

**25rd round of Informal Russia-EU Consultations on EU Regulatory Topics
&**

**18th meeting of the EU-Russia Gas Advisory Council's
Work Stream on Internal Market Issues (WS2 GAC)**

22 January 2016

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

MINUTES

1 Greetings /opening remarks

Co-Chairs Mr Boltz and Mr Konoplyanik welcomed the participants to the 18th meeting of the EU Russia Gas Advisory Council's Work Stream on Internal Market Issues and the 25th Round of Informal Russia-EU Consultations on EU Regulatory Topics. Mr Konoplyanik congratulated the participants with Anniversary meeting (Consultations), underlined the importance and relevance of such meetings and highlighted the mutual benefits. Mr Boltz further added, that due to substantial changes in the gas markets, new and challenging topics for these meetings will continue to arise thus providing the agenda for our future gatherings.

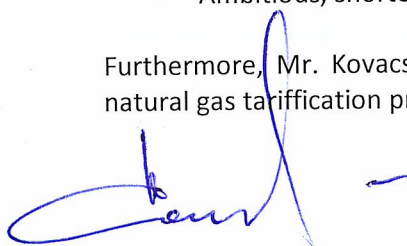
2 EU draft legislation on incremental capacities (NCs on Incremental Capacities and on Tariffs)

(i) DG Energy: Way forward for Network Codes on Incremental Capacities and on Tariffs

In his presentation Mr. Kovacs presented the way forward for the NC on Tariffs and the amendment of the NC CAM Network Code (NC). He informed the participants about planned amendments to NC TAR and NC CAM, which are intended by the European Commission. In particular, the presentation included the following key proposals:

- Reference price methodology can be chosen freely but must be compared to a capacity-weighted distance benchmark and be subject to pragmatic ACER review
- Asset split can be applied if transit is very high or for very significant new capacity projects (in both cases to shelter domestic customers)
- Inclusion of cost transparency
- Fixed price for incremental capacity only subject to alternative allocation methodology (large projects)
- Strengthening notion of firm capacity offer preceding interruptible sales
- Day-ahead and within-day multiplier set to decrease to 1.5 after 4 years unless path is adjusted on the basis of prior assessment to be conducted
- Default storage discount but possible deviation therefrom
- Ambitious, shorter implementation period

Furthermore, Mr. Kovacs indicated that the European Commission is ready to look into broader natural gas tariffication principles (including general charging principles and in the broader context of



deepening market integration). This should be done as a separate project and not through Comitology. The study is supposed to start in 2016.

Mr. Kovacs furthermore informed about the process and highlighted that the European Commission has benefited from the technical experience from ENTSOG and ACER / NRAs over the last month. According to Mr. Kovacs, the European Commission will focus on finalizing the legal drafting by the end of January. From today's perspective the adoption and entry into force is foreseen by the end of 2016.

After the presentation the questionnaire, which was addressed to the European Commission by Gazprom, was discussed:

1. *What will be the standard benchmark methodology against which the countries will be able to choose their own methodologies to be applied? (slide 10) How detailed will it be?*

Although the draft foresees the possibility for MSs to set their own methodology, they should also calculate the benchmark methodology and present reasoning for the chosen methodology complying with the principles of the Gas Regulation and for deviations from the benchmark capacity weighted distance methodology.

2. *There is no mention of the "grandfather clause" introduced in the previous version of draft NC TAR which protected contracts signed prior to November 2013 – does it mean that grandfathering will not be applicable? Will historical contracts be protected under the NC TAR?*

The grandfather clause will remain.

3. *With regard to cost transparency issues to be achieved by TSOs – can you please specify whether the sufficient amount of information regarding the chosen tariff methodology will be published to enable the network users to make necessary tariff calculations? (slide 13) Will tariff calculation models be published?*

The exact model won't be published due to confidentiality issues. In addition, it was highlighted that the entire model is very complex and not suitable for publication. Therefore, Mr Kovacs, Mr. Ingwersen, and Mr. Kamphues underlined the need to find a pragmatic solution to this problem and to publish a simplified model which should still reflect very closely reality.

With regard to this discussion Mr. Barnes highlighted that the difference between the simplified and the full module may be crucial for shippers to decide whether a project is profitable or not. He highlighted the difficult positions shippers are in due to this arrangement. Despite his concerns regarding the implementation, Mr Barnes welcomed the clear wording of the European Commission's proposal and appreciated the work done by ENTSOG.

4. *Can you please clarify the application of the mechanism when day ahead and within day products have a multiplier of 3 which reduces to 1.5 within 4 years with a possible revision in 2 years? What kind of basic factors will be applied to impact the increase or decrease of the multipliers? (slide 14)*

Mr. Kovacs stressed, that the multipliers of 1.5 for products beyond day-ahead are to be implemented as of application date. Multipliers of 3 are defined for day-ahead and within-day products which automatically reduce to 1.5 in principle within a period of 4 years.

However, the report on the impact of the multiplier change which is envisaged 2 years after the implementation may trigger amendment to prolong or expedite further the envisaged reduction.

5. *Why quarterly products and monthly products have the same multiplier whilst having a significantly different duration? What is the rationale behind it? (slide 14)*

The approach which the European Commission has proposed (which does not deviate from the ENTSOG proposal) has to be considered in view of avoiding adding an additional layer of complexity to the mechanism. Thus multipliers are set on the same level for monthly and quarterly products but differently for daily products.

6. *Do we understand correctly that while taking as the basis the principles outlined in the NC TAR the TSOs will still be able to apply alternative multipliers for the capacity products? If so, how will this mechanism work?*

Multipliers need to be within the above-mentioned bands so specific values may still differ.

7. *Transit / domestic consumption split: TSOs may assign a set percentage of their costs / assets to transit and domestic (i.e. national / local) consumption to ensure that domestic consumers do not bear the risk of changes in flows for transit. However the precise way in which this will be calculated is yet to be determined – can you please explain the mechanism in detail? How will cross-subsidization be avoided in such case?*

For TSOs with large transit flows an asset split is possible, which effectively separates the two and "encapsulates" the risks. In addition a cost allocation test has to be performed by all TSOs in which they demonstrate how the charging principles work for the proposed tariffs for cross-border and domestic bookings/flows.

8. *Fixed tariffs will be allowed for investments in large incremental capacity projects only (to enable network users to make sufficient binding commitments for the project to go ahead) – does this mean that floating tariffs will still be applicable?*

Floating tariffs are still applicable in non-price cap regimes.

9. *What is the criteria for large incremental capacity projects?*

Criteria is still to be defined but whether a project is a PCI could be one.

10. *Interruptible capacity: The default of ex ante pricing which is already applicable by some TSOs is generally welcome but it is not clear how the "fixed ex post discount" mechanism will work in practice – can you elaborate on this?*

The default rule is ex ante discount but there is the possibility to apply a fixed ex post discount (high enough to dissuade TSOs from abusing it) in systems with low risk of congestion


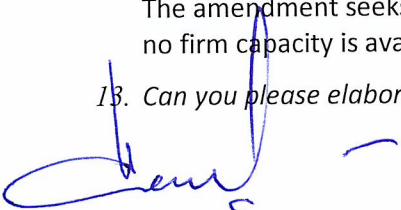
11. *What will be the role of ACER in tariffication process? (slide 4)*

The methodology and other tariffication principles are subject to assessment of ACER, which publishes a non-binding opinion. There is no legal basis for ACER to force countries to follow a certain methodology. The European Commission, as for Mr. Kovacs, has enforcement rights and can start infringement procedure where appropriate.

12. *With regard to NC CAM amendments on offering firm and interruptible capacity can you please specify on the proposed text: "Transmission system operators may offer interruptible capacity products of longer duration as well, but only if the respective fully allocable firm capacity product of the same duration was sold out or not offered." - What do you mean by capacity which is not offered? Can you please give examples of TSOs not offering or not planning to offer firm capacity products? If firm capacity product is not fully offered can interruptible capacity be offered by TSOs? (slide 15)*

The amendment seeks to clarify the hierarchy of products: interruptible should only be sold if no firm capacity is available.

13. *Can you please elaborate on the study to be launched in 2016? (slide 6)*



The study – responding to market players' call for a broader discussion on tariffs (beyond the scope of a network code) will look into questions regarding potential steps necessary to further integrate EU gas markets and foster supplier competition there, having regard to lower domestic production, the changing role of LNG, etc. This study should also consider the gas target model and should investigate the effect of a different transmission charging regime which will necessarily also include assessment on a potentially broad inter-TSO compensation mechanism.

14. Is EC Impact Assessment of NC TAR already available? If not when will it be available?

The EC Impact assessment has already been finalised.

15. When will the full text of renewed draft NC TAR be available for assessment?

Mr. Kovacs informed, that the legal drafting should be finalised by the end of January. After the Commission-internal consultation in February, the draft will be circulated to Member States. Comitology meetings are supposed to start in March. From today's perspective, the adoption and entry into force is foreseen by the end of 2016.

Concluding the discussion, Mr. Boltz considered the NC TAR as a good compromise between all parties involved. He once more pointed out that this NC TAR has to be considered as the most difficult one for implementation and that adjustments will most likely be needed in the future.

(ii) Proposed WS2 joint work on “Reality check” of Network Codes on Incremental Capacities and on Tariffs

In the framework of the presentation “Reality check CAM NC INC”, which was jointly developed by Mr. Konoplyanik and Mr. Boltz, Mr. Konoplyanik presented their view on the way forward with regard to the CAM NC INC.

He proposed to do a “reality check” with the aim to clarify and test the new draft EU legislation (NC INC + NC TAR) when its proposed legal procedures are clear, however not adopted yet. This approach has two advantages according to Mr. Konoplyanik: Should the test show that the draft legislation is ready for implementation, the test can be considered as a strong support for quick implementation. If the test however shows that there is room for improvement, there is still the possibility to adapt the draft legislation accordingly.

Mr Konoplyanik reminded the participants that thanks to the fruitful cooperation in the margins of this workstream it was possible to gain better understanding of each party's opinion, in particular with regard to the CAM NC INC. Mr. Konoplyanik stressed that it is now the best time to test the implementation of the CAM INC from a practical point of view.

Mr Konoplyanik suggested testing the draft legislation by using an “as if” approach:

- “As if” CAM NC INC already in force (not since 2018, but now),
- “As if” gas has come to Varna and need to go further onshore to EU (Baumgarten); (offshore route out of discussion).

An Ad-hoc group should be established which consists of participants from the European and the Russian side, and which should work closely with GAC WS2. While Gazprom should provide illustrative figures (such as volumes, durations, and destinations), ENTSO and TSOs should start to test Art. 20 (d) procedure, according to Mr. Konoplyanik .

This ad-hoc group should meet regularly (either via telco or on-site meetings) and should already start in February, so that the test can be finished before the draft legislation will pass through comitology procedure. The intention, as for Mr. Konoplyanik , is not to prove the validity of the project but to test draft NC.

Both Mr. Boltz and Mr. Konoplyanik pointed out that participation of Eastern-European TSOs (in addition to already experienced Western-European TSOs) is crucial for the success of the test. Mr. Poillion highlighted that northwest European TSOs should also participate in the ad-hoc group as their experience can be very valuable. Mr Kamphues informed the participants that ENTSOG is also thinking about establishing such a group, and therefore, welcomed very much the idea.

With regard to the composition of the ad-hoc group Gazprom would prefer a two tier approach: Operators from Southeast-Europe and Northwest-Europe should develop a common concept as a first step. NRAs should be included in the discussions at a later stage, after a first agreement has been found.

Mr. Boltz suggested leaving the decision regarding the formation of the ad-hoc group to the TSOs. Furthermore, he proposed a co-chairmanship for the ad-hoc group. Interested experts should indicate their interest in chairing the ad-hoc group to the GAC WS 2 Co Chairs within the next two weeks. According to Mr. Boltz first preliminary results of the ad-hoc group should already be presented at the next GAC WS 2 Meeting on 22 April 2016.

Participants underlined the importance to establish the ad-hoc group as soon as possible.

3 The future of LT contracts and pricing Russian gas in Europe: continuation of the debate

(i) LTCs and hub pricing (a follow up on Gazprom export presentation at Consultations/WS2 meeting on 30.11.2015)

In his presentation Mr. Dickel covered the issue of Long Term Import Contracts (LTICs) and Hub Pricing. The presentation should be considered as follow up on Mr. Komlev's presentation on 17th GAC WS2 meeting. Mr. Dickel draw the attention to the problem, that market structure has dramatically changed over time, and long terms contracts, although having adaptations clauses, were concluded under different circumstances. He pointed out that some flexibility is needed to adapt to these changes, which do beyond the existing adaption clauses.

In his presentation he stressed characteristics of LTCs and the benefits of LTICs, and made the participants aware of the difference of LTCs and LTICs with regard to the jurisdiction. He highlighted that governments should not interfere with LTICs and argued that conflict resolution should be solved within commercial relations. Furthermore, he mentioned that the changing role of aggregators has to be taken into consideration when discussing the future of LTICs.

Based on the lessons learnt Mr. Dickel raised questions on how LTICs could work in the future.

He stressed that arising LTICs with hub pricing can work in principle, however addressed concerns regarding hub pricing in multi-tier systems.

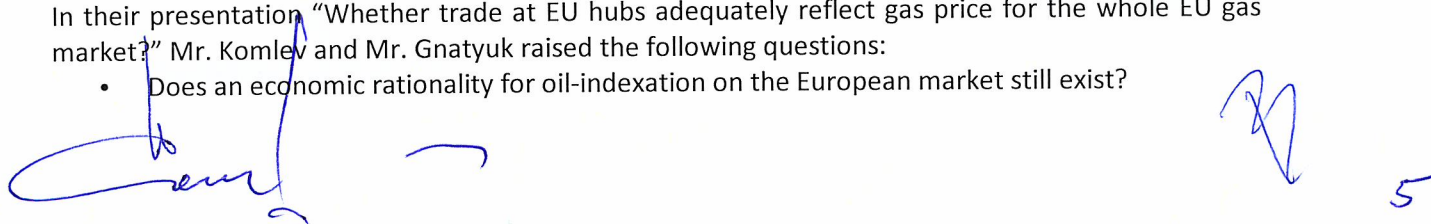
Concluding, Mr Dickel emphasised that it should be left to commercial actors to find new solutions. The past has shown that a variety of approaches and solutions have been developed by commercial actors so far, so Mr Dickel.

Reflecting Mr. Dickel's presentation, Mr. Boltz stressed that LTCs were usually developed with much political involvement. Bearing this in mind, governments should also be involved to a certain degree when renegotiating LTCs. Governments could for instance give guidance on the overall direction and the way forward; however, should not dictate market parties what to do.

(ii) Whether trade at the EU hubs adequately reflects the gas price for the whole EU gas market?

In their presentation "Whether trade at EU hubs adequately reflect gas price for the whole EU gas market?" Mr. Komlev and Mr. Gnatyuk raised the following questions:

- Does an economic rationality for oil-indexation on the European market still exist?

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- How does volumetric flexibility make hub and LTC prices different?
- Why are hub prices giving no indication of the market equilibrium for the whole European market, but only for the volumes not contracted under LTCs?

Mr. Komlev came to the conclusion that in OECD Europe rational for oil-indexation in gas pricing still holds due to strong competition between natural gas and oil products in industry and commercial sector. According to Mr. Komlev, no indications for a change in the foreseeable future can be observed.

In the next part of the presentation Mr. Gnatyuk stressed, that flexibility in LTC volume nominations provide a buyer with arbitrage opportunities between contract and hub prices, although premium for arbitrage has become less noticeable in recent years as prices have converged. Moreover, while end-users need flexible supplies due to remaining seasonality in demand, midstreamers underestimate its value as they optimize volumes via hubs that undermine storage business viability in EU.

Mr. Komlev summarized that hub prices are not an indication of the total supply and demand for Europe, but for the residual volumes left when the bulk of demand is met with the LTCs. Furthermore, he pointed out that although total demand for gas in Asia increased, 'homeopathic' reduction of demand for uncontracted volumes caused the spot prices in Asia to collapse in March 2014.

In the light of the discussion, Mr. Komlev concluded that LTC, which were designed in the past without hubs, have to be fulfilled according to commercial law. Regarding hubs, Mr. Komlev highlighted that hub prices in Europe tend to overreact and that they do not automatically represent the whole European market, but just a segment. Furthermore, he stressed that just changing the price clause of existing LTCs would put all the risk on the supplier, to say, Gazprom, which is not acceptable.

With regard to Mr. Komlev's presentation Mr. Boltz stressed that the existing pricing structure should be considered as the main reason for the collapse of the gas demand in Europe. The way prices have been set, together with European environmental and energy policies have had strong influence on the demand. He suggested that the issue on pricing structure could be discussed further at the next meeting.

Concluding, Mr. Konoplyanik mentioned that the WS has once more yield fruits. Both sides have gained better understanding of the other side's position. Nonetheless, Mr. Konoplyanik underlined, that there is still need for further discussions.

He stressed that hybrid pricing system will continue to exist in the future, which is why solutions have to be developed on how existing contracts can be adapted. Questions regarding the price of flexibility under hub price as well as under long term contracts would be one issue which should be addressed in one of the next meetings.

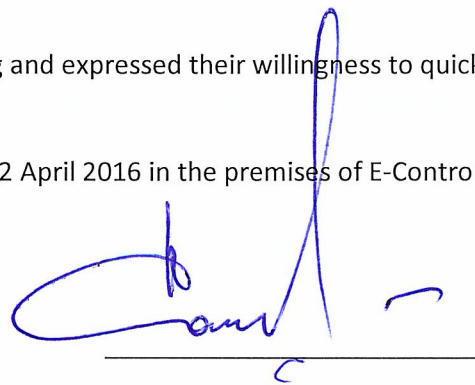
4 Concluding remarks and Next meetings

Both Co-chairs thanked the participants for the meeting and expressed their willingness to quickly set up an ad-hoc group for testing the CAM NC INC.

It was agreed that the next meeting will take place on 22 April 2016 in the premises of E-Control.



Co-Chair Walter Boltz



Co-Chair Andrey Konoplyanik

List of participants

Alex	Barnes	Gazprom Marketing & Trading Limited
Walter	Boltz	E-Control (Co-head of WS2 GAC from EU side)
Ralf	Dickel	Energy Consulting
Vladimir	Feygin	Foundation "Institute for Energy & Finance"/ Rosneft JSC (Co-Speaker of GAC, Co-head of WS1 GAC from Russian side)
Alexey	Gnatyuk	Gazprom export
Ivan	Gudkov	Gazprom
Vera	Gusenbauer	E-Control
Reiner	Hartmann	E.ON Global Commodities SE
Jan	Ingwersen	ENTSO
Alessandro	Ischia	E-Control
Stephan	Kamphues	Open Grid Europe (Co-head of WS3 GAC from EU side)
Sergey	Komlev	Gazprom export
Andrey	Konoplyanik	Gazprom export/Russian State Gubkin Oil & Gas University (Co-head of WS2 GAC/Coordinator of Consultations from Russian side)
Kristof	Kovac	European Commission
Andrey	Krutko	Gazprom export
Denis	Leonov	Gazprom
Margot	Loudon	Eurogas
Elena	Medvedeva	Gasunie
Carola	Milgramm	E-Control
Angeliki	Mourtzikou	Regulatory Authority for Energy (Greece)
Ekaterina	Orlova	Foundation "Institute for Energy & Finance"
Bernhard	Painz	E-Control
Maxim	Petchenko	Gazprom export
Alexander	Petrov	Saint-Petersburg International Merchandise Exchange (SPIMEX)
Christophe	Poillion	GRTgaz
Teodor	Shtilkind	Ministry of Energy/Russian Energy Agency (Co-head of WS3 GAC from Russian side)
Steinar	Solheim	Yara International ASA
Gottfried	Steiner	CEGH
Nikolay	Sudarev	Gazprom Germania
Katja	Yafimava	Oxford Institute for Energy Studies
Alexander	Yankovskiy	Gazprom Marketing & Trading Limited
Anna	Zhur	Gazprom export

