

Andrei A. Konoplyanik: Brief Abstract on the main statements

**Alpbach 2009 Economic Symposium - Working Group:
The future of security of supply – how does the ‘gas crisis’ affect European energy policy? (Wednesday, 2 September 2009)**

Proposed topic for Konoplyanik:

What structural, political and economic conditions does Russia consider necessary to secure Europe’s supply with Russian gas in the future? The Russian view on the January 2009 crisis.

Brief Abstract on the main statements:

January 2009 crisis is another result of continuing long and painful transition from political prices and pricing within the FSU area to contractually unbundled transit supplies through and export supplies to Ukraine, to differing market-based pricing mechanisms on exported gas to Ukraine (from politically-motivated “cost-plus” to market-based “net-back replacement value” pricing) and transit tariff-setting methodologies for transit of gas through Ukraine (from politically-motivated artificial transit tariffs, calculated to balance physical deliveries of exported Russian gas to Ukraine, on the one hand, by fees for transit of Russian gas to Europe through Ukraine, on the other hand, to market-based payment for actual work on providing transit services on the cost-plus basis (“CAPEX + OPEX + reasonable rate of return” according to draft Energy Charter Protocol on Transit).

Under existing Russian long-term gas export contracts (LTGECs) with the EU companies, obligation to deliver gas to the delivery points (the latter nowadays located deep within the EU area) is on the supplier/exporter (on Russia/Gazprom). But the January 2009 events has proved that Ukraine is incapable to deliver transit volumes to the EU in case of (contractually/legally proven!) diminished/stopped Russian export supplies to the Ukraine due to the specific architecture of Ukraine gas transportation and underground gas storage infrastructure (result of technological decisions of the USSR times). Transit is a multiple (at least a trilateral) task, thus to secure stable supplies of Russian gas to Europe through transit states – trilateral economic cooperation of the parties is needed as the best and balanced legal and economic solution. Among other options is the Russia-Ukraine-EU trilateral consortium on project development of technologically and contractually separated transit infrastructure of Russian gas deliveries to the EU through Ukraine. Proposed consortium will not own (this is prohibited by Ukrainian law) but will develop and operate such infrastructure. Proposed project structure: blocking packages for Russia/Gazprom (resource-owner and gas supplier) and for Ukraine/Naftogaz (owner of infrastructure), the balance is for group of major EU gas-importing companies and financial institutions (EIB, EBRD, etc.)

Stable and predictable gas supplies are the result of long-term and capital-intensive

upstream investments. To minimize investment risks and to stimulate such upstream investments, predictability of demand is needed. This desire cooperation and transparency

between the producer and consumer states on medium- and long-term forecasting both of gas demand in the EU as well as of (backed up by the) investment programmes in gas production and in internal gas demand in Russia. This means: from competition between the EU-oriented external suppliers of pipeline gas (since pipeline gas supplies provides the lowest flexibility) to long-term cooperation between gas producers and consumers. Competitive gas pricing mechanisms for Continental Europe based not on commodities pricing at the gas hubs/exchanges (not yet developed, churn lower than competitive edge of 15), but on continuously and slowly adapting pricing formulas within LTGECs with other more flexible elements of LTGECs contractual structure.

The EU need to move in its political thinking from the political aim “to increase non-Russian gas supplies” to economic aim “to increase competitive incremental gas supplies for Europe”. To develop “political” alternative of “non-Russian” gas supplies is a non-productive economic strategy, especially if such alternative intended supplies are not backed up by adequate & available proved reserves/booked production volumes/shipping contracts. Such “political” alternative would be rather difficult (if at all possible) to economically justify, to prove its project financing, and much more costly to realize/implement.