

Cross-border transportation/transit: how to make regulatory rules financeable & manageable (the shipper's view)

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INTERNATIONAL MEETING OF EXPERTS

ON RELIABLE AND STABLE TRANSIT OF ENERGY

“FACILITATING INVESTMENTS IN NEW TRANSIT INFRASTRUCTURE”,

ORGANISED JOINTLY BY THE ENERGY CHARTER SECRETARIAT & MINISTRY OF FOREIGN AFFAIRS OF
TUKRMENISTAN, BRUSSELS, BELGIUM, 22.04.2015

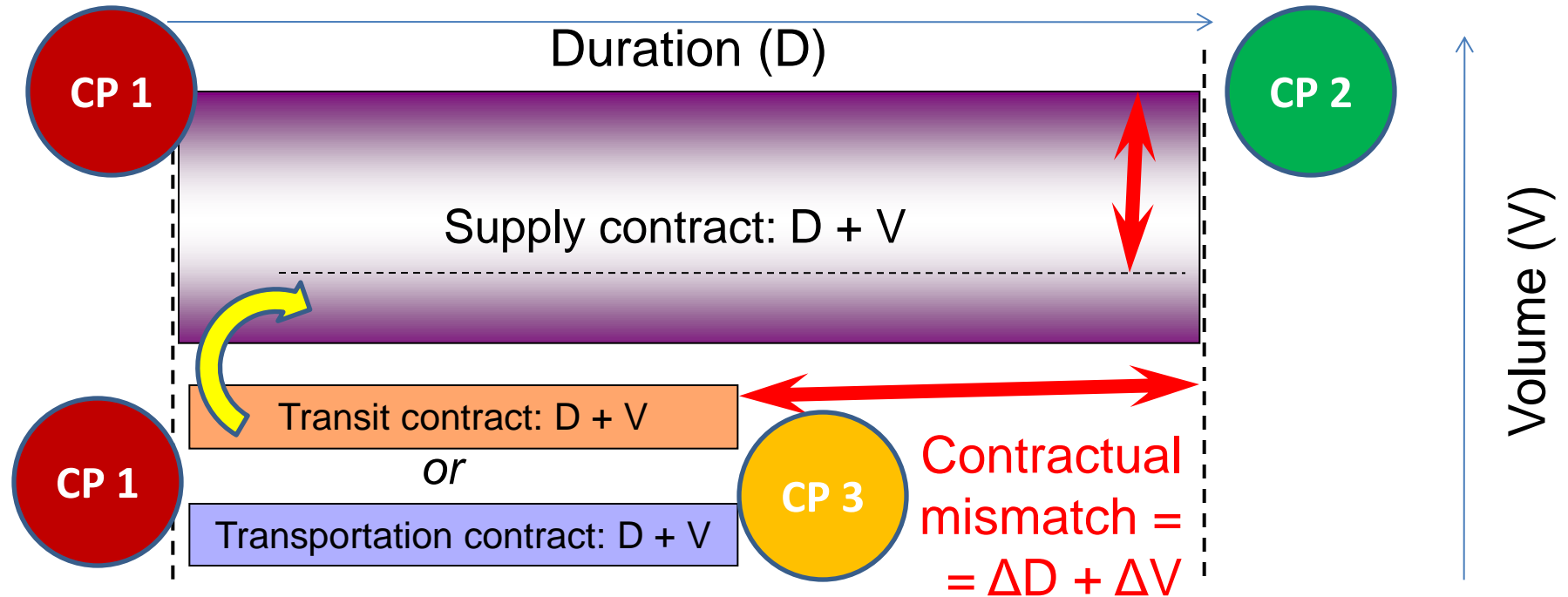
Different markets, different terminology, yet same problems to be addressed/solved (1)

- Energy markets can be:
 - **Bundled:**
 - (i) united commodity & capacity markets,
 - (ii) integrated VICs (ownership of pipe & gas in one hands),
 - **Unbundled:**
 - (i) separated commodity & capacity markets,
 - (ii) dis-integrated VICs = ownership of pipe (TSOs) & gas (shippers) in different hands
- Transit requirements for regulatory rules:
 - **Transit - basic definition:** cross-border flows between sovereign states/markets with more than 2 cross-borders/IPs
 - **Transit - usual practice** (more radical case): long-distance capital-intensive long-term transportation with multiple cross-borders/IPs
 - => long pay-backs, high & multi-facet risks of possible non-returns of debt-financing => **standard “project financing” requirements for regulatory rules: to be financeable (high CAPEX) & manageable (multiple cross borders)**

Different markets, different terminology, yet same problems to be addressed/solved (2)

- Effects on/risks for transit/cross-border transportation:
 - **Bundled markets**: risk of different rules between sovereign states in supply chain (sovereignty different national VICs/TSOs)
 - Minimal/no risk if different sovereign states – formally or informally – are part of REIO or similar unit (e.g. COMECON)
 - **Unbundled markets**: risk of different rules between sovereign states in supply chain **PLUS** risk of “contractual mismatch”
 - different management of - thus risk of non-coordinated rules for - commodities & capacities markets even within same state
 - Commodities markets tend to be short-term (trade), capacity markets tend to be long-term (investment)
 - **Unbundled markets in REIO** (e.g. EU, Energy Community Treaty area):
 - **SAME** rules for different sovereign States within REIO,
 - **BUT** risk of “contractual mismatch” in individual REIO MSs still exists,
 - **AS WELL AS** risks of non-financeable/non-manageable rules =>
 - => **transit/cross-border transportation risks de facto exist even under Third Energy Package architecture of “internal” EU gas market**

Contractual Mismatch Problem (Draft TP Art.8)



Mismatch between duration/volumes (D/V) of long term supply (delivery) contract & transit/transportation contract as integral part to fulfill delivery contract => risk of non-renewal of transit/transportation contract at **existing** capacity *or* non-creation of adequate **new** capacity => risk of non-delivery for existing/new **supply** contract (incl. arbitration consequences).

Core issue: to guarantee access to/creation of adequate transportation capacity for volume/duration of long term contracts; **shipper's contracts (booking guarantees) best financial security for debt/project financing**

Ways/means for non-interruptible transit/CBT

- 2 ways for providing non-interruptible transit/cross-border transportation (CBT) on a non-discriminatory basis:
 - **Without CAPEX** => with capacity deficit still to exist
 - **With CAPEX** => without capacity deficit to stay
- Non-discriminatory **access rules** to transportation capacities should be different for **available existing & new** (future) capacity:
 - **Available** (existing today, definition draft TP Art.1) => **without CAPEX** => part of technically existing, i.e. already built (financed, constructed), being or already paid-back,
 - **New** (to be available sometime in the future dependent on CAPEX) => **with CAPEX** => yet non-existing, yet-to-be-built, i.e. to be financed (usually debt/project financing), constructed, to be paid back => **operator rules to provide expected pay-back are crucial**
- **Project-based vs area-based** creation & operation of new capacity (**with CAPEX**) – 3 options:
 - **Project-based** creation (financing, construction) & operation
 - **Area-based** creation (financing, construction) & operation
 - **Project-based** creation & operation **till end of pay-back** period, then transfer to area-based operation

Mandatory Third Party Access (MTPA)-based allocation rules for infrastructure

- MTPA-based allocation of **existing** deficit infrastructure (**without CAPEX**):
 - **Auction**
 - **Pro-rata**
 - **FCFS** (“first come – first served”)
 - **RFR** (“right of first refusal”)
 - **Lottery**
- MTPA-based allocation of **existing & new** infrastructure (**with CAPEX**) = creation of new infrastructure aimed to provide MTPA to existing & new capacity without capacity deficit:
 - **Open Season**: based on **market demand for new capacity** at (i) single & (ii) multiple IPs = cross-border new capacity
 - **Auction**: if **offer of new capacity** at single IP

EU: Allocation rules for transportation capacity

- **Pro-rata:**
 - TAG 1st expansion stage (Dec'2005, 149 winners); last resort/limited use in EU CAM NC INC (Amended Reg. 984/2013 Art. ...)
- **Lottery:**
 - TAG 2st expansion stage (May'2008)
- **FCFS:**
 - not allowed by EU DG COMP
- **RFR:**
 - not allowed by EU DG COMP; one of 3 open issues on draft Transit Protocol between Russia & EU (bilateral consultations 2004-2007, **technically agreed solution: from RFR to OSP**)
- **Auction:**
 - The only allowed option for **existing** scarce capacity (CAM NC): standard capacity products, up to 15Y advanced booking (+5Y in CAM NC INC), detailed workable procedure of ascending clock auction mechanism, etc.
 - “Default procedure” for **new** capacity in CAM NC INC => regulatory conflict with OSP (Art.20a(3) Amend.Reg.984/2013)
 - Can be financeable for individual IPs, difficult (***if at all possible***) to be manageable & financeable at multiple IPs (cross-border routes)
- **OSP:**
 - The only financeable & manageable mechanism for cross-border new capacity – ***IF rightly organised and coordinated => draft Art.20(h) for Amended Reg.984/2013***

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

- Nord Stream project pipelines
- Yamal pipelines
- Ukrainian transit flows
- Turkish Stream project pipelines



47BCM at 2019:
How to move from Turkish border to existing DPs in EU acc.to EU rules?

Post
01.12.2014

South Stream
(Cancelled)

Turkish Stream

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

Solution for new cross-border capacity within EU E-E zones: project financing approach (COSP, ring-fencing, ITSO, fixed tariffs till pay-back, etc.)



Parameters of new IPs/CBPs to be coordinated within chain of the zones and with supply contracts backing demand for new capacity within each zone

Pipelines-interconnectors between two neighbouring EU zones = single IPs with bundled products

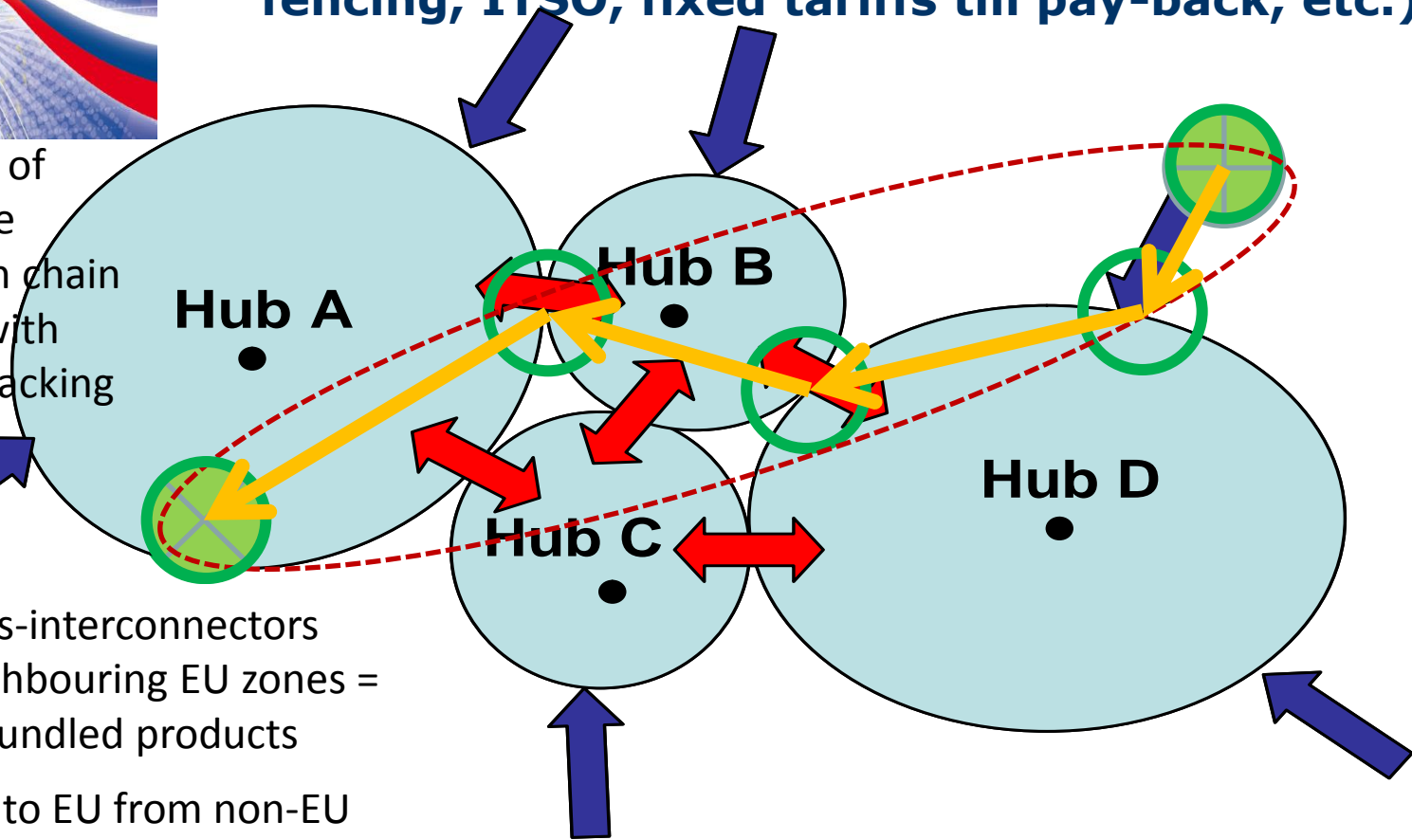
Supplies to EU from non-EU

Non-EU producer
Its EU customer

ITSO

New Capacity = multiple IPs with bundled products to be balanced, cross-border coordination of TSOs to avoid two types of contractual mismatches:

- (1) at each IP: between term supply & transportation contract, and
- (2) at all IPs on the route from zone to zone: between bundled products at each IP





“Project-based” financeable & manageable proposal for OSP: Art.20(h) for draft Amended EU Reg.984/2013

New cross-border capacity project life-cycle

Investment + pay-back period

Post-pay-back period

OSP (project-based proposal – Art.20(h))

- Project-based approach through pay-back
- Tariff as swing parameter in economic test
- NPV as criteria for economic test
- Fixed tariff through pay-back period
- F-factor =100% (90% = shippers demand, 10% = NRA guarantees, securitized by EU Fin. Inst.)
- No cost socialization
- Cross-border unitization, ITSO for unitized project, TSOs coordination within single project
- Costs/revenues reallocation within project
- No contractual mismatch

Amended EU Reg.984/2013 (CAM NC INC+ draft NC HTTS)

- System-based approach
- Volume as swing parameter
- WTP as criteria
- Floating tariff
- F-factor established by NRA, flexible, less 100%
- Huge cost socialization (1-F)
- Cross-border coordination for existing & not yet existing cap.
 - ...between diff. market areas
- Risk contractual mismatch high

Cross-border new capacity (“transportation route”) principle: until capacity is built & paid-back – OSP procedure based on project-based (not system-based) approach

Any future role of Transit Protocol?

- To convert Energy Charter draft Protocol on Transit into draft Protocol on Cross-Border Long-Distance Long-Term Transportation (CBT Protocol) ?:
 - If so, existing draft Transit Protocol as a basis, plus new articles/topics & related instruments on:
 - risk mitigation provisions for long-distance long-term capital-intensive cross-border transportation via immobile fixed infrastructure (aimed at financeability & manageability of corresponding procedures),
 - prevention of transit interruptions, incl. further expansion of multilateral Early Warning Mechanism of the Energy Charter,
 - transit disputes other than on transit tariffs, incl. compensatory mechanisms, etc.

Thank you for your attention!

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