

The 3rd Energy Package and the concerns of non-EU gas producers: An interview with Dr. Andrey Konoplyanik

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The EEO spoke with Dr. Andrey Konoplyanik, who is a consultant to the board of Gazprombank, advisor to the board of Neftegas Services B.V. and Professor on international oil and gas businesses at the Gubkin State University for oil and gas in Moscow. From 2002-2008 he served as the Deputy Secretary General at Energy Charter Secretariat in Brussels. The EEO asked him about his views on the EU's 3rd Energy Package and its consequences for non-EU gas producers, such as Russia. Also we asked him whether there still is a prospect on a role for Russia in the Energy Charter Treaty.

Mr. Konoplyanik, the EU is planning the implementation of the 3rd Energy Package in the near future. It's not just some EU members and European energy companies that are questioning several clauses of the 3rd energy package, but Russia, as non-EU producer and the EU's biggest gas supplier, has concerns of its own. Could you tell us what Russia's main concerns are in this respect?

First of all, the EU's future energy demand will be of vital importance to Russia. In order to fill all this infrastructure and pipelines, big investments are needed in the gas value chain outside of the EU, somewhere deep in Western Siberia or far up in the North of European Russia, or the Arctic offshore. It is quite clear that Russia and the EU are mutually interdependent, with Europe being Russia's major energy export market. They are not just interdependent as buyers and sellers, but are also connected through a fixed and immobile infrastructure, in particular the gas infrastructure. In the long term this infrastructure will need to keep functioning, as Russia and the EU will stay key interdependent players when it comes to energy. For this, investors will need to invest heavily and be able recover their investments. So, if there is no clarity about the EU's future demand, it will cause incremental risks for the investors.

Secondly, in order to plan our investments we need clarity about the EU's long term policy goals. The main gas fields are nearing their natural production decline and this will need to be compensated by developing new fields and thus by new investments. If Europe remains the key market, than production needs to be increased. Besides supplying our domestic market, we also have an intention to send our gas to the East. So, Europe's energy demand trends will be key in shaping Russia's energy development strategy, both for the domestic and export markets. In this respect, it is clear that the development of the EU's legislation concerning energy, plays an important role for us. It is not just EU policy that sets the aims, such as the 20/20/20 policy, legislation also plays an important role. When we look

at some of the forecasts of European future gas consumption, we see a projected decline instead of an increase of consumption. The latest official EU forecasts shows that future gas consumption will be below the amount that is already contracted by Russian suppliers to Europe.

Furthermore, what is characterising for interdependency, is the increase of investments flows. This means that the Russian business community would like to invest in the European Union. Naturally, the EU's attitude towards third party investors and trade flows is of great importance to us.

Why is this so important?

Historically the gas delivery points were located on the border of the former West and East. However, after the dissolution of the Comecon and the USSR, and the expansion of the EU, these delivery points found themselves deep inside the EU. So, the legal regime that applies to the existing trade flows and future investments, which are needed to expand existing or to develop new infrastructure in order to deliver additional supplies from Russia, is of key importance to Russia.

We are aware that the EU is expanding its legal rules through the cross border gas value chains, stretching from the EU to the gas producing countries. This is done through different mechanisms. The EU's first directives were 'exported' through the Energy Charter Treaty (ECT), because the ECT is based on the principles of the EU's first Energy Directives. Characterising for the 2nd Energy Directive, from 2003, was the Mandatory Third Party Access (MTPA) and the unbundling of transportation and production. This was simultaneously spread outside the EU through the Energy Community Treaty. Former USSR republics, Ukraine and Moldova, last year became full members of the Energy Community Treaty. So, we see that the legal regime related to energy has not only been changing in the EU itself, but also in the neighbouring countries. This means that we have to assess the potential challenges, the positive outcomes, but also the potential risks for external gas suppliers, such as Russia.

If we look at the 3rd Energy Package (EP), then we see certain clauses that are further exporting EU legislation to neighbouring countries. The 3rd EP demands that companies from these countries, that wish to invest and do business in the EU, should be organised in their mother states according to EU market legislation. Moreover, a violation of these 3rd EP provisions can lead for the mother companies from these third countries to receive penalties reaching up to 10% of their global turnover. This of course has a direct affect on the costs and risks the external suppliers need to take. On the other hand, these external suppliers have the privilege to take their decisions independently, based on their sovereign rights, and are not obliged to implement decisions, for example, from Brussels. So, when we are looking at how this legislation is developing, we are trying to understand whether it serves as a stimuli for future investments and whether it encourages

trade flows into the EU. It is therefore natural to question whether our long term cooperation with the EU, based on mutual interdependency, will broaden. Possibly, in case these new developments are regarded as discriminatory to the investments of external suppliers, the area of cooperation could narrow.

As I understood you have initiated consultations or a working group together with your EU colleagues to address these concerns.

Yes, we started these consultations with our EU colleagues one year ago. At the Alpbach 2009 Economic Symposium, in Austria early September 2009, just a day before the 3rd Energy package came into force, it turned out there was a need and an opportunity to initiate a dialogue. Russia, as a non-EU supplier, has some particular concerns that affect it. One of the panellists at the Symposium was Walter Boltz, Head of Austrian energy regulator E-Control and Vice President of ERGEG. I myself was also among the panellists. Since we know each other for some time, we thought it might be practical to find some form of depoliticised professional dialogue, where we could reduce the 'zone of misunderstanding'. We both created a team of experts and succeeded in holding regular informal expert consultations (see the photo after the first one held in E-Control headquarters, in January 2010). The Russian team, amongst others, consisted of representatives of the Russian Energy Ministry, Gazprom and GazpromExport. All of them were selected for their personal skills as experts and energy professionals. Formally our team is headed by Mr. Alexander Medvedev, Deputy CEO of Gazprom and Director General of GazpromExport. I have the privilege to act as the coordinator of the Russian team of experts.

The aim of these consultations is to put into a practical dimension our intention to minimise the risks and costs we could face. Furthermore, it is the intention to create mutual understanding between the parties, so that the new EU legislation will not be discriminatory of any player in this gas value chain. This cross-border gas value chain originates far outside the EU, but is destined for the EU. Russia is an important supplier to the EU and that is why we are one of the key parties taking part in these discussions. It was not so much our intention to put forward specific business concerns of a particular company, but more general economic concerns of non-EU suppliers, also including Algeria, Norway and some transit countries.



Russian and EU experts meet for first informal consultations. 7th from the right is Walter Boltz, Head/coordinator of the group of European experts. 8th from the right is Alexander Medvedev, Head of the group of Russian experts. Dr. Konoplyanik is 6th from left.

Have these consultations proven useful?

After five series of meetings, in the first half of 2009, we saw that the explanations and justifications related to our concerns were useful to our EU counterparts, so that they could better understand our positions. On the other hand, it was also very helpful for us, since we gained understanding of how they wished to further develop their legislation. As a result, we reached a more practical dimension and were invited to join the process of public consultations. Although public consultations are only meant for EU member states, they nevertheless thought it was helpful to know our informal position. In particular, we offered our views on some provisions of the 3rd EP which are already in place (Third Gas Directive and two gas-related Regulations) and on some draft Framework Guidelines, which are currently being developed. We are trying to explain the potential challenges and risks, if the legislation develops in a particular direction, in order to reduce the risk of wrong or more costly investment decisions. On the EU side, a representative of

the European Commission (EC) was always present and they realised that these consultations might be helpful.

So you could say that the EC is listening?

Yes, at least they are informed and listening. Of course, it is crystal clear to all participants, taking part in the consultations, that the EU has the sovereign right to develop its legislation as it wishes. It is not our intention, as a non-EU player, to downplay the EU's sovereign right in this process. The only available instrument at our disposal is the "force of argument" by explaining our justified concerns regarding the 3rd EP. It is up to the EU whether or not it takes these arguments into consideration and incorporates them into the new documents that are being drafted. Judging by the presentations of some EU officials, it seems to me that the voice of non-EU producers is regarded as an important and valid one. Moreover, the Energy Commissioner, Mr. Oettinger, recently stated that the regulation for the EU's internal energy market should be developed up to 2015. This means that the legal framework for this does not have to be ready prior to March 2011 (when the 3rd Energy Package enters into full effect), but that a longer period of time will be needed to develop 12 Framework Guidelines and 12 Network Codes, in addition to the 3rd Directive and two Regulations. Also the discussions that started about the architecture of the EU's future gas market, meaning regional zones with liquid hubs, is to some extent taking into account the concerns that were raised. Based on our soft proposals we have been invited to take part in this debate on a conceptual model a the European Gas Market.

We, as non-EU member, have our own sovereign voice and being an important supplier, delivering about a third of all EU gas imports, we will so remain an important player. So, it is an important voice and our EU colleagues realised that we were not discussing politicised issues. We are just looking for ways to diminish the risks and costs for all the participants within the cross-border gas value chains that are destined for the EU. The lower these risks and costs are, the lower the price will be for the EU end user. But the supplier also needs to receive a fair rate of return. It is up to the experts and specialists to find this balance, not to the politicians and civil servants. So, we received support for this approach from both sides and that is what we are currently doing by discussing these important issues on a technical expert level.

Would you say that this initiative is special compared to the existing channels of communications?

Political initiatives usually tend to last much longer and often are influenced by factors that are not related to business. It is more difficult to discuss technical issues and to find technical solutions in a political environment. Of course, the EU has the right to develop a gas market model as it seems fit. But the most important question is whether this model will be workable or not. It is for this reason that it

might be helpful for non-EU experts to give their opinion on the issue in non-formal discussions, free from politics. By not being part of the EU, in particular Russia and Gazprom representatives, we are actually more free to speak openly on these issues than some EU business structures and member-states. They are much more dependent on the political forces of their countries and Brussels than we are.

So, we are able to talk more openly about our concerns and to give a critical assessment of the legal model that is being developed for the future gas market. Also our argumentation is purely based on a business perspective, since our team is composed of energy-gas professionals and experts and not of politicians, that sometimes do not know how the energy business operates. In contrast to EU companies, that have no choice but to accept this model, we have the choice to accept it or take another sovereign decision. If it turns out that it will be less profitable to export to the EU market, we will have to decide whether we want to continue with the same level of supply or look for other markets.

Is Russia able to speak with one voice when it comes to these concerns or is there disagreement about which approach to follow? There is for example the Chairman of the Russian Gas Society, Mr. Yazev, who adheres a more confrontational approach.

Mr. Yazev always tries to talk on the behalf of Russia. First of all, there are only two persons in my country that can speak on the behalf of Russia, those are our President and the Prime Minister. Secondly, I would like to distance myself and our initiative from what Mr. Yazev is doing. Mr. Yazev is a politician and the Deputy Chairman of the Duma. I do not know what Mr. Yazev's motives are behind his statements. From my point of view, most of his statements do not bring and, are not even meant to bring, the stakeholders closer together, but actually further widen the line between them. Well, that's part of democracy and people have the opportunity to express their own views.

During my time as Deputy Secretary General at the Energy Charter Secretariat in Brussels, Mr. Yazev was one of my major long-term opponents. I remember that Mr. Yazev was criticising the ECT for something that was not mentioned in it. For example, the ECT does not demand MTPA, but Mr. Yazev was for some years criticising the ECT for its allegedly MTPA provisions. But I am not yet ready, nor willing to comment on his statements about the 3rd Energy Package, because I am not sure whether he is familiar with all the documents. Politicians sometimes have the privilege to criticise something that they have not read.

You have been Deputy Secretary General at the Energy Charter Secretariat. In your opinion, is the ECT completely off the table after Russia refused to ratify it?

No, not at all. First of all, there is no other international legally binding multilateral document like the ECT (Energy Charter Treaty), that addresses energy in particular and brings together so many countries. So, all its benefits for reducing the barriers

of cross-border energy-related investments and trade flows are quite clear. Just as with any other multilateral treaty, there is room to further develop and improve it. The ECT was a product of the early nineties and is a reflection of the stakeholders' balance of interests at that particular time. It was therefore mostly investment oriented and reflected the desire to protect the existing energy trade flows from East to West and investment flows going from West to East. Moreover, the Treaty reflects to a large extent the international energy markets' state of development from those days, but those markets have continued to develop since that time.

With the Russian-Ukrainian gas crisis in January 2009, there was an expectation that the Energy Charter would act. However, the Energy Charter was silent prior and during the crisis. In my personal view, my country's leadership was very disappointed of the Energy Charter's passive role. They criticised the ECT for lacking a mechanism that would allow to inform about such emergencies at forehand in order to prevent them. In the early nineties, this, however, was not part of the debate, because this was not foreseen at the time. I think it is still possible to develop the ECT without trying to find an alternative to it.

In April of 2009, the Russian President proposed his concept. The so called Medvedev 'Conceptual approach' can be regarded as both a way to improve the existing treaty or to create an alternative one. I was always of the opinion that this concept should be used as new input, as a trigger to improve and adapt the existing ECT. A lot of bureaucrats in Russia think otherwise. I found it a pity that my country withdrew from the provisional application of the ECT, a decision that I cannot understand. And I do not see any real argument for doing so, except for the disappointment about the Energy Charter's handling of the Ukrainian crisis. But in my view, the inaction of the Energy Charter Secretariat's political leadership, prior to and during this crisis, is not a valid argument to oppose to the Energy Charter Process as a whole. It makes more sense to be part of the process than being excluded from it.

But I think it will become clear, in the course of the debate, that Medvedev's proposal will be used as a driver to adapt the ECT and not as a replacement of the ECT, but rather as an instrument to push forward its development. I do not think that any ECT member state would be prepared to sign up to developing an alternative, parallel to the ECT, or to withdraw from the Treaty that they already have ratified. This would just be illogical. The only rational way would be to merge these two and further develop the ECT. That could be regarded as a sort of ECT+.

Thank you!

The EEO spoke with Dr. Konoplyanik at the European Gas Conference in Vienna, January 25.