



## **Reliability and Flexibility: Russia-EU Gas Links**

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# Evolution of the European gas market

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## Market Development Stages

	Infrastructural	Institutional	Consumer
Mission	<ul style="list-style-type: none"> <li>Creation of basic infrastructure from a well to an end user</li> <li>Promotion of gas as a new, alternative Energy source</li> </ul>	<ul style="list-style-type: none"> <li>Improving the gas value chain efficiency due to increased competition</li> <li>Integration of national gas markets</li> </ul>	<ul style="list-style-type: none"> <li>The creation of a transnational market</li> <li>Client orientation</li> </ul>

## "Menu" of contracts

Volume	Destination point	Timeframe	Pricing
Rigidly fixed	Transfer possibility in case of change of final demand geography	1 year	Spot link
Reducing is possible		2 years	A substitute link
Increasing is possible		3 years	Mixed link
		...	Fixed price + variable costs
		30 years	

- ▶ We are probably at the end of the 'Institutional' period of the European gas market development in transition to a new "Consumer" period
- ▶ The need for a whole 'menu' of contract terms is a new market trend
- ▶ Gas buyers aspire to the individualization of contracts (specific business interests must be taken into account), the regulators – to their unification (to achieve equal conditions). This opposition is the main contradiction of the coming stage

## New market conditions

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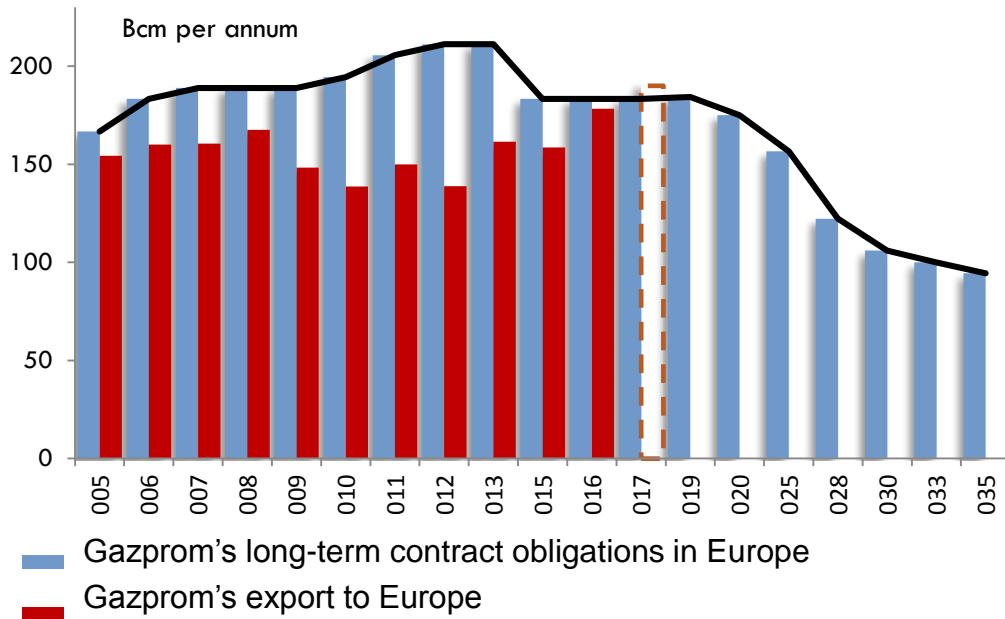
	<b>Sunrise</b> of traditional long term contract	<b>Sunset</b> of the traditional long term contract
Demand	<ul style="list-style-type: none"> <li>rapidly growing</li> </ul>	<ul style="list-style-type: none"> <li>Decline / slow growth</li> </ul>
Import	<ul style="list-style-type: none"> <li>4 major pipeline suppliers (Russia, Norway, Algeria, Libya) with almost non-overlapping markets</li> </ul>	<ul style="list-style-type: none"> <li>LNG as an alternative gas supply for most sub-regional markets</li> <li>Overlapping of the sales markets by increasing the connectivity of the gas network</li> </ul>
Demand Aggregators	<ul style="list-style-type: none"> <li>Major regional monopolists</li> <li>No choice of supplier for final consumer</li> <li>Long-term guaranteed market</li> </ul>	<ul style="list-style-type: none"> <li>No monopoly rights</li> <li>Consumers can choose suppliers and contract conditions</li> <li>Only short-term demand guarantees are available</li> </ul>
Gas-gas pricing and spot trade	Not developed	Their role is getting stronger in the structure of gas contract pricing

- Conditions in the European gas market have changed completely
- Gazprom's traditional partners in Europe have lost their guarantees of long-term demand and therefore they cannot provide similar guarantees for Gazprom and another external suppliers

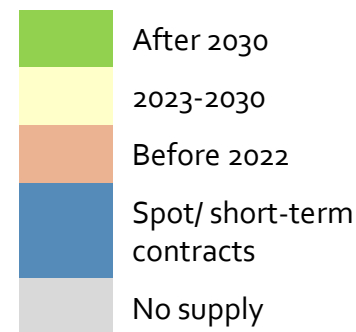
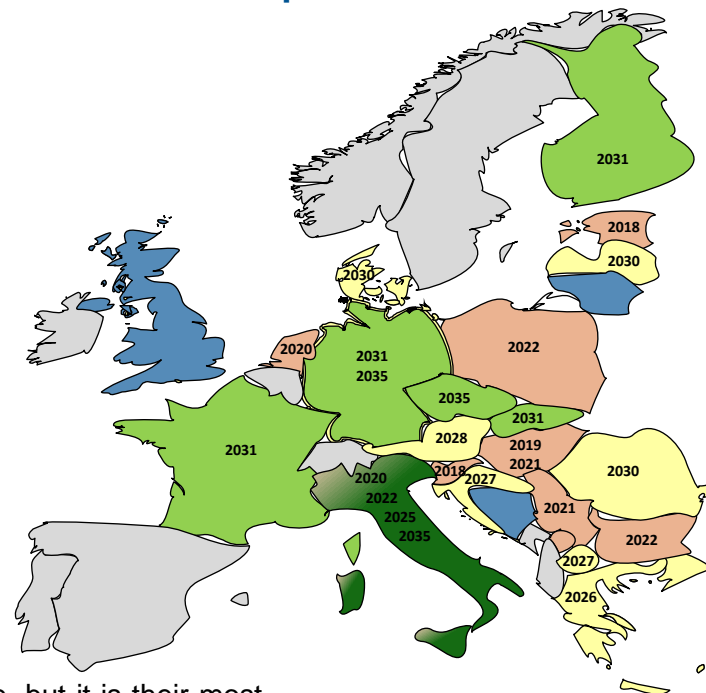
# But Russian LTC are still dominated in the EU gas market

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## Gazprom's long-term contracts in Europe



## Completion terms of Gazprom's contracts

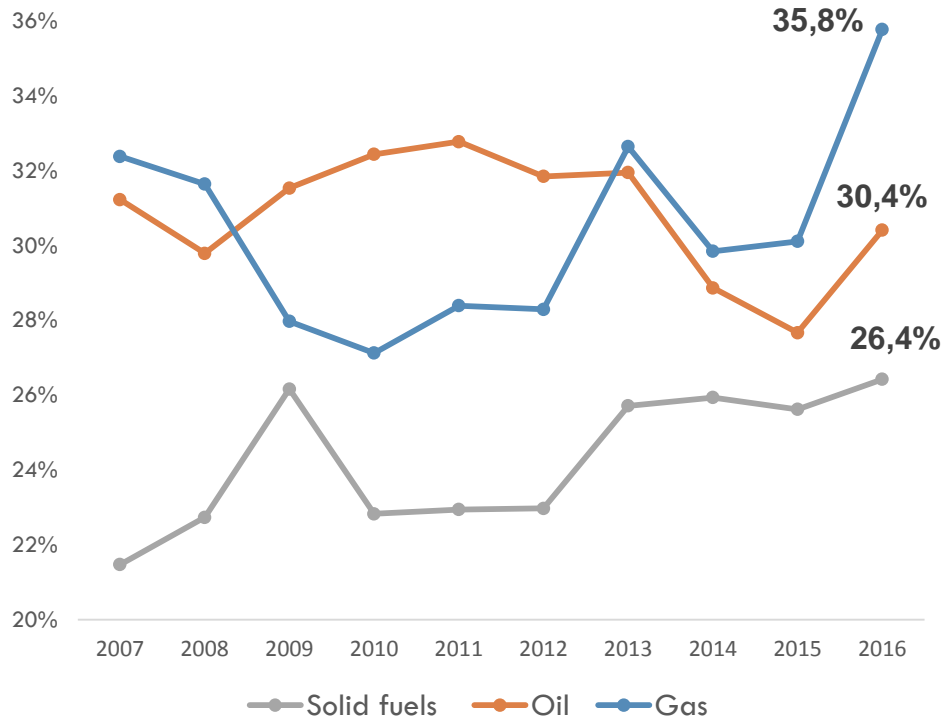


- ▶ Gazprom was not a developer of traditional long-term contracts of Groningen type, but it is their most consistent supporter
- ▶ Gazprom export provides 51% of the all long-term gas supply contracts with consumers in the EU-28, while Norway - 29% (mainly using spot link), Algeria - 17% and Libya - 3%;
- ▶ 73% of all long-term gas contracts are concentrated in only 5 countries: Germany (27%), Italy (24%), France (8%), UK (8%) and Spain (6%);
- ▶ In the last three years we have observed increase using of maximum long-term contracts volume level

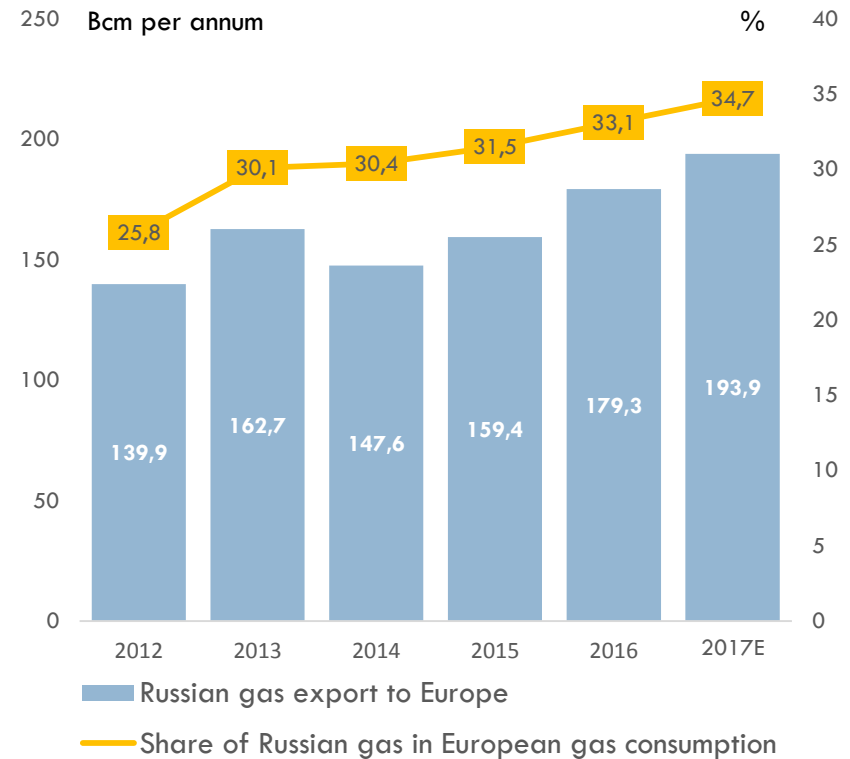
# Russian energy exports to the EU-28 is growing despite EU-Russia political tensions

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## Russia's share in the EU-28 imports of major energy resources



## Dynamics of Russian gas deliveries to Europe, 2012-2017

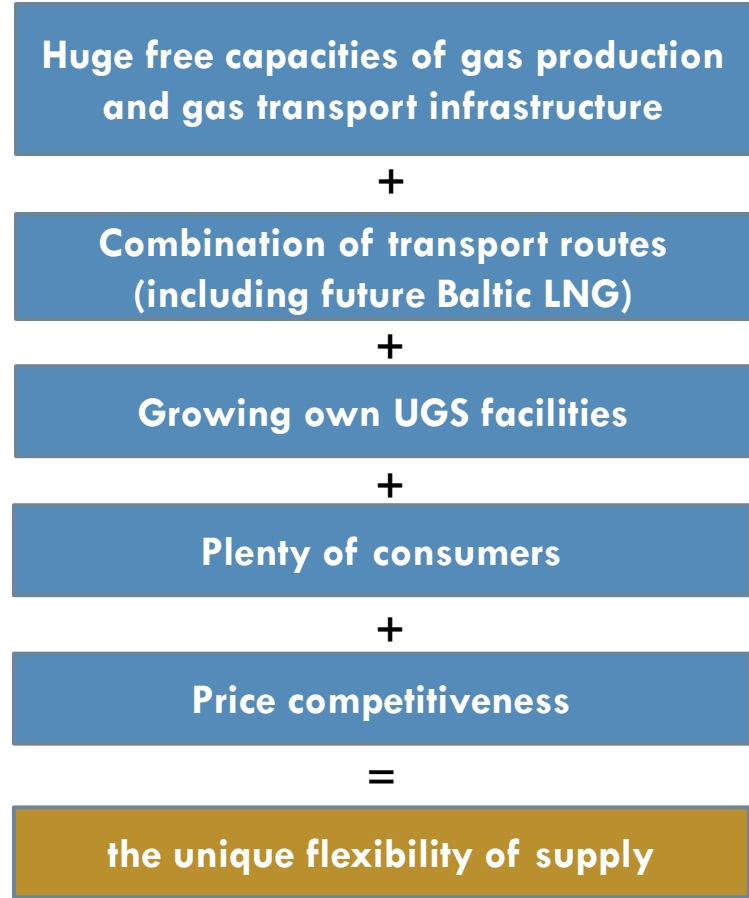
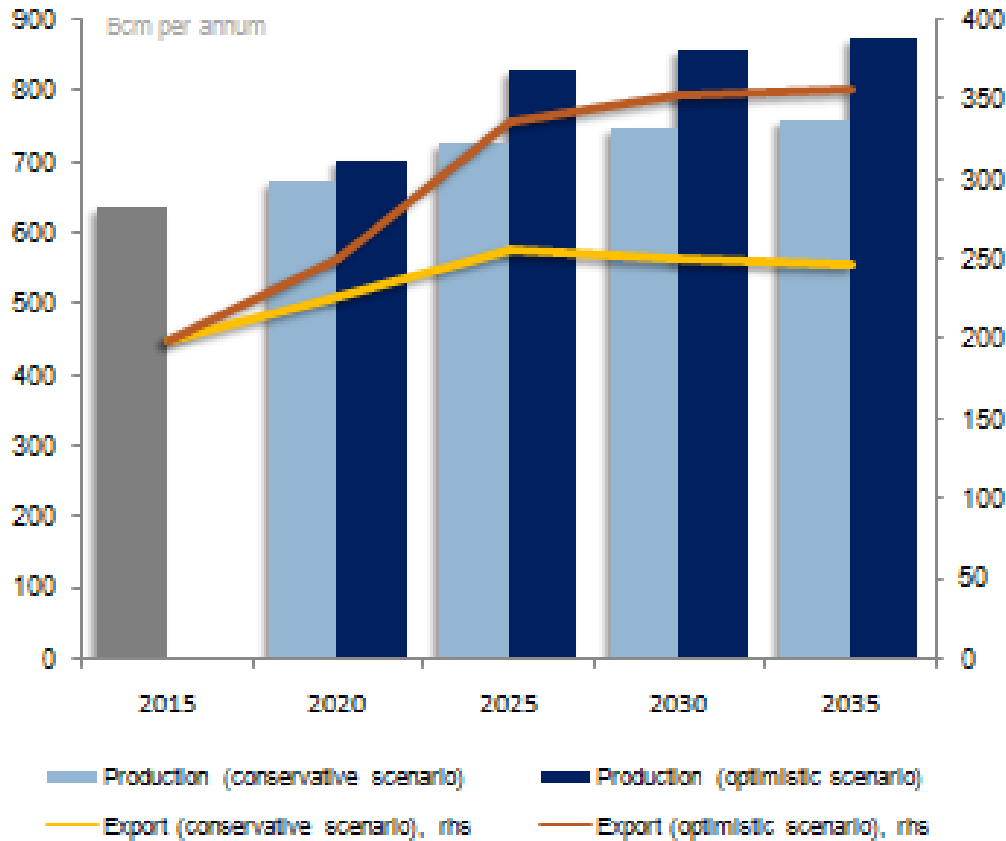


- ▶ Russian hydrocarbons are very competitive in the European market
- ▶ Russia provides more than 26% of imported coal, 30% of imported oil and 36% of imported gas
- ▶ Since 2014 Russian gas deliveries to Europe (including Turkey) have grown by 31,5% (+46,3 bcm)

# Russia has the unique advantages to continue to be the most attractive gas supplier for EU

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Russian outlook for gas production and exports up to 2035



▶ Russia has no resource limits for gas export and its volume is determined only by the demand

▶ Russia is most flexible gas supplier in the EU

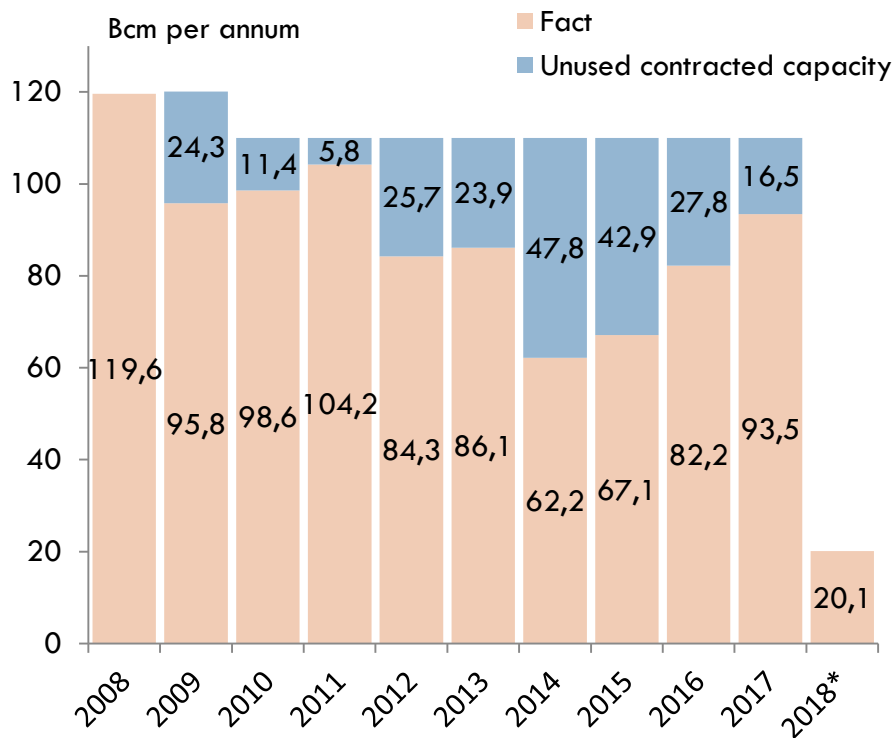
# Nord Stream 2: 'Apple of Discord' for the EU or 'Specific Tool' for Dialogue with Russia

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## Differences between opponents of the Nord stream 2

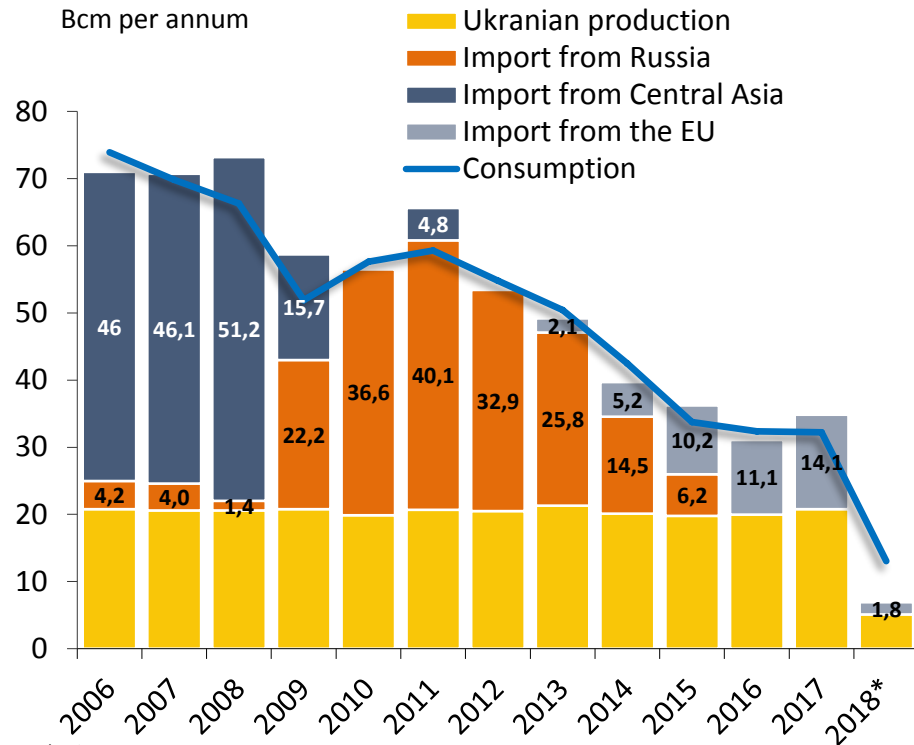
No	Characteristic of the group	The level of rejection in the subgroup	Members of the subgroup
1a	Nord Stream 2 poses a direct economic threat (losses in transit payments, degradation of infrastructure, reduced role in international trade, risks for gas supply in periods of peak demand)	total	Ukraine
1b		partial (it is possible to reach agreement on condition of preservation limited volume of gas transit through Ukraine)	Slovakia, Hungary
2a	do not accept the project due to geopolitical reasons (there are no real economic reasons behind)	total	Poland, Lithuania, Latvia, Estonia, Czech Republic
2b		partial (there is no final position)	Denmark
3a	Nord Stream 2 poses an indirect economic threat (as an object of economic competition)	total, but negotiable (the reason is a competition with Germany and the unwillingness to loose control of gas supplies running through the Ukrainian corridor)	Italy
3b		partial (there is no final position; the main reason of the rejection is to form favorable price conditions for the US LNG at the European market)	USA
4	using Russian interest in the implementation of this project as an instrument of political pressure on it	partial (there is no real rejection of the project, but there are requirements to what conditions it should be implemented)	The European Commission

## Transit of Russian gas through Ukraine



\* - 3 months (January-March)

## Gas supply of the Ukrainian market



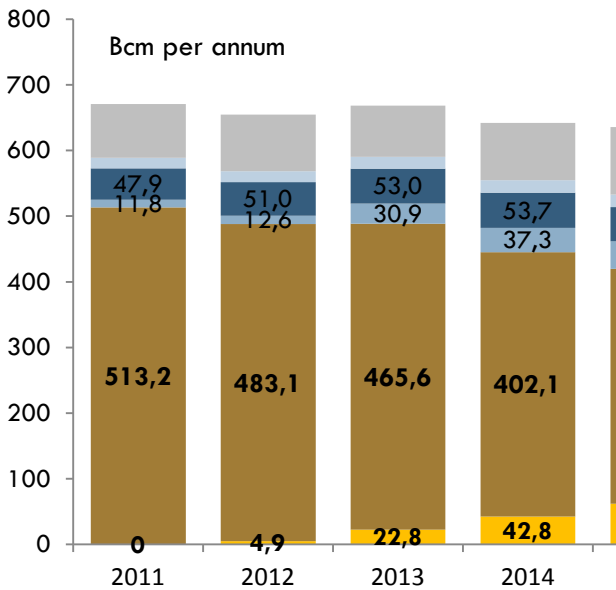
\* - 3 months (January-March). Consumption – without technological needs of the gas transportation system

Source: FIEF, Ukrstat, Naftogas

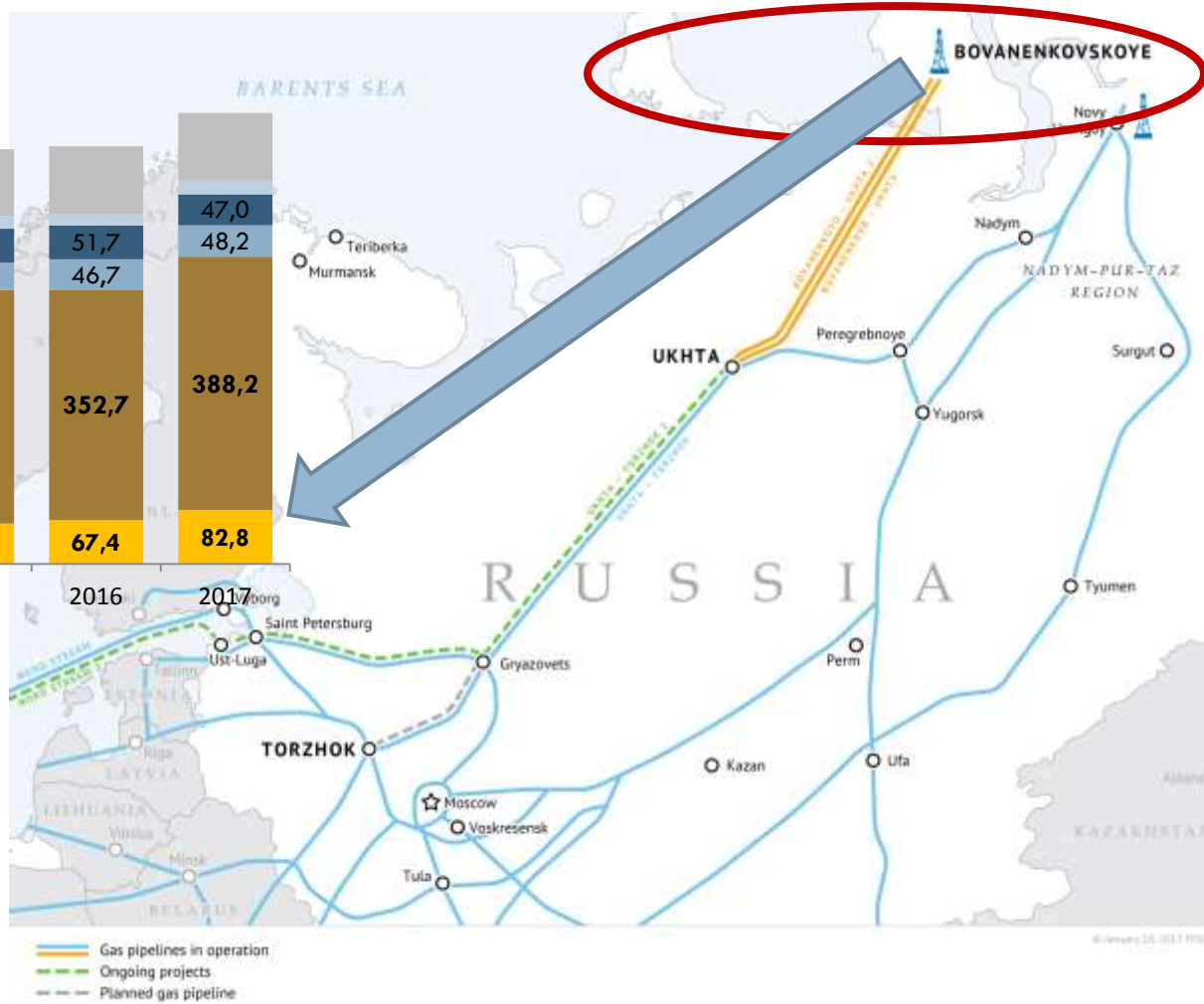
- ▶ Russia is actively using the Ukrainian gas transport system, despite the geopolitical risks of Ukrainian transit
- ▶ The decrease in the use of Ukrainian GTS in recent years is mainly due to a sharp drop in gas consumption in Ukraine
- ▶ The main problem of further use of the Ukrainian GTS is too high economic risks associated with extremely high physical wear of the infrastructure, lack of investment in its modernization and threats of sharp, economically unjustified growth of transportation tariffs



# Russia' gas production shift to the Yamal makes Ukrainian transit less cost-effective compared to the North Stream 2



- Other producers
- LUKOIL
- NOVATEK
- Rosneft
- Gazprom Group (except for Bovanenkovskoye)
- Bovanenkovskoye field (the Yamal peninsula)



# The Stockholm Arbitration Decisions on dispute between Gazprom and Naftogaz creates a new risk area for the European gas market

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## Common challenge

- ▶ Instead of reconciling Russia and Ukraine, Stockholm arbitration has only exacerbated their gas contradictions, guided by the principle of 'double standards'
- ▶ The arbitration dealt a significant blow to the EU and the European Commission possibility to be an effective mediator in resolving the fate of Ukrainian transit

## Key challenges for the European market

- ▶ serious doubts about:
  - ▶ reliability of contractual terms;
  - ▶ credibility of long-term contracts for suppliers;
  - ▶ return on long-term investment in the development of natural gas extraction and transportation.
- ▶ further politicization of gas relations, even at the level of judicial decisions;
- ▶ increasing middle-term and long-term risks of gas transit through Ukraine.

## Key challenges for the Russian-Ukrainian relations

- ▶ loss of confidence in a mediation in disputes resolution;
- ▶ economic inefficiency of existing contracts with Naftogaz for Russia;
- ▶ deep demotivation to preserve transit relations in future.

# We need a dialogue as never before...

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	GAC Work Stream on Internal Market Issues (WS2)	Topics
2014	11 WS2 Meeting	New Capacity Case Study, Framework Guideline on Tariffs
	12 WS2 Meeting	ENTSOG Incremental Proposal
	13 WS2 Meeting	Gas Target Model, New European Energy Security Strategy
	14 WS2 Meeting	TYNDP
2015	15 WS2 Meeting	Early Warning System Gas Monitoring, Energy Union
	16 WS2 Meeting	NC CAM Incremental capacity, TYNDP 2015-2035, Energy Union
	17 WS2 Meeting	The future of LT contracts and pricing Russian gas in Europe, Internal Gas market in Russia, Energy Union
2016	18 WS2 Meeting	NC CAM on Incremental capacity and Tariffs, LTICs and Hub Pricing
	19 WS2 Meeting	Legacy capacity contracts vs. reverse flows on pipelines with these contracts, NC CAM on Incremental capacity and Tariff
	20 WS2 Meeting	NC CAM on Incremental capacity and Tariff, COP-21
	21 WS2 Meeting	Gas transit risks in Ukraine, REMIT
2017	22 WS2 Meeting	Transportation contracts and IPs, Cooperation SPIMEX – CEGH, REMIT
	23 WS2 Meeting	Issues at the UKR/RUS border, The alternate fuel directive, TYNDP 2017, Que Vadis
	24 WS2 Meeting	Issues at the UKR/RUS border, Que Vadis, New Security of Supply Regulation, Methane emissions along the gas value chain, Future role of gas

- Despite the freezing of the Energy dialogue at the official level, there is still a high need for it on both sides
- Gas Advisory Council is an efficient mechanism of the Dialogue, ready for use