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

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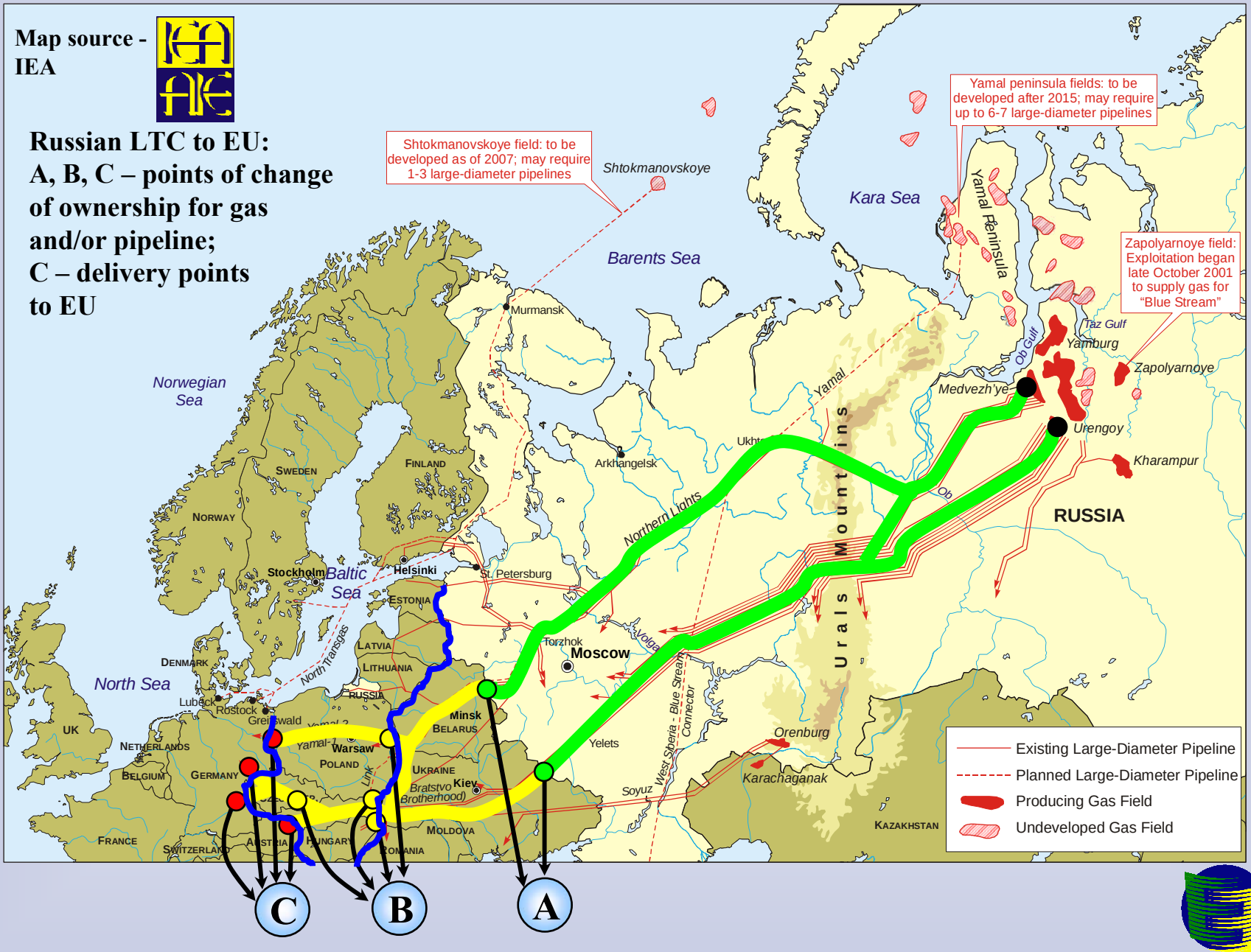
SOVIET / RUSSIAN GAS TO EUROPE: DEVELOPMENT OF CONTRACTUAL STRUCTURE

- 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



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

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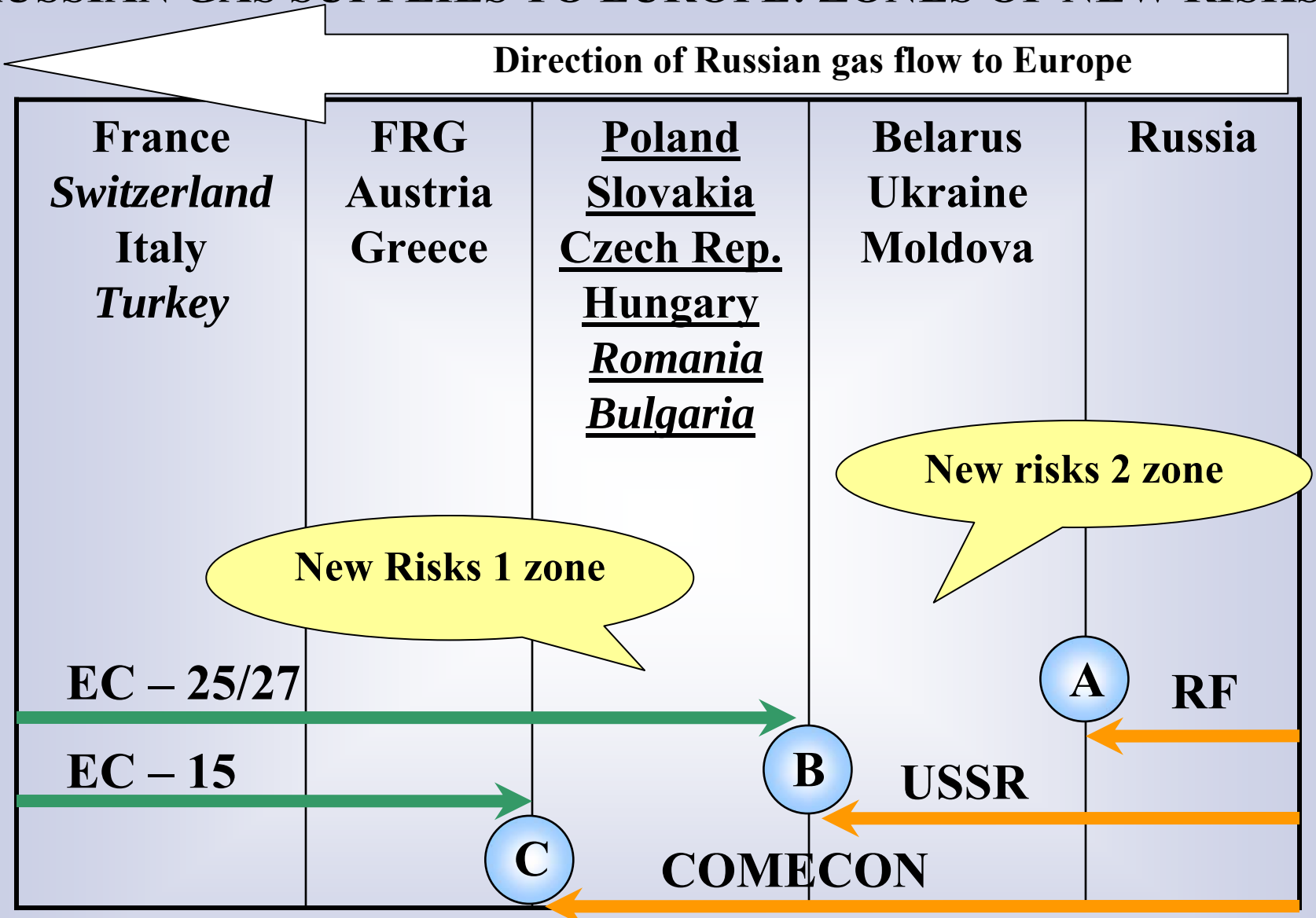
NEW RISKS FOR RUSSIA'S GAS SUPPLY TO EUROPE: WHICH, WHEN & WHERE

- 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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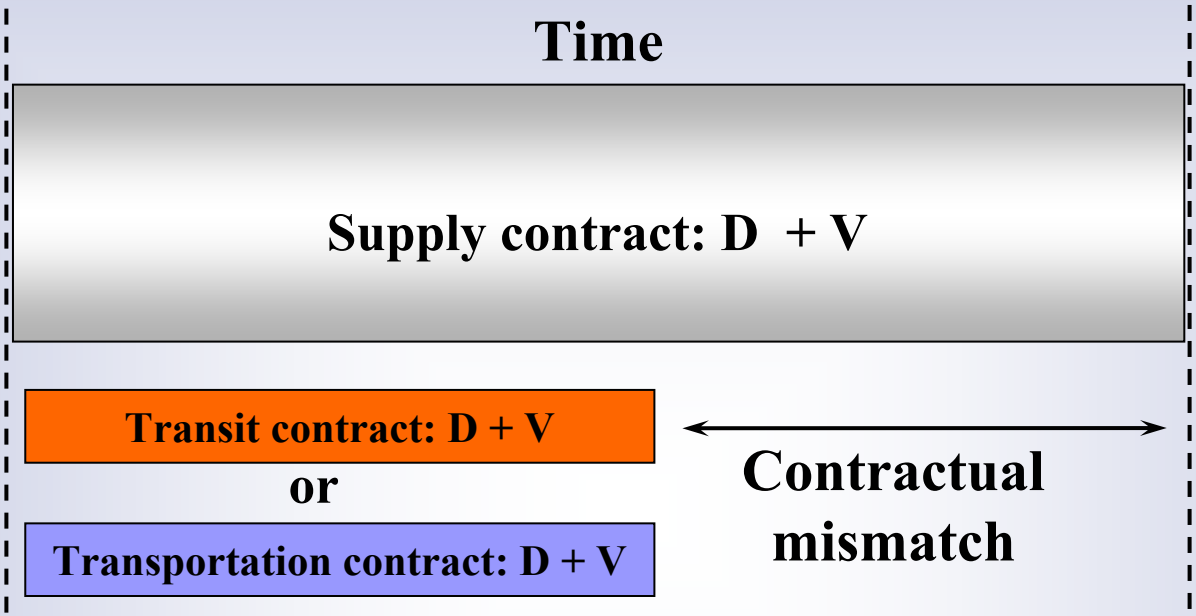
NEW RISKS 1: EU RELATED (SINCE 2004)

- **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)



<u>Mismatch</u> 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.

<u>Core issue:</u> 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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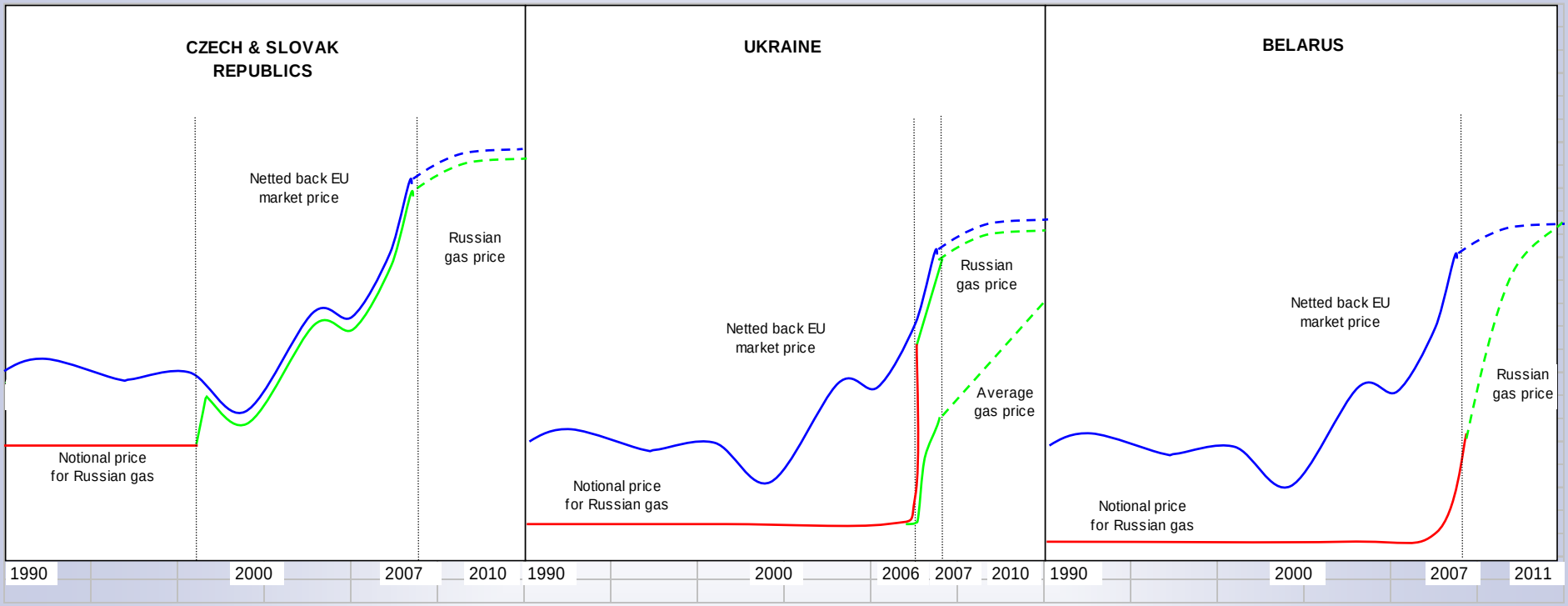
RUSSIAN GAS PRICES TO EU & COUNTRIES ALONG THE PIPE



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!

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