

**26rd round of Informal Russia-EU Consultations on EU Regulatory Topics
&**

**19th meeting of the EU-Russia Gas Advisory Council's
Work Stream on Internal Market Issues (WS2 GAC)**

22 April 2016

**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. Medvedev and Mr Konoplyanik congratulated Mr. Boltz on his work at E-Control for the last 16 years, wished Mr Boltz all the best for the future and welcomed the continuation of cooperation in the framework of the WS2/Consultations with Mr Boltz staying as Co-Chair from the EU side of both undertakings.

2. Legacy gas transport (transit) contracts vs. reverse flows on pipelines with these contracts: what still prevent to conclude interconnection agreements in South-East Europe and what could be done about this:


(i) view of EU/NRAs

(ii) view of Gazprom export (GPE)

Mr Krutko reported on the recent developments with regard to legacy gas transport contracts. Mr Krutko informed that an intense exchange of views has taken place with the Bulgarian counterpart to solve the outstanding issues. Although it was not possible to solve all open issues through bilateral discussions with Bulgartransgaz, it was agreed to implement a test phase as early as possible – potentially from 1 June to 1 October. This test phase, which is based on a protocol outlining the framework, and signed by both sides, should be considered as a provisional solution and as a “learning by doing” approach. It is foreseen to sign this protocol at the beginning of May. Adaptations, which might be necessary after the test phase, should be included in the final agreement. Mr. Krutko pointed out that this test phase allows capacity access for shippers other than Gazprom.

With the Romanian counterpart (in the context of respective plans for interconnection agreements) it is still difficult to reach solid conclusions, according to Mr Krutko. He mentioned that due to the expiration of one legacy contract, auctions will start on Transit 2 in near future. Bearing this in mind, Mr Krutko expressed concerns as Gazprom has not seen the draft contract so far and has not received any information on tariffs and methodology for holding auctions.

With regard to Poland – where the Mallnow point is already a bookable interconnection point – Mr Krutko emphasised the willingness of Gazprom to make the final adaptations to the contractual framework of the new system. However, Mr Krutko stressed the importance of fulfilling certain



requirements such as a fair allocation of costs. He further pointed out that Gazprom does no longer bear responsibility for gas quality and pressure, as this is now managed by TSOs.

Furthermore, Mr Krutko raised concerns regarding the latest drafts of the proposed amendment of CAM NC which foresees a virtual reverse flow priced at marginal costs. According to Mr Krutko the draft contradicts the idea of well-balanced sharing of costs by all shippers. In this situation just the normal-flow shippers bear all the infrastructure and operational costs and at the same time allow gas quantities to be nominated in reverse flow.

Mr. Kamphues agreed with the fact that this way of pricing is absolutely misleading and unfair.

Mr Krutko emphasised that coming to an agreement for interconnections points at the EU external border is more complicated. With regard to the interconnection point at the Ukrainian border there is no robust legal framework in place, even though Ukraine is a member of the Energy Community and is supposed to implement the European legal framework. A new agreement would undermine the well-working existing transport contract and agreements and would harm security of supply. Therefore, he warned against adapting the current agreement with the Ukraine.

He further mentioned that Gazprom faces similar problems with interconnection points in Turkey and Macedonia and Gazprom efforts to adapt the contractual framework to potential Interconnection Agreements are limited to points between EU member states.

Mr Krutko concluded that despite all these difficulties Gazprom is confident that all open issues can be solved on a bilateral basis. Nonetheless, Gazprom is keen on hearing the thoughts of the European Commission on these issues.

In his presentation, Mr Kovacs briefly outlined the key principles of EU gas transport framework which have to be respected when moving from the old to the new system, also in the case of the CEE/SEE region. Mr. Kovacs underlined, that the Gas Directive and Regulation, as well as NCs have created a legal framework which

- is based on effectively unbundled TSOs operating networks
- is offering capacity in a non-discriminatory manner to network users and freeing up unused capacity and
- allows TSOs charging regulated tariffs for their (regulated) services.

Referring to the concerns of Mr. Krutko, Mr Kovacs stressed that the new system clearly defines the responsibilities of TSOs which they have to bear and that the Commission makes sure that these responsibilities are taken. This is also the case in countries of the Energy Community, where the European law has been implemented and the same legal framework is in place. It is crucial, so Mr. Kovacs, that the above is being accepted by all parties.

Mr Kovacs named the Trans-Balkan route as the only remaining EU gas infrastructure without third-party access. He highlighted the importance of the IAs which are under preparation by TSOs on the EL-BG, RO-BG and RO-UA borders respectively, allowing those interconnection points to become bookable and ensuring that EU access rules can apply (EL-BG and RO-BG are the last intra-EU points necessitating such change).

As regards Gazprom's concerns over the UA-RO (or other UA-EU MS) interconnection agreements Mr Kovacs questioned how security of supply concerns may possibly arise from executing an interconnection agreement which (as at all other EU points) simply sets out the business rules by which TSOs interact at a cross-border point. In addition he stressed that, notwithstanding the contractual disputes that Gazprom and Naftogaz may have, Gazprom should not prevent the implementation of such interconnection agreements for reasons other than commercial ones.



Mr Kovacs welcomed the envisioned interim solution (until 1 October 2016) Gazprom is in the process of developing through bilateral discussions with Bulgartransgaz and other counterparts. However, he also stressed that the issues have to be solved as soon as possible, respecting the legal framework in place. Bearing this in mind, he raised concerns whether discussions at bilateral level are the best format for solving the remaining open issues. With regard to the given legacy contracts (including IGA in BG) Gazprom needs to cooperate to allow for those rules to be implemented. The European Commission could therefore provide input and its point of view.

Referring to Mr. Konoplyanik's question, Mr Kovacs confirmed that a short delay of implementation with regard to the interconnection point in Bulgaria (the NC on Interoperability foresees a deadline for IAs on 1 May; the test phase however, starts in June) is no problem given that there is only a delay of one month and that the test phase is considered as an interim period. The European Commission is aware of the complexity, but reaffirms, that the deadlines as indicated for the test phase have to be met.

Mr Krutko pointed out that the existing contractual arrangements on transit through Ukraine serve as a solid basis for an uninterrupted gas flow since its conclusion, provide for a clear and transparent methodology for determination of quantities of gas transported and have proved their sustainability throughout the recent years. A change of contractual mechanisms determining the transported quantities might lead to a dilution of the transporter's responsibility and will thus change the commercial balance which will potentially lead to disputes affecting the safe transit of Russian gas to European customers. In the first place, not all relevant European legislation was transposed into Ukrainian law so far, and even if such a transposition will be made in the near future, it is highly questionable that the Ukrainian legal and regulatory system is able to generate the necessary trust and to provide enough comfort for Gazprom to change the agreed allocation mechanisms under its contract. Concluding, Mr Krutko reassured that Gazprom export's contracts at all interconnection points except the interconnection points at the EU border, will be in line with the NCs by October at the latest in case Gazprom export's partners will be also willing to incorporate the necessary contractual changes.

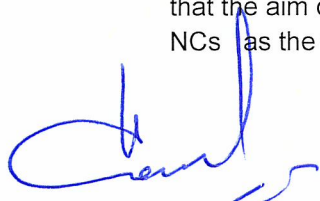
With regard to the different treatment of virtual reverse flow and interruptible flow, Mr Boltz highlighted that this is indeed a policy discussion. In his view, different treatment should be allowed, as the benefits of such an approach would outweigh the negative aspects. Although a different treatment contradicts the old legacy contracts the developments in the market justify such an approach, according to Mr. Boltz.

Both Mr Krutko and Mr Barnes pointed out that such an approach would increase the risk of creating stranded costs and that a lower pricing of reverse flow capacity means in practice discrimination of the forward flow shipper.

3. EU draft legislation on incremental capacities (Network Codes on Incremental Capacities and on Tariffs):
(i) first results of the ENTSOG-managed "Reality check" of Network Codes on Incremental Capacities and on Tariffs based on "realistic project"

Mr Vitovsky from ENTSOG gave a comprehensive overview of the work that has been achieved so far by the reality check WG on to the Network Codes on Incremental Capacities and Tariffs. This expert group, consisting of experts from ENTSOG, TSOs, prime movers (Gazprom Group, IFIEC, IOGP and GIE) and the European Commission (observer), started its work on 18 February and envisages to present final results in June. This reality check has been undertaken based on the realistic but virtual INC project among TSOs from NL-BE-FR.

On behalf of the reality check group Mr Vitovsky presented the first preliminary results. He pointed out that the aim of the reality check group was to make limited number of amendments to CAM and TAR NCs as the finalisation of the text is already in process.



- With regard to the booking horizon for existing capacity – Art. 11(3) of the CAM NC – the following text has been proposed: ‘The auction process shall offer capacity for no longer than the upcoming 15 gas years for existing capacity. In case of incremental capacity, the offer levels may be offered in yearly capacity auctions for a maximum of 15 years after the start of operational use.’
- Regarding booking horizon for INC capacity – Art. 20d(1) of the CAM NC – the text proposal has been adapted to the following: ‘An exceptionally extended time horizon on top of the 15 years and for up to 5 additional years shall be considered and may be allowed by national regulatory authorities if there is a significant probability that the economic test could not be passed based on the 15 years’ bookings.’
- On the “absence of / late NRA decisions – Art. 20b(5)-(6) of the CAM NC – the WG proposes the following wording:
‘In absence of such coordinated decisions, the Agency shall take the respective decision following the process set out in Article 8(1) of Regulation (EC) No 713/2009.’
- With regard to Art. 20b (6) of the CAM NC (auction as a fall back from alternative allocation mechanisms) the WG proposes to redraft the text as follows:
‘Where the relevant national regulatory authorities cannot reach an agreement on the proposed alternative allocation mechanism within the prescribed period, the Agency shall decide on the alternative allocation mechanism to be implemented, following the process set out in Article 8(1) of Regulation (EC) No 713/2009.
- Furthermore, the reality check WG proposed to change the text on Art. 20 d(4) (20% of CAP to be set aside) as follows: ‘If either booking duration or bids for higher amounts of capacity are prioritised, national regulatory authorities shall may set aside an amount equal up to 20% of the technical capacity at each interconnection point when applying Article 8(8)’

Mr. Konoplyanik added that such a proposal (to move to a flexible “up to 20%” formulae from fixed 20% quota in all cases) would provide a dynamic balance between a steady political intention of the legislators to reserve (at any cost) a portion of yet-to-be-created capacity for its future short term possible users and necessity to stimulate investment by providing flexibility and thus minimizing negative effect of this pure political consideration. In his view, the idea of setting aside fixed 20% of CAP is not necessary to guarantee short term booking and warned that such an approach would diminish the financial feasibility of projects and could lead to stranded assets.

- Regarding the application of fixed price, the Art. 3(28) should be adapted as follows:
‘alternative allocation mechanism’ means an allocation mechanism for offer level or incremental capacity designed on a case-by-case basis by transmission system operators and approved by national regulatory authorities to accommodate conditional demand requests.’
- At the same time, Art. 25(1)(b) should be adapted as follows:
Replace (a) by ‘for cases where only existing capacity is auctioned’; (b) ‘for incremental capacity and existing capacity offered in the same auction or in the same alternative allocation mechanism’

Mr Konoplyanik mentioned that the work of the reality check WG is highly appreciated by all WS2 participants and considered its work as very helpful and productive. On behalf of Russian side he has proposed that WS2 adopt draft statement on the “Reality check” Working Group with support of activities of the latter and invitation to the Commission to submit the draft amendments to the comitology process with a recommendation for the committees to accept these amendments. In case this support is obtained, the Minutes, he proposed, may reflect that the WS2 GAC members support proposals of the “Reality Check” Working Group on amendment of certain provisions of the current versions of the Network Codes (CAM NC INC and TAR NC) in order to make them more efficient, and that WS2 members support inclusion with the proactive assistance of the European Commission of these amendments into the current versions of the Network Codes within the ongoing comitology process

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Mr Kovacs pointed out, that, prima facie, many of the proposals for amendments are fine for the European Commission.

It was agreed by all participants that the GAC WS 2 should encourage the Commission to take note of the work of the reality check group, that the preliminary results are based on a sound analysis and are therefore, worth for consideration.

Mr. Nasretdinov stressed that in the course of its work the reality check WG has identified a number of «grey areas» that create legal uncertainty for market participants and may complicate the process of creation and allocation of incremental capacity. Therefore it would be reasonable to present the concerns and proposals of the reality check WG at the next Commitology meeting with the support of the European Commission. Mr Kovacs confirmed this possibility and it was agreed that he will forward the preliminary findings of the reality check WG to the member states, which will meet on 28-29 April in the framework of the Commitology meeting. Mr. Kovacs highlighted that such an approach would be a fair and transparent process and thanked all participants of the reality check WG for their work. In addition, it was agreed that the reality check group should continue its work as soon as possible and should send their new preliminary results to Mr. Kovacs at the end of May. This way it can be guaranteed that the input can be forwarded to the MSs in time.

- 4. Proposal for a joint regular “horizontal” overview and cross-check analysis of the new (planned / intended to be developed) and already being developed EU gas-related regulatory acts (further to the Third EU Energy Package, Energy Union and other key EU energy-related initiatives) with possible critical effect on the current and future Russian/Gazprom gas supplies to the EU:**
- (i) the EU view on the key points for Russia/Gazprom consideration, and**
 - (ii) Russia/Gazprom view on key risks and uncertainties for Russia/Gazprom’s supplies to the EU**

In their presentation Mr Konoplyanik and Mr Barnes proposed to introduce a “horizontal” overview and cross-check analysis of new and already ongoing regulatory acts in the field of gas to the WS 2 with the aim to identify at the as early stage as reasonable new risks and uncertainties for both parties for more detailed joint further examination. Mr Konoplyanik highlighted, that based on the third energy package a big amount of regulatory documents to establish the new architecture of the internal EU gas market has been introduced and that the complexity of the EU energy regulation will most likely increase in the future since each new Commission de facto adds its own “regulatory pyramid” to those established by the previous Commissions. Therefore, Mr Konoplyanik raised the question on how to organise discussions in the framework of the WS 2 on new upcoming legislative acts. In order to increase efficiency he proposed a so-called “Early Warning System” that should be applied in the WS 2. He proposed to develop a regulatory matrix including a time frame, which should provide all relevant information regarding upcoming activities and potential challenges. The EU side can indicate its advances vision on which particular document(s) in this matrix might have major impact for the market players. This will provide opportunities for the latter to make corresponding assessments earlier. This way, so Mr Konoplyanik, challenges and uncertainties could already be addressed at a very early stage, which is important as stakeholders have only a limited time to interact and participate in the drafting process.

The matrix should therefore include a short description of the current status of the particular document and key points for consideration (both for network users and for EU regulators)

Mr Barnes further mentioned, that such an approach would allow to address important issues already at an early stage and would enhance the mutual understanding.

Mr Boltz stressed, that a defined and well-working process is already in place, in which stakeholders have possibility to provide input. Therefore, he raised concerns regarding the duplication of such a

process. Instead of introducing such a matrix and creating additional administrative burden, he proposed the following: as soon as the Russian side has identified an issue of concern, it should be brought to the agenda of the WS 2. It does not make sense to discuss issues on an abstract level as long as no clarity on legal texts is available. Therefore, he urged to start discussion on issues only after proposals have become more concrete.

Ms Loudon agreed that a well-working process is already in place and raised concerns regarding adding an additional process.

Mr Kovacs also raised concerns regarding this proposal as such an approach would most likely be considered as a special treatment for Gazprom and would create an imbalance with other stakeholders. He stressed, that the process in place in the WS 2 is working well.

Due to the concerns raised it was agreed not to make adaptations to the existing process.

5. Main matters of concern for market players in some key new EU gas-related documents under discussion - unclear aspects of the suggested regulations and possible contradictory signals to the market including an unclear role of gas in the EU economy decarbonization:

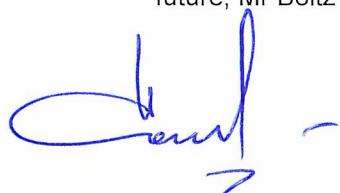
- (i) Gas SoS Regulation (16/02/2016 Reform of Regulation 994/2010/EC)**
- (ii) LNG and Storage Strategy (16/02/2016 "Winter package")**

The scope of Mr Leonov's and Mr Sudarev's presentation was to express some important matters of concerns regarding documents released in the context of the so called "Winter package" of the European Commission. In particular, both presenters raised concerns regarding the proposal of the revision of the Gas SoS regulation, the Heating and Cooling strategy, and the LNG and storage strategy.

According to the presenters, the strategy on LNG and storage reveals some contradictory signals coming from the European Commission. On the one hand, the strategy encourages completing the EU internal gas market and attracting the necessary investments as well as points out a positive role of LNG as a potential alternative fuel, on the other hand the strategy includes critical concerns regarding the ecological footprint of natural gas and its role in the decarbonisation of the European economy. These contradictory signals impact negatively the investment attractiveness of the European gas industry. As two examples, Mr Sudarev mentioned the Study on actual GHG data for diesel petrol, kerosene and natural gas which was issued in 2015 by DG ENER, and the report "The role of natural gas and biomethane in the transport sector" from February 2016 by Ricardo Energy and Environment.

Mr Sudarev criticised the exaggerated attention to the dependence on Russian gas, which is a purely political issue and should not be addressed in all documents of the Commission, including mainly technical studies. The above mentioned study on GHG data indicates extremely negative values for natural gas from Russia. Mr Sudarev as well as Mr Konoplyanik argued that the presented values do not adequately reflect the reality and stressed the risks of basing political developments on wrong numbers. Upcoming regulation changes (a new Renewable Energy Directive and the bioenergy sustainability policy for 2030 and a Review of Directive 2012/27/EU on energy efficiency, etc.) will have significant influence on the role of gas. Therefore, the correctness and reliability of the input data or parameters are highly important. Mr Konoplyanik proposed to clarify this issue by testing if these figures from the Study on actual GHG data are reflecting the reality.

Mr Boltz and some other participants raised concerns regarding the WS 2 publicly calling for strengthening the role of gas as this WS should not be linked to lobbying activities. Mr Boltz concluded, that although the issue of gas being considered as a dirty fossil fuel has to be addressed in future, Mr Boltz does not consider the WS 2 as the best format for doing so. The topic of carbon



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intensity (in particular of Russian natural gas as one of major supply sources to the EU), however, could be discussed in this group, so Mr. Boltz. Furthermore, he stated that concerns of the Russian side are understandable and reasonable so it is worth checking the values of the presented study. As these values may have a big impact on Gazprom, he proposed that both presenters should get in contact with the writers of the study to gain a more in-depth insight into the methodology of the study. Mr Konoplyanik welcomed this approach and proposed to put the follow-up of the issue on the agenda of the next meeting.

Mr Kovacs highlighted that the European Commission recognises the importance of gas in the long term. At the same time the European Commission does not foresee a growing gas market in Europe. European Climate policy and the ETS are very broad policies that have been decided at European level and which have to be accepted. Bearing this in mind, he mentioned that looking at the carbon intensity is of course possible. He agreed to get in contact with the consultant and forward their contact details.

6. Signing the Minutes of the WS2 meetings as of 30.11.2015 and 22.01.2015

Both Co-Chairs signed the minutes of the WS2 meetings of 30.11.2015 and 22.01.2015

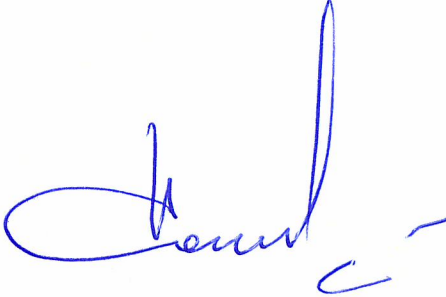
7. Any Other Business / Concluding remarks / Next meetings

It was agreed, that the next meeting of the GAC WS2 meeting will take place either on 27 June or 1 July. An email asking for preferences will be circulated after the meeting.

Both Co-Chairs thanked the participants for their active participation.



Co-Chair Mr Boltz



Co-Chair Mr Konoplyanik

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