

**Impact of liberalisation processes in the European and  
Russian gas markets on prospects of production and  
export of Russian gas to Europe  
(with particular reference to ECT Protocol on Transit)**

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Deputy Secretary General  
The Energy Charter Secretariat**

**Conference - Exporting Oil & Gas from Russia and the CIS  
“Gas Market Liberalisation”**

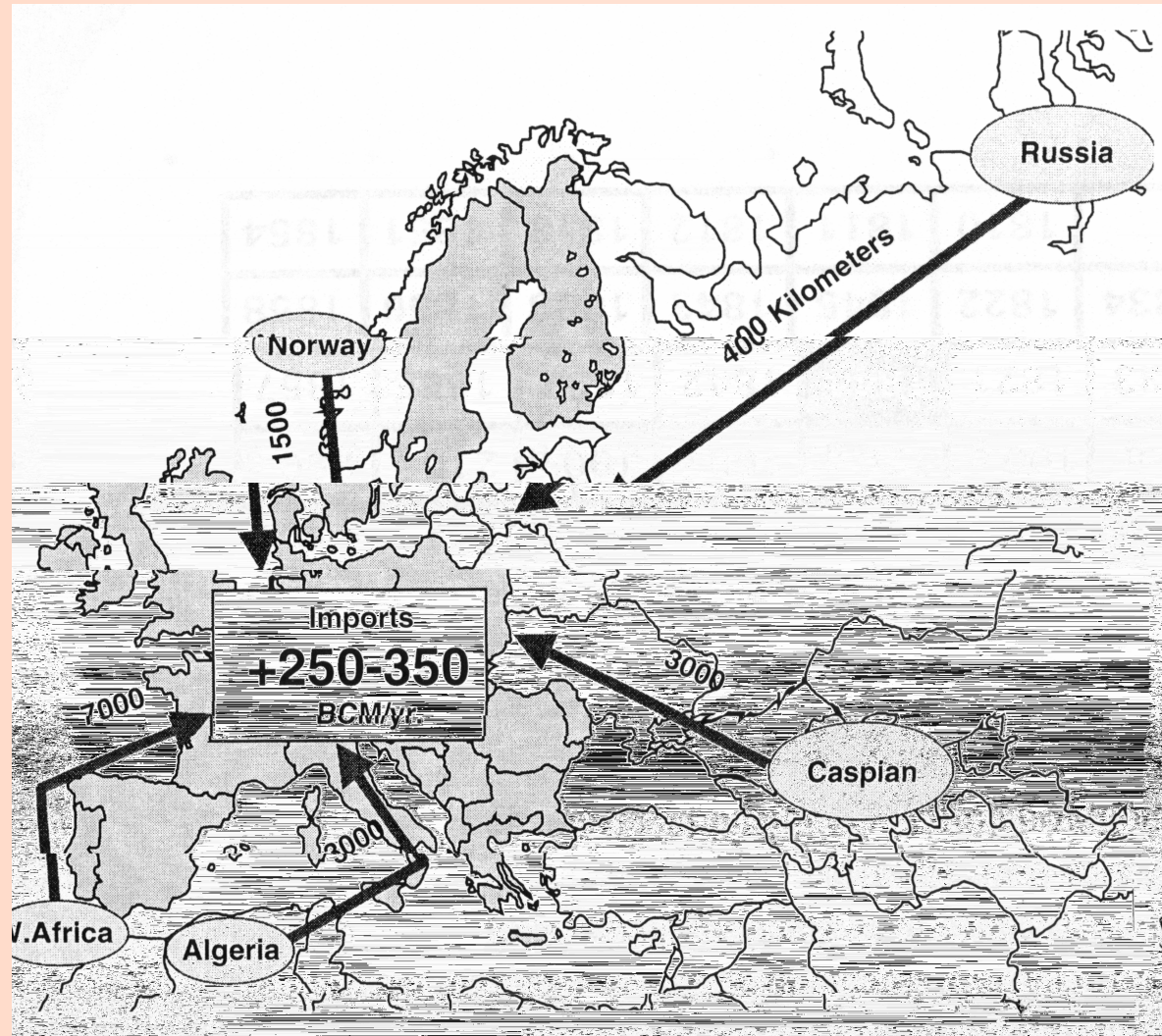
**4-5 November 2002, Hotel Baltschug Kempinski, Moscow**

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- 2. Evolution of gas markets development, incl. long-term contracts**
- 3. Energy markets vs. investors protection, incl. ECT and WTO**
- 4. ECT Protocol on Transit: outstanding issues**
- 5. Final remarks**

# 1. Russian gas in Europe, incl. transit

# EUROPEAN GAS MARKET OUTLOOK



**By 2020:**

- **Demand up  
200-300 BCM/yr**
- **Imports up  
250-350 BCM/yr**
- **New investments  
250-300 billion \$**



Figure 1

# RUSSIAN GAS IN EUROPE

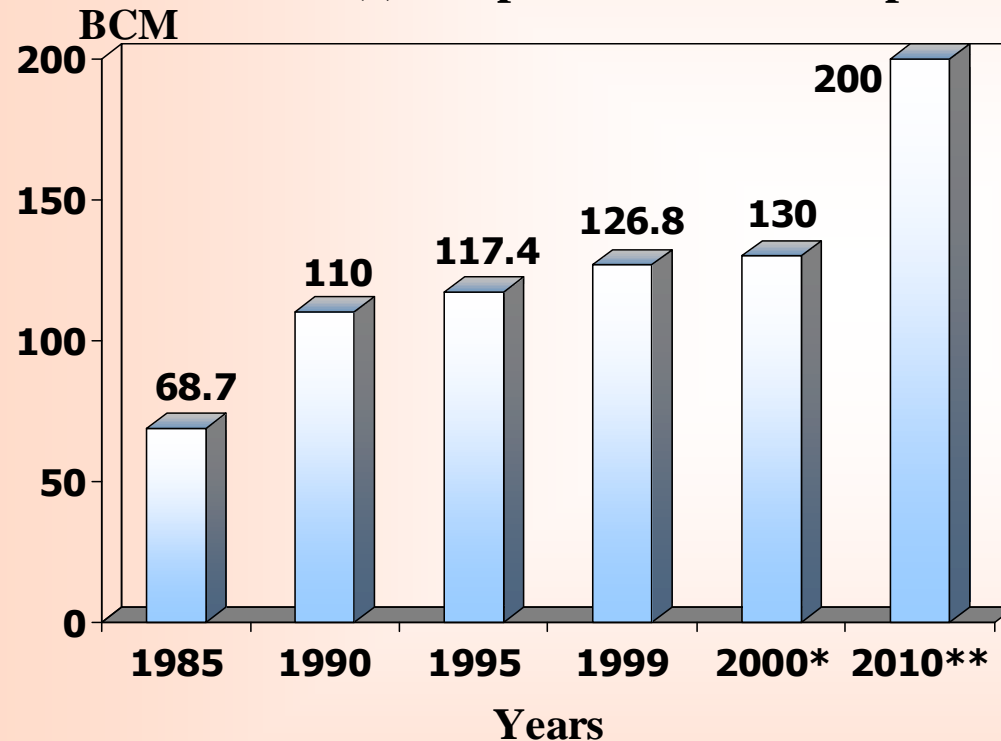
## (a) Share of Russia in gas consumption:

All Europe	>25%
Central & Eastern Europe	40%
Eastern Europe	>90%

## (b) European importers of Russian gas

- **Austria**
- Belarus
- Bulgaria
- Bosnia
- **Hungary**
- **Germany**
- **Greece**
- **Italy**
- **Latvia**
- **Lithuania**
- Macedonia
- Moldova
- **Poland**
- Romania
- **Slovakia**
- **Slovenia**
- Turkey
- Ukraine
- **Finland**
- **France**
- Croatia
- **Czech Republic**
- Switzerland
- **Estonia**
- Yugoslavia

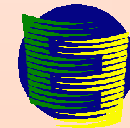
## (c) Gazprom sales in Europe



\* Estimate

\*\* Forecast

TOTAL: 25



## GAS TRANSIT ROLE FOR MAIN EXPORTERS TO EUROPE IN 1999

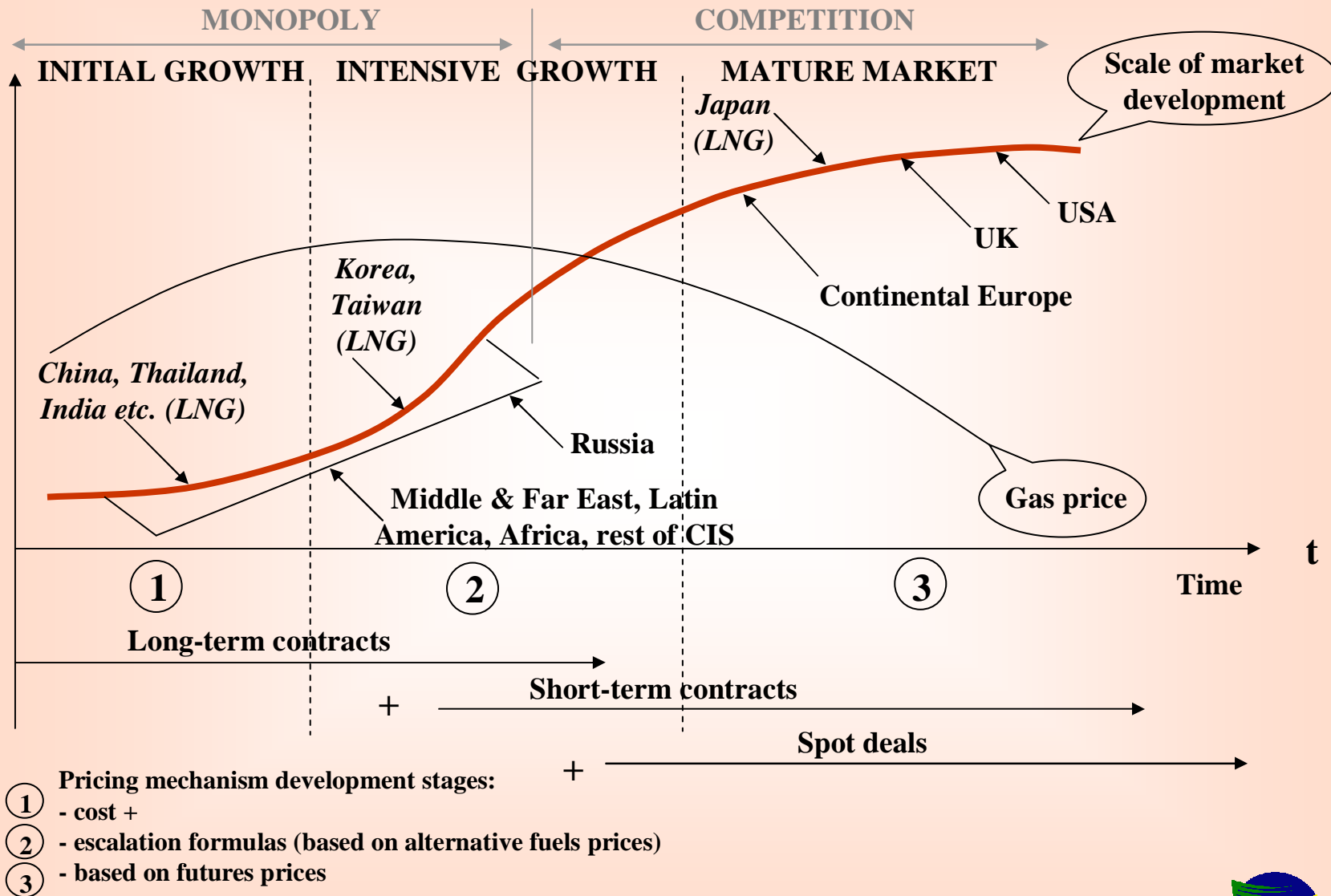
Country-exporter	Direct supplies, % of volume of exports	Transit through the territory of: % of volume of exports			
		one country	two countries	three countries	four countries
Netherlands	76,2	13,8	10,0	-	-
Norway	67,7	7,5	21,4	3,4	-
Algeria	44,9	14,8	9,6	24,3	6,4
Russia	5,4	-	8,9	67,6	18,2



Figure 3

## **2. Evolution of gas markets development, incl. long-term contracts**

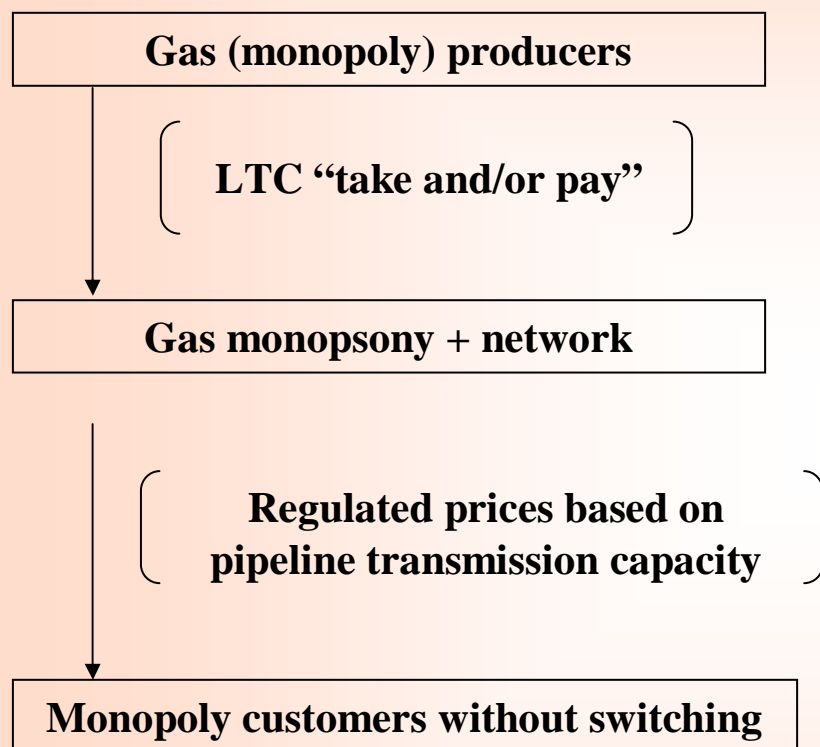
# EVOLUTION OF GAS MARKETS DEVELOPMENT





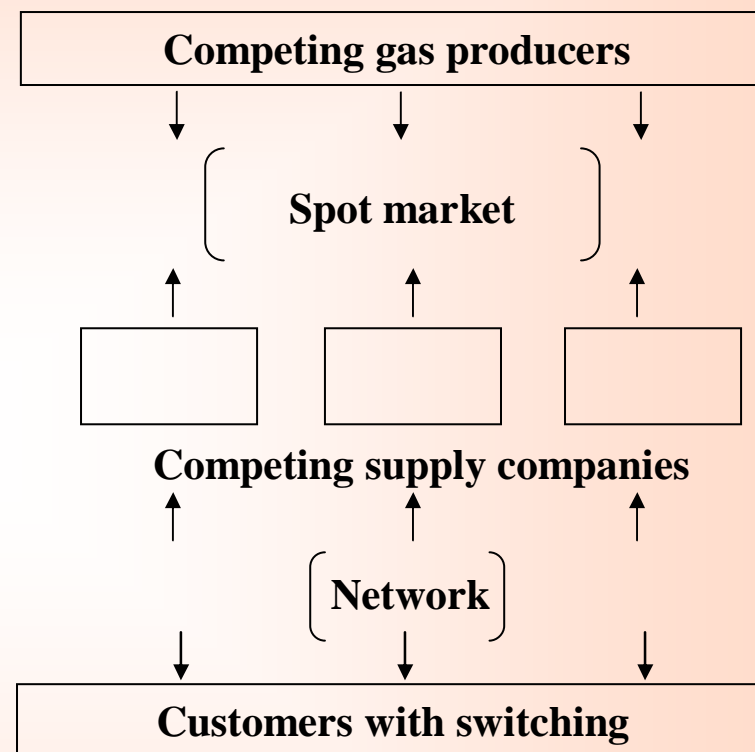
# LONG-TERM CONTRACTS AND COMPETITION IN GAS MARKETS IN EUROPE

(A) Existing organisation of the market



Supply-based consumer prices defined by monopoly producers and suppliers (pricing mechanism: cost-plus; escalation formulas)

(B) Future organisation of the market



Demand-based producer prices defined by consumers (pricing mechanism: spot + forward + futures)

Based on: D.Helm / OXERA

## **GAS: DIFFERENT PROJECTS – DIFFERENT CONTRACTS**

(1) New projects in mature regions with existing infrastructure, with available transportation capacities (usually less capital-intensive projects, relatively small to the existing market) =

(a) short-term contracts (“take and/or pay”) – for the duration of payback period (?)

(b) spot deals – when payback period is over (?):

- dated
- forward
- futures

Regions: Western, Central & Eastern Europe

(2) New projects in new regions with no/lack-of infrastructure for both production and transportation (usually more capital-intensive projects, relatively big to the existing market) =

(a) long-term “take and/or pay” contracts

Regions: Russia, CIS, Asia

# **GAS: LONG-TERM TAKE AND/OR PAY CONTRACTS (LTC TOP) AND PROJECT FINANCING RISKS**

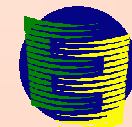
$$\text{Financing} = f(\text{revenue}) = f(\text{volume} \times \text{price})$$

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- (1) LTC TOP = mechanism of supply risks («volume» risks) reduction**
  - (2) LTC TOP + adequate pricing mechanism = mechanism of “price” risks reduction:**
    - prior to exchange pricing: escalation formulas**
    - exchange pricing: futures + hedging**
- (1) + (2) = mechanism of project financing risks reduction (long-term capital-intensive Greenfield projects, i.e. in new regions with no/lack-of production & transportation infrastructure)**
- 
- 

**LTC TOP as a mechanism of risks reduction related to investments into new (Greenfield) gas projects yet has no alternatives at the emerging energy markets**



## LONG-TERM CONTRACTS

**Item 22: “Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objectives of this Directive and are compatible with the Treaty, including competition rules.”**

**Source:**

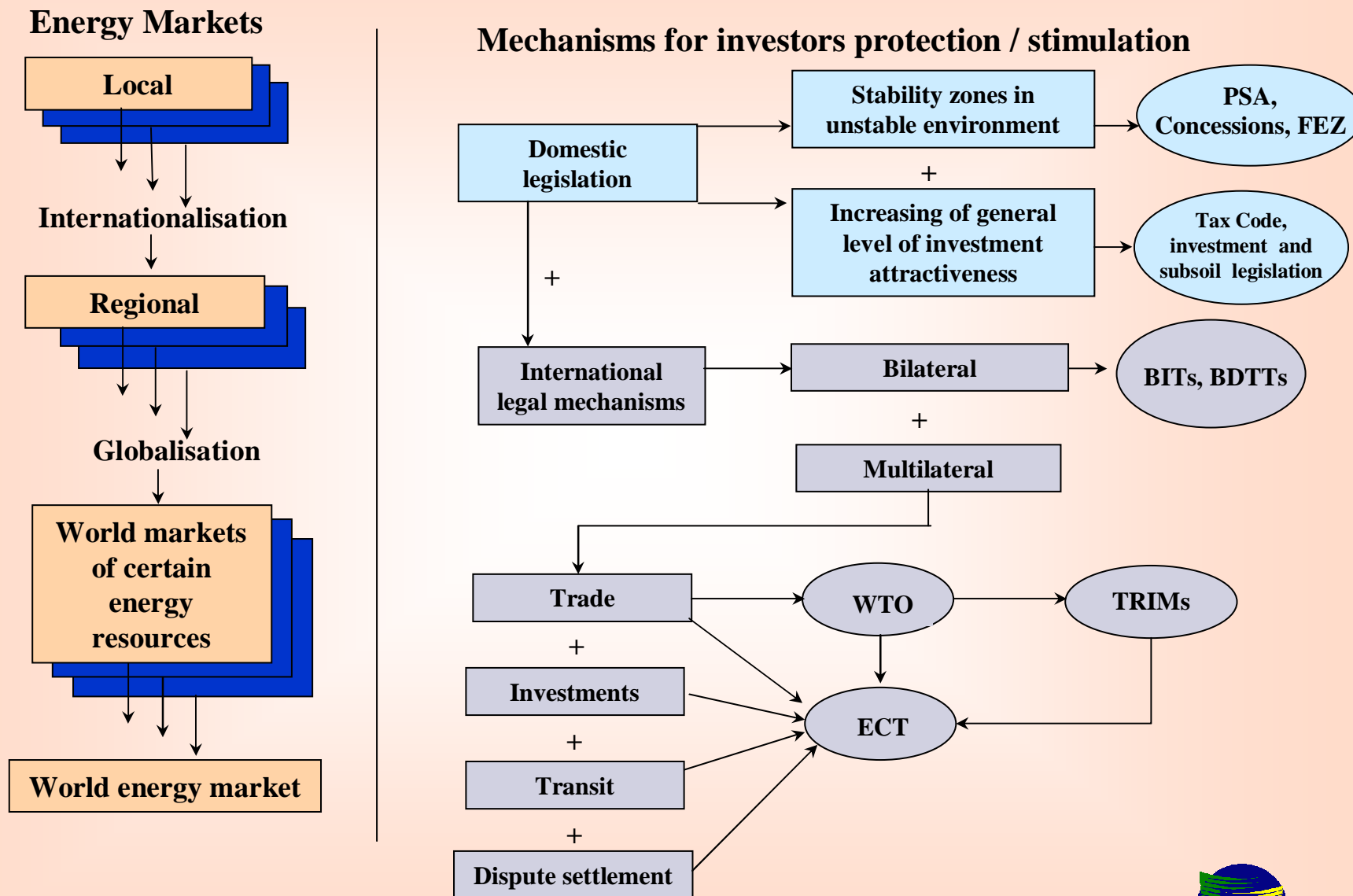
**Amended proposal for a**

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

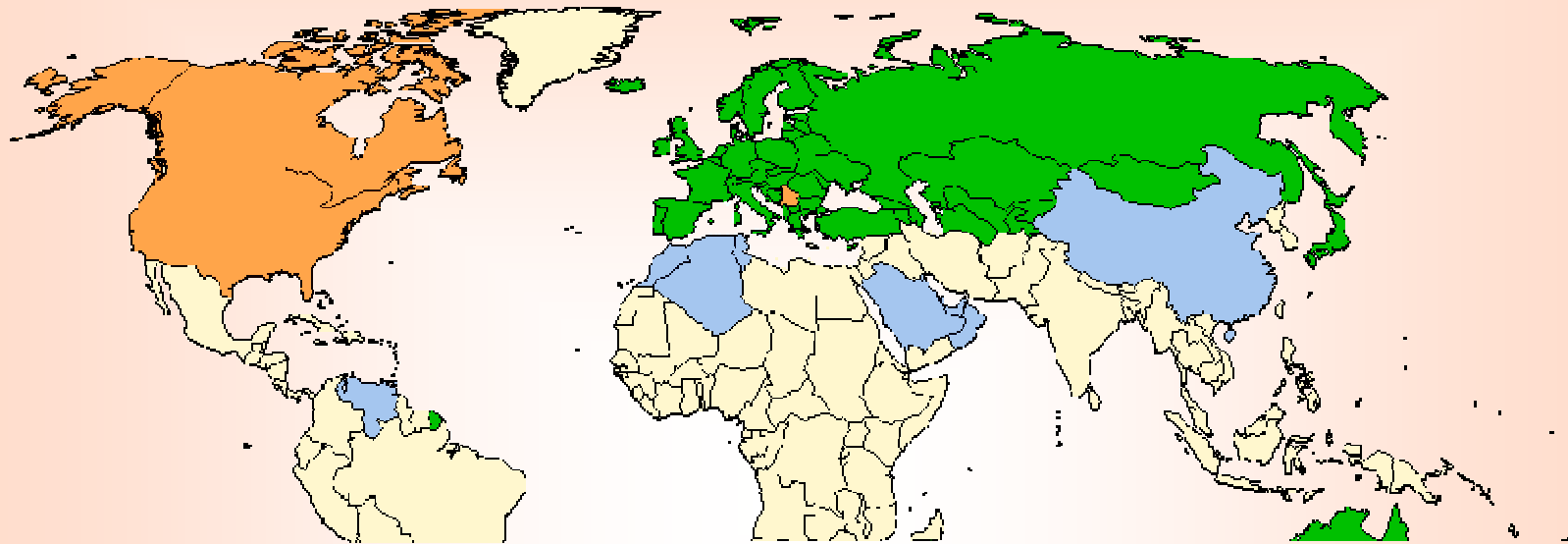
**amending Directives 96/92/EC and 98/30/EC concerning rules for the internal markets in electricity and natural gas**

### **3. Energy markets vs. investors protection, incl. ECT and WTO**

# DEVELOPMENT OF ENERGY MARKETS AND MECHANISMS FOR INVESTORS PROTECTION / STIMULATION



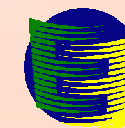
# ENERGY CHARTER TREATY: GEOGRAPHY



- Energy Charter Treaty Signatory States (1994)
- Observer States that have signed the European Energy Charter (1991)
- Other Observer States

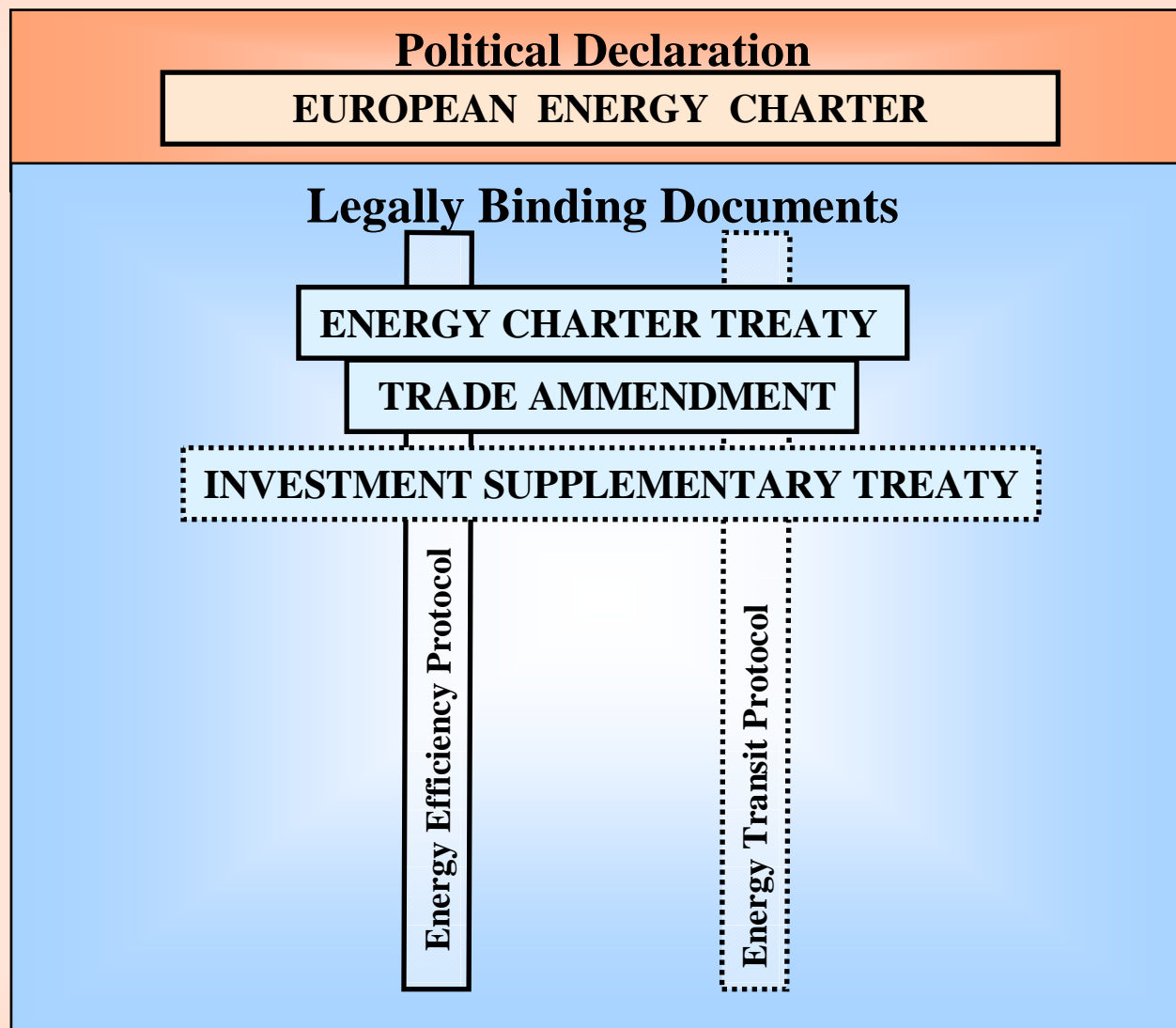
# ENERGY CHARTER HISTORY

<b>June 25, 1990</b>	<b>Lubbers' initiative presented in Dublin</b>
<b>December 17, 1991</b>	<b>European Energy Charter signed</b>
<b>December 17, 1994</b>	<b>Energy Charter Treaty (ECT) and Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) signed</b>
<b>June, 1996</b>	<b>Russia started ECT ratification process</b>
<b>April, 1998</b>	<b>ECT came into full legal power</b>
<b>January, 2001</b>	<b>RF State Duma: Russia will ratify ECT, but not yet (depending on Transit Protocol)</b>
<b>As of November 1, 2002</b>	<ul style="list-style-type: none"> <li>• <b>ECT signed by 51 states + European Communities = 52 ECT Contracting Parties</b></li> <li>• <b>ECT ratified by 46 states (excl. 5 countries: Russia, Belarus, Iceland, Australia, Norway ) + EC</b></li> <li>• <b>Russia: provisional application, together with Belarus</b></li> </ul>

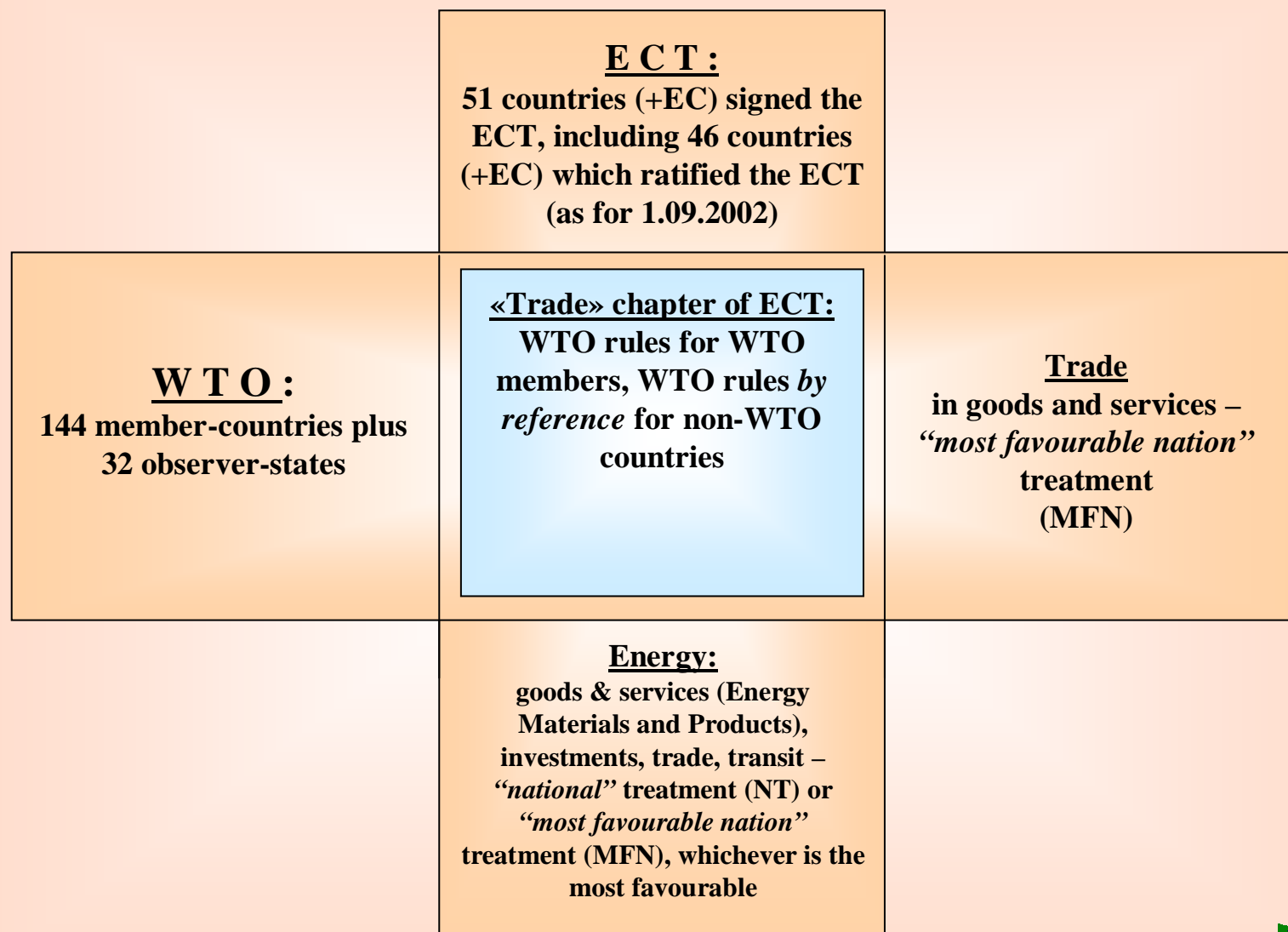




# ENERGY CHARTER AND RELATED DOCUMENTS



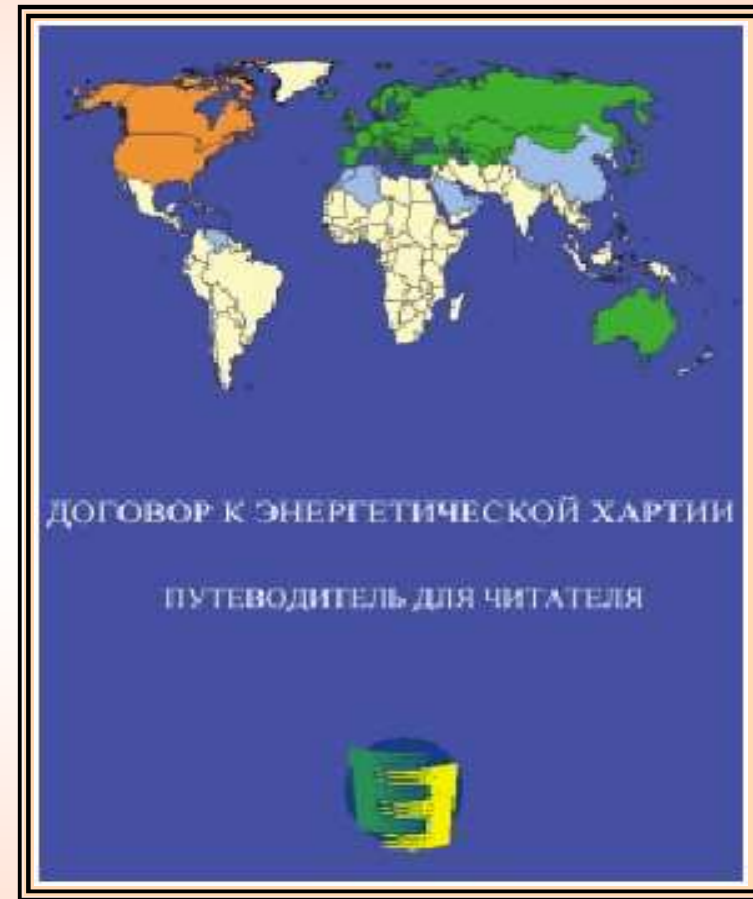
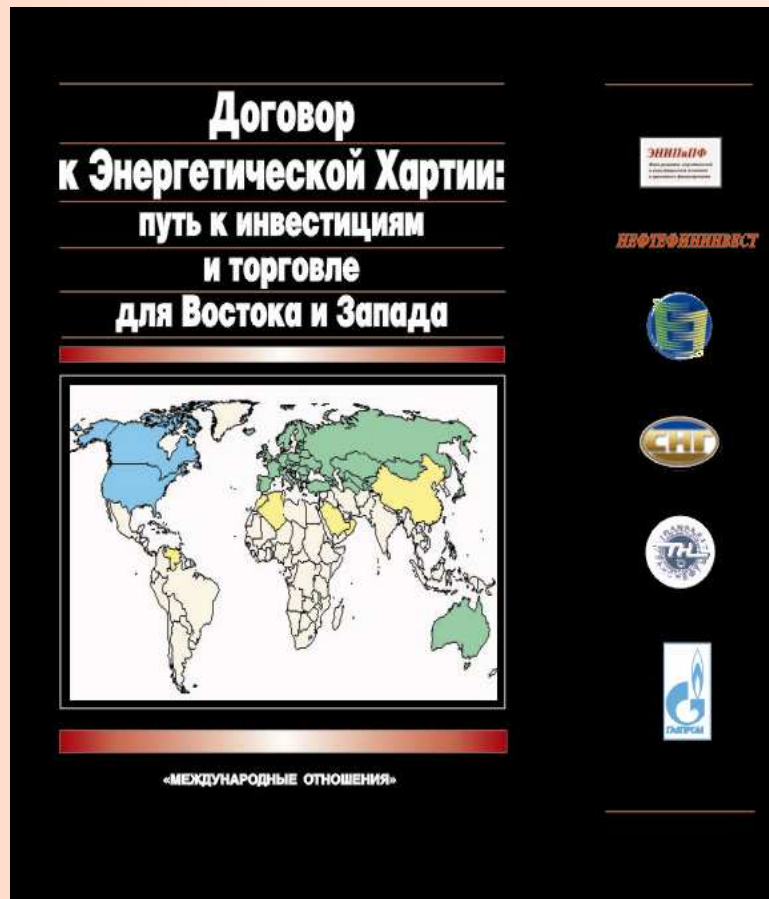
# CORRELATION BETWEEN GEOGRAPHICAL SCOPE AND ACTIVITY TARGET OF ECT AND WTO



# ECT MAJOR OPPONENTS IN RUSSIA AND THEIR ARGUMENTS

Arguments against ECT ratification	Comments
<p><b><u>Gazprom:</u></b></p> <ol style="list-style-type: none"> <li>1) ECT demands obligatory TPA to Gazprom’s pipelines for cheap gas from Central Asia</li> <li>2) Obligation to transit Central Asian gas at low (subsidised) domestic transportation tariffs</li> <li>3) ECT will “kill” LTCs</li> </ol>	<p>No such obligation. ECT excludes obligatory TPA (ECT Understanding IV.1(b)(i)).</p> <p>No such obligations (ECT Article 7(3)). Transit and transportation are different in non-EU.</p> <p>Not true. Economic niche for LTCs will become more narrow due to objective reasons, but they will continue to exist as a major instrument of financing greenfield gas projects.</p>
<p><b><u>Ministry of Nuclear:</u></b></p> <ol style="list-style-type: none"> <li>1) Bilateral RF-EU trade in nuclear materials is not regulated by ECT</li> </ol>	<p>Prior to ECT signing in 1994, RF and EU has agreed to regulate nuclear trade bilaterally (P&amp;CA).</p>

## MOST RECENT PUBLICATIONS ON ECT:



## 4. ECT Protocol on Transit: outstanding issues

## OUTSTANDING ISSUES RELATED TO TRANSIT OF ENERGY (prior to TWG 24-25 October 2002)

<p><b>1. Available capacity</b></p> <p><b>2. Environment</b></p> <p><b>3. Geographical scope</b></p> <p><b>4. Conciliation of transit disputes</b></p>	<p style="text-align: center;"><b>Solved in substance</b></p>
<p><b>5. <i>Transit tariffs</i></b></p> <p><b>6. <i>Right of first refusal</i></b></p>	<p style="text-align: center;"><b>Russia – EU trade-off is possible</b></p>
<p><b>7. <i>REIO clause</i></b></p>	<p style="text-align: center;"><b>Major unsolved issue. Subject for bilateral consultations, in particular Russia – EU</b></p>

**Negotiations on Transit Protocol: under way since 2000, to be finished (successfully or not) at December 2002 Energy Charter Conference**

# OUTSTANDING ISSUES RELATED TO TRANSIT OF ENERGY

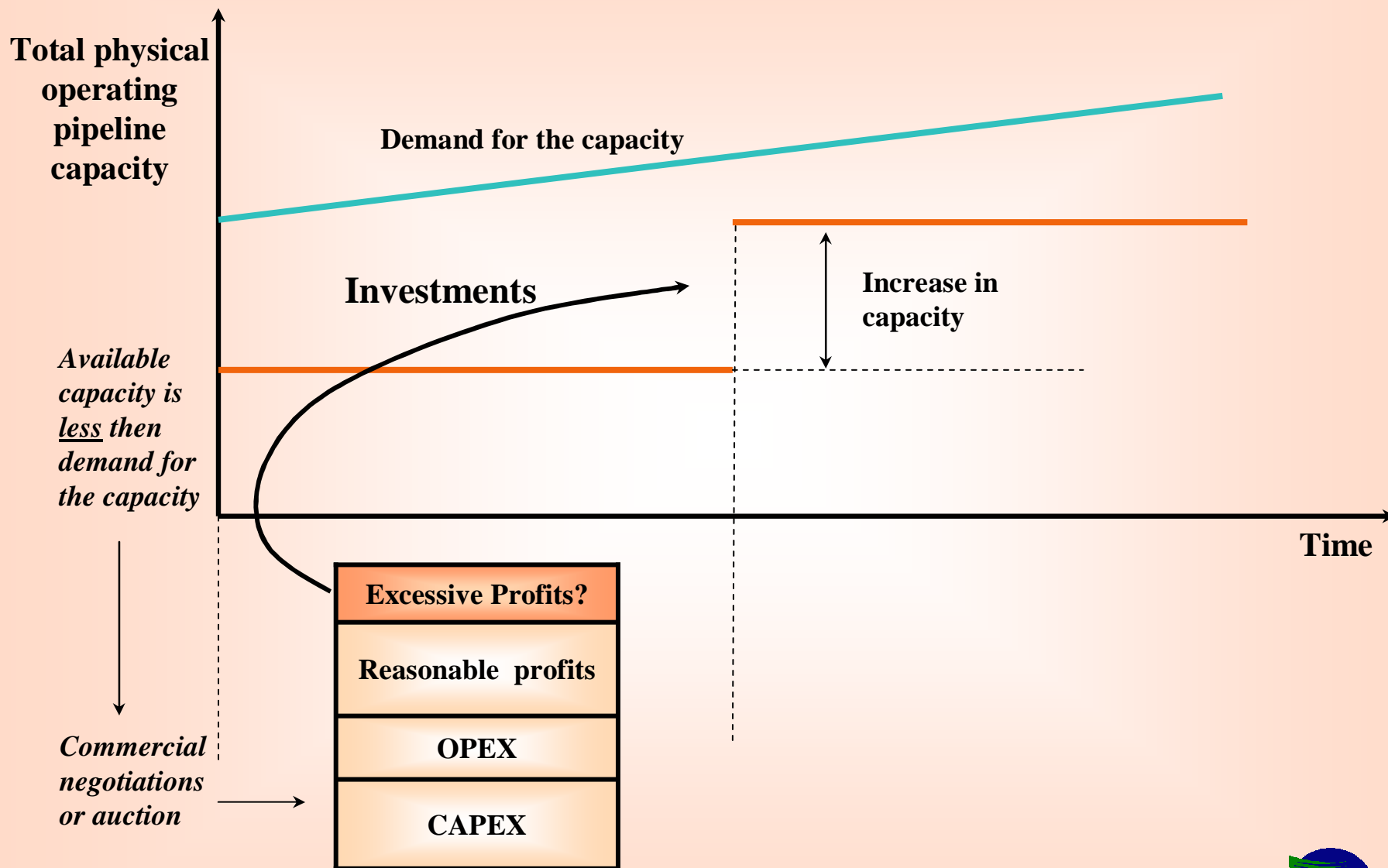
(after TWG 24-25 October 2002)

<p><b>1. Available capacity</b></p> <p><b>2. Environment</b></p> <p><b>3. Geographical scope</b></p> <p><b>4. Conciliation of transit disputes</b></p> <p><b>5. Transit tariffs</b></p>	<p><b>Solved in substance</b></p>
<p><b>6. <i>Right of first refusal</i></b></p> <p><b>7. <i>REIO clause</i></b></p>	<p><b>Subject for bilateral consultations, in particular Russia – EU.</b></p> <p><b>Russia – EU trade-off is possible</b></p>

**Negotiations on Transit Protocol: under way since 2000, to be finished (successfully or not) at December 2002 Energy Charter Conference**

**Russia has packaged: TT + RFR + AC**

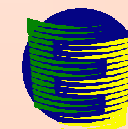
# TRANSIT TARIFFS (EU PROPOSAL)



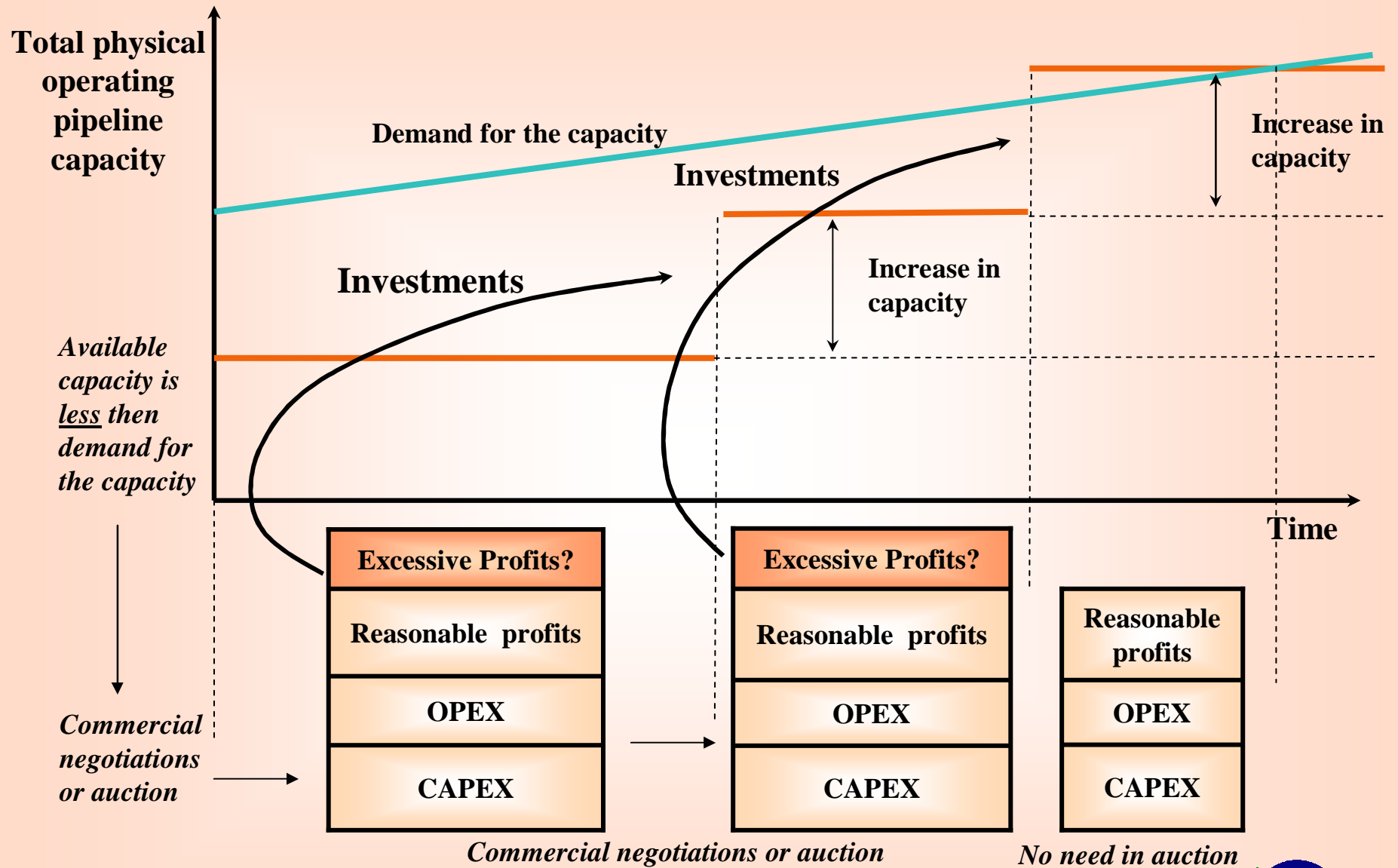


# TRANSIT TARIFFS (EU PROPOSAL, continued)

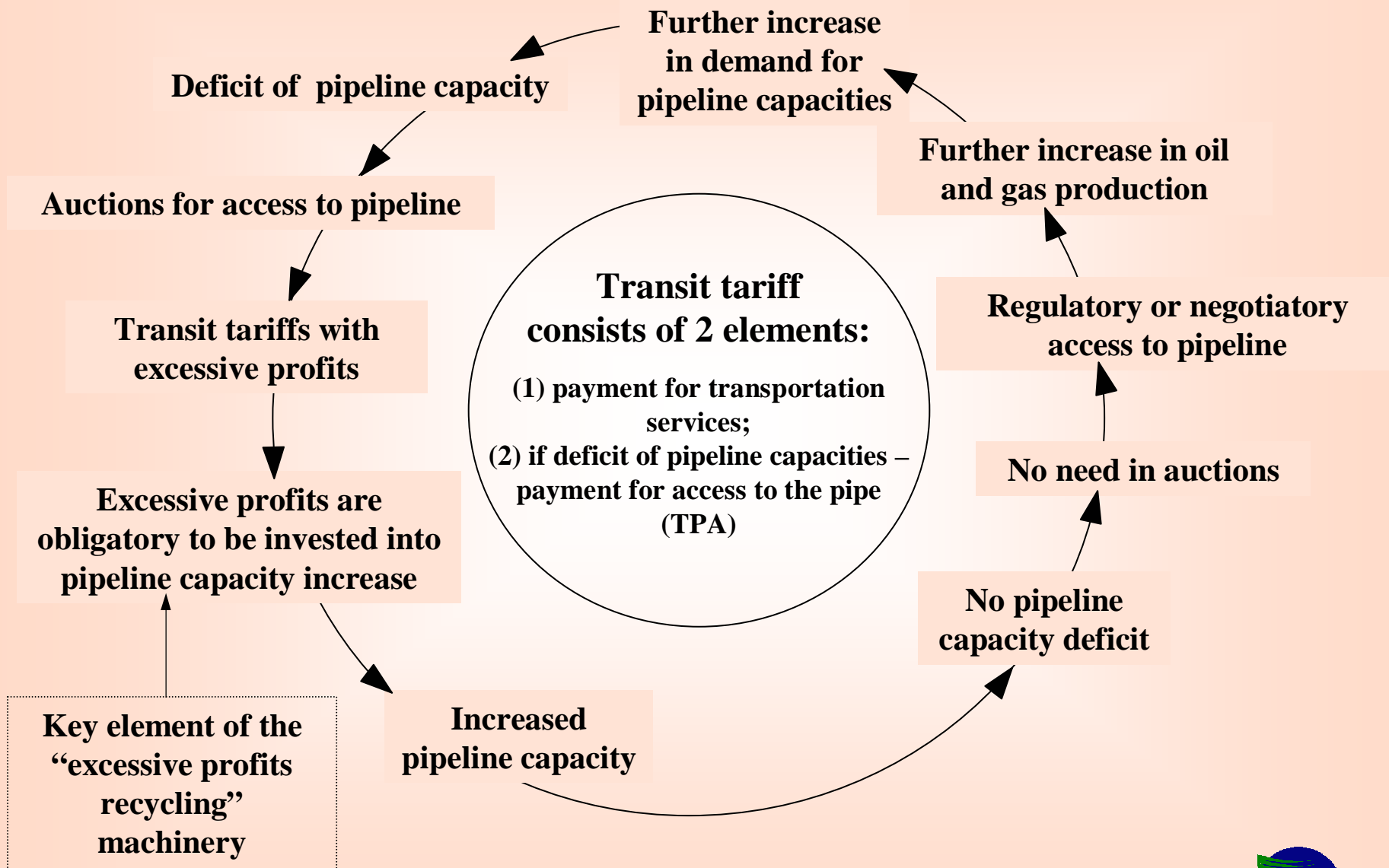
Time



# TRANSIT TARIFFS (EU PROPOSAL, continued)

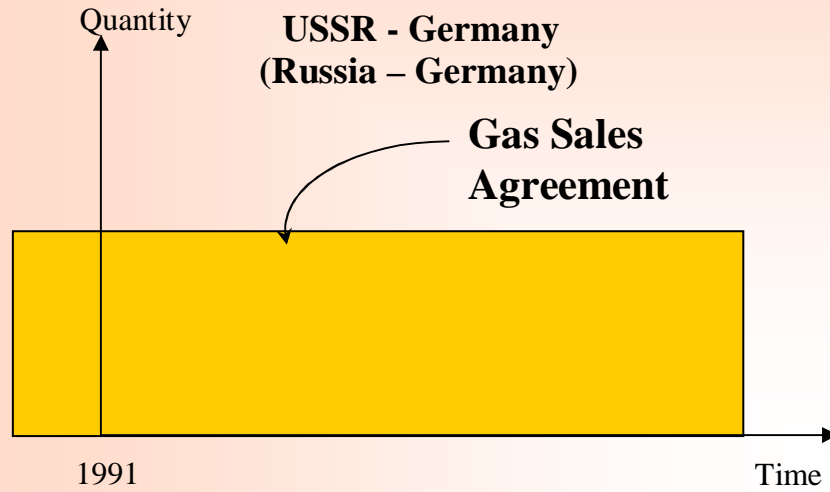


# TRANSIT TARIFFS AND AUCTIONS: “EXCESSIVE PROFITS RECYCLING” MACHINERY (EU PROPOSAL)

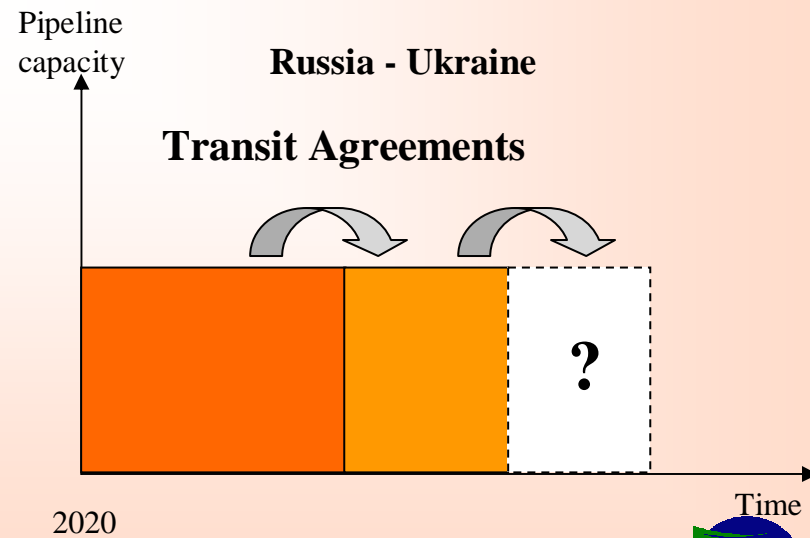
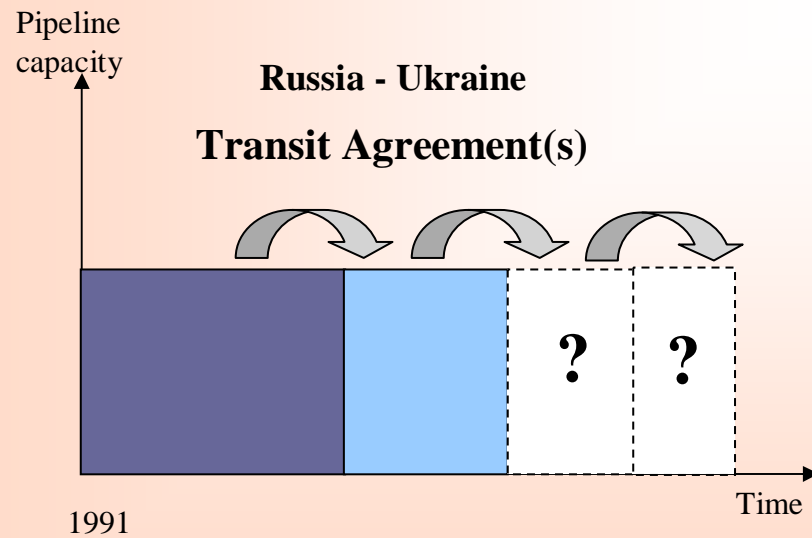
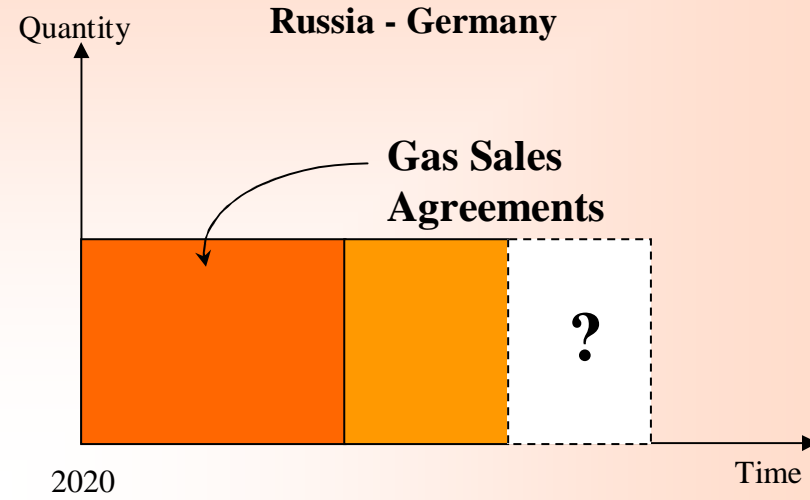


# RIGHT OF FIRST REFUSAL

**Currently**

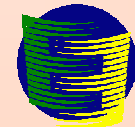


**In the future**

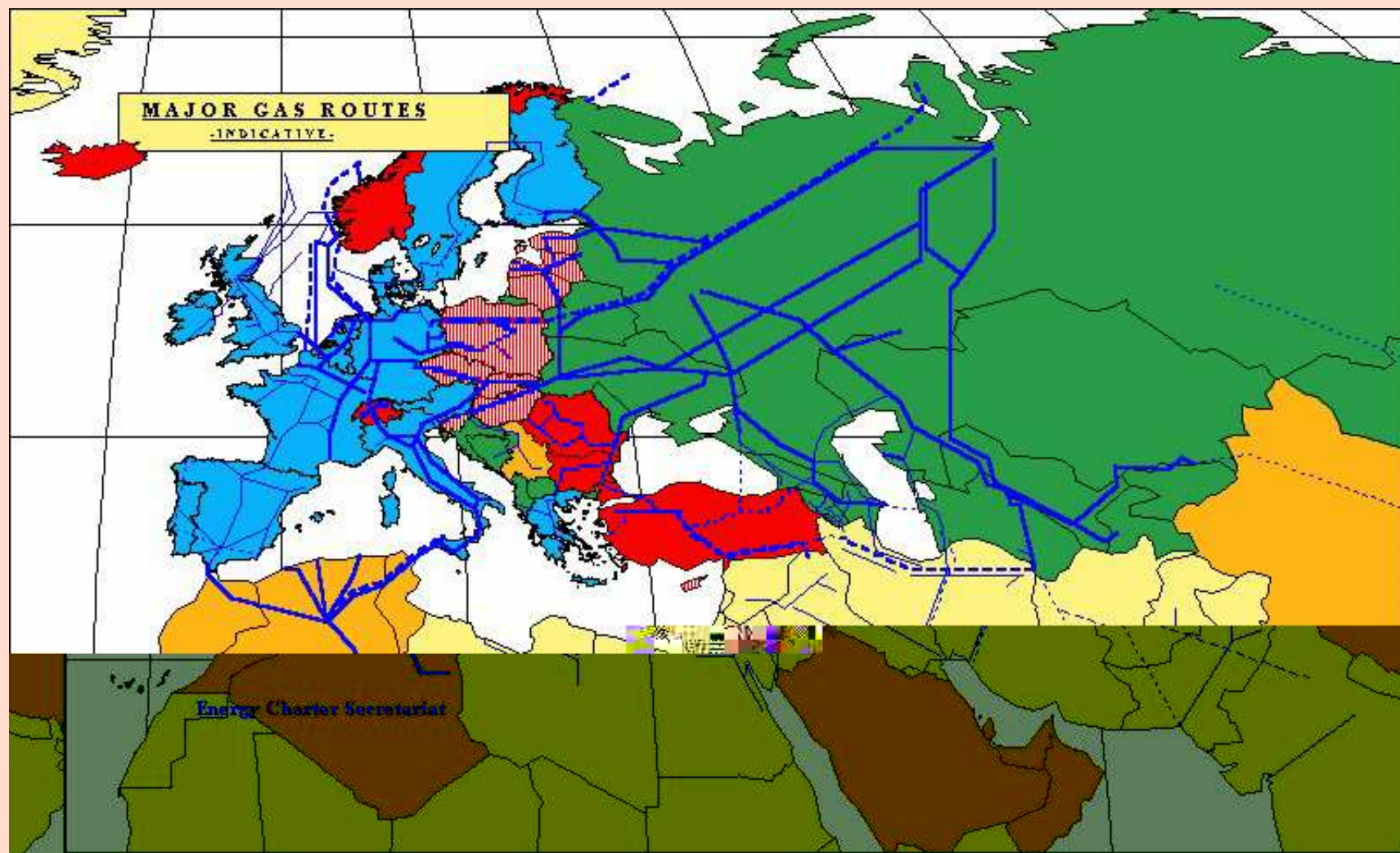


## **TRANSIT TARIFFS (IF NO AUCTIONS) VS. RIGHT OF FIRST REFUSAL**

**Abandonment of the auctions system for establishing Transit Tariffs means that a certain transit operator has no other mechanism, with open and transparent procedure, for selecting a transit shipper except the Right of First Refusal**

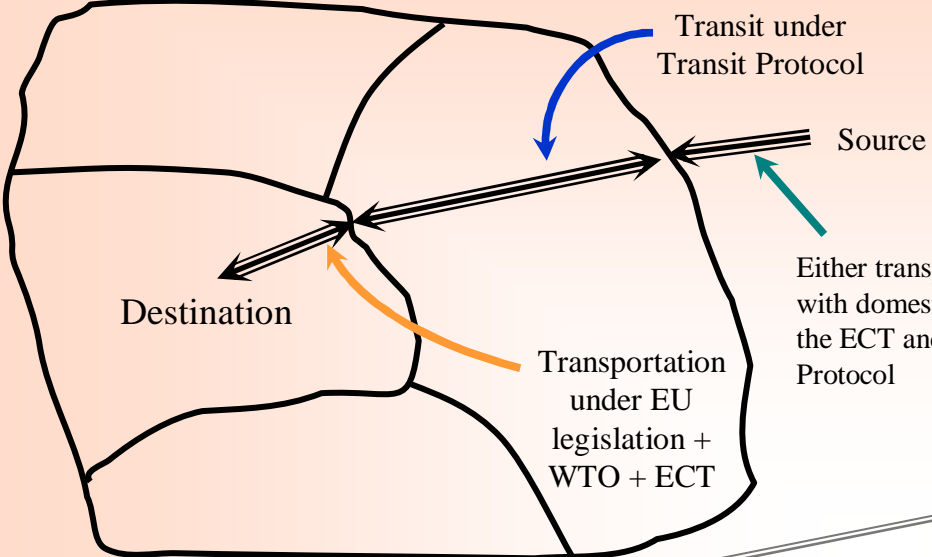


# REIO CLAUSE: GEOGRAPHICAL ASPECTS



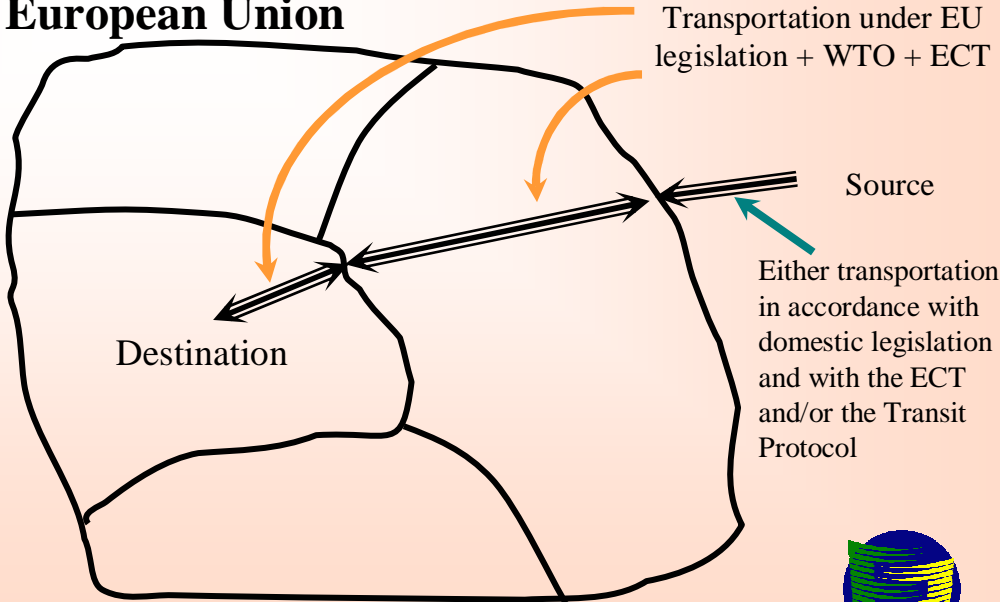
# REIO CLAUSE: LEGAL ASPECTS

## European Union

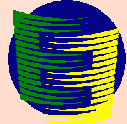


### (a) Before REIO:

## European Union



### (b) After REIO:

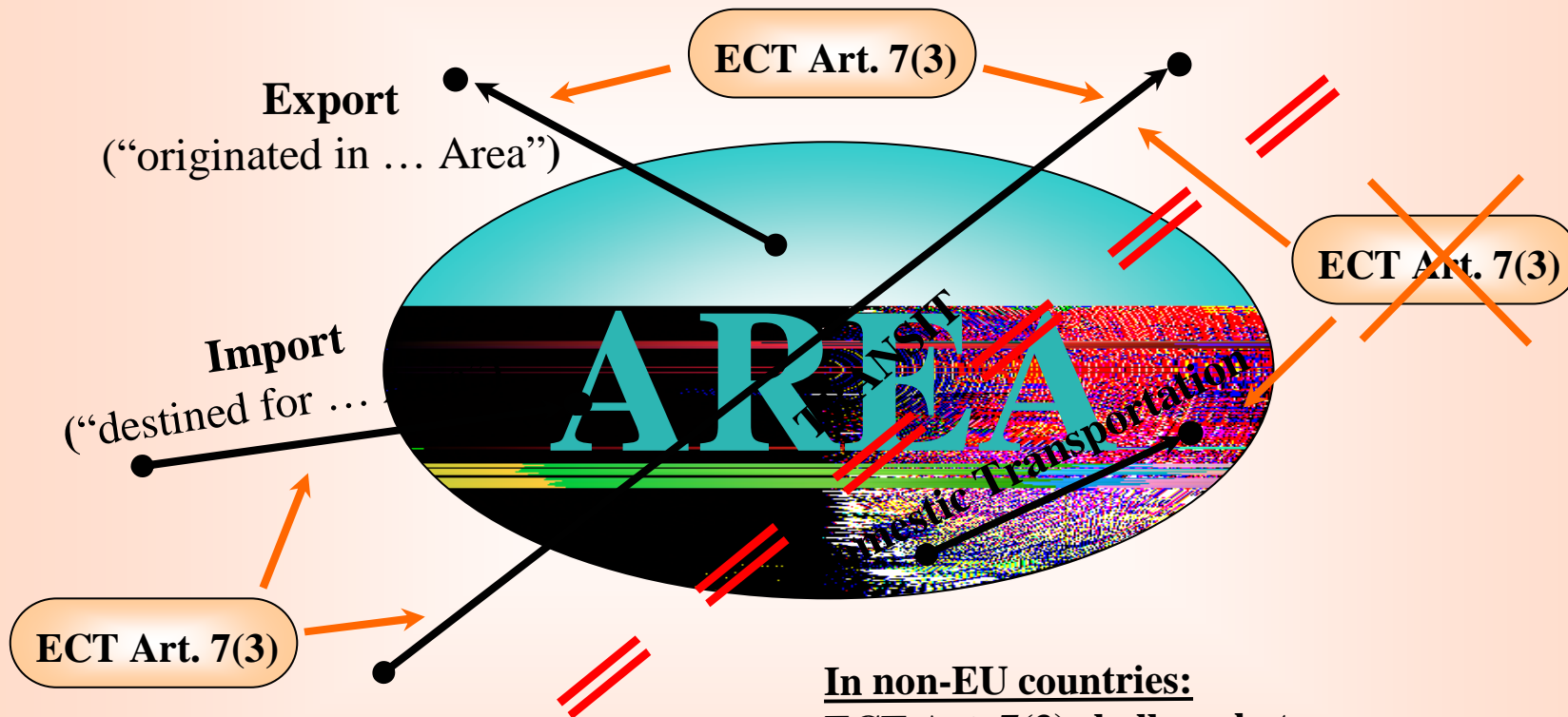




# ARE THERE ANY BENEFITS FOR RUSSIA IN REIO CLAUSE?

## ECT Article 7(3):

“Each Contracting Party ... shall treat Energy Materials and Products in Transit in no less favourable manner than its provisions treat such materials and products originating in or destined for its own Area ...”



In EU countries (with or without REIO):  
ECT Art. 7(3) shall apply to all means of transportation (free movement of goods)

### In non-EU countries:

ECT Art. 7(3) shall apply to:

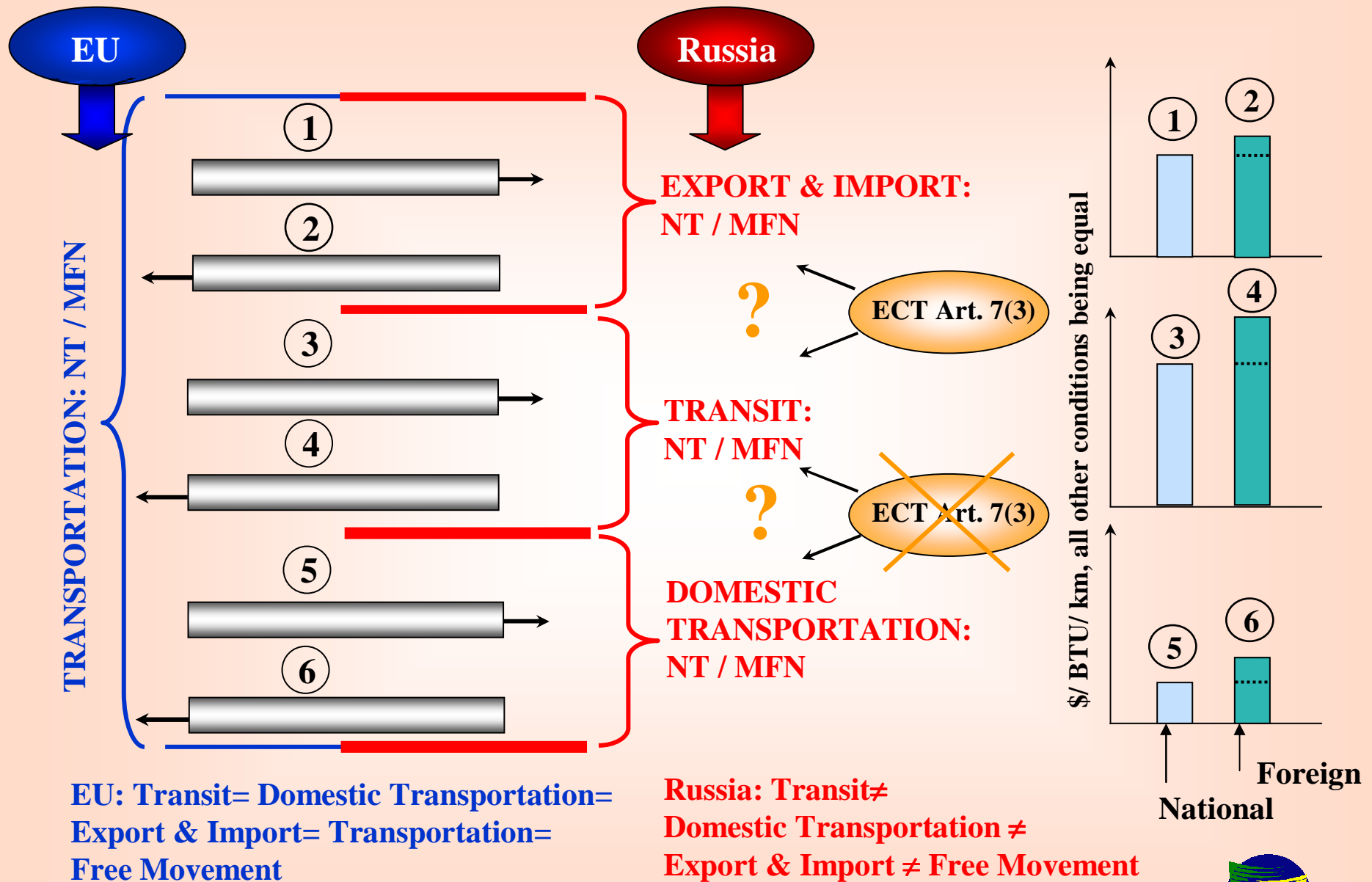
- transit vs. export / import

ECT Art. 7(3) shall NOT (?) apply to:

- transit vs. domestic transportation



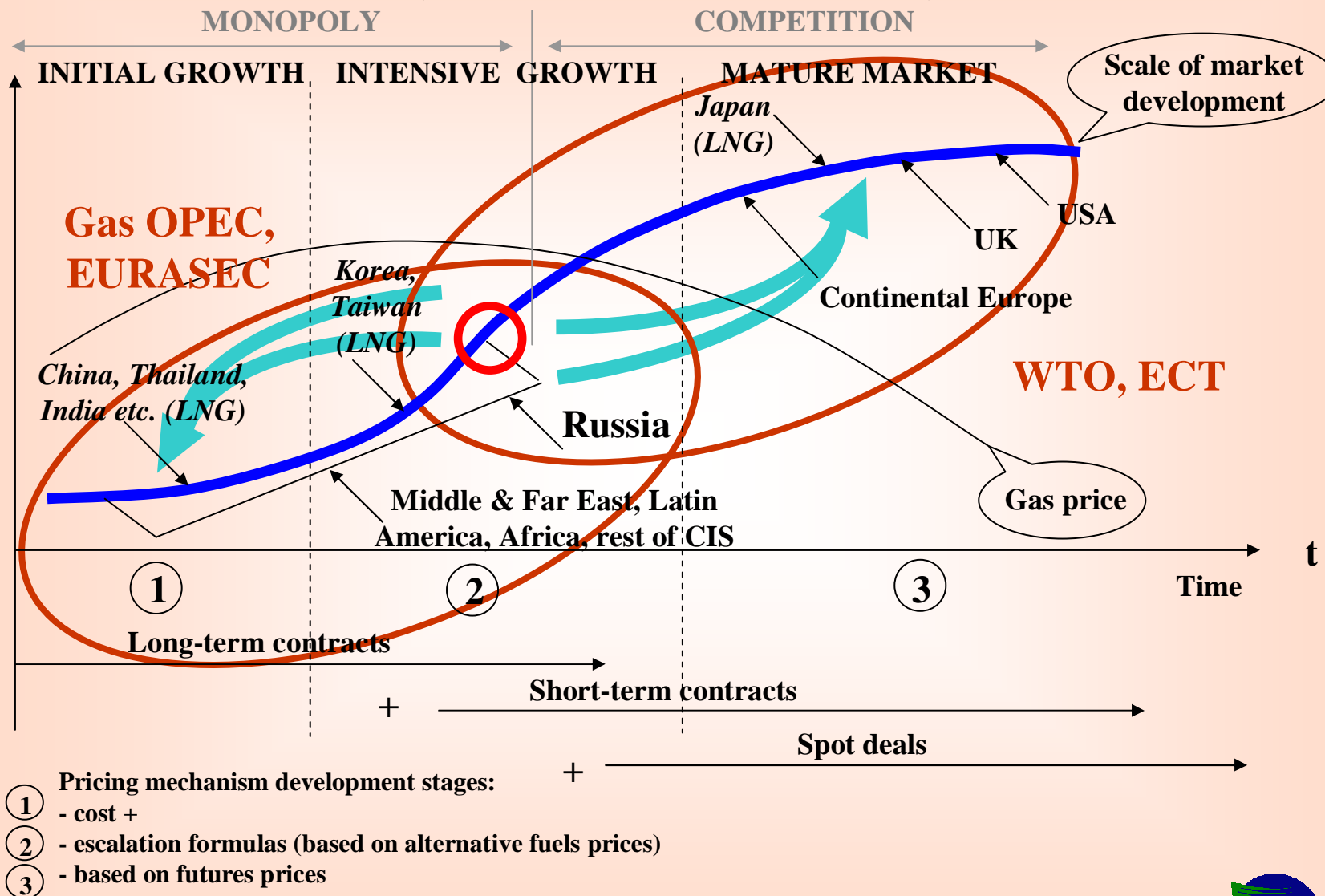
# REIO CLAUSE: TRANSIT VS. TRANSPORTATION (EU/non-EU)



# 5. Final remarks

# EVOLUTION OF GAS MARKETS DEVELOPMENT – 2

## (With whom is Mr Putin?)



# ECT & LEGISLATIVE PRIORITIES OF PRESIDENT PUTIN

