

**24rd round of Informal Russia-EU Consultations on EU Regulatory Topics
&
17th meeting of the EU-Russia Gas Advisory Council's
Work Stream on Internal Market Issues (WS2 GAC)**

30 November 2015

**E-Control
(Rudolfsplatz 13A, A-1010 Vienna, Austria)**

MINUTES

The agenda is attached to the minutes.

1. Greetings / Open remarks by Co-Chairmen

Co-Chairs Mr. Boltz (WS2 GAC), Mr. Medvedev (Consultations) and Mr. Konoplyanik (WS2 GAC) welcomed the participants. Mr. Konoplyanik highlighted the importance of this work stream and called for holding WS2 meetings more frequently.

2. The future of LT supply contracts and pricing of Russian gas in Europe

Mr. Komlev gave a presentation outlining Gazprom's view on pipeline long term supply contracts (LTSCs) in the "new world" of European natural gas by focusing on the current state of the European gas market and the adjustments which should be made. Mr. Komlev stated, that currently, the European natural gas market has to be considered as a hybrid with oil indexation being a dominant form of pricing for imported volumes, and gas-on-gas competition its subordinate form. He pointed out that oil indexation is an extremely efficient way of pricing. Furthermore, he noted that Europe exercises soft power to change the current pricing paradigm and that the European Commission and regulators push for imposing hub pricing to be the new standard. Due to this development in the pricing model a new design for pipeline gas LTSCs is required.

Mr. Komlev presented Gazprom's view on how existing LTSCs could be retrofitted in order to balance the interest of both seller and buyer, and presented three new gas-indexed pipeline Gas LTSCs prototypes:

- Hub indexed LNG export contracts with redirection option.
- Downstream short-term hub-indexed contracts in the USA and the UK, with limited flexibility compared to "Groningen" LTSCs.
- Norwegian hub-indexed flat supply contracts with a 100% take-or-pay clause.

Mr. Komlev considered the last prototype as the closest proxy for the new type of LTSCs.

Bearing this in mind, three main adjustments to the structure of LTSCs should be made in order to balance the interests of both parties involved, according to Mr. Komlev:

- 1) Volumetric fine-tuning
- 2) Restructuring of buyers' nomination rights to have fair risk sharing
- 3) Revision of the price review clauses

Mr. Komlev concluded that the developments with regard to the pricing paradigm require a profound redesign of the "Groningen" type LTSCs. He pointed out that efficiency of the price review mechanisms in place in the current LT contracts is not sufficient enough to upgrade existing contracts to the "new world" challenges. Ignoring suppliers' interests will have destructive impact on the EU energy security, according to Mr. Komlev.

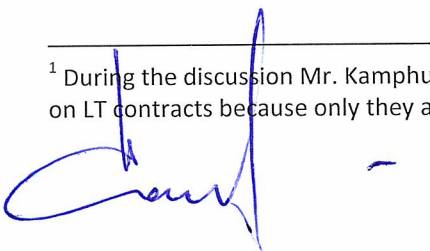
Mr. Boltz pointed out that Europe does not consider LTSCs as a problem per se, but rather the exclusivity rights which are implied, and the high amount of existing LTSCs with such right create the problem. As this is, in his view, not compatible with the idea of the internal market, the old structure of LTSCs is no longer valid. According to Mr. Boltz a certain share of LTSCs is in the interest of Europe. However, the share of LTSC which has existed in the past has to be reduced in order to allow a certain amount of flexibility. He further highlighted the problem, that the natural gas price is still linked to oil. As gas is no longer competing with oil, but rather with renewables and coal, this price indexation does not reflect reality any longer, in his view. Mr. Boltz said that oil is not competing to gas in the Western Europe. He further highlighted that pricing gas to oil can create disadvantages to customers in the long perspective as indexing gas to commodity which has limited competition is not correct in his view. Then he added that EU would prefer to have a smaller share of LT contracts indexed to oil while the bigger share of contracts would be indexed to the other commodity which is more competitive. Then he also added that there are still discussions and doubts whether it is correct to index prices to 1 single hub or create a cumulative index composed of different hubs.

According to Mr Boltz the main task is to find a new balance of different interests of buyers and sellers. Buyers need stability of contract terms, prefer indexation clauses which are close to market developments and favour protection for undue contract terms which grants an option for ad hoc decisions of sellers. On the other hand, sellers have an interest in long-term agreements to justify their upstream investment decisions and prefer indexation clauses which are predictable and close to liquid markets.

Mr. Borchardt agreed with Mr. Boltz, stating that LTSCs are not disapproved per se as a certain amount of LTSCs contributes to security of supply. However, he stated that the current volumes of LTSCs and the price formula foreclose the market and hinder the development of the internal market. Mr Borchardt also agreed with Mr. Boltz on the discontinuation of oil price indexation. With regard to the pricing formula, the European Commission would prefer to take as reference value the average price of all hub prices rather than the price of one individual hub.

He further pointed out the gap between contracted and imported volumes which has to be considered as a problem for suppliers. Both Mr Borchardt and Mr. Kamphues¹ raised concerns regarding the different existing forecasts for gas demand for Europe and which impact they might have.

¹ During the discussion Mr. Kamphues also highlighted that the construction of infrastructure has to be based on LT contracts because only they allow to obtain a bank guarantee.


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According to Mr. Borchardt the main challenge will be to develop a framework which best captures the new development.

Mr. Konoplyanik concluded that there seemed to be an agreement among participants, that LTSCs per se are not the problem. The question is how best effectively to adapt them to new realities, to new emerging architecture of the EU gas market for the mutual benefit of both suppliers and consumers thus taking in due consideration justified economic interests of both parties. Both Mr. Boltz and Mr. Konoplyanik agreed that the discussion should be continued in the next meetings; however, pointing out that discussions should only cover fundamental and general issues leaving commercial decisions for particular market players. The objective is to continue gaining a common understanding of the views by both sides to narrow the gap of possible misunderstandings and different interpretations of the issues.

3. Legacy capacity contracts and why reverse flow on pipelines with these contracts is seen as a problem, and what could be done about it

(i) The view of EU/NRAs

In his presentation Mr. Boltz talked about the need to convert transportation contracts from the Point-to-Point system to the Entry-Exit system. He highlighted that the existence of Entry-Exit and contract path is in contradiction with Regulation 715/2009, which is why all transport contracts have to be adapted and transferred into the Entry-Exit System. The legitimate rights of shippers should remain in place after the conversion. He underlined however, that the exclusive usage of gas pipeline is no longer possible so that market foreclosure can be avoided. This would imply the obligatory booking for reverse flow and a "use-it-or-lose-it" (UIOLI) clause.

As examples Mr. Boltz mentioned that legacy contracts between Eustream and Gazprom are in place, where specific rights, not in line with the requirements of the 3rd Energy Package, have been granted to Gazprom. Mr. Boltz also stated that similar agreements are in place in Bulgaria and Poland. The legacy transportation contracts guarantee rights to carry out activities which in EU member states are exclusive part of the TSO duties (e.g. matching).

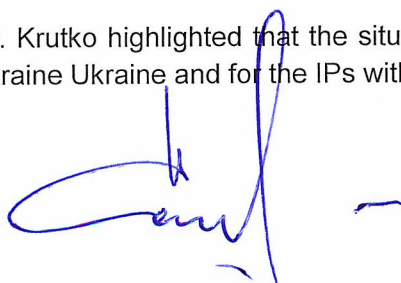
Mr. Borchardt pointed out the need to differentiate between different situations:

- In Slovakia, Poland, Romania legacy contracts are in place between European TSOs and non-EU shipper.
- In Hungary no legacy contract is in place, that's why it was easier to conclude an interconnection agreement between a European TSO and Ukrtransgaz.
- Between Greece and Bulgaria the TSOs are currently working on an interconnection agreement.

The main challenge will be to find a neutral solution, taking into account the interest of shippers, said Mr. Borchardt.

(ii) The view of Gazprom export

Mr. Krutko highlighted that the situation is quite different for the IPs at the EU borders including Ukraine and for the IPs within the EU.



As far as the IPs within the EU are concerned, Mr Krutko underlined that Gazprom is aware of new network codes and methodologies, is not against the process of EU market integration, but needs legal and commercial comfort that the obligations on both sides are fulfilled. Gazprom has never been delaying or blocking the process of system adaptation, on the contrary has always been very constructive and cooperative with the European TSOs in this respect. Mr Krutko highlighted that Gazprom export has contracts in place that allow for efficient transportation. He underlined the need to take into account these existing transport contracts while implementing new regulatory rules. With regard to the system costs, Mr. Krutko outlined that these have to be borne by all shippers involved in the system and therefore called for a transparent methodology which guarantees fair cost allocation.

There are a number of other issues to be addressed in this regard – including but not limited to metering, determination of quantities, balancing, responsibility for the loss of gas, gas quality. With regard to gas quality issues Mr. Kovacs has outlined that the TSOs should take on all the responsibility for gas quality in the transmission systems. Mr Krutko welcomed this approach.

With regard to IPs with Ukraine, the problem of legal and commercial comfort is even more of an issue. Gazprom has a contract in place with Naftogaz Ukraine and not with Ukrtransgaz. The contract in place guarantees Gazprom the possibility to verify gas quality and quantity at the entry-exit interconnection points. Mr Krutko stated that Gazprom bears responsibilities towards its clients, responsibilities which it might not be able to fulfil in case Gazprom is deprived from its right to verify the gas quality and quantity at the entry/exit IPs, as well as the measurement accuracy. Therefore Gazprom is convinced that it is crucial to preserve the existing contractual structure in order to maintain the required balance of commercial and legal interests.

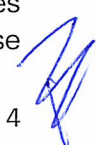
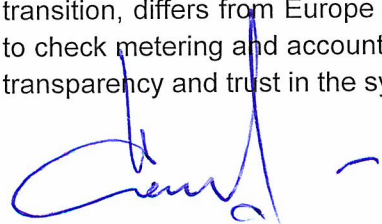
Referring to European legislation, Mr. Borchardt made it clear that within the EU shippers cannot control and operate infrastructure. He further stated that the operation of the infrastructure, including the metering activities, are the core responsibilities of TSOs and highlighted that TSOs are under obligation to work only with other TSOs and not with shippers. The example of Hungary / Ukraine, where an agreement with neutral commitments is in place, shows that these interconnections agreement, which exist in Europe, are working effectively and the only way forward.

Mr. Krutko stated that Gazprom needs to protect the security of its transit chain and that Gazprom is not ready to be the risk taker in the new reform, thus not being able to accept the changes at the EU external border points.

With regard to Ukrtransgaz it is not clear at all which standards for transportation of gas are supposed to be applied. The current contract between Gazprom and Naftogaz ensures an appropriate commercial balance and legal security for both sides. Regarding the Interconnection agreement signed by Ukrtransgaz and FGSZ, he stated that Gazprom is not aware of the substance of such Interconnection Agreement because the TSOs did not publish it.

Mr. Borchardt however admitted that the specific condition of the Ukrainian Gas system and legal framework have to be taken into consideration and that an agreement has to be found which enhances Gazprom's trust in the system.

Mr. Kamphues pointed out that the system in the Ukraine, which is currently in complete transition, differs from Europe and that interim measures (such as the possibility for third parties to check metering and accounting) could be introduced. Installing such measures, which increase transparency and trust in the system, could help to overcome this problem.



Mr. Konoplyanik welcomed the initial exchange of views on this topic and proposed to have a discussion at the next meeting on how to proceed on this issue. The objective should be to reach a common understanding of both sides.

The European Commission pointed out that the matter of legacy contracts should be further discussed between the respective TSOs (EU TSOs for now due to Gazprom's specific position relative to transit through Ukraine), and Gazprom with participation of the European Commission with due respect to the international law with a view to finding a quick solution (over the next few months) that allows EU TSOs to fulfil their obligations under EU law but also provides Gazprom the necessary comfort as a shipper.

Due to time constraints the order of the agenda items were slightly changed.

4. Exchange trade in Russia & GPE Auctions experience and expectations:

(i) How does GPE see their auctions and what are the plans for further auctions

Before moving to this agenda item Mr. Medvedev commented on the previous agenda item. He expressed his concern over the unclear ownership and operational rights of the Ukrainian gas transportation system, which is, in his eyes, the main obstacle for finding a solution here. He reminded about the long-time outstanding issues around the international consortium, supposed to clarify the transit issues in Ukraine. Mr. Medvedev stressed also that currently there is no certified network operator in Ukraine. Before entering into discussions with Ukraine on important issues regarding the ownership of Ukrainian gas system, financial responsibility and the operatorship of the infrastructure have to be finalised.

With regard to the auctions, Mr. Medvedev informed that in September 2015, Gazprom Export conducted a series of natural gas sales auctions for the Delivery Period Winter 2015/2016. Auctions were held for gas supplies to several North-West European delivery points in total volume of 3.24 bcm. Three different offers were auctioned:

- Auction A: 48 lots 60 MWh/h each at the Delivery Point Greifswald NEL with optional for the buyers Delivery Point VP Gaspool
- Auction B: 57 lots 60 MWh/h each at the Delivery Point Olbernhau II with the option for the buyers to purchase entry capacity to the CZ gas transport network from Gazprom Export
- Auction C: 22 lots 60 MWh/h each at Delivery Point Greifswald OPAL exempted. Adjacent OPAL capacity with the exit point Brandov can be purchased from the Network Operator

Despite the difficult market situation and declining prices, about 1.37bcm were sold. Mr. Medvedev informed that the average weighted price for the auctioned natural gas was higher than the market price (on average 1,5 euros higher than the Gazpool price). In total 48 lots were sold out where Auction A lots were the most attractive and Auction C lots were of the least interest (only 1 lot was sold).

Mr. Medvedev expressed the willingness of Gazprom to use the created legal and instrumental base for extending the gas sales through auctions. In his opinion this mechanism should play a significant role in the optimization of gas deliveries to Europe. Mr. Medvedev also pointed out that 100% ownership of WINGAS will also contribute significantly to the envisaged optimization

process. Next auction for the total volume of 6 bcm should be held in February 2016. This time there is an intention to add some seasonal and yearly lots (with the offtake during the corresponding year). In 2-3 years the annual volume of gas sold in the auctions should reach 10% of Gazprom's export to Europe, around 15-16 bcm annually.

(ii) Overall characteristics of exchange trade in Russia

Mr. Rybnikov gave a general presentation about SPIMEX, the CJSC Saint-Petersburg International Mercantile Exchange, which was established in 2008. He informed that SPIMEX's shareholders include Transneft, Rosneft, Gazpromneft, Zarubezhneft, Surgutneftegaz, Sovcomflot, RZD and others market players. Although SPIMEX focuses on organizing domestic trading in oil products (sophisticated market for physically delivered oil products with trading volume over 17 million tons in 2014), it also trades natural gas. He mentioned that SPIMEX is the only exchange in Russia which trades natural gas and that SPIMEX has traded about 7.2 bcm since the launch of natural gas trade in October 2014. Furthermore, he informed that SPIMEX started only recently with day ahead trading. He pointed out that although the volume of traded natural gas is still small, it is steadily growing.

Mr. Boltz pointed out that this development is a very positive signal.

5. Energy Union

Mr. Boltz gave a brief update on the developments with regard to the Energy Union. He informed, that the first State of the Energy Union report was presented by the European Commission on 18 November. The report contains, inter alia, the progress made with regard to the internal energy market and security of supply, and outlines the way forward. Mr. Boltz mentioned that the SoS Package, which is supposed to be published in February 2016 contains the revision of the SoS Regulation, the LNG and Storage Strategy and a review of the Decision on Information Exchange Mechanisms (intergovernmental agreements). Furthermore, the Commission is working on a legislative proposal on a new energy market design, which should be published in the second half of 2016. Although the focus is placed on electricity, the market design will also have an impact on the gas markets.

Mr. Boltz informed that no further questions of the Energy Union Questionnaire can be answered at this stage, as no legislative proposals have been published since the last meeting.

6. Comparison of existing and new options for creating new capacity in EU

In their presentation Mr. Konoplyanik and Ms Orlova compared existing and new options for creating new gas transportation capacity in the EU. Both stated that two options for creating new cross border gas transportation capacities are in force today in EU, namely, Exemption route based on Article 36 of the Third Gas Directive, and PCI / TYNDP procedure, and one isn't in force yet, this is CAM NC on Incremental Capacity procedure (Amended Regulation EU 983/2013, Art. 20 (d)) in collaboration with Tariff NC (both are not yet approved and are not in force).

The idea behind the comparison is to find the best financeable and manageable, market-based procedure with "tolerable risks and uncertainties" (for all parties involved) to cover justified demand for new cross-border transportation capacity.

Based on this comparison Mr. Konoplyanik and Ms Orlova came to the following conclusions.

The period for making exemption decision, especially for interconnectors (if no cross-borders, just simple IP) (up to 2 years) is shorter than the Incremental Capacity Project (2.5 years) and Project of Common Interest (up to 4 years) permit granting processes. But, in case of project disintegration the prolongation of exemption decision process can follow. Eventually the whole exemption process (plus its prolongation) can last up to 5-6 years.

The PCI / TYNDP route has the longest permit granting process compared to other procedures – 4 years. There are no ways to make it shorter.

The Incremental Capacity Project process (2.5 years) consists (will consist) of two phases: the long non-binding phase (1 year 10 months) and shorter binding phase (6 months). The further shortening of the non-binding phase is possible if, e.g. existing gas supply LTCs will back-up new capacity (they will secure financing and will immediately pass positive economic test).

Both presenters consider the last option as the most efficient one for development of new cross-border capacity. Based on these findings Mr. Konoplyanik addressed the following question to the European Commission:

Is it possible to further effectively shorten the non-binding phase of the CAM NC INC procedure in the case that a positive economic test for a new capacity project is given?

In the light of this presentation Mr Borchardt mentioned that the amendment of the CAM NC will most likely not be enforced before early 2017. He further informed, that it was mainly developed to have a tool available for shippers to make TSOs and NRAs to build pipeline when the economic test was passed. This way resistance of one individual country can be overcome. However, Mr. Borchardt also pointed out, that comparison provided by Mr. Konoplyanik and Ms Orlova is misleading. The comparison does not consider the permit procedure which all project have to undergo, and therefore provides an incomplete picture.

Mr. Boltz pointed out that the CAM NC INC does not include a minimum duration period and that the process can therefore be carried out faster if all requirements are met.

In Mr. Konoplyanik's view it would be more efficient if this proposal could already be included before the NC goes into comitology. It would also be helpful, in his view, to test on a basis of a realistic case new regulatory procedure before it goes to comitology.

7. Concluding remarks and next meetings.

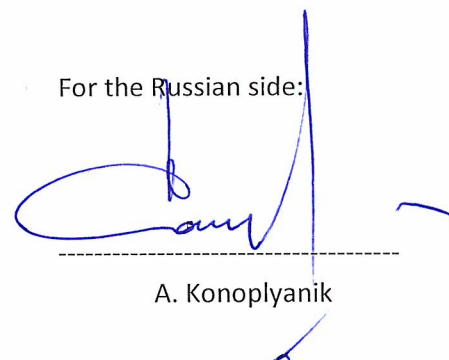
Mr Boltz and Mr. Konoplyanik informed that the next meeting of GAC WS 2 will take place on 22 January 2016 in the premises of E-Control.

For the EU side:



W. Boltz

For the Russian side:



A. Konoplyanik

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AGENDA

Time	Items	Presenters
Morning Session 10:30–13:00	1. Greetings / Opening remarks by Co-Chairmen	W.Boltz, A.Medvedev/ A.Konoplyanik
	2. The future of LT contracts and pricing Russian gas in Europe (i) View of Gazprom export (GPE) (ii) Reaction from EU/NRAs	S.Komlev (GPE), A.Gnatyuk (GPE) W.Boltz
	3. Legacy capacity contracts and why reverse flow on pipelines with these contracts is seen as a problem, and what could be done about this: (i) view of EU/NRAs (ii) view of Gazprom export (GPE)	W.Boltz, K.Borchardt (EC), K.Kovac (EC) A.Krutko (GPE)
	4. Exchange trade in Russia & GPE Auctions - experience and expectations: (i) Overall characteristics of exchange trade in Russia, (ii) How does GPE see their auctions and what are the plans for further auctions, (iii) How does the EU see these auctions	A.Rybnikov (SPIMEX) A.Medvedev W.Boltz
Lunch 13:00-13:45		
Afternoon Session 13:45–16:30	5. Comparison of existing and new options for creating new capacity in EU (CAM-INC, Exemptions, PCI/TYNBP)	E.Orlova (FIEF), A.Konoplyanik
	6. EU update on EU Energy Union <ul style="list-style-type: none"> • Overview • Issues of concern to the Russian side (based on list of Qs) • What next on the European side as far as known at the moment 	W.Boltz
	7. Concluding remarks and Next meetings	W.Boltz, A.Medvedev/ A.Konoplyanik

List of participants

Barnes Alex	Gazprom Marketing & Trading
Boltz Walter	E-Control Austria
Borchardt Klaus-Dieter	European Commission
Gnatyuk Alexey	Gazprom export
Gudkov Ivan	Gazprom
Gusenbauer Vera	E-Control Austria
Heidrecheid Cecile	ENTSO
Issia Alessandro	E-Control Austria
Kamphues Stephan	Open Grid Europe
Komlev Sergey	Gazprom export
Konoplyanik Andrey	Gazprom export/Russian State Gubkin Oil & Gas University (Co-head of WS2 GAC/Coordinator of Consultations from Russian side)
Kovac Kristof	European Commission
Krutko Andrey	Gazprom export
Medvedev Alexander	Gazprom (Co-head of Consultations from Russian side)
Millgramm Carola	E-Control Austria
Orlova Ekaterina	Foundation "Institute for Energy & Finance"
Painz Bernhard	E-Control Austria
Potemkin Alexander	Russian Trade Representation in Austria
Rybnikov Alexey	Saint-Petersburg International Merchandise Exchange (SPIMEX)
Shtilkind Theodore	Ministry of Energy/Russian Energy Agency (Co-head of WS3 GAC from Russian side)
Sudarev Nikolay	Gazprom Germania
Temnichenko Mikhail	SPIMEX
Timofeev Ivan	Gazprom export
Yankovsky Alexander	Gazprom Marketing & Trading
Zhur Anna	Gazprom export