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Stanislav Tsygankov, Head of International Business Department,
Gazprom

ROLE OF NATURAL GAS IN EUROPEAN ENERGY SECURITY

Ladies and gentlemen!

I dare say that the subject of our debate today "Sustainable energy policies: the key to energy security" is in the best way timely. Not only does it reflect the approach which most experts are developing now on the solutions of numerous accumulated energy challenges but it is also an indirect evidence of the fact that, unfortunately, in the countries which are most concerned about energy security the **sustainable** energy policy has a long way to go from declaration to reality.

In this respect I would like in my speech to:

1. present Gazprom's view on peculiarities of the EU gas market liberalization and new trends in this process;
2. dwell on the consequential risks which both producers and consumers are to face with regard to security of supply;
3. say a few words concerning what steps Gazprom takes in the current situation to maintain and develop its market position.

Capability of market forces to promote social objectives, such as energy security, is being lately put in doubt by an increasing number of experts including those in the UNECE.

In our opinion, such conclusions reflect the practical results of implementation of EU Gas Directives, such as "gas release programs" which effectively impose artificial limitations on volume and contract duration between wholesalers and local utility companies. This practice

indirectly erodes the existing long-term agreements' system, while the alternative guarantee of secure and foreseeable supplies over the long-term outlook hasn't been invented yet.

Moreover, the EU leaders are about to continue following this path. At the recent Conference on European Energy Strategy in Lisbon it was stated that because of long term contracts "new entrants cannot buy enough gas to build up a business, or access enough customers to create a sustainable customer base". In fact, it was suggested to expand the program of mandatory release of art of imported gas, which was adopted in certain countries (Italy, Germany, and Austria) under the pressure of the EC several years ago. Actually this scenario increases Gazprom's risks as a supplying company in respect of long-term gas supplies.

Another set of problems that Gazprom faces as the biggest gas exporter to the EU is related to the forthcoming drastic changes in the structure of the EU gas market.

Until now many analysts have, not without a reason, believed that the liberalization process itself creates investment uncertainty for producer countries that could cause a supply shortfall even in the next decade.

I think that implementation of some of the proposals for the New Energy Policy for Europe will add more reasons to that opinion.

I mean in particular the introduced motion on "ownership unbundling" also voiced in Lisbon that provides for a ban of sole ownership of both gas transmission networks and supply companies.

And Commission President José Manuel Barroso acknowledged on Friday at Russia-EU summit press-conference in Helsinki that this trend is to form a basis for the New Energy Policy.

The next logical step, it seems, will be to claim that the owner sells one of these companies, which basically violates the private property rights underpinning the market economy. And at the same time it is stated that

this unprecedented step would lay the groundwork for industry investment incentives.

I'd like to note that such practice would scarcely bring positive results. What it will definitely lead to is a lack of any pay-back guarantees for investors, and that would mean a standstill in key players' investments in energy infrastructure development.

Now we are at the threshold of making an investment decision on "Nord Stream" construction, on entering the BBL offshore pipeline, let alone investments made in German and UK gas infrastructure.

We need the utmost clarity on this matter since because such legal uncertainty impedes decisions on multi-billion projects.

Who would dare to risk large-scale investments in situation like this? If the European Commission is ready to cover these risks it is fine with us but we would like to get reliable information on the capacity of upcoming European infrastructure assets as well as when and where they are to be set in order to be able to develop the necessary reserve base for new gas supplies.

Regulatory and investment uncertainty in the European energy sector is aggravated by integration risks related to the fact that the expanding Europe experiences more and more difficulties in sustaining a common policy approach in its relations with Russia.

The fact that the European Commission failed to obtain Poland's approval to begin negotiations on new Partnership and Cooperation Agreement between Russia and the European Union is an evidence that achieving the balance of interests will be more complicated over the years. By the way, the Poland's demarche coincided, strangely enough, with the price revisions for Russian natural gas supplies to Poland and with "Nord Stream" construction progress talks.

This is not the first time when new EU member-states think of their own interests rather than the collective European ones. And sooner or later

the EU will have to determine its position – either the EU is concerned with reliable and safe gas supply to Europe (and in this case all the matters related to realization of large-scale infrastructure projects are to be discussed between us and the European Commission which would voice a unified approach of all member-states), or not.

Despite considerable uncertainty and risks in the market we continue to develop relations with our traditional consumers and we place emphasis to honoring existing commitments and fostering security of our supplies. Thus this summer we signed an Agreement with E.ON Ruhrgas on prolongation of existing contracts for natural gas supplies till 2035 (total volume - 300 bcm), as well as an Agreement for additional gas supplies via the Nord Stream with total gas volume of up to 100 bcm by 2036.

On November 14, 2006 Gazprom and ENI signed an Agreement on Strategic partnership. The Agreement contemplates among other things, extending the existing contracts for gas supply to Italy till 2035.

I believe that prolongation of the aforementioned contracts is a clear and sufficient response to recent attempts to convince Europeans that Gazprom's strategy on market diversification may allegedly deprive Europe of guarantees of Russian natural gas supplies in the future.

But in our case entering new markets is just a natural response to an ongoing economic development. As consumers strive, in the period of uncertainty, for the security of gas supplies, likewise producers strive for security of demand. And that is why we're also proceeding towards the East.

Under the Agreement with the China National Petroleum Corporation (CNPC) Russian gas is to be shipped to China in 2011. The transmission will be carried out from Unified Gas Transit System via 2 routes: the Western route which will bring gas from traditional gas production regions of Russia, and the Eastern route which will deliver gas from the Sakhalin

deposits. Annual total supply via Western route will be 30 bcm, and via Eastern route – 38 bcm.

We also started commercial discussions with the Korea Gas Corporation on natural gas supplies from Russia to South Korea. The Korean party confirmed their commitment to import up to 10 bcm a year starting between 2010 and 2012. The gas will be supplied from the Sakhalin deposits.

Today we hear a lot of fears that Gazprom's gas resources are not sufficient to accomplish these ambitious plans. But facts suggest otherwise: we increase our production capacity year by year and expect to achieve the production benchmark of 550 – 560 bcm a year by 2010 in Russia only with gradual increase up to 580 – 590 bcm by 2020. That will allow Gazprom to meet the total demand of the internal market and to fulfill international contract commitments.

In this respect we plan to develop more actively both our traditional and new oil and gas provinces, including such regions as Yamal peninsula, Arctic offshore deposits, East Siberia and the Far East as well as our deposits abroad.

In conclusion I would like to once again stress the following:

1. High regulatory and investment risks aggravate the development of transmission infrastructure, which requires a high degree of capital investment;
2. This situation is worsened by the increase of politicization of commercial relations linked to supply of Russian natural gas;
3. The companies capable to perform large-scale investments require clear, concise, economically feasible and sustained rules of the game within the energy sector;
4. The natural gas market today is becoming more and more a really global one, and as new large demand centers in Asia-Pacific are growing stronger Europe will have to compete

with them for energy, and not only for Russian energy at that.

Europe has all the makings to be a very attractive market for energy suppliers but that attractiveness depends totally on Europe itself. I believe that the lack of long term sales security and the prospect of “ownership unbundling”, let alone unequal terms of access to European financial resources and export credit guarantees restrictions will hardly be to the benefit of Europe in that competition.

Thank you, ladies and gentlemen.