

*Address by S.E. Tsygankov, Head of the Department of Foreign Economic Relations, Gazprom,  
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Ladies and gentlemen,

The subject for discussion at this Round Table on *Securing Reliable Natural Gas Supply in the Context of Sustainable Development in the UNECE Region* is nothing new. However judging by the attention it has lately received at all levels it is still a pressing issue.

Let us try to find out why it happens and what has been done to bring positive changes in this issue.

The region we are now talking about covers different countries from Armenia to the United States. Obviously, the degree of importance of the problem and the underlying causes differ from country to country, therefore there is and will be no universal solution.

Therefore, I would like to focus on the countries that we as the major gas exporter know best of all, and which due to the ongoing market liberalization processes are affected by similar factors. I mean the member-states of the European Union.

Let us have a look at certain theses in this respect that are often presented as fundamental truths to the general public.

**Thesis one:** The market liberalization ensures gas supply security.

If we look back we will notice that while the European gas market was undergoing reforms, the gas supply security concerns continued to grow, while ten years ago they were not even discussed. In this context, some European officials are at least illogical when saying that further market liberalization will improve the supply security.

On the contrary, free and open market reality means that the market will certainly satisfy the demand albeit in a different manner: demand and supply will be balanced due to increase in price rather than decrease in supply. Simple facts evidence in favour of this argument: while at the start of liberalization transportation capacities were in excess in Europe, nowadays the process is accentuated by the obvious underinvestment in the transportation sector. Everybody admits it, but where is the way out? And here we come to the second common thesis.

**Thesis two:** splitting transport business off the existing vertically integrated companies (the so-called ownership unbundling) will help create real market competition and stimulate investments.

Such conclusions are in particular expressed in the energy sector investigation report published on January 10, 2007. It says that "*the current level of unbundling of network and supply interests has negative repercussions on market functioning and on incentives to invest in networks. This constitutes a major obstacle to new entry and also threatens security of supply*".

The fact that the unbundling process has been underway for several years and passed several phases brings up a legitimate question: perhaps the problem is not with the unbundling but with the absence of clear-cut and homogenous market regulations?

In our opinion, which is by the way appreciated by experts from the Energy and Transport Directorate of the European Commission, the current law **can ensure** that an operating network owner, even if it is a vertically integrated company, respects the interests of other market players when increasing its transport capacities.

Of course, to design standard procedures and regulations to be observed by a network operator in such cases requires tiring and meticulous work. It is much easier to declare that "the current level of unbundling is *inadequate*".

The European Commission admits that regulatory actions shall be predictable and primarily based on economic principles rather than political goals, and there is no other way to win investor confidence. However, in practice things are quite to the contrary.

We are absolutely sure that mandatory unbundling of vertically integrated companies will most probably lead to unbalancing and defragmentation of investment process.

Investment expenditures will become intermittent depending on the earning power of this or that sector of gas industry, thus making capital investment expenditures in gas infrastructure, where the expensive transport component makes up a larger portion of investment, more complicated. Let along the fact that such actions come into conflict with the fundamental principles of sanctity of private property and freedom of entrepreneurship.

**Thesis three:** long-term contracts for natural gas supply hamper normal development of competition and are incompatible with liberalized market principles.

This thesis is all the more incomprehensible for us because at the same time the effective Gas Directive underlines that "*long-term contracts continue to be an important element of gas supply in the member countries*".

Besides, the practice of the fully liberalized markets in the United Kingdom and United States, where long-term contracts make up a substantial portion of supply, shows that there exists no alternative to such contracts as a guarantee of stable and predictable supply for a long-term perspective.

A deliberate curtailment of long-term contracts just for the sake of bringing new players to the market has nothing in common with standard market performance rules. We believe that under these circumstances it is

possible neither to give a supply guarantee to the buyers nor to protect them from the risks associated with the gas price fluctuations.

**Thesis four:** It is necessary to diversify the European resource base to ensure supply security and enhance competition between energy suppliers.

This is a quite reasonable thesis, no doubt, however the rules of the game which are currently being introduced in the European energy sector as well as the attitude to the incumbent suppliers will hardly make the European market attractive for potential outside players.

I mean, in particular, numerous attempts to taint Gazprom's image as a reliable gas supplier.

For example, we have lately often heard "concerns" that **Gazprom does not have available resources** to provide for already signed contracts as it allegedly fails to make sufficient investments in natural gas production.

The facts are, however, that the Company's volume of investment for the coming year alone is USD 20bln. The funds will be used for upgrade, including development, of promising fields such as Yuzhno-Russkoye oil-gas condensate field. And there is no doubt that our expectations for a long-term production increase will be met by all means.

The Gazprom's consistent strategy aimed at discontinuing of the Soviet-era practice of latent financing of CIS countries by undercharging them for gas is being described as **political pressure** on the neighboring countries.

Yet one forgets that economically feasible prices are an essential condition of development of normal market relations allowing the producer to get reasonable profit and ensure a timely increase of investments in gas exploration, production and transportation.

Discontinuation of subsidies will also facilitate the measures targeted at energy saving and more efficient use of natural gas thus releasing extra gas volumes for the European consumer.

In this context, long-term arrangements with Belarus that helped us prevent interruption of gas supply to our consumers once again proved that Gazprom is a reliable long-term gas supplier.

And finally, our only natural desire as a supplier to be more active in the European energy market (access to the final consumer, acquisition of interest shareholding in European companies) is more and more frequently being made subject to the automatic acceptance of the counter obligations to provide foreign companies an access to our resource base.

As well as any other company, we would engage our partners in hydrocarbon reserves development only if such engagement is likely to improve resource production efficiency in unfavorable geological conditions.

By providing an access to our deposits Gazprom in its turn has intends to receive assets that will complement our business abroad.

In this connection we stick to the following basic principles: the swap assets shall be of equal value, and the received asset shall be strategically attractive to us.

Our 2006 performance results in this area confirm that our foreign partners fully acknowledge with this approach.

Thus, on December 31, 2006 the Board of Directors of Gazprom approved an asset swap deal with BASF in the areas of gas production and distribution assets exchange.

By this transaction Gazprom will increase its share in Wingas from 35% to 50% less one share. Besides, Gazprom will acquire a 49% interest in Wintershall AG, the holder of shares in exploration and production assets in Libya.

BASF/Wintershall in their turn will receive 25% less one share and a block of non-voting shares in Severneftegazprom, the upstream license holder for Yuzhno-Russkoye gas field.

Alongside with the implementation of this transaction last year we took some serious investment decisions relating to our products and markets diversification, which was inter alia influenced by the ongoing changes in the European market.

I relate to the Gazprom joining the Sakhalin-2 Project, including natural gas production, and production and distribution of LNG.

On December 21, 2006 we signed a protocol with Shell, Mitsui and Mitsubishi on the Gazprom's joining Sakhalin Energy as a leading shareholder. In accordance with the protocol Gazprom will acquire 50% plus one share in Sakhalin Energy at 7.45 billion US Dollars.

For the purpose of the transaction each existing shareholder of Sakhalin Energy will decrease its share by 50% on a pro rata basis. As a result, Shell will hold 27.5% shares, while Mitsui and Mitsubishi — 12.5% and 10% shares respectively.

Besides our deliveries of LNG to the East, we expect to start supplying pipeline gas to China and South Korea in the nearest five years.

Gas will be supplied to China from the Unified System of Gas Supply along two routes: the western, from traditional Russian gas producing regions, and the eastern one, from the Sakhalin fields. The scope of supply through the western route will be 30 billion cubic meters per year, and 38 billion cubic meters per year through the eastern route.

Up to 10 billion cubic meters per year will be supplied to South Korea from the Sakhalin fields.

The above plans will be implemented along with our current projects such as Nord Stream, intended to provide transportation capacities required to supply gas to our traditional consumers.

In this connection I would like to touch upon the issues of natural gas transit. We are very much concerned about the inconsistent stance of the European Union relating to certain players' obligations to supply gas to the market.

Each time when due to whatever reason the gas transit flows find an obstacle on their way to the European consumer, the liability for any possible interruption of supply is a priori placed with Gazprom.

This was the case when last January Europe failed to receive gas transiting through the Ukraine due to well-known reasons. The situation repeated in December when many forecasted a repetition of the January scenario in Russia-Belarus relations.

Such a position is generally reasoned by the fact that transportation contracts are made with Gazprom rather than gas importers. And somehow one forgets that timely delivery of agreed gas quantities to delivery points is the liability of the transit country, but not of the gas owner, whoever it is.

Moreover, even taking account of this obvious fact we do not refuse to assume the liability for gas supply to the market. For this purpose we pursue a strategy of acquiring interest in transport enterprises in the countries involved in Russian gas transiting, and by doing so we undertake corporate obligations to ensure regular performance of such companies.

However in return we often see an absence of the government support and sometimes even allegations of attempting to capture the gas transport sector. Such an opinion is not only inconsistent, but is far from reality.

The most striking example here is the situation with EuroPolGaz, a Polish company. As you know, we, having a share of less than 50% in the company, almost completely financed the Polish section of Yamal-Europe pipeline that reached the projected capacity last January.

Following the said logic, we would have done everything possible to increase the transportation rate to get maximum profit, and the government would have sought to decrease the rate, making the regulation of transport tariffs more transparent. However, the facts speak quite to the contrary. And we have an impression that the European regulatory authorities prefer not to notice the "specific features" of the Polish regulators performance.

We hope that the reason for that is the Poland's relatively recent joining the European Union. In any case we are going to present to the European Commission a detailed report on the Polish gas transportation sector, and we expect that clear and comprehensive steps will be taken in the nearest future to change the current situation in Poland.

To sum up, I would like to make the following conclusions:

1. Market liberalization alone is not a guarantee of the security of gas supply.
2. Introduction of non-market measures, such as enforced ownership unbundling, will make investment in gas infrastructure even more complicated.
3. Long-term gas supply contracts are an important element of market development and ensure supply security and price forecasting.
4. Ever changing conditions in the European energy market do not allow major international players to view it as premium.
5. Security of supply can not be ensured without a clear-cut distribution of responsibility in each segment of the chain from the wellhead to the consumer.

Thank you for attention.