Quo Vadis: Crisis or Opportunity? Russia's concerns & proposals

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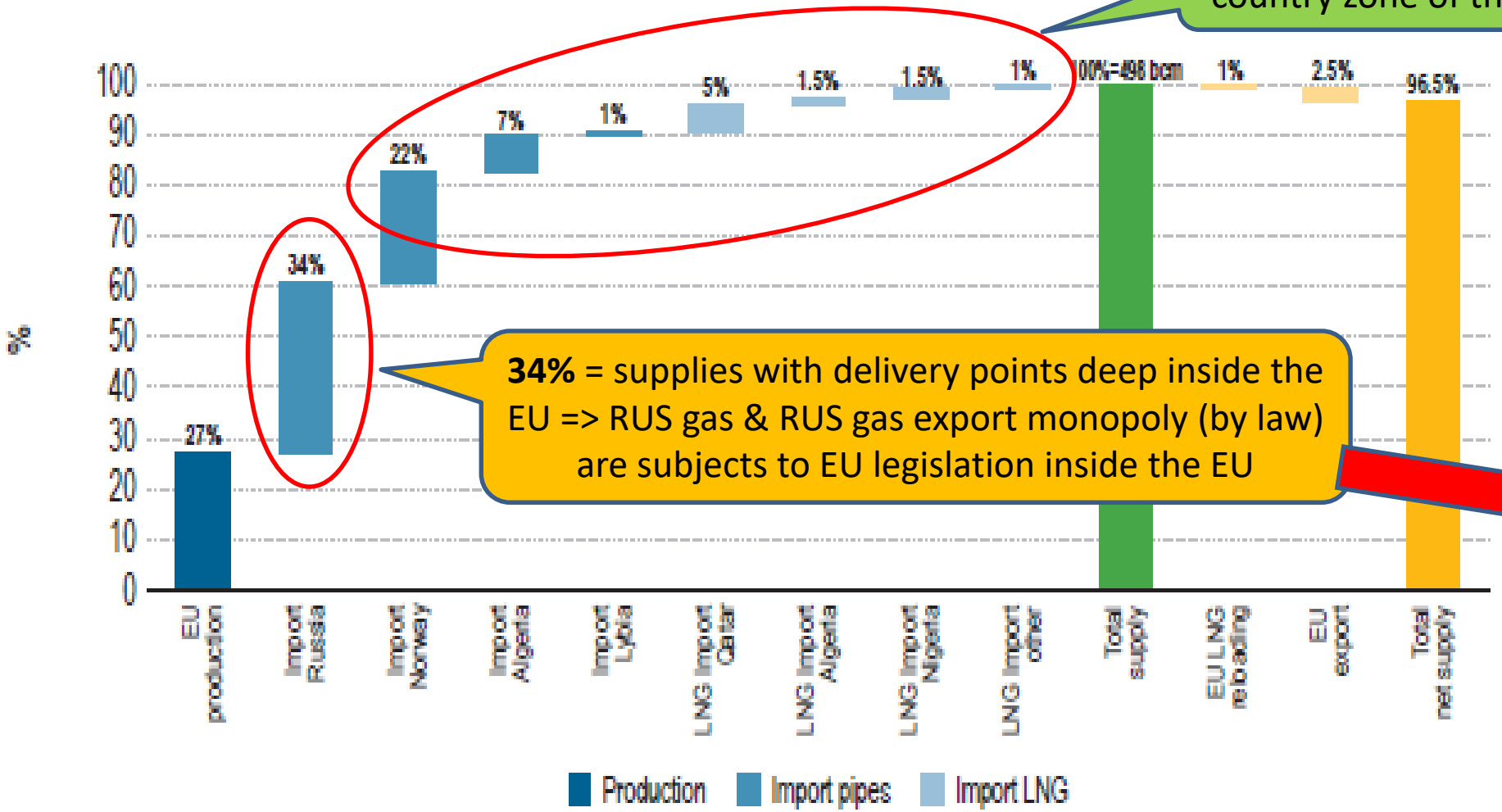
Presentation at the 24th meeting of Work Stream 2 "Internal Markets" of the Russia-EU Gas Advisory Council), Representative Office of the European Commission in Vienna, Austria, December 1st, 2017

Crisis!!!

Danger

Challenge, Chance

Figure 2: EU gas supply portfolio by origin – 2016 (100 = 498 bcm, %)



Source: ACER based on International Energy Agency (IEA), Eurostat and GIGNL[10].

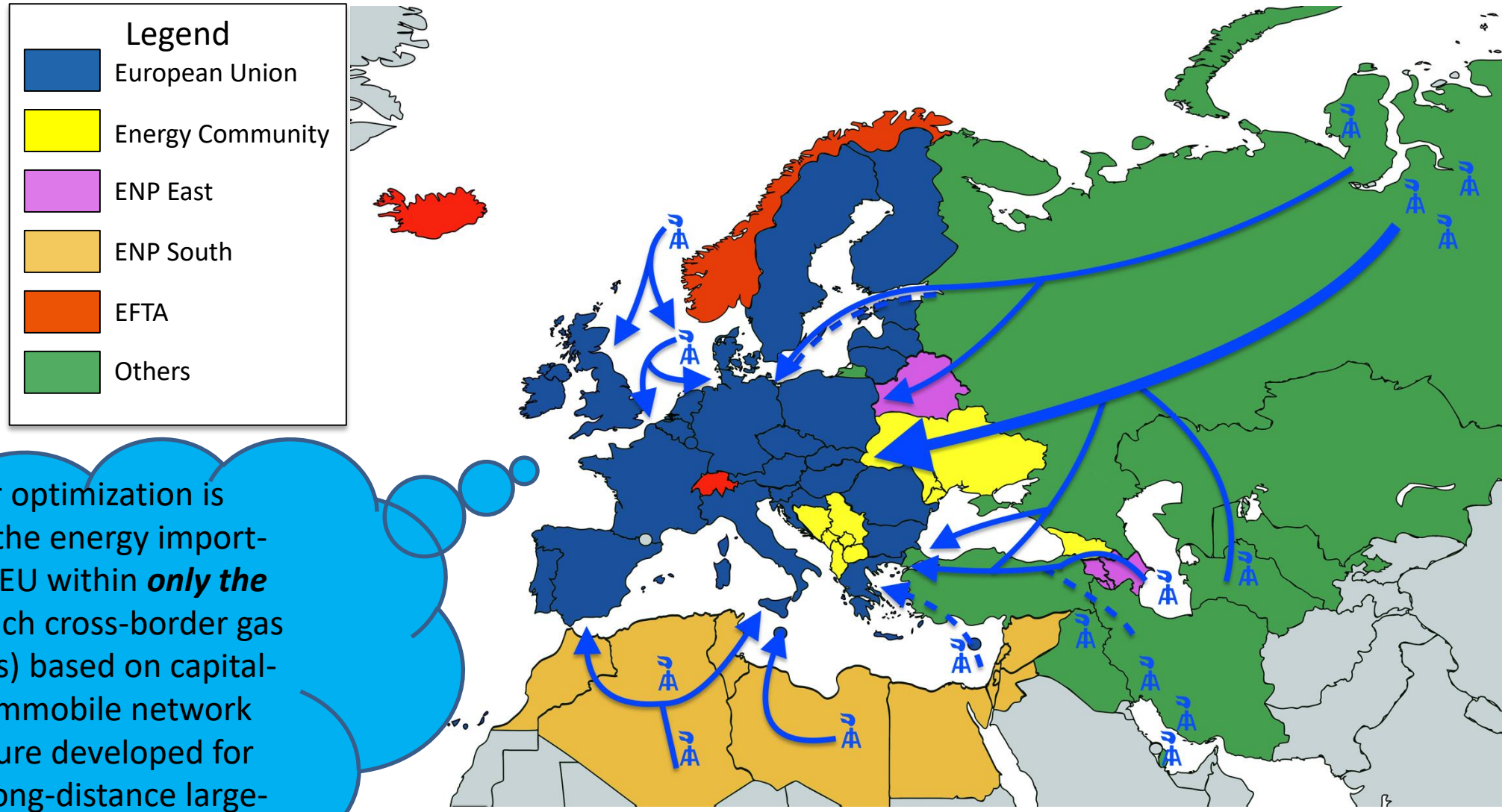
40% = supplies to the first entry market / country zone of the EU (on-border supplies)

34% = supplies with delivery points deep inside the EU => RUS gas & RUS gas export monopoly (by law) are subjects to EU legislation inside the EU

Russia and the EU = are integral mutually dependent parts of the "Broader Energy Europe" which are inseparably historically linked by cross-border capital-intensive immobile infrastructure network developed for long-term long-distance large-scale gas deliveries

Source: ACER/CEER Annual Report on Results of Monitoring the Internal Natural gas Markets in 2016, p.15

Internal EU gas market vs "Broader Energy Europe" (EU "energy acquis" tends to expand through the cross-border gas value chains upstream from the EU)

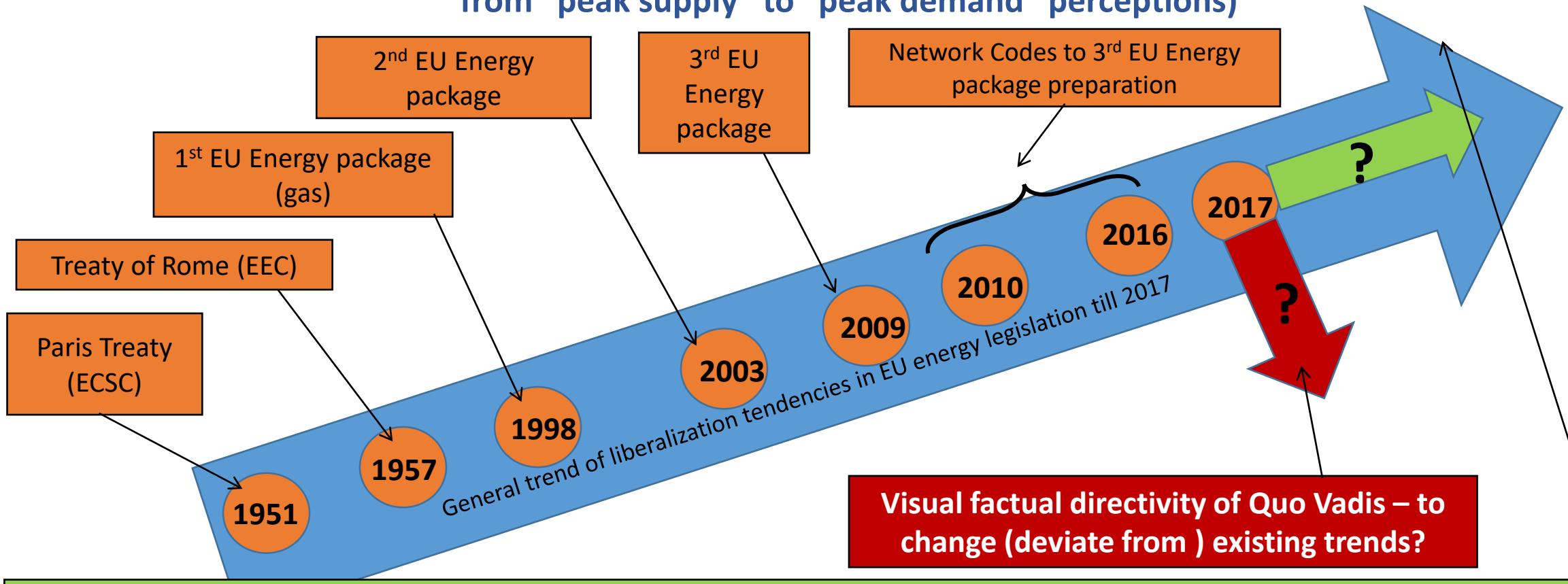


Whether optimization is possible in the energy import-dependent EU within ***only the portion*** of such cross-border gas value chain(s) based on capital-intensive immobile network infrastructure developed for long-term long-distance large-scale gas deliveries?

Map prepared by A.Haug, post-graduate student, Russian State Gubkin Oil & Gas University

Quo Vadis 2017: continued liberalization of EU energy legislation – *OR* factual deviation from liberalization trends (i.e. same rules for all?) to protectionism and discrimination of (selective preferences for) some players?

(in the narrowing relative demand niche for fossil fuel within changing paradigm of world energy development: from "peak supply" to "peak demand" perceptions)



Suggestion of expected directivity of Quo Vadis:

(i) this comes from the logic of prior 60Y+ historical development of common EU economic space, incl. in energy;

(ii) it is expected to be the project for efficiency evaluation of the gas regulatory system of the still emerging internal EU energy market;

(iii) the latter has been teleologically developed through the past 60Y based on provisions of the Treaty of Rome and progressively liberal instruments of their implementation

Quo Vadis project: its major task & sequence of tenses

- DG ENERGY website: *"The aim of the study is to provide substantiated analysis as to whether the current regulatory framework in the EU gas sector is the most effective in order to maximise overall EU welfare or whether amendments may be necessary, and if so provide recommendations"*:
  - 26.06.2017 (Brussels, 2nd stakeholders meeting): Preliminary EY/REKK report "**Quo Vadis EU gas market regulatory framework – Study on a Gas Market Design for Europe (Preliminary Report, Draft for discussion purposes)"**,
    - **RUS part WS2 provided its comments to DG ENERGY & REKK on 12-14.07.2017**
  - 26.07.2017 (Budapest): debate on modelling methodology
    - **RUS part WS2 provided its proposals (20.07.2017) & comments (18.08.2017) to DG ENERGY & REKK**
  - 19-20.10.2017: debate on Quo Vadis at Madrid Forum
    - **Rather critical comments from market participants, esp. on scenarios 1-4**
  - 13.12.2017 (Brussels, 3rd stakeholders meeting): next stage of public debate, *hopefully,* with due consideration of RUS proposals/justified interests
- **BUT:**
  - Third EU Energy Package in gas in its full integrity, incl. NCs, only since April 2017; two-year-long cycle of CAM NC INC procedure; => first results of practical implementation of Third Energy Package in gas in its full integrity – mid-2019 =>
  - Quo Vadis modelling is made & proposals are based on perceptions, without testing (passing through "learning curve") of integral Third Energy Package practical implementation?

Major Task of the EU-Russia Gas Advisory Council

- **"…aimed to diminish mutual risks and uncertainties to the tolerable level"** ***(Philip Lowe, Director-General, DG ENERGY, 1st/Inaugural GAC meeting, Vienna, 17.10.2011)***

Quo Vadis Modelling: general concerns & proposals (see Part 1)

- **Imbalanced study (pre-determined by Terms of reference):**
  1) "EU welfare" modelling is based **only on the interests of EU final consumers** (though questionable – see below) **and EU gas market internal participants**, ***without*** taking into consideration justified interests/concerns of non-EU suppliers to the energy import-dependent EU
     - **BUT:** EU & Russia are interdependent parties of the "Broader Energy Europe" => we are inseparably historically linked by cross-border capital-intensive immobile infrastructure network developed for long-term long-distance large-scale Russian gas deliveries to the EU
  2) "Maximization of EU welfare" is modelled based on scenarios within **"zero-sum game"** by:
     - Shifting incremental risks and costs on non-EU gas suppliers to the EU (firstly on Russian side), &
     - Transmitting gained benefits to (their redistribution in favour of) to EU final consumers (though questionable – see below) plus to wholesale buyers-resellers/traders of (firstly Russian) gas from the non-EU producers
  3) Welfare of **final consumers** is modelled based on wholesale, **not retail**, prices (ToR DG ENERGY)
     - **BUT:** The levels and trends of wholesale and retail prices in EU are different; role of taxes
  4) **Inertia** of modelling process => impossible to correct/update the process from the middle of the way within fixed limited project time-frame (June => July => October => December ?)

Quo Vadis Modelling: general concerns & proposals (see Part 2)

- **Nevertheless,** it seems reasonable, based on value added of Quo Vadis exercise, to:
  - **Complement** Quo Vadis project (REKK's modelling) by a **new separate EU-Russia joint** scenario(s) / undertaking which will take into consideration justified interests/concerns of the Russian side and will be based on the balance of mutual interests of the parties and on their cooperative experience of the recent past within GAC, i.e.:
    - on PRIMES modelling in WS1 (2011-2013),
    - on GTM in WS2 (2011-2013),
    - on CAM NC INC/TAR NC in WS2 (2013-2016)
  - **RUS side WS2 proposal** on this to DG ENERGY for consideration (as of 18.08.2017)

Quo Vadis !!!

Danger

Challenge, Chance

Part 1. Concerns

Five selected Quo Vadis scenarios

1) **Tariff reform**
   - nullification of intra-zone E-E tariffs, compensatory increase of entry (to EU wholesale market) and/or exit (to EU retail market) tariffs, centralized redistribution of compensatory revenues (via newly established TCF)
2) **Real merger of market zones**
3) **Virtual merger of market zones**
   - paving the way for virtual reverse flows to UA
4) **Shift of delivery points to the external border of EU** (area of EU acquis => EU + Energy Community area)
   - Russian gas to be delivered to RF-UA border
5) **Expansion of pipeline infrastructure to deliver regasified LNG from coastal import terminals to inside EU** (the main/Rus delivery points)
   - To substitute their Rus gas shifted to RF-UA border? who will finance? Via TCF?

My final conclusion (devil's advocate/worst-case interpretation): Quo Vadis in its current structure presents an integral programme of pushing out the (more cheap) Russian pipeline gas supplies to the periphery of the EU/Energy Community area (RF-UA border) and its substitution in the (Eastern EU) area of its historical presence by (more costly) US LNG

A.Konoplyanik: publications & presentation on Quo Vadis with further/more detailed argumentation

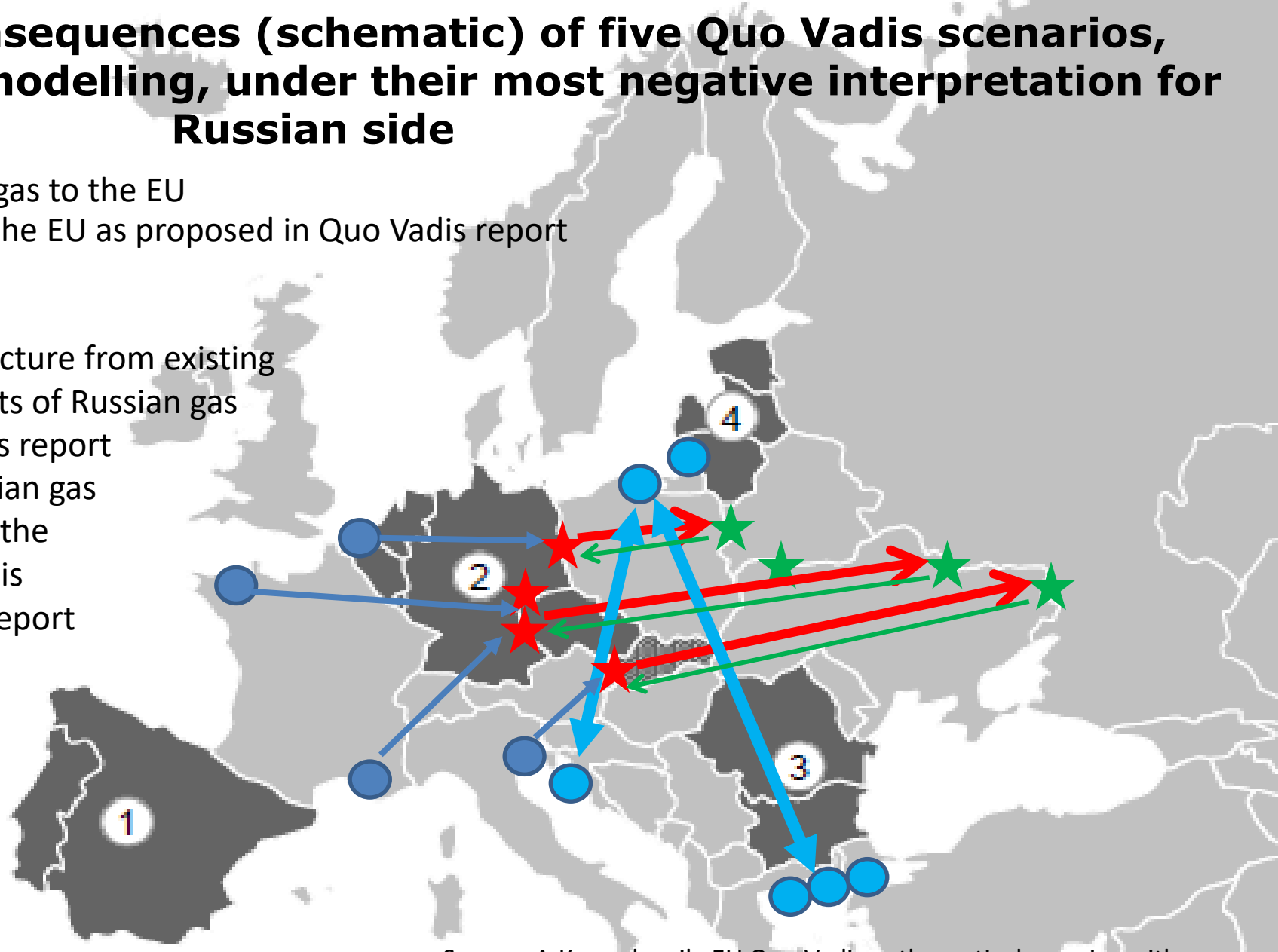
- **Publications:**
  - Расчистка рынка: как в ЕС хотят изменить правила покупки российского газа. // *«РБК-daily»,* 31.07.2017
  - В одни ворота. // *«Нефтегазовая Вертикаль»,* 2017, № 15-16, с. 52-57
  - «Санитарный кордон» ЕС на пути углеводородов. (Попытки регулирования европейского рынка голубого топлива ведут к ограничению присутствия отечественных компаний в Старом Свете) // *«НГ-Энергия» №8 (121), Приложение к «Независимой газете»,* 10.10.2017, с. 9, 12-13
  - Соблазнение Европы. (Между Россией и США: чей газ будет покупать Евросоюз в ближайшие годы) // *Профиль (деловой еженедельник),* №7, 16.10.2017, с. 47-51.
  - EU Quo Vadis: a theoretical exercise with an anti-Russian Flavour? // *"Natural Gas World - Global Gas Perspectives",* 19 October 2017
  - Quo Vadis: оценка эффективности Третьего энергопакета ЕС или тест на формирование новой «линии Керзона» новой Еврокомиссией? // *«Нефть, газ и право»*, 2017, №4-6 (в печати)
- **Presentations:**
  - «Проект *Quo Vadis* ЕС: путь к (мифическому) Четвертому энергопакету ЕС или попытка (корректной?) оценки эффективности выстроенной за 6 лет системы регулирования / функционирования формирующегося единого внутреннего рынка газа ЕС на базе Третьего энергопакета ЕС?» // Presentation at the Expert Meeting "Russian response to the upcoming 4th energy package - EU gas market regulatory framework", 19 April 2017, Moscow School of Management SKOLKOVO
  - "In the search of an efficient EU gas market model: Quo Vadis? (introductory remarks of the moderator)". // Presentation at the Workshop "In the search of an efficient EU gas market model" (under the supervision of the Co-chairs of Work Stream 2 - "Internal Markets" of the Russia-EU Gas Advisory Council), Representative Office of PJSC "Gazprom" in Belgium, 30th May 2017
  - «Проект Еврокомиссии Quo Vadis по оценке эффективности и возможных корректировок системы регулирования рынка газа ЕС» // Выступление на семинаре «Обзор Европейского рынка природного газа и СПГ», организованном компанией Thomson Reuters, Москва, 12 июля 2017 г.
  - Оценка эффективности Третьего энергопакета ЕС - и проект Еврокомиссии «Quo Vadis». // Выступление на конференции «Энергетическая безопасность и перспективы развития» IX Международного Газового Форума, 03-06 октября 2017 г., Санкт-Петербург
  - Проект Еврокомиссии «Quo Vadis»: оценка эффективности Третьего энергопакета ЕС в газе *или* техзадание для новой Еврокомиссии на Четвертый энергопакет ЕС для газа с антироссийским уклоном? (роль политики в современной экономике) // Выступление на семинаре «Европейский вызов международным рынкам газа» в рамках Форума «Нефтегазовый диалог ИМЭМО РАН, Москва, ИМЭМО, 24.10.2017
  - Quo Vadis: оценка эффективности Третьего энергопакета ЕС или подготовка новой «линии Керзона»? // Выступление на конференции «Проблемы и перспективы взаимоотношений России и Европы в газовой сфере», Москва, ИНП РАН, 07.11.017

Quo Vadis: possible consequences (summarizing worst reading) for Russian gas

- **Scenario 1:** Creation for non-EU gas suppliers to EU (firstly Russian gas) entry tariff limitations, worsening its competitive advantages in EU (i.e. against US LNG) => *administrative entry barriers for Russian gas*
- **Scenarios 2-3:** "Import" to non-liquid market zones (within EU & Energy Community) of gas prices from liquid EU marketplaces => **substitution** of direct supplies of Russian gas to UA from the East by supplies to UA from the West (from EU) of gas originated from Russia => *the form of business-support of EU midstream companies*
- **Scenario 4:** Removal of delivery points of Russian gas to the periphery of EU acquis implementation area => **transfer** of transportation (transit) services to "old" Russian delivery points to EU companies – traditional wholesale buyers-resellers of Russian gas => *form of business support of EU midstream companies*
- **Scenario 5:** Creation of new gas pipeline infrastructure within EU to deliver regasified LNG from EU coastal import terminals to traditional delivery points of (Russian pipeline) gas inside EU => *creation of technical capabilities to substitute Russian gas by LNG within EU*
- **In result:** formation of "vertical" gas transportation corridor in the Eastern periphery of EU connecting new LNG terminals aimed (on top of its technical reasoning) to cut-off Russian pipeline gas from the area of its historical presence/dominance (programmes CESEC, PCI, TYNDP) ???

Possible application consequences (schematic) of five Quo Vadis scenarios, selected for quantitative modelling, under their most negative interpretation for Russian side

- Existing key delivery points of Russian gas to the EU
- New delivery points of Russian gas to the EU as proposed in Quo Vadis report
- Existing LNG terminals
- New LNG terminals
- Development of new pipeline infrastructure from existing LNG terminals to existing delivery points of Russian gas within the EU as proposed in Quo Vadis report
- Shift of existing delivery points of Russian gas inside the EU to their new locations at the external border of the zone of EU acquis application as proposed in Quo Vadis report
- Transfer of existing transit business of Russian gas to existing delivery point within the EU to the mid-stream companies of the EU as proposed in Quo Vadis report
- (1) New merged regional gas market zones as proposed in Quo Vadis report
- New North-South EU gas pipeline corridor in the Eastern part of the EU to connect new LNG terminals

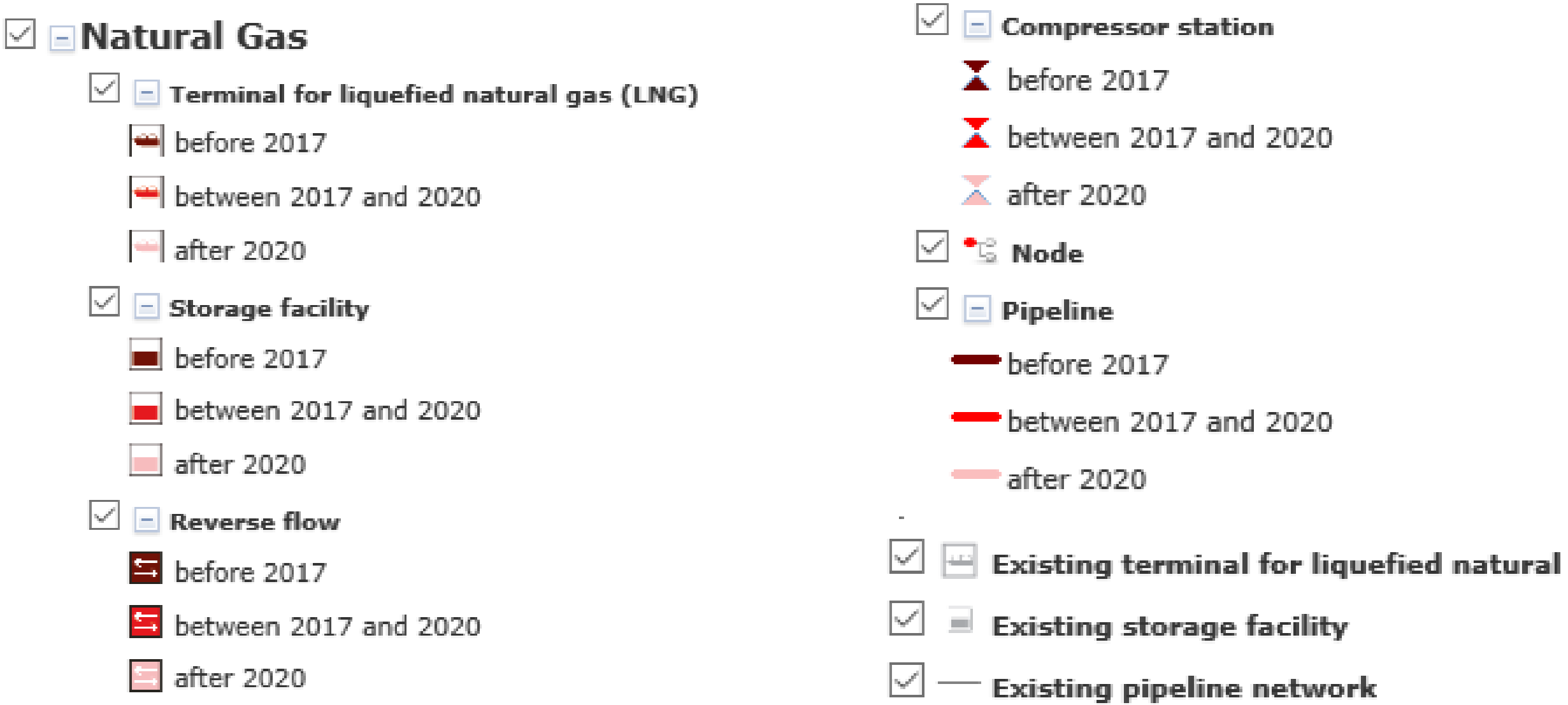


Source: A.Konoplyanik. EU Quo Vadis: a theoretical exercise with an anti-Russian Flavour? // *"Natural Gas World - Global Gas Perspectives"*, 19 October 2017; https://www.naturalgasworld.com/gpp-eu-quo-vadis-a-theoretical-exercise-with-an-anti-russian-flavour-56079

New (incremental) European gas infrastructure (PCI) (see legend)

Источник: http://ec.europa.eu/energy/infrastructure/transparency_platform/map-viewer/main.html

Legend to figure with new (incremental) European gas infrastructure (PCI)



Источник: http://ec.europa.eu/energy/infrastructure/transparency_platform/map-viewer/main.html

Quo Vadis, Russian pipeline gas & US LNG in EU : attempt of unfair competition? At the cost of EU? What the Presidents are saying…

- In its current structure Quo Vadis seems to be factually aimed at justification of substitution in EU **by more expensive** US LNG **of more cheap** Russian pipeline gas; on the routes of the latter to EU (both on existing and on prospective ones) it is modelled to create incremental barriers. => Quo Vadis scenarios well correlate with new anti-Russian US sanctions against existing and new Russian export pipelines and might lead not to increase but **to decrease of EU welfare**. It seems that Quo Vadis scenarios are constructed not in favour of EU, but **in favour of US:**
  - US President **D.Trump** (Warsaw, 04.07.2017): "Maybe, the price will come slightly higher – but that's OK…" ("US Energy Dominance" & "America First" strategies)
  - Russian Prime-Minister **D.Medvedev** (St.Petersburg, 21.09.2017): "…American Administration - and Congress… - try to promote its own suppliers and to substitute Russian Federation at this market"
  - Russian President **V.Putin** (Sochi, 19.10.2017): "… recent sanctions' package adopted by US Congress openly aimed at pushing Russia away from European energy markets, to force Europe to turn to more expensive US LNG …"

Dividing line from Baltic to Black sea (Project "Intermarium") – major aim of USA in Europe (acc. to G.Friedman, "Stratfor")

"…final aim of the US consists in creation of "Intermarium" – territory between Baltic and Black Seas, which concept was developed as far back as by Pilsudski. First aim for US is not to allow that German capital and German technologies were united with Russian natural resources and labour resources in the invincible combination. … Trump card of US which defeat such combination - dividing line between Baltic states and Black Sea."

(https://www.thechicagocouncil.org/event/europe-destined-conflict)

Source: Presentation of George Friedman, Founder and President of private intelligence agency "Stratfor" at the conference of "The Chicago Council on Global Affairs", 4 февраля 2015 г., https://www.youtube.com/watch?v=iOY1dDqa7F0; https://www.youtube.com/watch?v=xewzbMYmC_I

Quo Vadis!!!

Danger

Part 2. Proposals

Challenge, Chance

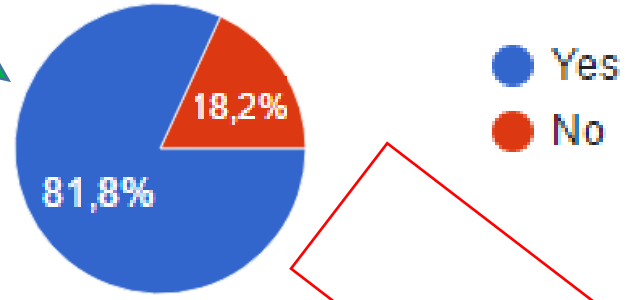
A.Yanovsky (Russian Co-Chair, GAC) on non-EU suppliers' role in Quo Vadis

- "…We welcome initiative of the European Commission to undertake certain "revision" of the results of development and implementation of the documents on gas market regulation in elaboration of Third EU Energy Package. … We will attentively follow the course and results of this study in the hope to prevent new imperfections and inaccuracies, which can not be excluded without engaged joint discussion of the problems in substance. **In our view, it will be advisable to foresee involvement in such study of the gas exporters to the EU since success of EU gas market functioning depends on their satisfaction with the regulatory rules at the this market.** … Moreover, in our view, any market can unlikely be sustainable in principle if its regulation is oriented exclusively (or even primary) to the interests of the buyers"
  - *(from presentation of Russian Energy Deputy Minster A.Yanovsky at the Plenary session of the International Conference "Prospects of Russia-EU energy cooperation: gas aspect", June 15, 2017, Berlin («Газовый бизнес», 2017, №3, с.12))*

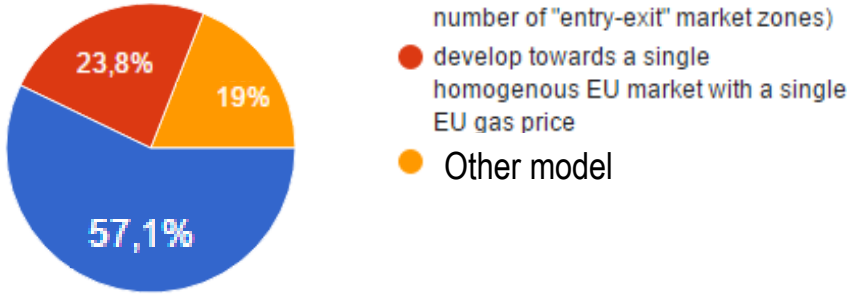
Results of 30.05.2017 Workshop (*) registration poll (non-Gazprom Group attendants' answers only)

Is there a need for further improvement of the EU gas market regulatory environment?

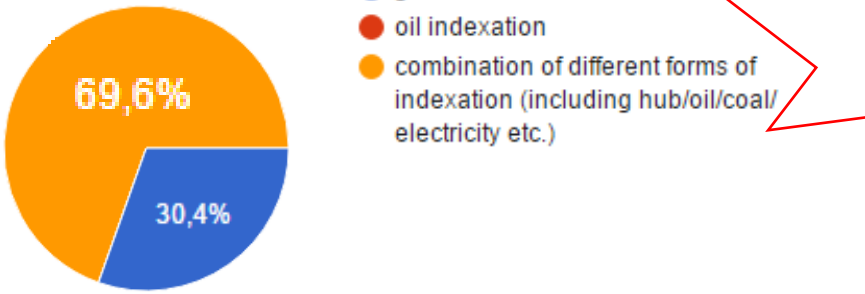
Improvement not necessarily means radical changes



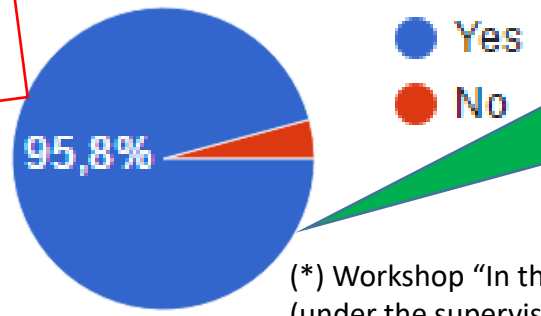
Should the future architecture of the EU gas market:



What is the most effective future pricing mechanism for the EU internal gas market?



Shall stakeholders be fully involved in any further market developments initiated by the EU regulatory bodies?



AK: stakeholders through the whole cross-border gas value chain within "Broader Energy Europe"

(*) Workshop "In the search of an efficient EU gas market model" (under the supervision of the Co-chairs of WS2 GAC, Representative Office of PJSC "Gazprom" in Belgium, 30th May 2017

Collected & summarized by D.Udalov

Russian side of WS2 proposal to the DG ENERGY coordinator of Quo Vadis project (as of 18.12.017)

- "…In this regard the Russian/Gazprom Group side of the WS2 GAC propose DG ENERGY and its Consultant (EY & REKK) on "Quo Vadis" project to consider possibility to jointly (under the umbrella of the Russia-EU GAC WS2) "assess the current regulatory framework and conclude whether – considering the overall costs and benefits – a change in that framework is necessary…" *(as it mentioned in the "Tender Specification" for Quo Vadis…)(*)*, but "considering the overall costs and benefits" in such assessment with:

  - due consideration of the justified concerns of the non-EU producers/external gas suppliers/exporters to the energy-import-dependent EU, and

  - adjustment of the above-mentioned imperfections of the REKK's EGMM model for the given task."

(*) Call for Tenders No ENER/B2/2016-413 "Quo Vadis EU gas market regulatory framework – Study on a Gas Market Design for Europe", Tender Specifications, p.9 "Tasks"

A bigger Pie for both Parties?

- Quo Vadis study includes investigation of methods entailing a welfare shift from gas producers to European gas users
  (i.e. welfare shift: from Russia → to EU).
- Suggested additional analysis (***additional*** study to Quo Vadis, ***not within current*** Quo Vadis project):

"Win-Win" extension to Quo Vadis study :

How can we

- increase the pie for both parties in the Russia-EU gas business (EU and Russia together)
- and equitably distribute the additional welfare?

Win-Win Extension: suggested steps

- **Step 1: Discovery exercise**
  - Which areas of collaboration exist that could lead to a total welfare gain for EU and Russia in the gas business?
  - How could such collaboration look like in practice?
- **Step 2: Evaluation of welfare gain**
  - Analysis of size of welfare gain per collaboration opportunity
- **Step 3: Welfare distribution**
  - Developing options for principles and operational methods of distributing the additional welfare identified (duly considering the toolbox developed in Quo Vadis study)
- **Step 4: Implementation**
  - Planning and facilitating implementation

Win-Win-Extension: suggested Project organisation

EU – Russia
Gas Advisory Council *or* WS2 GAC
(Steering committee)

Joint Consulting Team

- Consultants from EU

  collaborating closely with

- Consultants from Russia

Stepwise approach:

1) Select consultants
2) Use consultants' experience to develop study design for maximising joint success
3) Potentially limit initial task to **Step 1** (Discovery exercise)

Prerequisites for project success as regards consultants:

- Both parties need to have trust in both consultants.

Suggested procedure for selecting consultants:

- **Option 1:** Each side proposes consultant from other party's area (i.e. EU proposes Russian consultant and Russia proposes EU consultant) with right of refusal by other party
- **Option 2:** Each party produces short-list with consultants from its own region (3-5 consultants) for other party to chose from

Thank you for your attention!

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