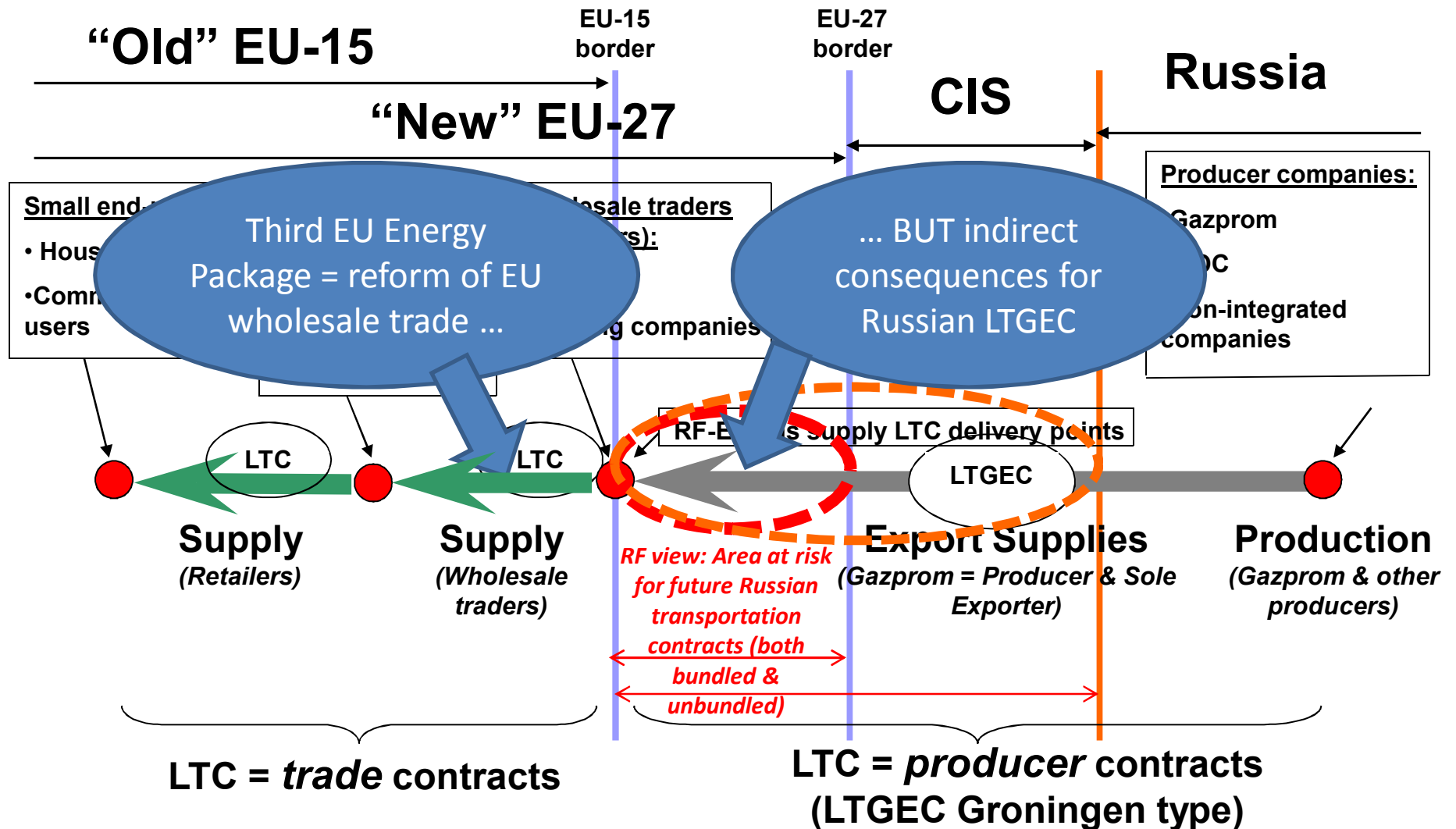
- (1) Capacity allocation: **short-term** vs. **long-term**? At zone borders? At hubs? Bundled products – volumes vs. duration? How to overcome inconveniences of the 3rd Package? (long-term: transportation = 1 year+, supply = 10 years+ => “contractual mismatch” ?)
- (2) Gas pricing at hubs: on **all** gas volumes *or* just on **portion** of gas supplies? When gas hubs would become really liquid in Europe? All or only few of them? Which ones?



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

A.Konoplyanik, WIEN group meeting, Moscow, 25.05.2011

RUSSIA-EU GAS VALUE CHAIN & Third EU Energy Package



Trade LTC are of specific concern of CEC (DG COMP) and are directly influenced by 3rd EU Energy Package (by reform of internal EU wholesale gas trade), but lack of clarity has been interpreted as fight against Russian LTGEC & has established a “grey zone” for them from implementation of EU legislation (problem of “contractual mismatch”, etc.)

Russia's reaction on 3rd EU Energy Package

- Gazprom's intention to continue participate in gas business inside the EU as both an owner/operator of gas transportation system **and** a shipper (supplier), **BUT**: Oettinger (03.03.2011): "The Russian partners have to accept our rules",
- Gazprom's intention to receive exemptions from MTPA for its new infrastructure projects (South Stream, OPAL, NEL, etc.) to provide their bankability, etc. => Art. 35-36 Directive 73/EC/09,
- Russia's intention to participate, together with EU Institutions, in forming comfortable - for ALL participants of the cross-border gas business - rules of the game at the emerging EU gas market aimed at final unbundling of gas supply & gas transportation => model with ***Gazprom only as supplier / shipper inside the EU => the task for our consultations***

Russian LTGECs – in the “grey zone” of 3rd EU Energy Package

- 3rd Package applied to interconnectors only (pipelines started & ended within the territory of EU MS) & to supply & transportation contracts between legal entities of the EU
- Pipelines originated from outside the EU and destined for the EU (Russian LTGEC) formally does not come under 3rd Package rules, but since they pass through EU territory until delivery points inside the EU these LTGEC enters into “grey zone” of 3rd Package implementation =>
- Scenarios for Russia/Gazprom behaviour:
 - Derogations from 3rd Package rules for Russian contracts (& pipelines ?) up through to delivery points (???)
 - Conservation of provisions of acting Russian LTGEC until their contractual term expiration
 - Application of 3rd Package rules only to new contracts (without forced termination of acting Russian LTGEC)
 - Adaptation of draft transportation regime of 3rd Package to justified concerns of Russian party

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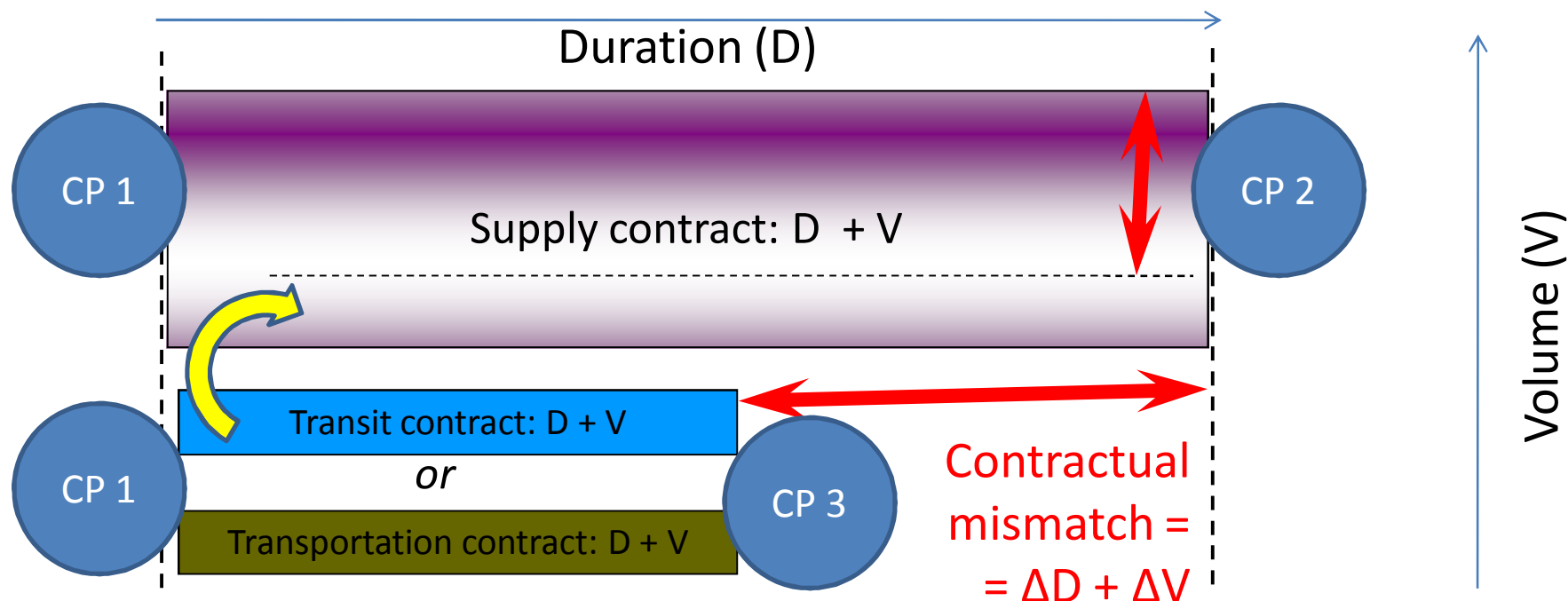
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Key provisions of the EU Gas Directives (1998/2003/2009) and the problems they created

Key CEC/DG COMP assumption/philosophy: *"The more competition (number of players / intermediaries) – the better it is for end-users"* (???) => the policies:

Key provisions 2 nd , 3 rd EU Gas Directives	Problems they creates (incremental risks for trade & investment)
Segmentation of VIOC (unbundling)	"Contractual mismatch" (long-term supply vs transportation contract: correlation in duration & volumes)
Mandatory third party access (MTPA) to gas transportation infrastructure,	Bankability of investment projects (MTPA discriminates project financing)
Switch from LTGEC with indexation to spot trade with futures	Increased price volatility & diminished price predictability (price losing its guidance for long-term & capital-intensive investment decisions)

Contractual Mismatch Problem



Contractual mismatch: 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 non-renewal transit/ transportation contract => risk non-fulfillment supply/delivery contract.

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

3rd EU Energy Package = risks of disbalances:

(1) long-term vs. short-term & (2) commodity vs. capacity

Unbundling & MTPA rules changes architecture of gas system with bundled supply & transportation contracts within single VICs to unbundled system with separated supply & transportation contracts within different entities => to balance (long-term & short-term) + (capacity & commodity) contracts within now separated markets

	Commodity	Capacity
Long-term	No ?	No ?
Short-term	Yes, but with risky instruments	Yes, but with risky (wrong?) instruments

All architecture of gas target model (MECOS) is based on and resulted from definition of “wholesale market” as short/mid-term spot commodity market inevitably leading to development of paper gas market with all its deficiencies - despite the statement (MECOS, 04.04.2011, # 1.1) that “all economic pipeline investments (are to be) done”

2nd & 3rd EU Energy Packages: what is long-term supply contracts?

(a) Item 25, (b) Item 42: “Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings **in so far as they do not undermine** the objectives of this Directive and are compatible with the Treaty [of Rome, 1958 - AK], including **competition rules**. It is therefore necessary to take them into account in the planning of supply and transportation capacities of gas undertakings.”

Source: (a) DIRECTIVE 2003/55/EC ... of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, (b) DIRECTIVE 2009/73/EC ... of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC

Item 11: Long-term contracts have played a very important role in securing gas supplies for Europe and will continue to do so.

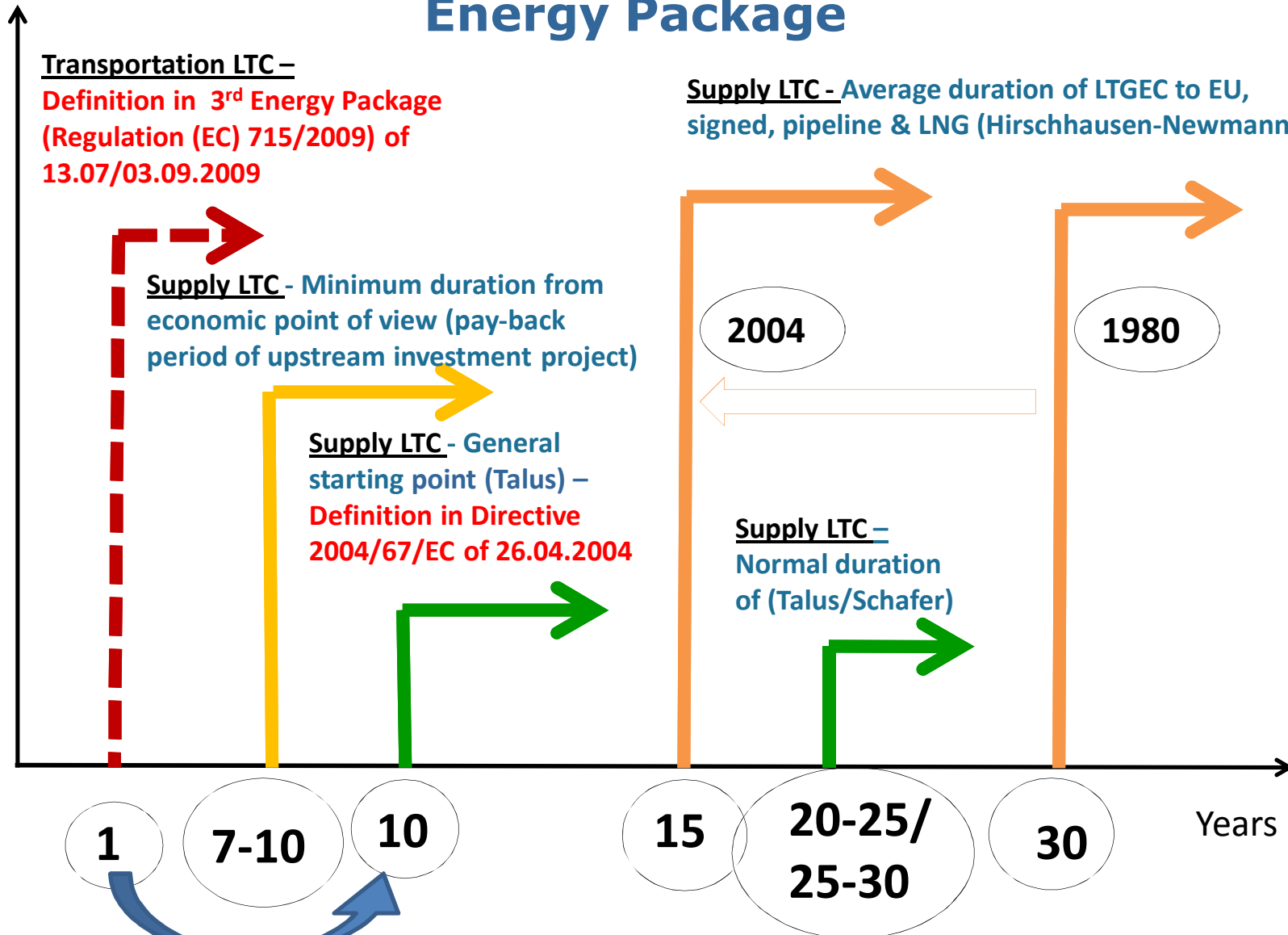
Art. 2(1): ‘long-term gas **supply** contract’ means a gas supply contract with a duration of **more than 10 years**

Source: Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply

2nd & 3rd EU Energy Packages: what is long-term transportation?

- Regulation (EC) 1775/2005 (28.09.2005) on conditions for access to the natural gas transmission networks => Article 2 “Definitions”:
 - (14) ‘long-term services’ means services offered by the transmission system operator with a duration of **one year or more**;
- Regulation (EC) 715/2009 (13.07.2009) on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 (03/09/2009) => Article 2 “Definitions”:
 - (14) ‘long-term services’ means services offered by the transmission system operator with a duration of **one year or more**;
- ***Nothing has changed*** from 2nd to 3rd Package regarding taking into consideration justified Russia’s concerns => still risk for long-term transportation due to “contractual mismatch” problem => if there are instruments of long-term access to transportations infrastructure mitigating this risk?

“Long-term” (gas export contracts): different durations in historical European practice & its definition in 3rd EU Energy Package



Alternative proposals to the EU gas market model currently under development (for joint discussion & consideration)

➤ **Long-term supplies (firm contracts, main/basic demand load):**

More flexible LTGEC (off-taking of contractual volumes & pricing formulas & price review rules)

+ long-term access to transportation capacity for full duration & volume of LTGEC (open seasons)

+ modified pricing formulas linking gas to its replacement fuels (indexation not only to petroleum products)

➤ **Short-term supplies (interruptible contracts, additional/semi-peak & peak demand load):**

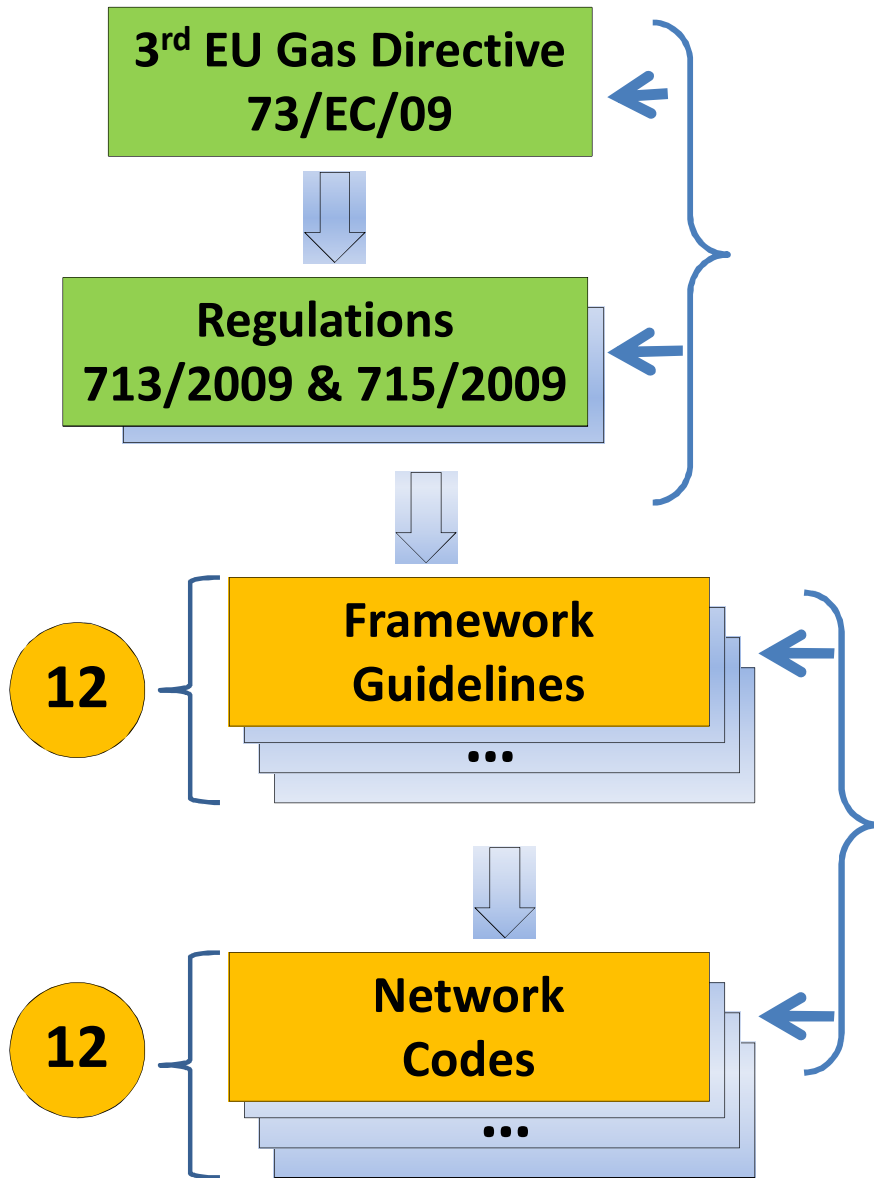
Spot contracts

+ exchange pricing (futures, gas indexes, forward curves)

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Third EU Energy Package (gas)



Third EU Energy Package (gas): Directive 73/EC/09 + Regulations 713/2009 & 715/2009

- **Legally binding, entered into force 03.09.2009;**
- **EU MS were to comply by March 03, 2011 (Art.11 Directive - by 03.03.2013) => None has done in time**
- **CEC (28.02.2011): “7 MS are expected to notify the Commission of the arrangements required “in the coming weeks”, 9 others - are expected to follow suit in the summer”;**
- **Oettinger gave MS “until the autumn to transpose Community law into national law”.**

Third EU Energy Package (gas): 12 Framework Guidelines + 12 Network Codes

- To become legally binding after preparation & approval
- EU Heads of State (28.02.2011): a clarion call for the “speedy & full implementation” of energy market liberalization – by 2014 => [...] of 24?
- If positive reading of new (later) date: it opens broader window of opportunities to make 3rd Package effectively workable (BUT: from “learning by doing” to “learning by advanced thinking & discussing”) =>
- 3rd Package to be effective in practical use – regular, continuous & well structured cooperation/discussion needed with major suppliers & transit states =>
- This is the aim of our informal consultations supported by political leadership within RF-EU Energy Dialogue

Informal expert consultations Russia-EU on problematic issues of 3rd EU Energy Package

- 02.09.2009 (Alpbach, Austria) – expression of mutual interest in dialogue (EU: to explain intentions, RF – to explain concerns)
- Jan. 2010 – regular informal consultations started + Russian/Gazprom Group experts began to participate in internal EU public consultations on draft FG/NC & on Gas Target Model
- Consultations participants: Russia/Gazprom Group experts + Energy Regulators of EU MSs & representatives of the Commission
- 22 June 2011 – 7th round of consultations planned

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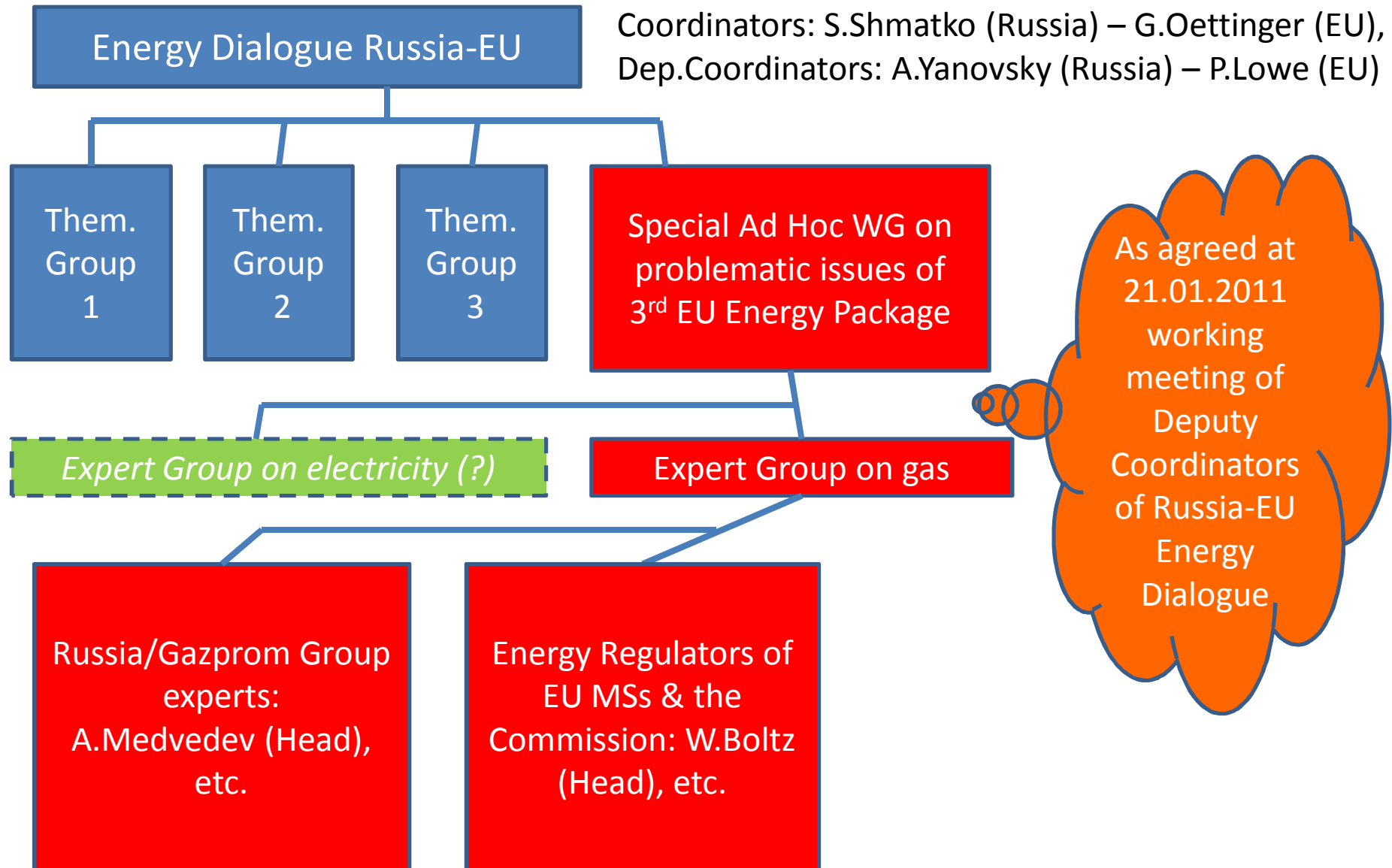
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See V.Feygin's presentation

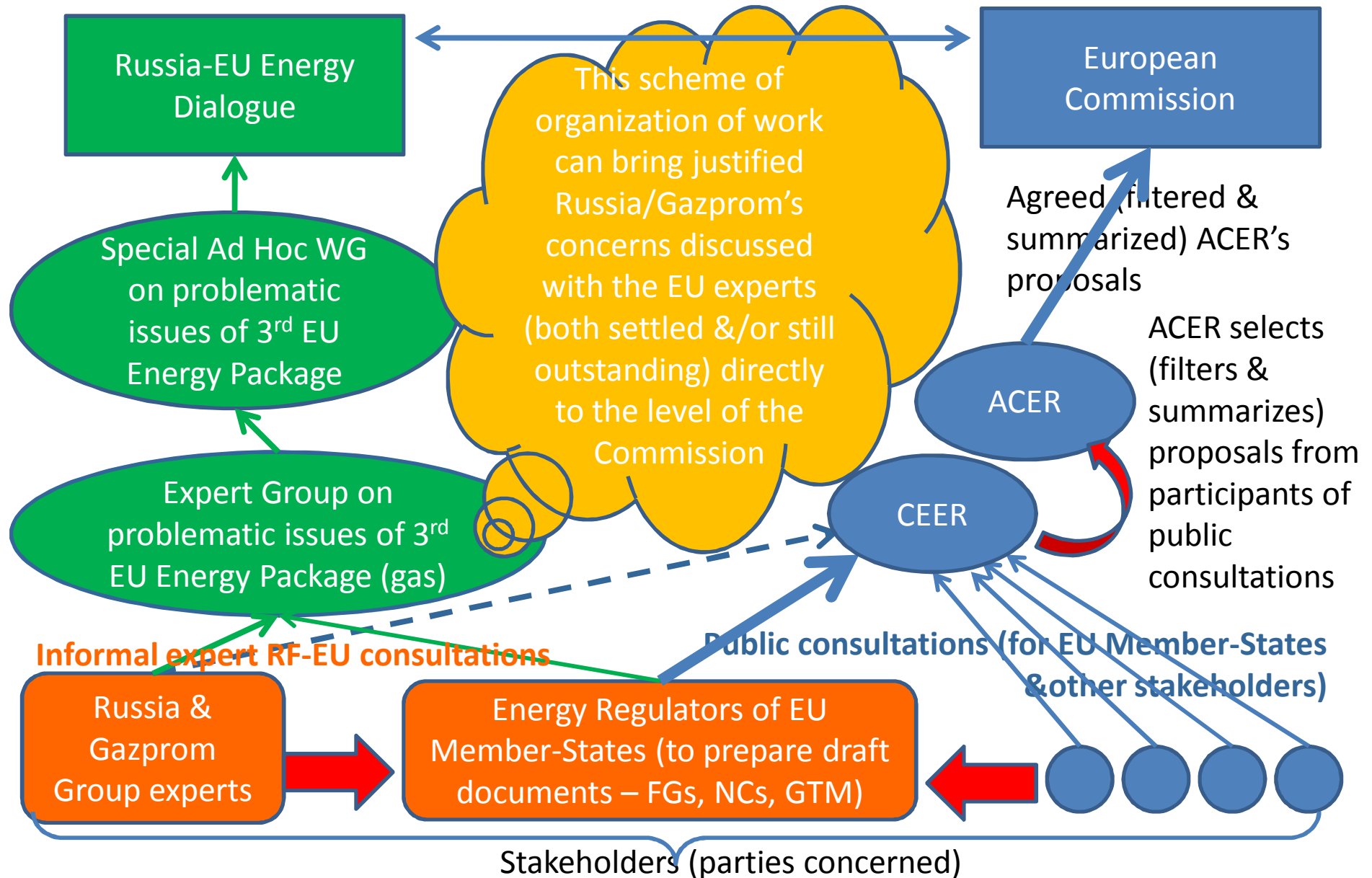
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Work organization on problematic issues of 3rd EU Energy Package within the framework of Russia-EU Energy Dialogue



How Special Ad Hoc WG on problematic issues of 3rd EU Energy Package within Russia-EU Energy Dialogue can work



Thank you for your attention

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