

**22nd round of Informal Russia-EU Consultations on EU Regulatory Topics
&
15th meeting of the EU-Russia Gas Advisory Council's
Work Stream on Internal Market Issues (WS2 GAC)**

11 May 2015

**E-Control Headquarters
(Rudolfplatz 13A, A 1010 Wien, Austria)**

MINUTES

The agenda is attached to the minutes. The order of items was changed in the course of the meeting. The item on the Madrid Forum was skipped due to time constraints.

1. Greetings / Opening remarks by Co-Chairmen

Co-Chairs Mr. Boltz (Consultations/WS2 GAC) and Mr. Medvedev (Consultations) and Mr. Konoplyanik (WS2 GAC) welcomed the participants.

Mr. Medvedev opened the meeting by informing that when Russia-Ukraine gas transit contract will expire, Gazprom will irrevocably stop transiting gas via Ukraine after 2019 due to technological and economic constraints, and will move its gas flows to other less risky routes, including to those that are yet to be developed, such as Turkish Stream and its extension beyond Turkish-EU border inside the EU. He has advised Consultations/WS2 to focus its talks on practical issues related to the preparation for the post-2019 period. He added that gas transit via Ukraine will probably remain only for minor volumes (not more than 10 bcm) mainly destined for Moldova, Romania, Poland.

Mr. Medvedev further announced that preparations for works on the Turkish stream pipeline are ongoing. He mentioned that a portion of the gas flowing through Turkish stream will stay in Turkey, however, a total of 47 bcm will be available for Europe at the Turkish/Greek border. Mr. Medvedev called for an urgent discussion in Consultations/WS2 on practical aspects of how these volumes can be brought to target markets in Europe based on the Third Energy Package rules.

2. Southern Gas Corridor and related issues

(i) What next after the cancellation of South Stream & Russian decision on Turkish Stream. Gazprom's plans and possible EU reactions

Co-Chair WS2 GAC Mr. Konoplyanik gave a presentation outlining his personal vision and expert opinion of Russia/Gazprom's plans after the cancellation of South Stream. He explained the rationale behind the decision for Turkish Stream with a view to counter possible misperceptions on the EU side about the project. In this context, Mr. Konoplyanik clarified that the decision for Turkish stream and its required extension in Europe to existing delivery points of Russian gas was made in order to eliminate transit risk through Ukraine. According to the Russian side, the transit risk through Ukraine has been a real and measurable risk which could no longer be taken by Russia/Gazprom since it provides a threat to fulfillment of its existing gas supply contracts to the EU. Mr. Konoplyanik explained that Gazprom's primary interest was to reroute existing supply contracts to the EU via Turkey keeping unchanged the delivery points within the EU fixed in these contracts. He clarified that the intention was not to create a new delivery point at the Turkish-EU border since this will require renegotiations on and reopening of the existing supply contracts with EU. Mr. Konoplyanik also stated that the Turkish stream project does not constitute a threat to the EU Southern Corridor as may be perceived by the EU. In fact, the decision for Turkish stream would allow the Southern Corridor to stand for true diversification as it could comprise sources from many origins (Azerbaijan, Iraq, Iran, East Med) including from Russia, if EU regulation on allocation of new capacity (yet not finalized/adopted) is developed in such a way that it guarantee all the prospective shippers full amount of transportation capacity they have booked. This means that demand for transportation capacity for gas deliveries from such sources shall be available in addition to demand for capacity required by post-2019 deliveries of Russian gas via Turkish Stream, and thus the overall prospective capacity of Southern Gas Corridor will be equal to $[(47+X)+10\%]$ BCM according to Mr. Konoplyanik. He added that there would be a common interest of the EU, external non-EU producers and Turkey to develop adequate (financeable and manageable) EU rules for new infrastructure. A number of negative examples in the past when EU regulatory rules prevented effective allocation/development/utilization of new/incremental transportation capacity (TAG, Nabucco, OPAL) confirm the need to establish more manageable and financeable EU regulatory rules, in Mr. Konoplyanik's view.

In Mr. Konoplyanik's understanding, as he noted, the EU is strongly in favor of keeping transit through Ukraine despite the risks involved. He argued that the EU might wish to apply several indirect measures to defend this policy and to make other, i.e. non related to Ukrainian transit, options more difficult and/or not timely available when needed in 2019, namely through a) slowing down the NC CAM INC Amendment process, b) producing an NC CAM INC Amendment which is unfavorable to financing new cross border capacity and c) pushing for Art. 36 exemptions route which is lengthy and cumbersome.

Mr. Konoplyanik then listed possible options for the realization of new cross-border capacities within the EU, incl. an extension of Turkish Stream to Central Europe. He mentioned 3 paths: 1) PCIs, 2) Art 36 exemption and 3) via draft NC CAM INC Amendment process which aims to develop standard

regulatory procedures based on 3rd package rules. In his view, Gazprom's preference is through option 3, especially if draft Art.20(h) is incorporated in CAM NC INC (draft Amended Regulation 984/2013) Mr. Konoplyanik pledged for a strong "project finance" approach presented in draft Art.20(h) which comprises of open seasons, ring-fencing, the concept of an independent TSO, fixed tariffs (at least through pay-back period for project CAPEX), etc. in order to effectively realize cross-border infrastructure projects, especially when aimed to bring gas from external suppliers into the EU. Mr. Konoplyanik referred to ENTSG TYNDP-2015 survey results (as well as to his own involvement through 2014-2015 in ENTSG work on CAM NC INC), according to which the current network development approach in Europe contains significant regulatory, financial, market and permitting barriers. He advocated an Independent TSO (special purpose company) concept which would be responsible for the development, financing and operation of entire ring-fenced cross-border new infrastructure capacity project.

Mr. Konoplyanik argued in favour of using formal criteria to determine whether such new capacity is to be allocated via auctions or open season. He has indicated that Art.20a(3) of draft CAM NC INC (draft Amended Regulation 984/2013) contains already such formal criteria (i.e., if 2 or more interconnection points are involved, then new capacity shall be allocated via Open Season Procedure), but then two procedures are merged again into one at the later procedural stages on the basis of a default auction rule. He proposed to separate these two mechanisms since default auction rule is mostly detrimental for new cross-border capacities with multiple interconnection points. Based on the work earlier done in ENTSG working group on CAM NC INC, Mr. Konoplyanik proposed the effective way, in his view, of how to eliminate this obstacle in CAM NC INC with minimal changes of the existing text.

Mr. Konoplyanik proposed a pilot test for CAM NC INC based on case study for South-East European "Vertical Gas Corridor" with the aim to test financeability of EU investment rules for new capacity on the practical example of Turkish Stream extension within EU. He proposed to test both current version of draft Amended Regulation 984/2013 (without Art.20(h)) and inclusive of proposed Art.20(h).

Mr. Medvedev stated that it was the EU who had to finally make a decision and inform Gazprom how the EU is going to handle 47bcm from the Turkish-Greek border after 2019 since, according to Third Energy Directive (Art.13.2), it is the obligation of the corresponding TSOs to develop new capacity when there is a justified demand for such capacity (i.e. when prospective shipper is ready to book it in advance). If the EU decided to build up an infrastructure to re-distribute above-mentioned volumes and call Gazprom to be investor/developer for its part, Gazprom will examine such proposals and, if it will be economically feasible, Gazprom could decide on such involvement. Such EU decision was crucial and urgent given the time horizon (2019) according to Mr. Medvedev.

Interventions followed by WS2 members:

Mr. Stern asked whether the Russian side could imagine the EU to make transit contracts of its own with Ukraine and, thus, keep receiving gas via Ukraine. Mr. Medvedev responded that 47bcm of Russian gas re-routed from Ukrainian transit will only be made physically available at the Turkish/Greek border from 2019 on. Therefore to consider an arrangement when delivery points of existing Russian supply contracts with EU companies are to be moved to Russia-Ukraine border and, thus, transit via Ukraine will continue to occur, was not an option. Mr. Stern expressed doubts as to

how the rerouting of gas could be arranged in such a short time and stated that some thought should be given to possible interim solutions.

Co-Chair Mr. Boltz also commented on a number of issues raised in Mr. Konoplyanik's presentation. He first made clear that the EU side is in no way slowing down the NC CAM INC procedure. On the contrary, he stressed that the process was well under way and in time. Mr. Kamphues added that ENTSOG finalized the work on the NC CAM INC and handed it over to ACER. He also stated that work on the Tariff NC has substantially progressed and that these codes should be ready in the foreseeable future. Mr. Boltz then said that Gazprom can definitely go ahead with a project that has no PCI status. He explained that PCIs may get EU funding and have some other advantages; however, the status was by no means a prerequisite for a project. On the issue of auctions vs. open seasons in the context of the NC CAM INC amendment work, Mr. Boltz stated that both mechanisms have pros and cons and opinions within ACER on the issue are mixed. A final decision still has to be taken by ACER which will be done soon. Mr. Boltz also reacted to the negative example stated by Mr. Konoplyanik in relation to the TAG pipeline auctions and explained that this example was not really valid anymore given that auctions today are based on different principles as compared to many years back on TAG. Given that Mr. Konoplyanik had also argued in favor of a ring-fencing approach in big projects, Mr. Boltz stated that in the current Tariff NC a possibility for ring-fencing is included. Mr. Boltz finally said that there is neither a need to wait for the NC CAM INC amendment nor for the Tariff NC to push ahead with projects that provide capacity from Southern to Central Europe. Given the time horizon of 2019, a lot of steps will need to be taken before the rules are in place.

Mr. Boltz further stressed that the discussion now needed to focus on the detailed facts and what the transportation needs exactly are. He presumed that less than 47bcm will be transported from the Turkish/Greek border to Baumgarten as some gas will be going to Bulgaria or other countries along the route. Generally speaking, Mr. Boltz said he believed that the EU will be able to provide the necessary capacity and that the EU would be interested in a participation by Gazprom.

Mr. Medvedev said that indeed some volumes will be going to Bulgaria, however, the lion share of the 47bcm will need to reach Baumgarten. He added that Gazprom is ready to book the capacity to Baumgarten but the rules of the game need to be clear and predefined. Long-term booking must be made possible in order to allow the project to be financed. Mr. Konoplyanik added that this would be a full commercially financed project where funds will be raised from the market and no public money was involved, except, maybe, for 10% quota to be reserved, according to draft CAM NC INC, at the demand of ACER, for potential short-term bookings from undefined prospective shippers. According to Mr. Konoplyanik, it will be reasonable to expect that such quota, requested by EU public authorities, is to be financed (securitized) by EU public funds/financial institutions (EIB, EBRD, etc.).

Mr. Kovács asked whether the Russian side had a particular route from Turkey to Baumgarten in mind (referring to the "Tesla" route through GR, FYRoM, SRB, HU) and if any strong preferences in this regard existed. Mr. Medvedev stated that Russian side has no preferred/predetermined route in mind, but that pure economic logic says that (at least part of) the former South Stream route could be a possible option given that it is well known and relatively prepared given the work that has already been put into it. He added that this is not a must and that another route could be chosen if the EU wishes so. The "South Stream route" would, however, presumably save time given that permissions, etc. are already available which will save transaction costs Mr. Konoplyanik added. Mr. Kovács also inquired whether Gazprom had any plans to engage in IGAs in the post-South Stream

context. Mr. Konoplyanik clarified that in view of the EC's position on IGA's, this is very unlikely. He further explained that in case of South Stream IGAs were necessary since intended development of South Stream was to deviate from Third Energy Package rules. In case of Turkish Stream extension within the EU, it is to be based on and in full compliance with Third Energy Package rules. Therefore in Mr. Konoplyanik's view, the IGAs in this case would not be needed. He and Mr. Medvedev also confirmed that in the context of any Turkish Stream extension project, Gazprom was simply looking to contract (the most economical) capacity to carry gas as a regular shipper from the Turkish/Greek border to Baumgarten. Thus, as mentioned above, Gazprom does not have any specific strategic objective of taking part in project development but would be ready to consider doing so were it requested to do so by the EU and were the conditions appropriate.

Mr. Konoplyanik suggested carrying out a "pilot test" ("business game") in order to test the grounds (i.e. financeability of EU legislation on new capacities) for a case study project for which he propose to choose a 47bcm Turkish Stream extension to Baumgarten as a project of "mutual interest" for Russia and the EU and thus adequate to be dealt with under GAC umbrella. Mr. Kovács emphasized that such a "business game" had already been carried out and has flowed into and provided useful input to the NC CAM amendment discussion. Any similar exercise should, thus, be carefully considered as to its merits and should be agreed by both sides. In addition, he pointed out that the involvement of affected TSOs and NRAs may also be necessary. In any event, he reminded again of the NC CAM amendment process which is already foreseeing structures to allow large-scale capacity to be established in case there is demand for it.

(ii) Lessons from past EU pipeline projects: why projects need to be commercially viable and legally/regulatory sound?

Mr. Mitschek presented a number of lessons learned from cross-border pipeline projects. He stressed that in every project a clear project charter is needed from the very start and should comprise the following:

- a clear structure of shareholders and a clear governance system
- a clear project scope (it is the Turkish-Greek or the Turkish-Bulgarian border or both; completely new project or combination of existing and new sections; starting and end point; volume profile; routing; defined entries and exists, etc.)
- a clear regulatory regime (what are the access rules, open seasons, exemptions or mixed; investment incentives, etc.)
- a clear contractual framework (IGAs, interconnection point agreements, transport contracts, etc.)

Mr. Mitschek was asked about whether he believed a project could be realized until 2019 and if there was a way to align the clashing interests between the EU and Russia on the issue of necessary long-term bookings to finance projects vs. the aim to increase competition and the corresponding short-term provisions. On timing, Mr. Mitschek said that one way to save time was to use corridors with already existing feasibility and engineering studies. On the issue of short vs. long-term, he

added that a combination of short-term demand for capacity and long-term bookings is in principle possible. He added that these two principles do not necessarily exclude each other. However projects have to be bankable and therefore need a proven long term return. Mr. Konoplyanik stated that the question was who would be financing the capacity that needs to be available for short-term demand (10% quota). In his view, public financial institutions should carry the burden (rather than those who book long-term).

3. Energy Union

Co-Chair Mr. Boltz presented an overview of the Energy Union strategy document published by the European Commission in February 2015. He mentioned that the paper did not contain any major new ideas but summarized existing policies and next steps to be taken. Mr. Boltz ran through the various points in the document, inter alia the content on security of supply. In this context, he mentioned that the EU is aiming at reinforcing security of supply mainly through a well-functioning internal energy market/cross border cooperation and less focus on purely national points of view. He added that there was no intention to abandon Russian gas but to decrease vulnerability and to be able to live through supply shortages (if they occur) with the least possible damage. According to Mr. Boltz, rules are needed to come closer to this goal, for example strategic storage obligations in some countries, a specific level of diversification of sources but also a well-functioning whole sale market.

On the discussions about common gas purchasing, Mr. Boltz explained that common purchasing could perhaps be an option in some regions but nowhere close to being an obligatory mechanism across the EU.

A few questions were asked by WS2 members from the Russian side on whether specific criteria for security of supply already existed and if regional cooperation centers (such as planned for electricity) are also foreseen in the gas sector. Mr. Kovács said that most of these questions will be discussed in the framework of the review of the current SoS directive. The work is still underway and, thus, no concrete answers are available at this point in time. A proposal will be ready only by November.

Mr. Konoplyanik informed WS2 members that the Russian side prepared a list of questions on the Energy Union proposal which was finalized shortly before the meeting. Messrs. Boltz, Kamphues and Kovacs expressed their doubt regarding providing possible answers to some of the questions taking into account the ongoing work on a majority of issues raised. However, Mr. Boltz said responses could partially be provided where possible and suggested going through these questions at the next meeting.

4. Early Warning System (EWS) and Ukraine Monitoring

Mr. Kamphues informed WS2 members about the Early Warning System initiative launched at ENTSOG mentioning that it was inspired by WS3 discussions on a European dispatch center. Mr. Kamphues mentioned that Russia was not yet part of the system but that a letter welcoming its participation was sent to the Head of Gazprom Mr. Miller and the Russian Energy Minister Novak. Mr. Kamphues explained that the aim of the Early Warning System was to gather an overview of gas flows entering EU Member States especially in order to be able to react in a crisis situation. Before

the Early Warning System no centralized information of this kind was available. Mr. Kamphues stated that an Early Warning Team including a coordinator was constituted in September 2014 with a direct telephone line available 24/7. Several tools are at the disposal of the team such as swaps, redirecting of gas, extra capacity, etc. Mr. Kamphues also informed WS2 members about ENTSOG's Ukraine Monitoring mission which was set up to produce daily flow reports to be shared with the involved parties (EC, Ukrtransgaz, Gazprom, relevant EU TSOs).

5. Concluding remarks and Next meetings

In the end of the meeting a Co-Speaker (Mr. Feygin) has proposed to prepare a summary paper on practical results achieved by the GAC through the whole period of its existence since end 2011. It was decided that the GAC Co-Speakers (Mr. Stern and Mr. Feygin) will produce such a short-paper. Both Co-Speakers were present at this WS2 meeting and agreed with this task.

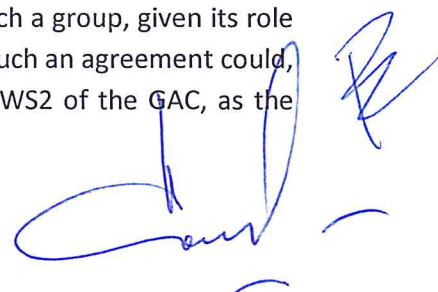
In light of the discussion held at this meeting, it was further suggested to start a more thorough discussion on the practical applicability of the CAM NC INC with a view to test the practical meaning of the parameters involved and to find workable solutions without focusing on a specific project or route but to acquire a sense of which issues need to be tackled in order to determine a number of gas transportation possibilities. This discussion could be held in a small expert group (no more than 6-8 senior experts with the relevant knowledge in total).

Mr. Konoplyanik proposed that a "Terms of Reference" document for the group could be drafted including but not restricted to the following content (and notwithstanding all other transportation options that can exist/be discussed) based on concrete assumptions, such as (list not exhaustive):

- o No transit via Ukraine from 2019, 63bcm are to be rerouted from Ukrainian transit to Turkish Stream,
- o 47bcm available at Turkish/Greek border from 2019 to be delivered to/towards Baumgarten,
- o No preference on route to Baumgarten, but gas must reach contractually stipulated delivery points in existing supply contracts which transportation arm is to be rerouted,
- o To check availability of corresponding permissions/documentation on other routes that might be appropriate as well (like South Stream, Nabucco, etc).
- o etc.

Options to be considered can be based on existing and draft legislation and are to be implemented in a timely manner.

Mr. Kovács made clear that - as in the case of the previously established similar case study group on the "Sweet Dream Project"- the assent of the EC was necessary to set up such a group, given its role as the leader of the EU side in the EU-Russia energy dialogue and the GAC. Such an agreement could, however, not be provided in this WS2 meeting and in general not by the WS2 of the GAC, as the matter needed further discussion.



The next WS2 meeting should take place at the end of June/beginning of July. Proposals for dates and agenda items (in addition to those postponed from today's WS2 meeting) will follow. WS2 members will be asked to communicate their availability.

For the EU side:



W. Boltz

Vienna, 22 July 2015

For the Russian side:



A. Konoplyanik

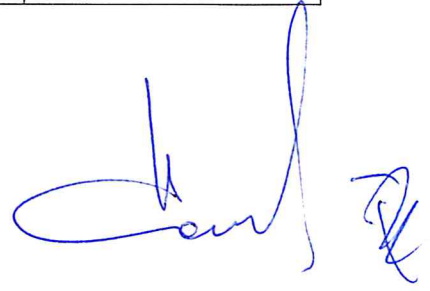
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AGENDA

Time	Items	Presenters
Morning Session 10:00 – 12:30	1. Greetings / Opening remarks by Co-Chairmen	W.Boltz, A.Medvedev/ A.Konoplyanik
	2. Update on relevant points discussed at 27th Madrid Forum	W.Boltz
	3. Early Warning System (EWS) and Ukraine Monitoring	S. Kamphues
	4. Southern Gas Corridor & related issues: (i) What next after the cancellation of South Stream & Russian decision on Turkish Stream. Gazprom's plans and possible EU reactions. (ii) Lessons from past EU pipeline projects: why projects need to be commercially viable and legally/regulatory sound?	A.Medvedev/ A.Konoplyanik R.Mitschek (OMV)
Lunch 12:30-13:30		



<p>Afternoon Session</p> <p>13:30 –16:30</p>	<p>5. EU Energy Union:</p> <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 <p>6. Concluding remarks and Next meetings</p>	<p>W.Boltz, A.Medvedev/ A.Konoplyanik</p> <p>W.Boltz, A.Medvedev/ A.Konoplyanik</p>
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