

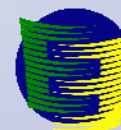
**RUSSIA'S RELIABLE GAS SUPPLIES TO EUROPE:
CHALLENGES & RISKS AND THE ENERGY
CHARTER'S ROLE**

**Dr. Andrei Konoplyanik,
Deputy Secretary General,
Energy Charter Secretariat**

**Presentation at the UNECE Round Table on “Securing reliable natural gas
supply in the context of sustainable development in the UNECE region”,
23 January, 2007, UNECE, Geneva**

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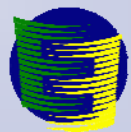
1. **Historical structure of Soviet/Russian gas supplies to EU**
2. New challenges and risks
3. New risks 1: EU related
4. New risks 2: CIS related
 - 4.1. Gas export pricing & prices
5. Energy Charter role



SOVIET / RUSSIAN GAS TO EUROPE: DEVELOPMENT OF CONTRACTUAL STRUCTURE

- Long-term contracts
- On-border (EU-15) sales/delivery points
- Pricing: replacement value + net-back
- Destination clauses
- Transit

Soviet/Russian contractual gas export structure is based on Groningen LTC concept for Continental Europe

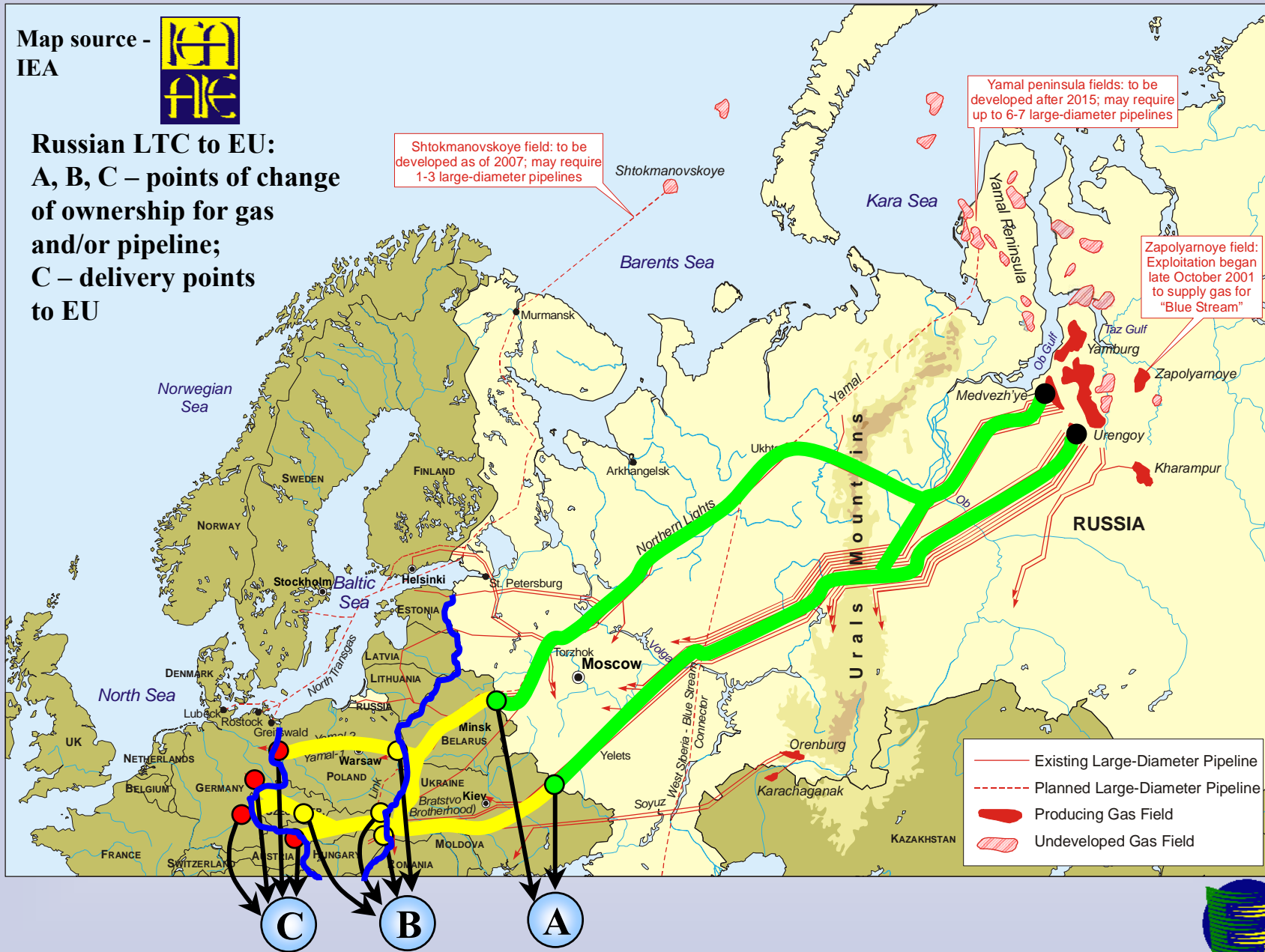


RUSSIAN GAS EXPORT TO EUROPE: ON-BORDER SALES AND TRANSIT LEGS

Map source -
IEA



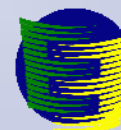
Russian LTC to EU:
A, B, C – points of change
of ownership for gas
and/or pipeline;
C – delivery points
to EU



Dr. A. Konoplianiuk, UNECE Round Table on Gas, 23.01.2007 - Figure 2

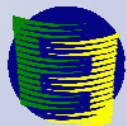
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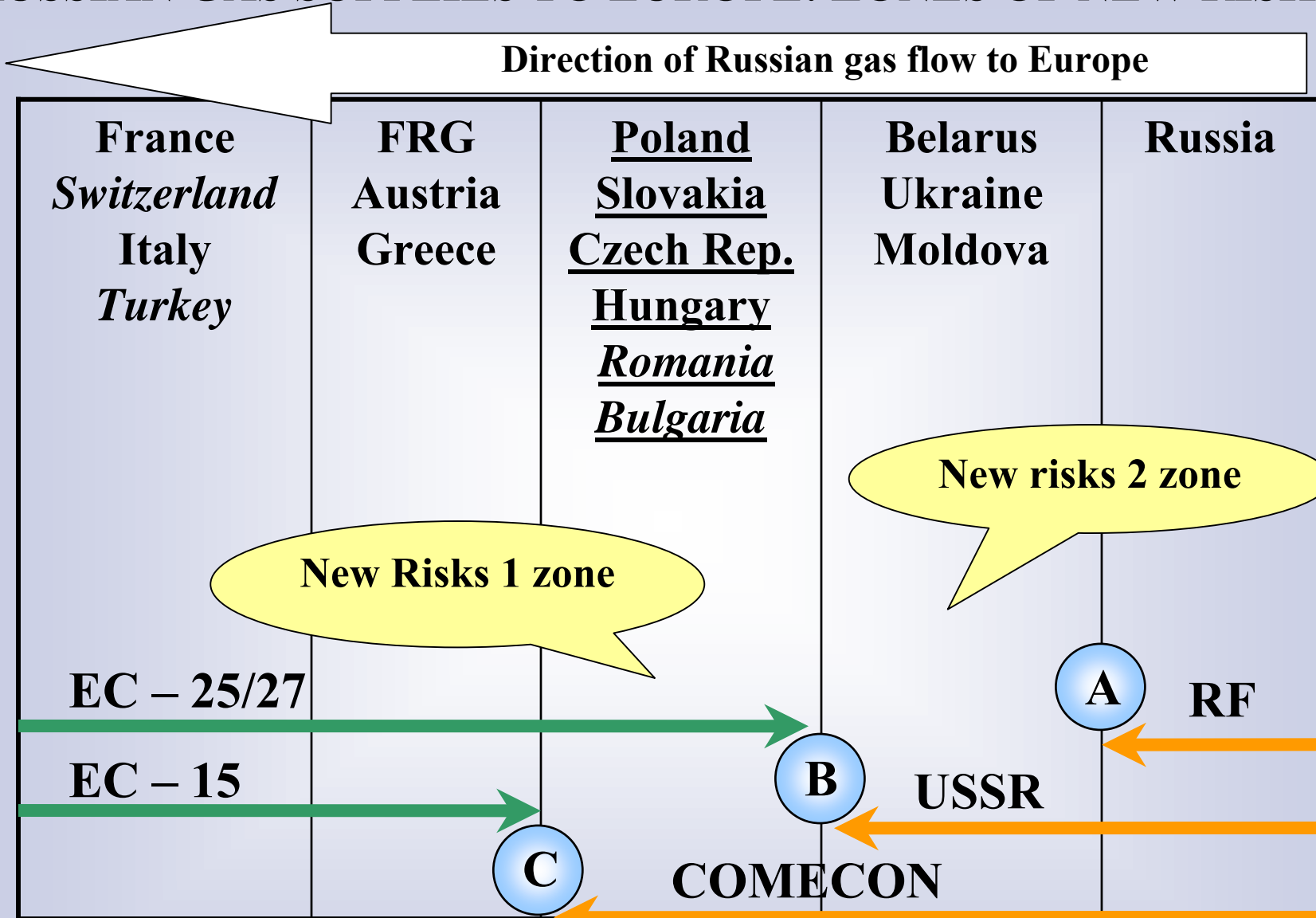


NEW RISKS FOR RUSSIA'S GAS SUPPLY TO EUROPE: WHICH, WHEN & WHERE

- Since 1991 – upstream to delivery points, within CIS/NIS = result of USSR dissolution => new transit risks
- Since 2002/03 – at delivery points (not at the market?); solution on destination clauses = package deal => but: e.g. TAG Dec'05 capacity allocation
- Since 2004/07 – upstream to delivery points, within enlarged EU-25/27 = combined result of EU expansion + EU gas market liberalization => new prospective transit/transportation risks



RUSSIAN GAS SUPPLIES TO EUROPE: ZONES OF NEW RISKS



Italic – non-EU countries; New EU accession states: underlined –since 01.05.2004, underlined + italic – since 1.01.2007
 A, B, C – points of change of ownership for Russian gas and/or pipeline on its way to Europe

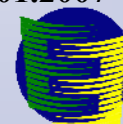
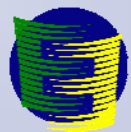


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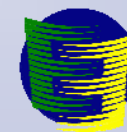


NEW RISKS 1: EU RELATED (SINCE 2004)

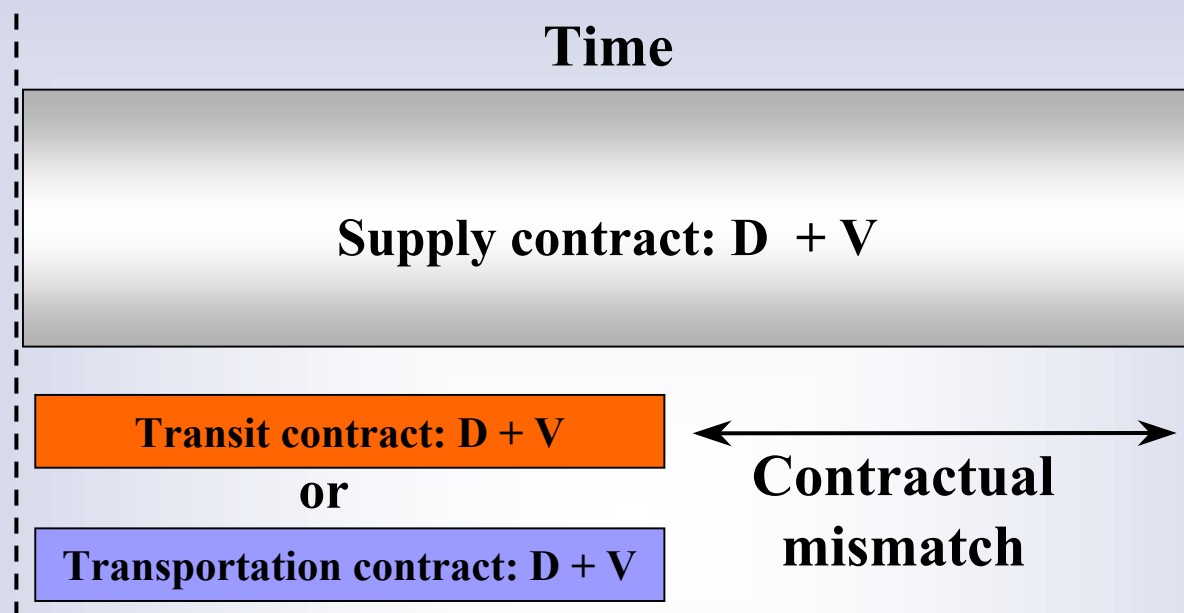
- **No transit of Russian gas inside EU up to May'2004 (EU-15)**
- **Transit of Russian gas inside EU since May'2004 (EU-25) and even more since Jan'2007 (EU-27)**
- **Transit risks for imported Russian & other non-EU gas inside EU:**
 - **Major elements of liberalization: unbundling + TPA,**
 - **No clear transit rules for internal EU gas market (domestic transportation = free flow of goods inside EU),**
 - **Problem of contractual mismatch (long-term access to infrastructure for transit flows to match existing supply LTC)**

Energy Charter role: draft TP + other gas/transit related activities ...

New risks = combined result of unclear EU rules on gas transit through single member states plus + EU expansion => transitional risk of EU liberalization



CONTRACTUAL MISMATCH PROBLEM (CORRELATION IN DURATION (D) & VOLUME (V) OF LONG-TERM SUPPLY CONTRACT VS. TRANSIT/TRANSPORTATION ARRANGEMENT)



Mismatch between expiration dates & volumes of long term supply (delivery) contract and transit/transportation contract as integral part to fulfill the delivery contract creates a risk of non-renewal of transit/ transportation contract.

Core issue: guarantee of access to adequate transportation capacity within the duration of existing (in force) delivery (supply) contract.

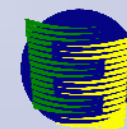
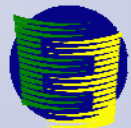


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NEW RISKS 2: COMECON / CIS RELATED (SINCE 1991)

- **Earlier structure :**
 - Barter deals
 - Political & friendly pricing
 - Transportation system – not transit system
 - No transit within USSR
 - Supply & transit are not separated within COMECON
- **Long & painful transition to :**
 - Contractual separation of transit & export supplies
 - Domestic transportation vs. transit legislation
 - From barter to cash payments
 - From political to market-based pricing:
 - Transit tariffs methodology
 - Market-oriented gas export pricing & prices

Energy Charter role:
draft TP +
gas/transit-
related
activities (e.g.
Transit tariffs
study
(Jan'06),
Pricing study
(March'07),
etc.

New risks = Result & long-term consequences of dissolution of USSR/COMECON system (transition risks)

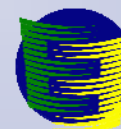
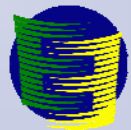
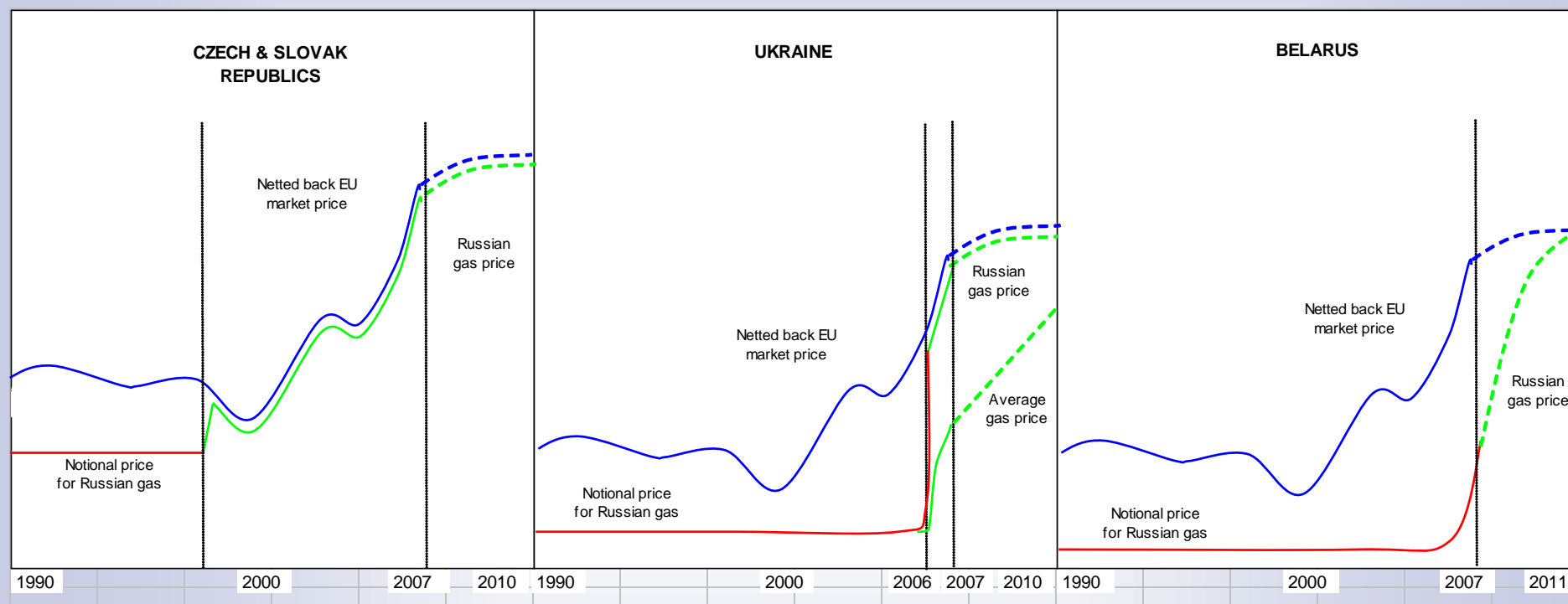


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RUSSIAN GAS PRICES TO EU & COUNTRIES ALONG THE PIPE



Source: International pricing mechanisms on Oil & Gas, ECS, to be released March 2007

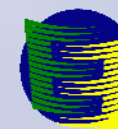
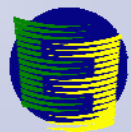


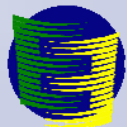
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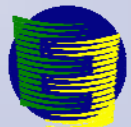
SECURING RELIABLE GAS SUPPLY IN EURASIA: ENERGY CHARTER'S ROLE

- **Risks for reliable Russian gas supplies to Europe = long-term objective economic results of political changes within the gas cross-border value chain:**
 - **Dissolution of USSR/COMECON,**
 - **EU expansion + gas market liberalization & formation of the single EU internal gas market**
- **ECT + draft TP = multilateral legally-binding instruments to mitigate these risks**
- **E.g. Russia-Ukraine gas (2006) & Russia-Belarus gas (2006) & oil (2007) disputes (Energy Charter principles addressed by parties in dispute + conciliatory procedure proposed by ECS)**



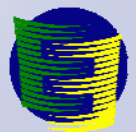
Thank you for your attention!

www.encharter.org



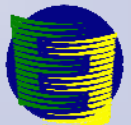
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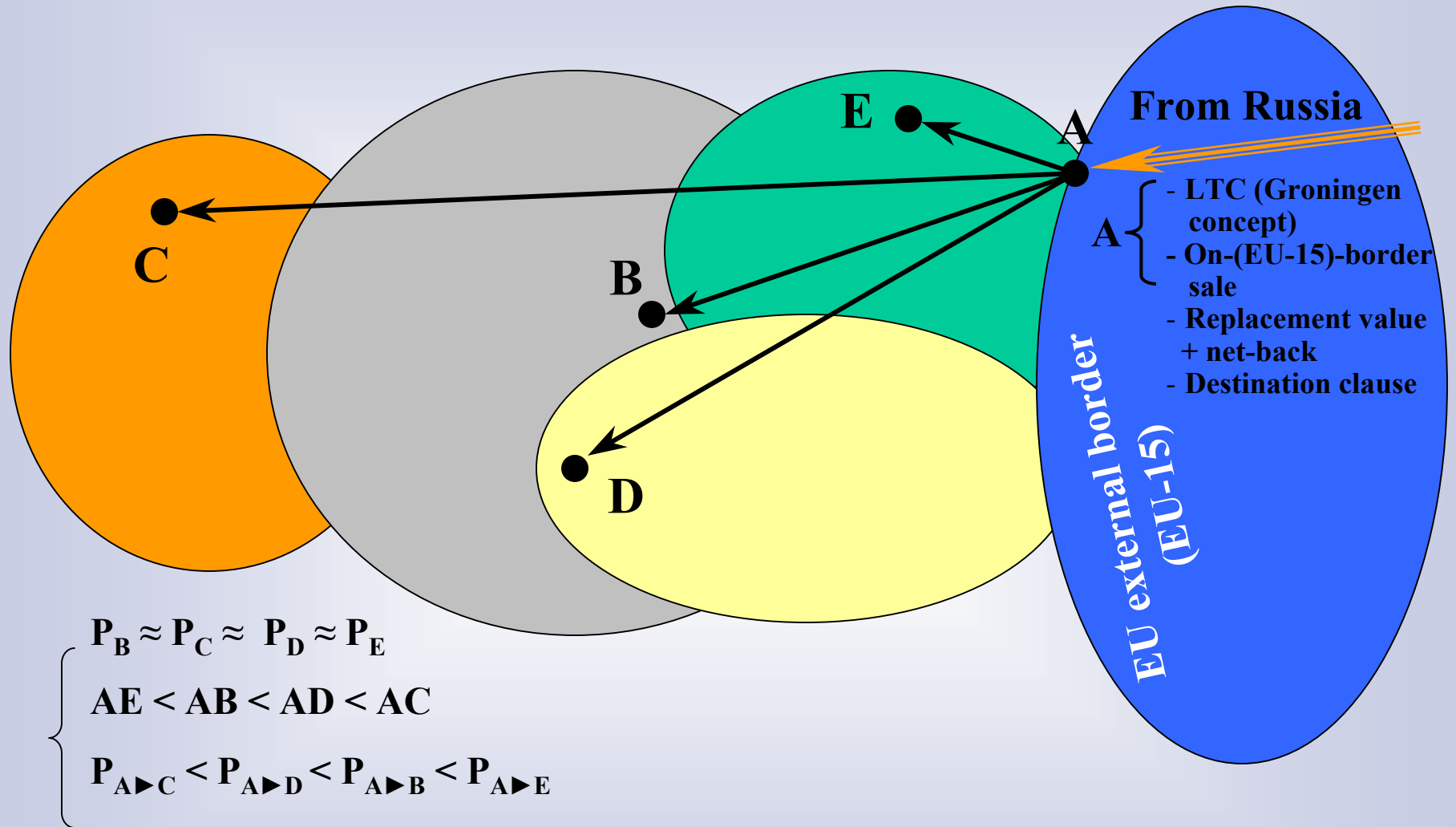


WHAT “SUSTAINABLE” MEANS?

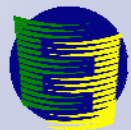
- Fair (non-discriminatory)
- Balanced (mutually beneficial, long-term)
- Economically proven (understandable)
- Market-based
- Transparent (predictable)
- No new risks & diminish existing ones
- Etc.



DESTINATION CLAUSES = ECONOMICALLY MOTIVATED INTEGRAL PART OF HISTORICALLY EXISTING RUSSIAN EXPORT SCHEMES TO EUROPE



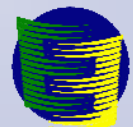
“Destination clauses” allowed gas supplier to sell gas to different buyers at different prices and conditions at one and the same delivery point.



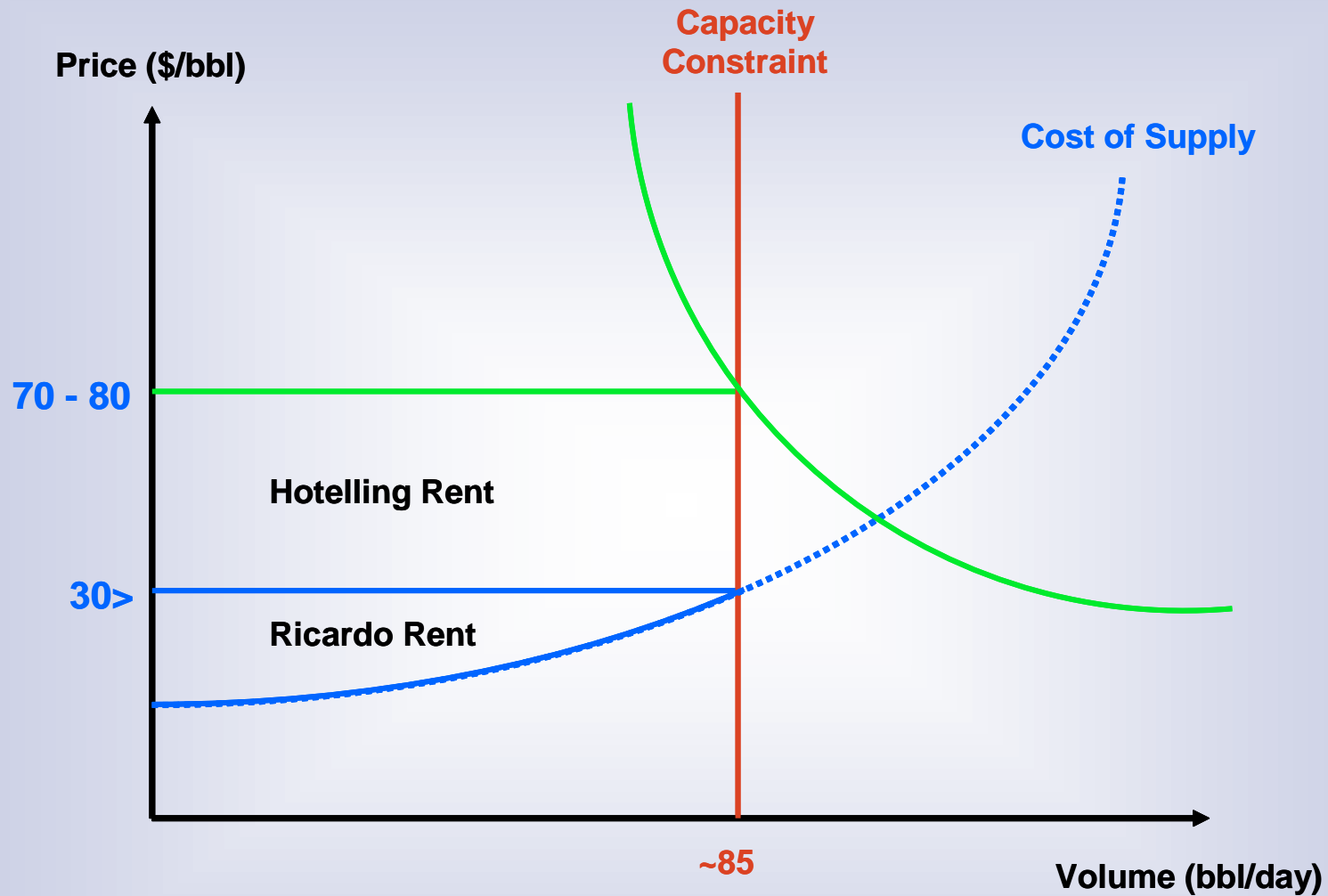
GAS EXPORT PRICING & PRICES

*Nothing is better than the good theory...
(a Classic...)*

- Ricardian vs. Hotelling rent
- Cost-plus vs. replacement value
- Soviet/Russian gas export contracts to the EU (historically), former COMECON (since after USSR dissolution) and FSU (since recently) are based (to be based) on modified original concept of Groningen export LTC



RICARDIAN VS. HOTELLING RENT



Source: International pricing mechanisms on Oil & Gas, ECS, to be released March 2007

