

The nature of future Russian gas exports to Europe

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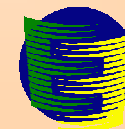
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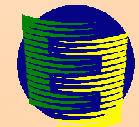


1. Current characteristic features of Russian gas exports to Europe



MAJOR ELEMENTS OF RUSSIAN GAS EXPORTS TO EUROPE:

- Long-term contracts
- On-border sales
- Destination clauses
- Key role of transit



LONG-TERM TAKE AND/OR PAY GAS CONTRACTS (LTC TOP) AND PROJECT FINANCING RISKS

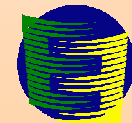
$$\text{Financing} = f(\text{revenue}) = f(\text{volume} \times \text{price})$$

(1) LTC TOP = mechanism of supply risks («volume» risks) reduction

(2) LTC TOP + adequate pricing mechanism = mechanism of “price” risks reduction:

- prior to exchange pricing: escalation formulas
- exchange pricing: futures + hedging

(1) + (2) = mechanism of project financing risks reduction (long-term capital-intensive Greenfield projects, i.e. in new regions with no/lack-of production & transportation infrastructure)



GAS: DIFFERENT PROJECTS – DIFFERENT CONTRACTS

(1) New projects in mature regions with existing infrastructure, with available transportation capacities (usually less capital-intensive projects, relatively small to the existing market) =

(a) short-term contracts (“take and/or pay”) – for the duration of payback period (?)

(b) spot deals – when payback period is over (?):

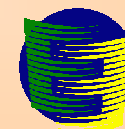
- dated
- forward
- futures

Regions: Western, Central & Eastern Europe

(2) New projects in new regions with no/lack-of infrastructure for both production and transportation (usually more capital-intensive projects, relatively big to the existing market) =

(a) long-term “take and/or pay” contracts

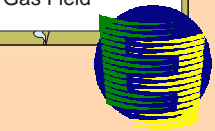
Regions: Russia, CIS, Asia



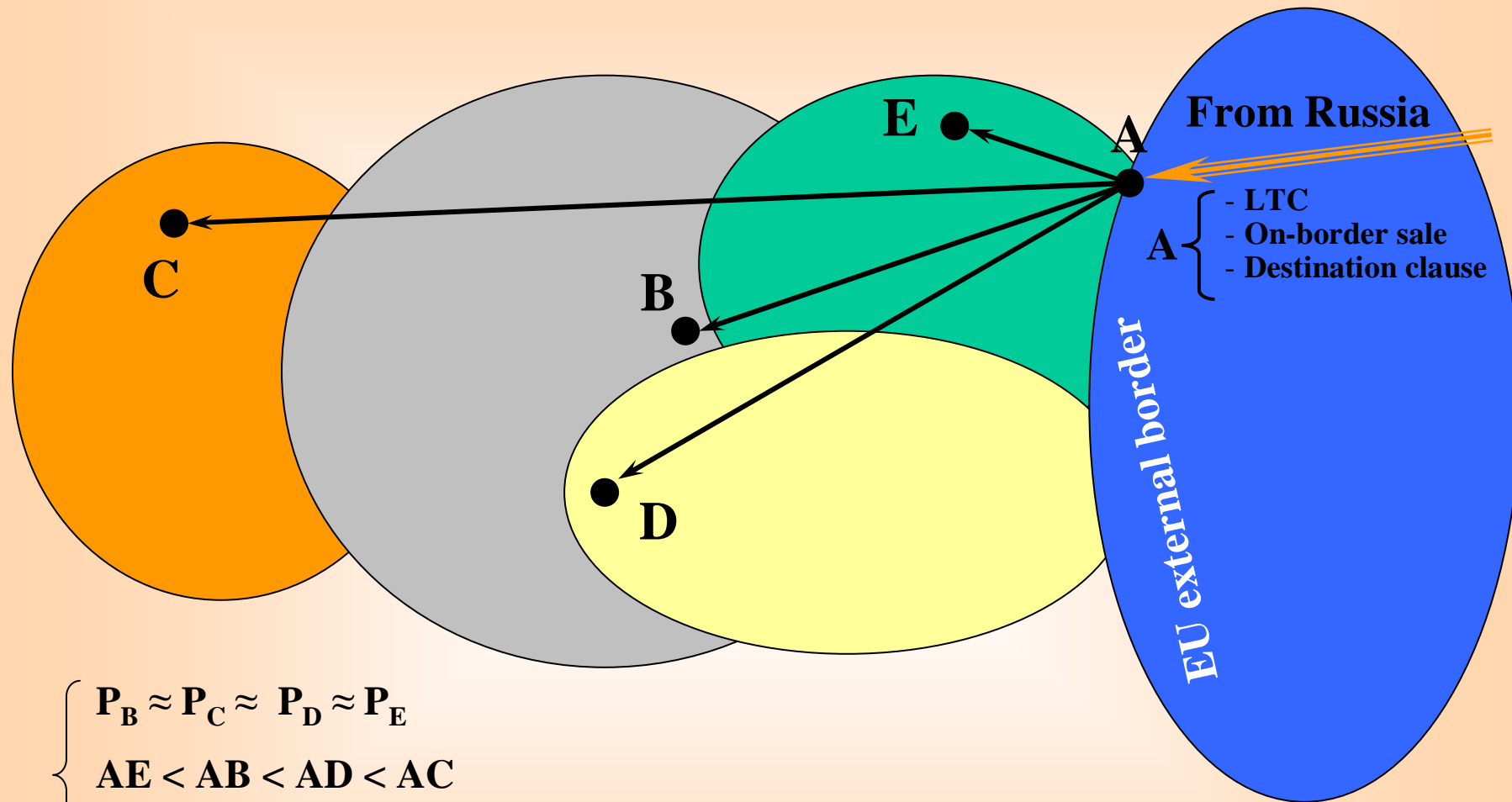
RUSSIAN GAS EXPORT TO EUROPE: ON-BORDER SALES AND TRANSIT ARMS



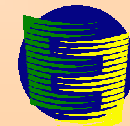
Figure 4



DESTINATION CLAUSES: AN INTEGRAL PART OF EXISTING RUSSIAN EXPORT SCHEMES TO EUROPE



$$\left\{ \begin{array}{l} P_B \approx P_C \approx P_D \approx P_E \\ AE < AB < AD < AC \\ P_{A \blacktriangleright C} < P_{A \blacktriangleright D} < P_{A \blacktriangleright B} < P_{A \blacktriangleright E} \end{array} \right.$$



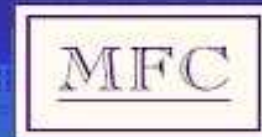
3.4 DESTINATION CLAUSES

GAS PRICE ARRANGEMENTS (SCHEMATIC) FOR RUSSIAN GAS AT BAUMGARTEN



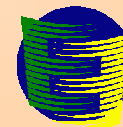
$F - F_E$ = French transportation adjustment
 $A_E - F_E$ = French Baumgarten "discount"

$I - I_E$ = Italian transportation adjustment
 = Italian Baumgarten "discount"

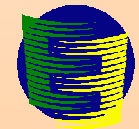


**ROLE OF GAS TRANSIT
FOR ITS MAIN EXISTING EXPORTERS TO EUROPE (1999)**

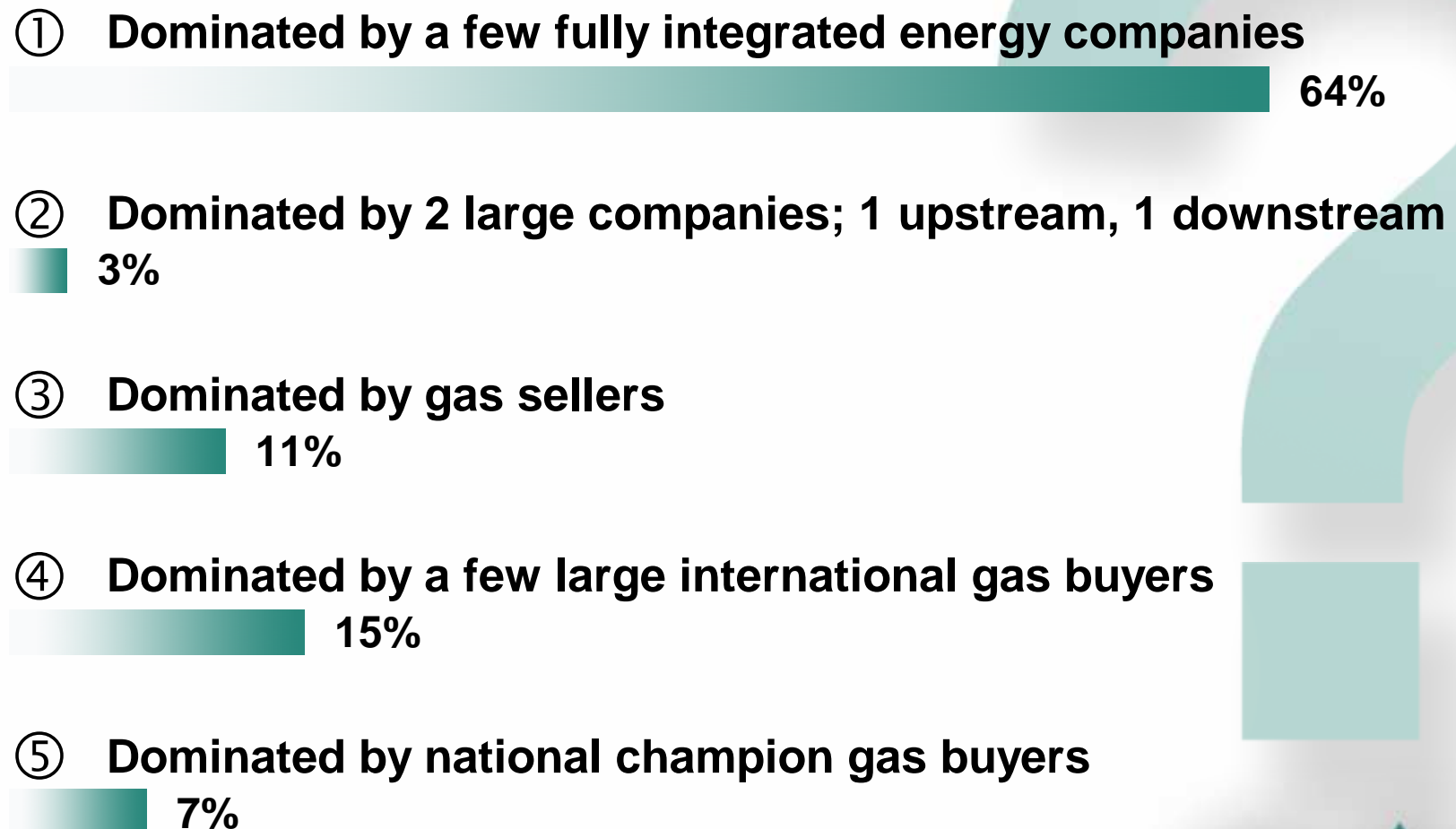
Country-exporter	Direct supplies, % of volume of exports	Transit through the territory of: % of volume of exports			
		one country	two countries	three countries	four countries
EXISTING EXPORTERS					
Netherlands	76,2	13,8	10,0	-	-
Norway	67,7	7,5	21,4	3,4	-
Algeria	44,9	14,8	9,6	24,3	6,4
Russia	39,5	9,4	11,4	28,1	11,6



2. EU gas market development trends (EU gas business community views)

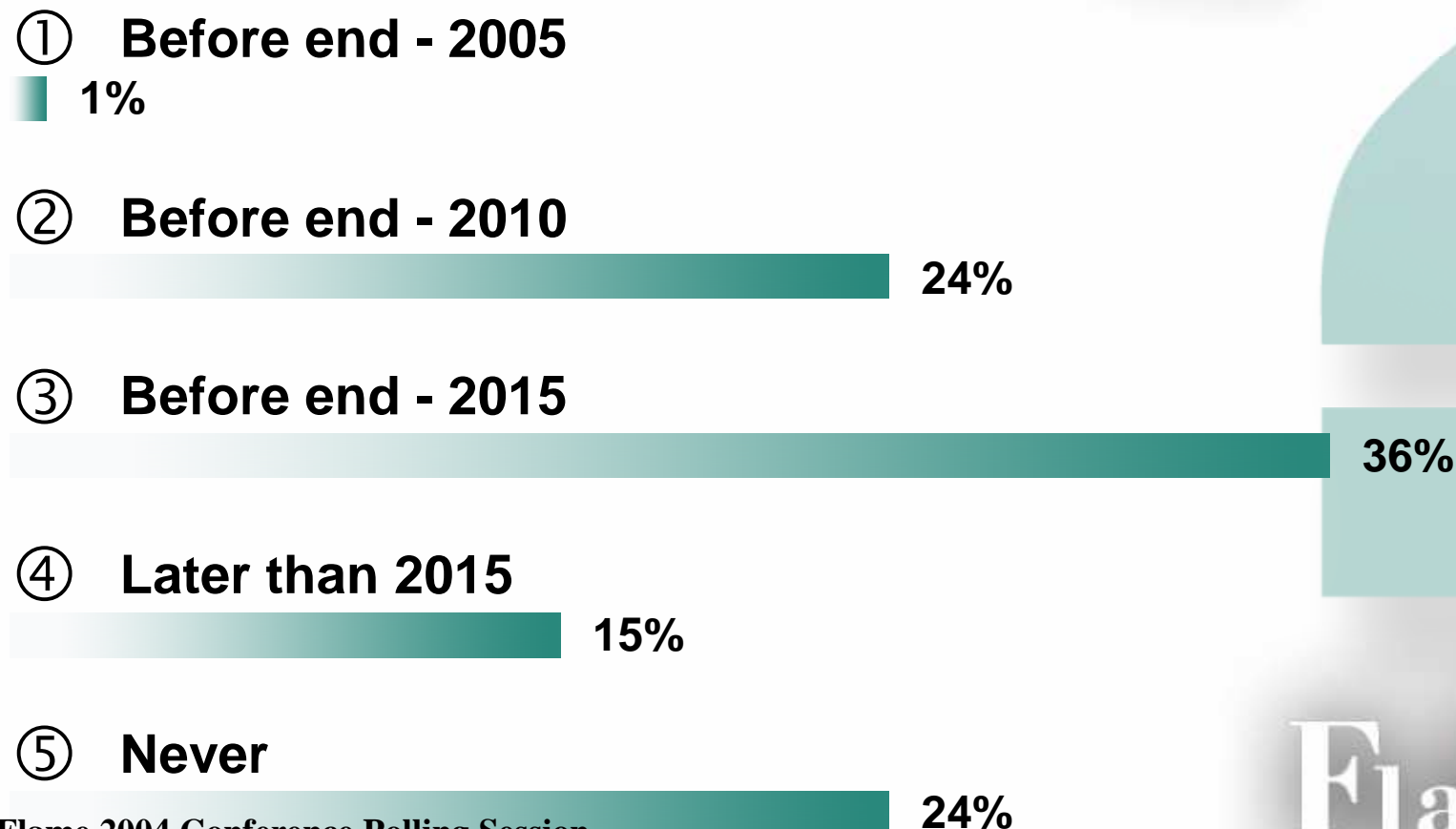


How would you characterise Europe's gas market in 10 years time?



Source: Flame 2004 Conference Polling Session

When do you believe that European long term contract gas prices will become decoupled from oil and determined by spot/futures prices?



Source: Flame 2004 Conference Polling Session

Dr. A. Konoplianiuk, ASI Energy Symposium, 15.03.2004, London - Figure 9



By the end of 2008 what will be the volume of gas sold at hubs as a percentage of total EU gas sales?

① 5% or less



② 6-10%



③ 11-20%



④ 21-30%



⑤ More than 30%



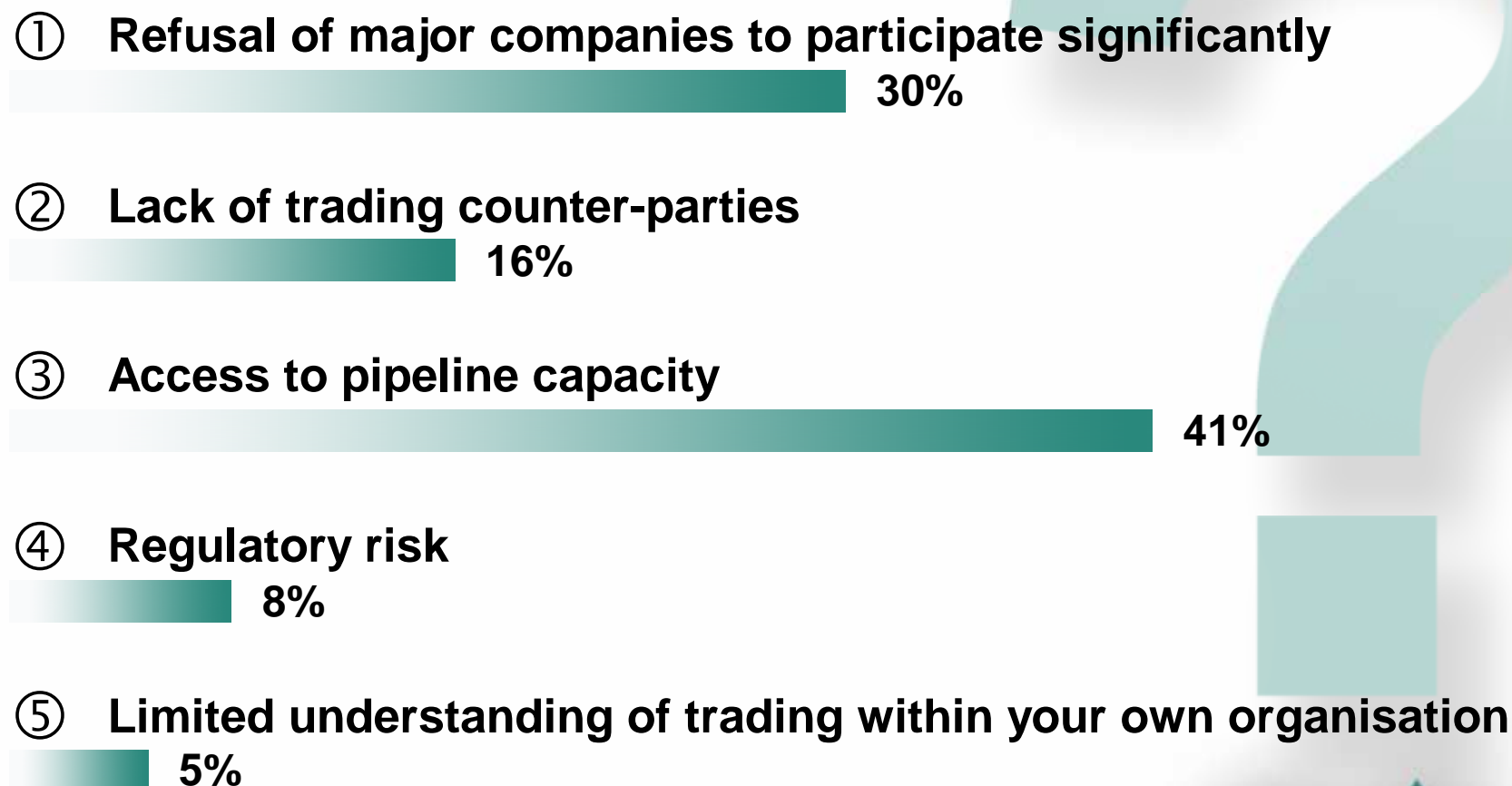
Source: Flame 2004 Conference Polling Session

Dr. A. Konopliank, ASI Energy Symposium, 15.03.2004, London - Figure 10



Flame

Why do you think that traded markets across Europe lack liquidity?

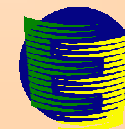


Source: Flame 2004 Conference Polling Session

Dr. A. Konoplianiuk, ASI Energy Symposium, 15.03.2004, London - Figure 11

Flame

3. Future developments of Russia's gas export characteristic features



EU POSITION ON LONG-TERM CONTRACTS

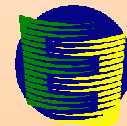
Item 22: “Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objectives of this Directive and are compatible with the Treaty, including competition rules.”

Source:

Amended proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

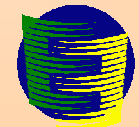
amending Directives 96/92/EC and 98/30/EC concerning rules for the internal markets in electricity and natural gas



EU COMMISSION – ENI – GAZPROM SOLUTION: SETTLEMENT FOR DESTINATION CLAUSES IN EUROPE?

- **Delete territorial sales restrictions from all existing gas supply contracts. Two delivery points (new contracts) instead of one (existing contracts). ENI free to re-sell gas to any destination, incl. outside Italy**
- **ENI committed to offer significant gas volumes to customers outside Italy over 5-year period starting 01.10.2003. If not sell sufficient volumes during first half of the period – auction at Baumgarten**
- **Refrain from introducing ENI consent clauses in new contracts in Italy**
- **ENI to promote capacity increase (2008-2011) of its majority-controlled TAG pipeline (100% of Russian gas to Italy) and to promote an improved TPA to use TAG for transit**

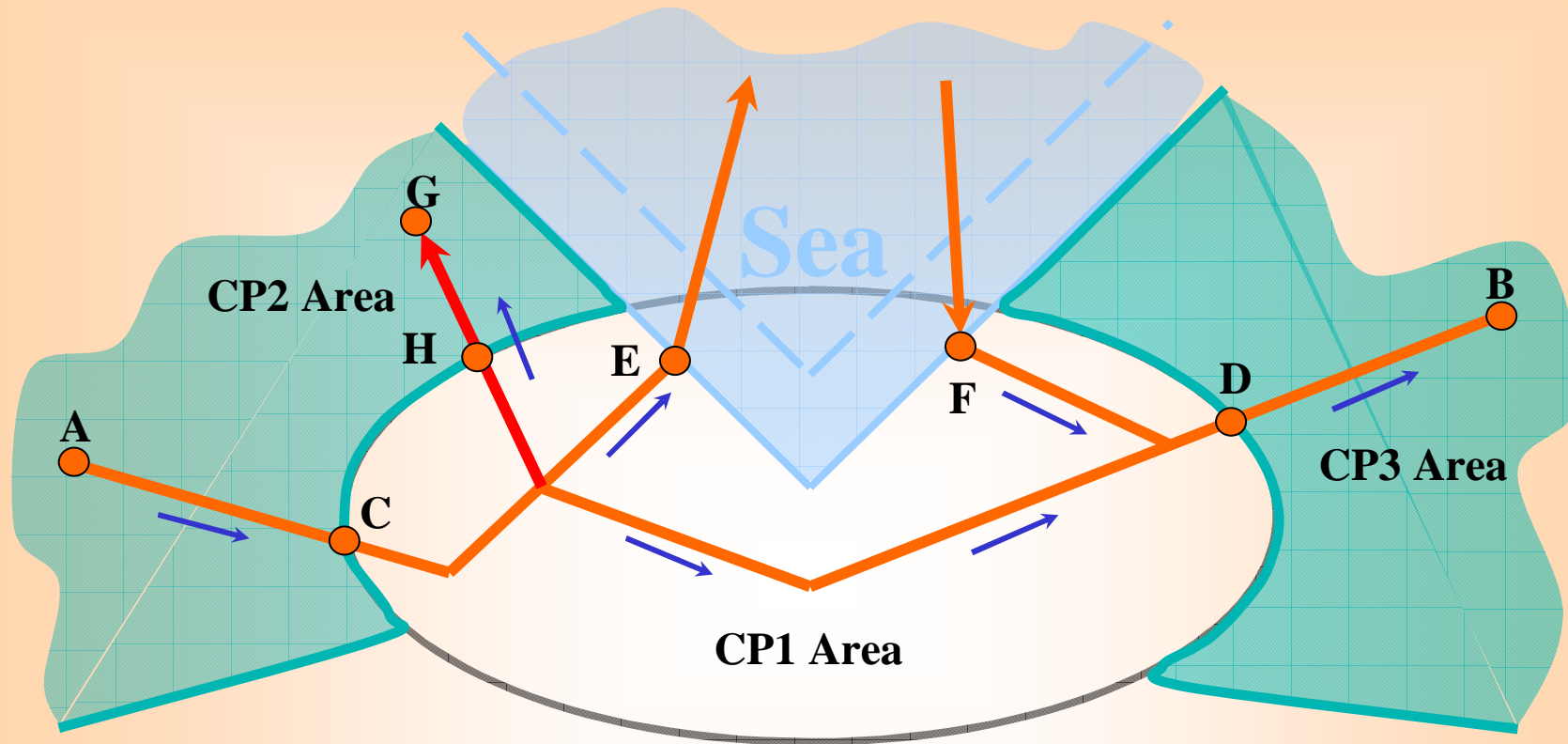
Source: Commission press-release on territorial destination clauses with Gazprom and ENI, IP/03/1345, 06.10.2003/ Commission Staff Working Paper “Energy Dialogue with Russia. Update on progress”, 28.01.2004, SEC (2004)114, Annex 6



5.2 CONCLUSIONS

- ▲ **The removal of destination clauses should be strictly tied to and be conditional upon the introduction of full and unrestricted TPA in the EU gas transmission system**
- ▲ **Removal of destination clauses without unrestricted transmission system TPA would give gas importers undue advantages over gas exporters**

TRANSIT IS NOT THE ONLY OPTION ...



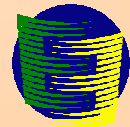
3 possibilities of energy supplies from A to B:

No transit (on-boarder sales at C, D):

RUF-EU, Turkmenistan-RUF, Kazakhstan-RUF, Algeria-Italy, Algeria-Spain

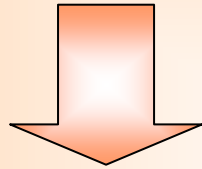
Transit:

- through the pipe owned/leased by shipper: France-Germany, Norway-France, Italy-Austria; planned RUF-CIS/EE
- through the pipe not owned by shipper

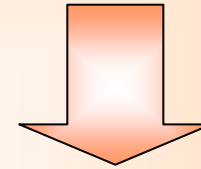


**... BUT IT MIGHT BE THE CHEAPEST ONE –
IF ADEQUATELY LEGALLY PROTECTED**

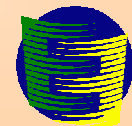
**TWO SCENARIOS OF RUSSIAN GAS EXPANSION FURTHER
INTO EUROPE**



- 1) Gazprom = owner of pipeline
(construction of new pipeline capacities, purchase of pipeline companies shares)**
- More expensive
 - Decreasing rights of pipeline owners on decisions for transit/ transportation conditions according to EC legislation

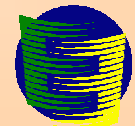


- 1) Gazprom = shipper (from gas sales at the border to wholesale buyers/resellers → to sales to final consumers within country)**
- Less expensive
 - Increasing rights of transporters on decisions... according to EC legislation

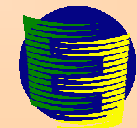
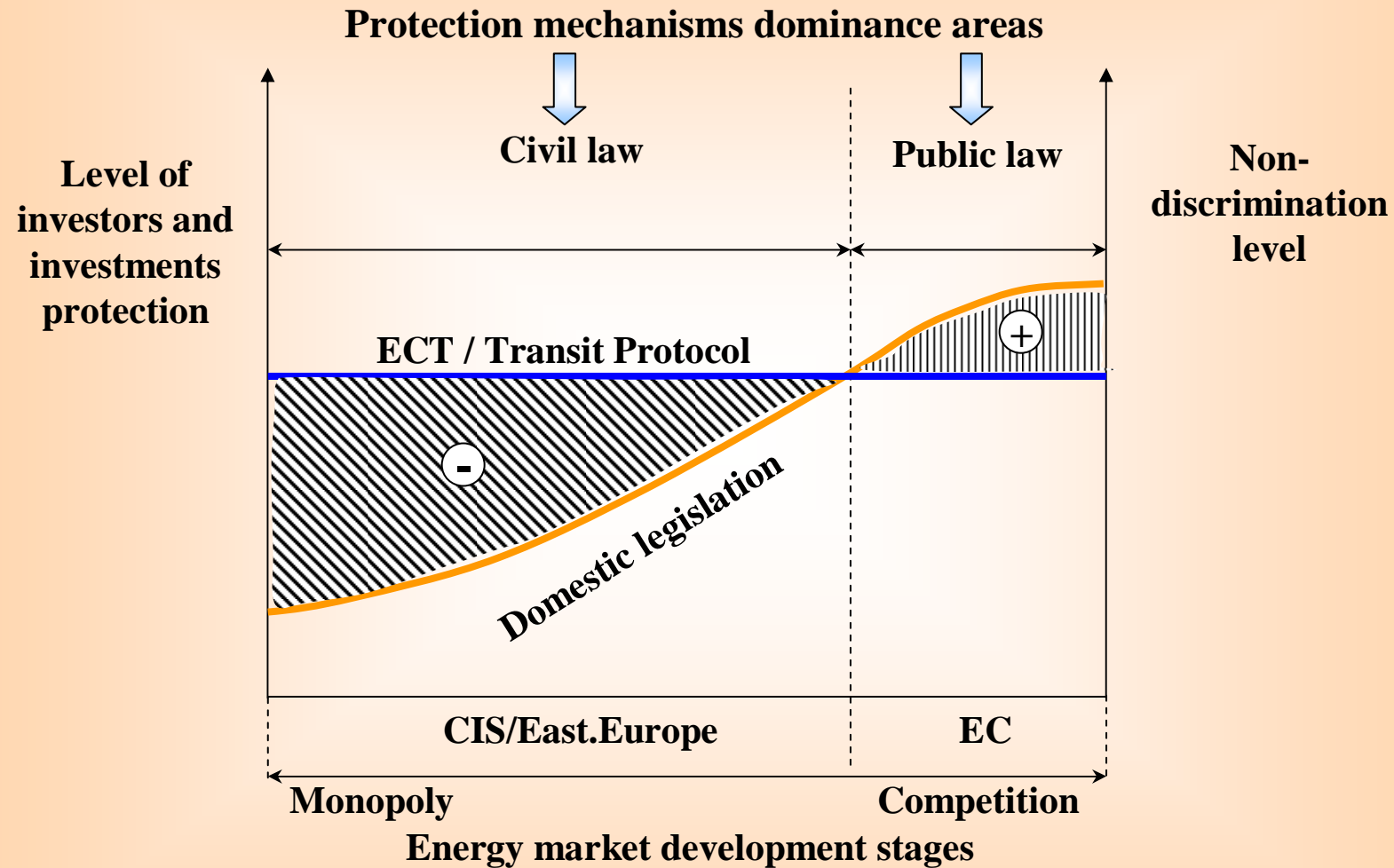


ECT TRANSIT PROTOCOL: MAJOR ISSUES ADDRESSED

- 1. Obligation to observe Transit Agreements**
- 2. Prohibition of unauthorized taking of EMP in Transit**
- 3. Definition of Available Capacity in Energy Transport Facilities used for Transit**
- 4. Negotiated TPA to Available Capacity (mandatory TPA is excluded)**
- 5. Facilitation of construction, expansion or operation of Energy Transport Facilities used for Transit**
- 6. Transit Tariffs shall be non-discriminating, objective, reasonable and transparent, not affected by market distortions, and cost-based incl. reasonable ROR**
- 7. Technical and accounting standards harmonized by use of internationally accepted standards**
- 8. Energy metering and measuring strengthened at international borders**
- 9. Co-ordination in the event of accidental interruption, reduction or stoppage of Transit**
- 10. Protection of International Energy Swap Agreements**
- 11. Implementation and compliance**
- 12. Dispute settlement**



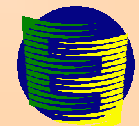
ECT TRANSIT PROTOCOL AND “MINIMUM STANDARD” PROVISIONS WITHIN AND OUTSIDE EU



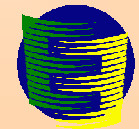
RUSSIA (V.KHRISTENKO) ON THREE OUTSTANDING ISSUES

“Ratification of the ECT means only one thing for Russia as of today - namely, completion of negotiations and reaching final formulations on the one single protocol ... That is the Protocol on Transit ... Consultations on this protocol ... are still being conducted. As of today, the Russian Federation still has a number of serious concerns. We have three points, which are quite serious ones for us, and on which we would like to find satisfactory answers. Once we achieve satisfactory results on this protocol, we will be ready to sign it ... Therefore, we are proposing to continue the work and seek a mutually acceptable outcome - and then, correspondingly, options will open up with regard to the ECT in general.”

(Press-conference given by Russian Deputy Prime Minister Viktor Khristenko at the Russian EU Mission in Brussels , 23 June 2003)



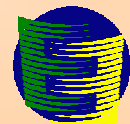
4. RUF-EU energy agenda – how and where to proceed



EU – RUF WTO ENERGY AGENDA (EU COMMISSION’S SIX DEMANDS ON RUSSIA)

- **Raise internal prices for natural gas**
- **End Gazprom’s monopoly on gas exports**
- **Lift restrictions on gas transit (“free transit”)**
- **Allow foreign investors to build pipelines in Russia**
- **Introduce equal prices for transit of gas for domestic users and for exports**
- **Cancel gas export tariffs**

Source: www.russiajournal.com , 02.03.04



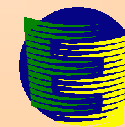
RUSSIA (V.KHRISTENKO) ON ECT - WTO

The issue of transiting Russia's gas across the European Union should be dealt with in the framework of the Energy Charter, not WTO.

V.Khristenko labelled "unexpected" the fact that the issue of gas transit across Europe has surfaced in the framework of negotiations on Russia's accession to the WTO. "From our point of view, this is impossible as a matter of principle: to leave aside the Charter which has been established especially to deal with such issues, and take the topic to negotiations on the WTO. Our position is simple - WTO in no way resolves the transit problems. This theme is not covered by WTO norms and rules"

"It is not possible to discuss a topic everywhere and in all places. For starters, clarity should be reached where to discuss and return to a single venue - either one or the other negotiating table". Vice-premier stated that, in all likelihood, the theme of gas transit in WTO negotiations will be dropped, after all, and the discussions will return to the Transit Protocol of the Energy Charter.

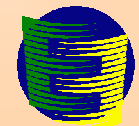
From RIA-Novosti, Moscow, 1 December 2003



EU ON TRANSIT PROTOCOL

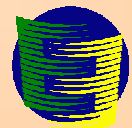
“The Council recalls the importance of the role of the Energy Charter Treaty in supporting long-term cooperation between the EU and its neighbors and partners by promoting investment in energy facilities, free trade in energy, and the uninterrupted transit of energy; underlines that the Russian Federation should be further encouraged to ratify the Energy Charter Treaty and seek agreement to the Transit Protocol...”

From Conclusions adopted by the Meeting of the European Union Council on Transport, Telecommunications and Energy, Brussels, 15 December 2003

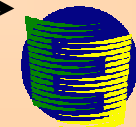
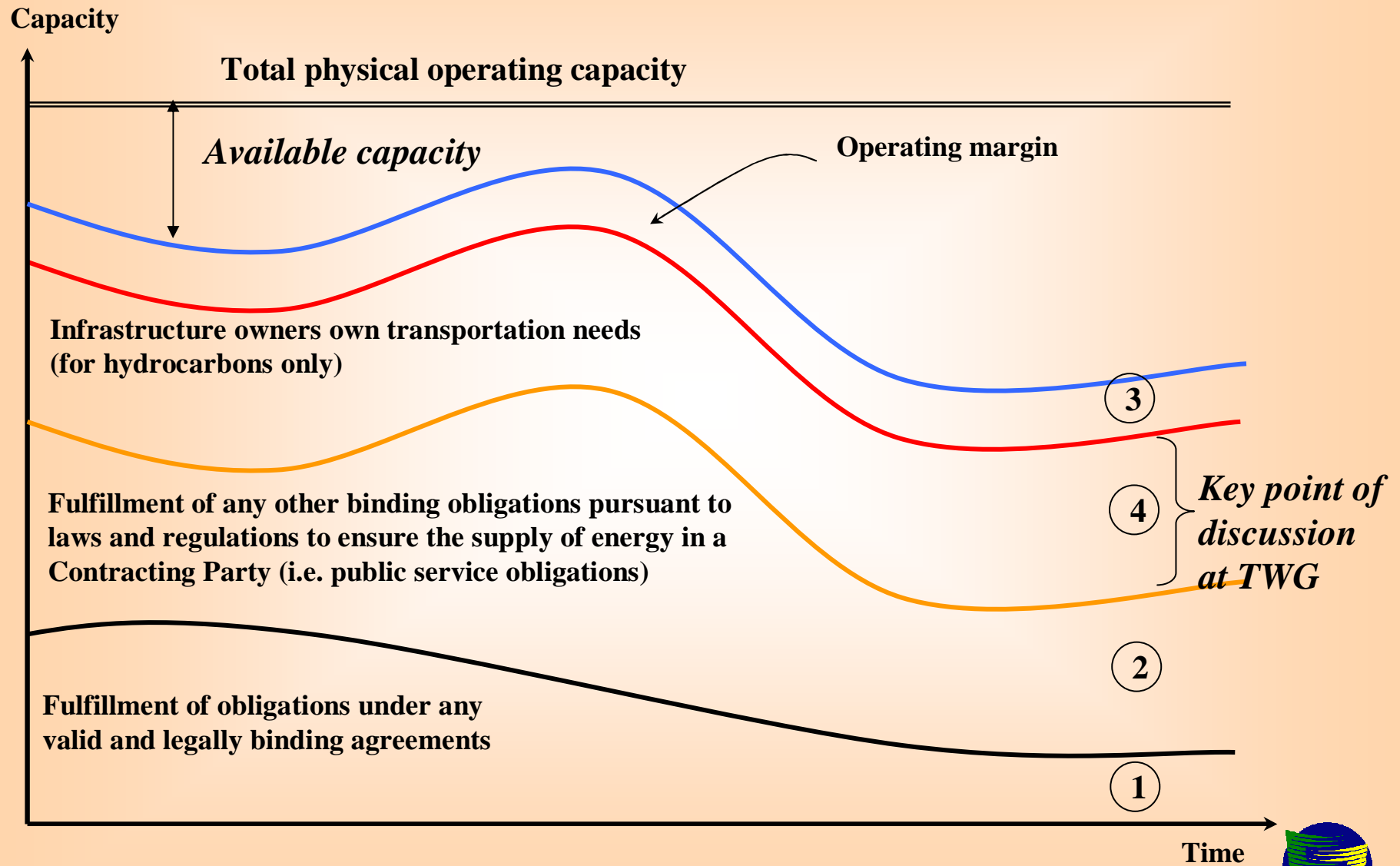


RUSSIAN POSITION ON ENERGY TRANSIT NEGOTIATIONS

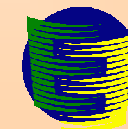
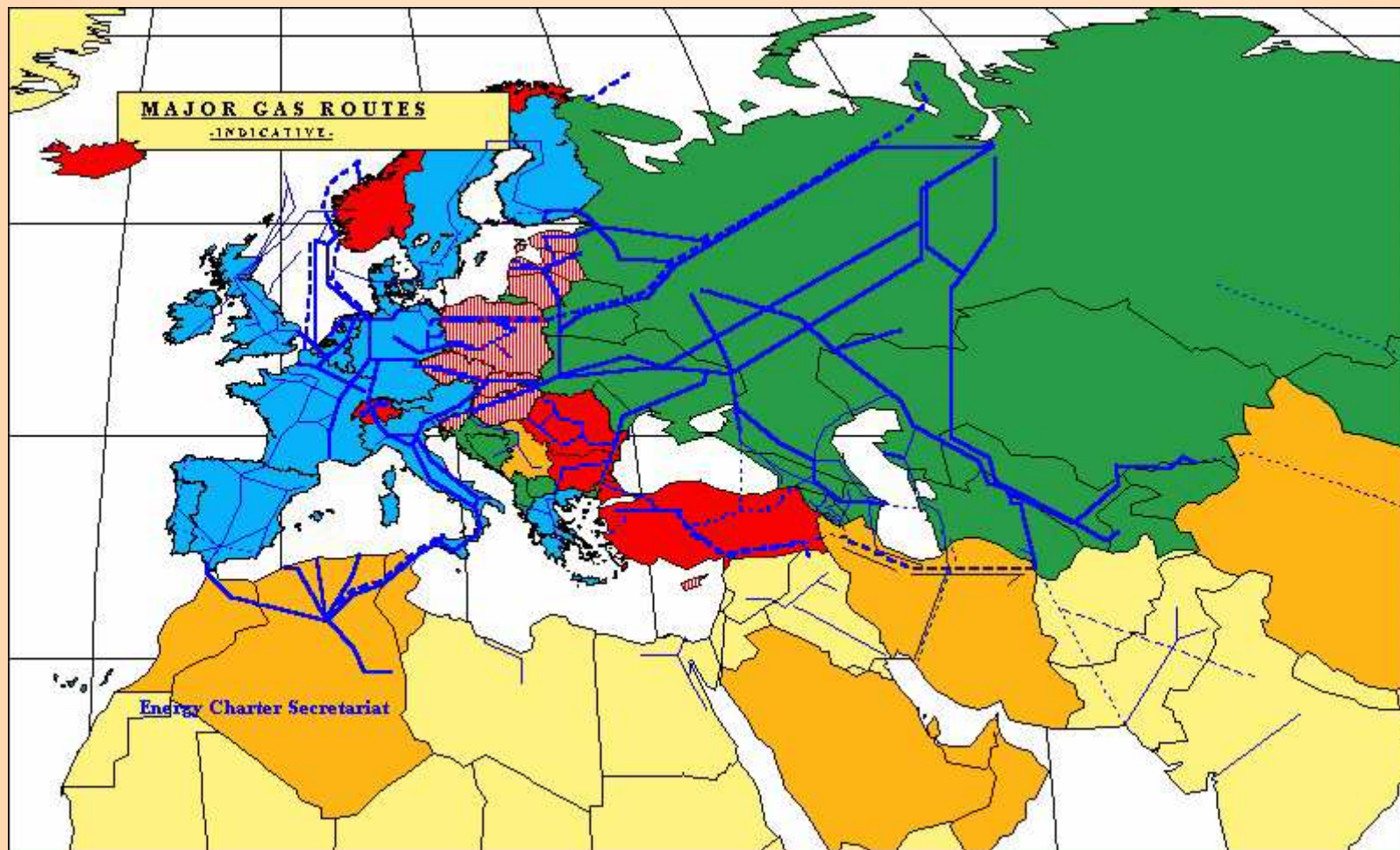
- **ECT TP three outstanding issues still not solved between RUF and EU**
- **RUF-EU 3 outstanding transit issues = part of multilateral ECT transit agenda, *or* 3 outstanding issues in multilateral ECT transit negotiations = part of bilateral RUF-EU agenda?**
- **To decouple WTO-ECT agenda (transit issues = under Energy Charter)**
 - **Multilateral negotiations (ECT TP) vs. unilateral demands (WTO accession)**
 - **Same topics – different negotiating teams**
 - **Same topics – different negotiating approaches**



DEFINITION OF AVAILABLE CAPACITY

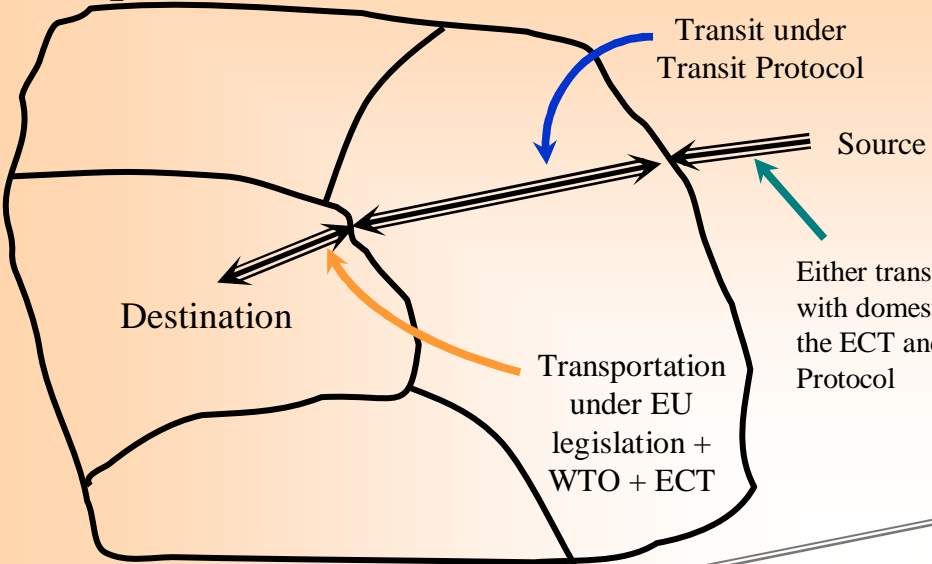


REIO CLAUSE: GEOGRAPHICAL ASPECTS



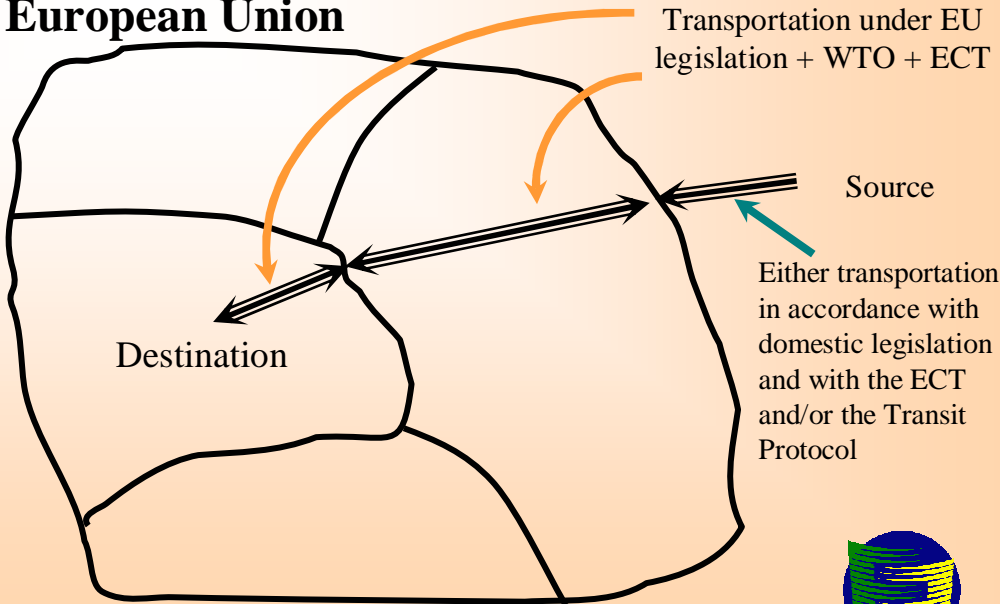
REIO CLAUSE: LEGAL ASPECTS

European Union

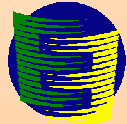


(a) Before REIO:

European Union



(b) After REIO:



RIGHT OF FIRST REFUSAL (RFR): SCOPE AND MECHANISMS OF APPLICATION

