

What consequences for the Russian gas strategy in view of the Ukrainian crisis?

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Demand for adaptation: not UA per se, but general economic trends incl. UA

- Since 2009 radical changes in architecture of EU internal gas market => 4 group of factors:
 - 2 economic (on demand & supply side)
 - Institutional (Third Energy Package)
 - Political (RF-UA gas transit crises Jan's 2006 & 2009)
- Consequences for all segments/players of gas value chain within “Broader Energy Europe”
- Ukraine is only one (important, but additional) element among other factors of gas market changes:
 - UA story has radicalized & made demand for changes more/most urgent
 - UA energy turned into political issue + time constrains => mythologization of the RF-UA gas story in Western media
 - Virtual picture vs real facts => deviations from balanced picture & neutrality are not helpful for achieving new equilibrium

Adaptation of Russia's gas export strategy in Europe

- General rule: maximization of marketable Hotelling/resource rent within competitive (NWE) &/or non-competitive (CEE/CIS) markets (resulted from adequate/inadequate CAPEX in EU/CIS infrastructure development)
- From sole oil-indexed LTGEC in undersupplied growing EU gas market - to flexible & adaptable two-segment structure in oversupplied (contractually &/or physically) EU mature market
- Then & now: 2 contractual structures/pricing mechanisms (though quite different):
 - Then (1968-2009): economic vs political
 - EU = LTC + replacement value = economic pricing from the very start
 - COMECON = political cost-plus till end-1990s/2004 => economic pricing afterwards
 - CIS = political till 2006/2009 => economic pricing with concessions afterwards (UA)
 - Now onwards (2009+): contractual vs spot
 - NWE = (i) LTC (volume) + replacement value (oil-indexed pricing) & (ii) spot (volume) + spot (hub-based pricing);
 - CEE & CIS = LTC + replacement value (+ price concessions from Groningen-formula-based oil-indexed price to UA) => no adequate technical background for competition – yet...

New model for EU: Evolution of gas value chain & pricing mechanism of Russian gas to EU (1)

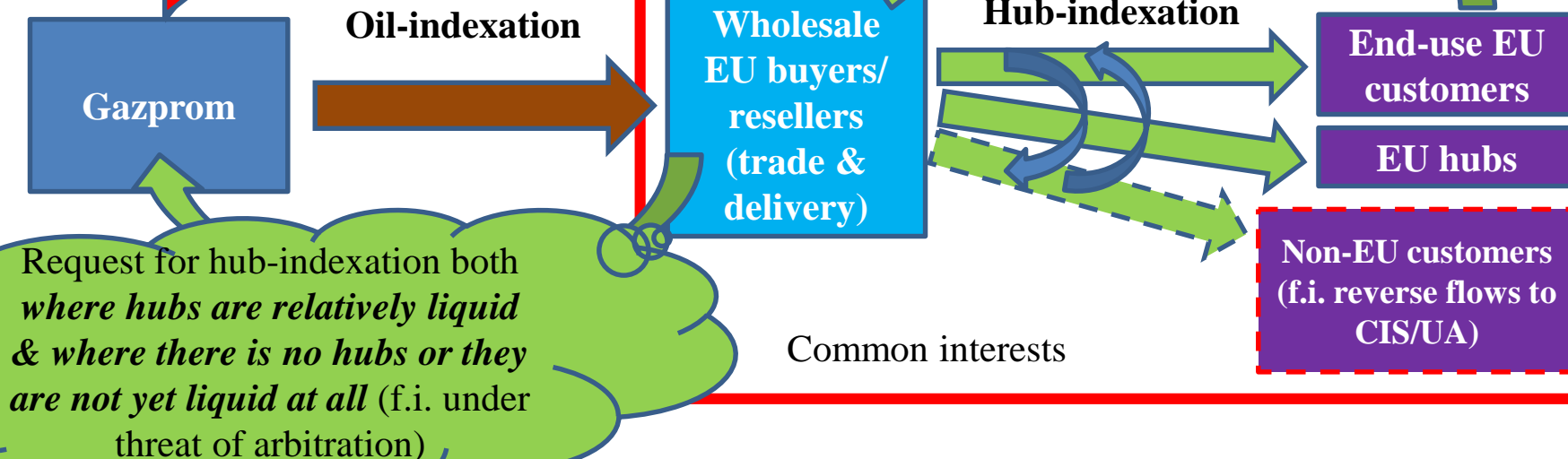
Past (Pre-2009) – growing EU market



Nowadays (Post-2009) – oversupplied (in NWE segment -?)
EU market with not yet clear future trends

Gazprom as price-taker from OIL market

Request for hub-indexation *where hubs are relatively liquid*



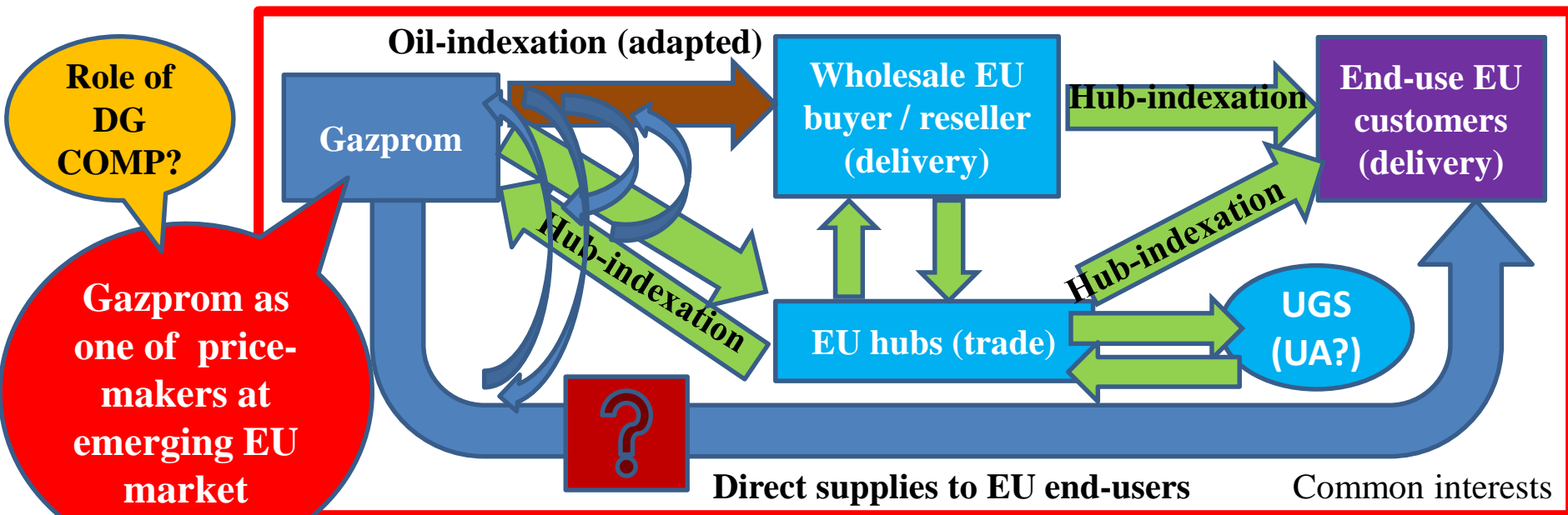
New model for EU: Evolution of gas value chain & pricing mechanism of Russian gas to EU (2)

Future (“NO GO” contractual scheme under any (?) supply-demand scenario)

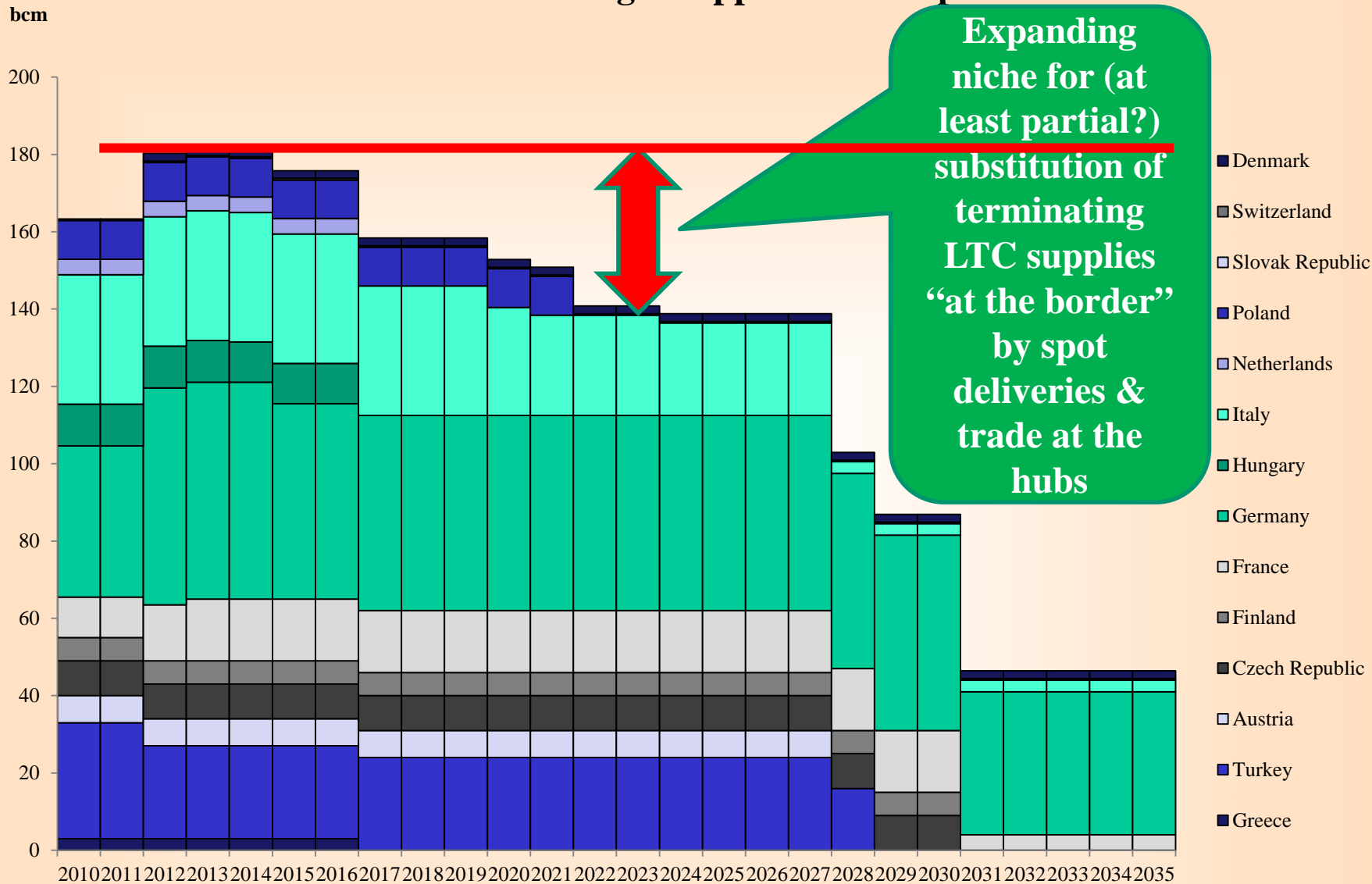


Gazprom as price-taker from GAS BUYER'S market (with no participation on it)? => NO GO

Future (what competitive niche for oil-indexed LTC & spot deliveries & trade to/within EU?)



Contracted volumes of Russian gas supplies to Europe



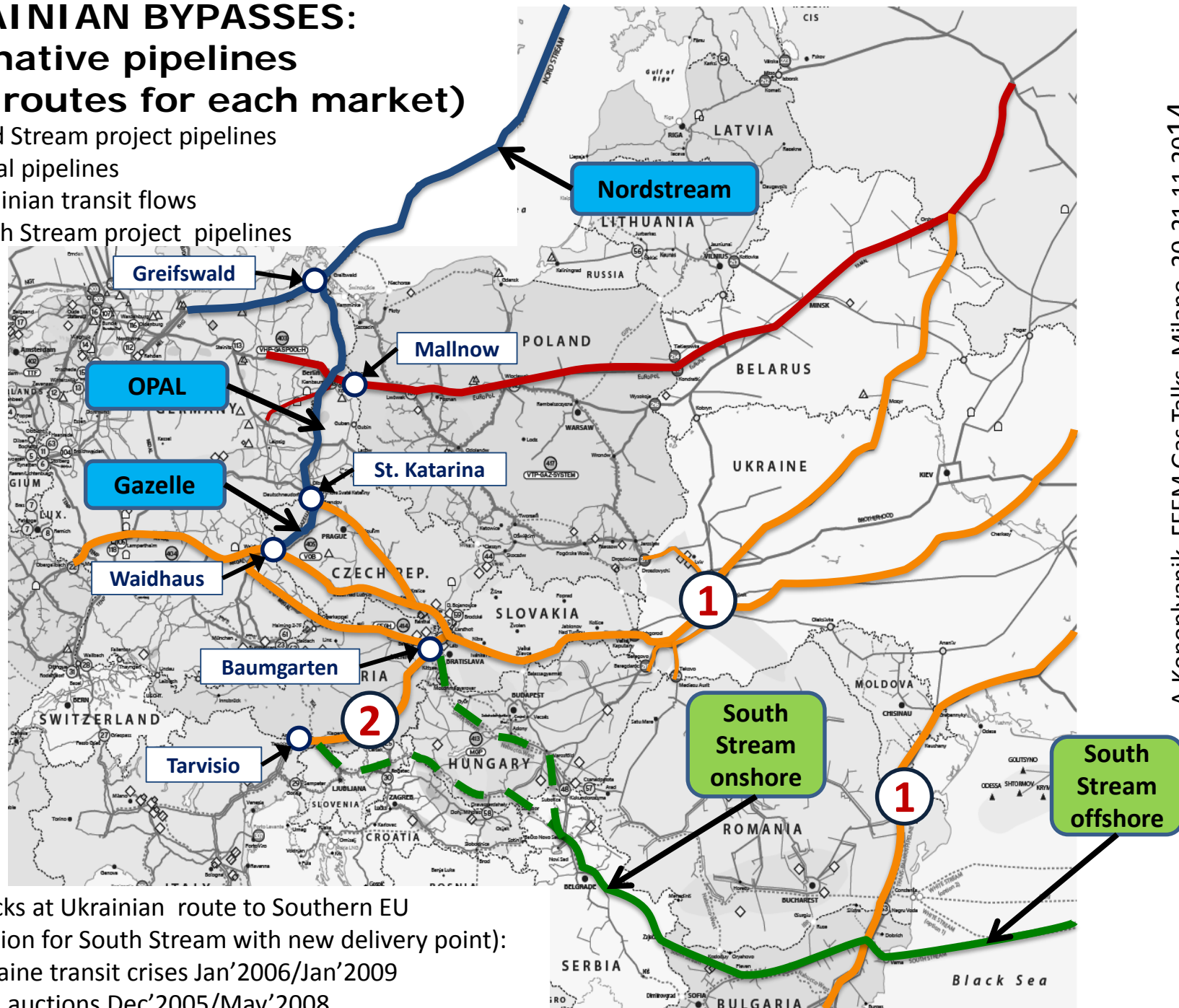
Source (primary chart): ERI RAS (T.Mitrova), reproduced in & taken from «The Russian Gas Matrix: How Markets Are Driving Change», Ed. by J.Henderson & S.Pirani, Oxford University Press, 2014, Fig.3.1/p.53.

Russia's gas export strategy: from "Russia & Europe" to "Russia & Europe & Asia"

- From priority of EU gas export market (when domestic supplies underpriced) – to dynamic balancing within three markets (EU export, RF domestic, Asian export) with (to be achieved) price parity
- From one export market (Europe) - to two export markets (Europe & Asia) balanced/interconnected through RUS domestic market infrastructure:
 - general adaptations of RF export strategy since first RF-UA crisis (2006) (or even since pre-Orange revolution/2004+) => lengthy process, so
 - new concept have materialised in new (Asian) contracts just now
 - “after” [2014] Ukrainian crisis does not mean “in result of” it
- Russia vs Europe & Asia:
 - Then => one export market => USSR/GOSPLAN => «one market = 1 pipe»
 - Now onward => since USSR & COMECON dissolution (transit risks) & RF-UA transit crises => two export markets concept (1 existing + 1 emerging) => “one market = 2 pipes/means of supply (pipeline &/or LNG)”
 - Still open question: Whether both pipes to each EU market will be used:
 - NWE: UA GTS +/-vs (Nordstream+OPAL+Gazelle)
 - SE: UA GTS +/-vs South Stream (off-shore + onshore)

UKRAINIAN BYPASSES: alternative pipelines (two routes for each market)

- █ Nord Stream project pipelines
- █ Yamal pipelines
- █ Ukrainian transit flows
- █ South Stream project pipelines



Bottlenecks at Ukrainian route to Southern EU
(justification for South Stream with new delivery point):

- ① Ukraine transit crises Jan'2006/Jan'2009
- ② TAG auctions Dec'2005/May'2008

Ukraine: “transit interruption probability” index (2009–2014)

To evaluate possible interruptions of transit supplies we consider 1009 newsbreaks, related to gas relations between Russia and Ukraine through 30.12.2008 to 10.10.2014 period. These newsbreaks were taken from the newswire <http://newsukraine.com.ua/> (prior to 28.02.2014) & <http://km.ru/> (after 28.02.2014). Then they were filtered to 170 newsbreaks which, in case of their realization, would have a main effect on interruption of gas flows in transit within the Ukrainian territory.

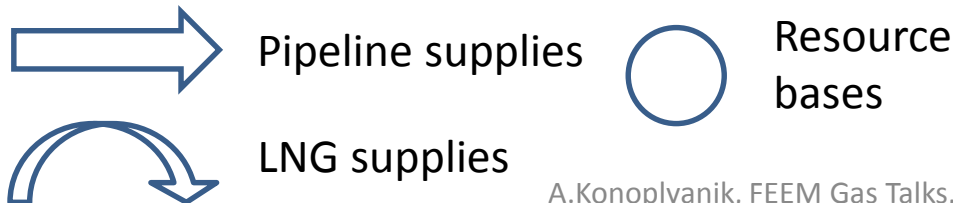


Calculated by M.Larionova, Russian Gubkin State Oil & Gas University, Chair “International Oil & Gas Business”, Master’s programme 2013-2015, based on the methodology jointly developed with the author

Russia & Europe in the past vs Russia & Europe & Asia in the future



Source of original map: <http://www.gazprom.ru/about/production/projects/pipelines/ykv/>



Thank you for your attention!

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The way forward for EU-Russian gas relations

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RF-EU gas relations: corridor of opportunities

- To understand new post-2009 realities in “Broader Energy Europe”:
 - new risks & uncertainties within new realities =>
 - whether “no return points” are passed through? =>
 - to search for new opportunities =>
 - only mutual & multilateral compromise possible
- Driving/balancing principle: to diminish risks & uncertainties to [mutually] tolerable level (P.Lowe/GAC RF-EU)

What to be done by EU

- To stop ASAP anti-Russian sanctions:
 - mutually negative for RF & EU,
 - aimed at slowing down EU economic recovery & at getting rid of EU as US competitor in global competition/recovery
- To implement adequate investment rules for existing capacity:
 - stop blocking OPAL (prevents pay-back of CAPEX already made => Art.13 ECT)
- To develop adequate investment rules for new capacity which:
 - will enable development & operation of South Stream (& similar projects) within Third Energy Package rules based on standard project financing principles
 - will depoliticize regulatory procedures
- To invest adequately in UA transition towards “Euro-integration” to escape negative results of earlier under-investing in CEE transition to EU rules (infrastructure density)
- To stop base its energy policy on perceptions, esp. on wrong perceptions

What to be done by Russia

- To stop treating Third EU Energy Package as deviation from the rules, not by the new rules
 - Sovereign choice of sovereign states (incl. EU) to develop its internal legislation, even if economically imbalanced (inter alia, trade vs investment stimuli)
- To stop treating implementation of Third package rules (EU energy acquis) in UA as pure political anti-Russia action, not as objective result of UA sovereign choice of accession to the Energy Community Treaty

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