

The structure of the Russian gas industry

First of all, a few words about the Russian gas industry.

Its territorial structure was laid back in the 60s of the last century, with the start of the development of the main centers of natural gas production in **western Siberia** and the construction of gas transportation facilities to access the main centers of consumption in **the European part of Russia**.

By the end of the 70's, the main direction of our gas exports was formed towards the West. **For almost half a century, Russian gas has been an essential resource for the economies of European countries.**

Now Russia is developing **new centers** of gas production on the **Yamal Peninsula, Eastern Siberia, Yakutia, the Far East**, and planning in the future to increase the use of the huge gas potential of Russian **shelf**.

Russia develops its **Unified Gas Supply System**, which consists today of **170 thousand** kilometers of main gas pipelines and **26** underground gas storages with the active storage capacity of more than **70 bcm**.

With nearly a **quarter** of the world's natural gas reserves, Russia in 2014 produced about **640 bcm** of gas. Frankly speaking, this result is lower than our real capabilities; and the reason for this is the fall in the gas consumption in Europe. Later, I will address the specific features of this regional market, in details.

The principles and priorities of the Russian gas industry

Next, allow me to highlight a number of basic priorities and conditions for our gas industry at the current stage.

First of all, the Russian Federation has highest standards in **reliability, sustainability and security of the entire supply chain** of natural gas from its production stage to the final consumer, including its exports.

Mineral resources in Russia are state-owned, and the developer is **obliged** to ensure natural gas production at the field in accordance with the license for its development and operation, both in terms of the timelines and production capacity. We believe that the **population of Russia** has to receive a **fair profit share** from the production and use of the natural gas as a **non-renewable** resource.

This is why our main priority is unconditional, uninterrupted gas supply of the **Russian** economy, our **domestic** market.

At the same time, for many years Russia is **the largest gas exporter in the world** and, I am confident to say this, represents the highest benchmark standard for reliability and competitive supply of gas to the foreign markets.

Annual gas exports account for **200 bcm**, out of which **three-quarters** flow outside the former USSR countries. It'd like to note that we already have **extra capacity for gas production**. In addition, we can provide maximum flexibility for our partners, and also use it for projects to diversify pipeline gas exports.

As you understand, **a favorable geographical position** between the largest to date market importer – the **EU** and the most promising gas market – **China**, gives us wide opportunities to develop the exports potential of Russia to the full extent in the long term.

The world economic trends and prospects of natural gas

Ladies and gentlemen, building an effective strategy for gas exports now, during the times of change, is a difficult task, **considering the current climate in the energy markets, and complex situation in the global economy in general.**

The experts predict that the share of gas in the global energy consumption will not change **until 2035**, and will be around **23-24%**, but the level of gas consumption in absolute terms may grow by **one-third** and exceed **4.7 trillion cubic meters.**

However, when speaking on the latest economic trends, in my opinion, it should be noted that overcoming the financial crisis that began in the US in 2008 has been **slower** than everyone would like it to be.

It's clear, that the direction is moving from the formation of a global economic space to the **regional** and group integration processes.

Examples of this are the US efforts to promote the ideas of the **Trans-Pacific and Trans-Atlantic** trade and investment partnerships, and intensification of such a powerful political and economic formation as the **BRICS** (Brazil, Russia, India, China and South Africa).

However, I believe that such **regionalization cannot have** a serious negative impact on the gas market, as **global** gas market does not exist.

The basic principles of gas supply

Dear colleagues, for the gas industry professionals it's obvious why a **single global gas market** is **impossible** today and in the near future.

They know very well that in reality, natural gas **is sold while still in the earth's depths**, on long-term basis, and with the mining operations planned by the producers **based on the knowledge** of the volumes of the future supplies.

This practice is based on the **physical properties of natural gas**, and the conditions for its transportation and storage that put forward **tough** requirements for infrastructure and considerably **limit** the ability of the parties to accumulate **and store** volumes of gas, depending on the situation.

Thus, gas producers too have limited opportunities to work "**in order to store**" on the one hand, and gas consumers are unable to store up the gas for future use **for a long time**. This applies to all methods of storage, but time-wise is particularly critical for LNG storage, as well.

About the failed "globalizers" of natural gas market

We believe partially due to this fact, the recent predictions of the LNG conquest as an **integrator** of regional markets into a single global gas market were not justified.

LNG supply share reached 30% of world trade and stopped at this level. We believe that this share **will not change significantly**, and LNG will continue to be subject to competition between regional gas markets.

The same role of a “globalizer” for gas market was expected from “shale gas”, anticipating that the extraction of shale gas would significantly change the structure of the market. However, it doesn’t happen on a global scale and the production of shale gas remains a local market trend for the US only.

As a result, today there are regional markets of Europe, North America, Southeast Asia and a number of others that, although not isolated, are still characterized by different terms and conditions.

On the subject of securing consumption and gas supply

I believe that in the next 30 years, **the division** between world production centers and centers of consumption of natural gas will continue, although international trade will grow due to the construction of new export pipelines and new LNG trains. Both require **guaranteed return on investment** in the form of long-term contracts that share the risks of suppliers and consumers to protect the interests of all participants in the gas industry.

In my opinion, the interdependence of the participants of the international gas markets is to remain unchanged and the international gas trade will still be mutually beneficial only on the condition of the **equal sharing of risks** between

its participants, in order to maintain **parity over security of supply and security of demand**.

I would like to clarify that for us the **core of the security of demand** is the **market competition** between natural gas and other types of energy based on their **objective** benefits for the consumer and **real final price** that is not distorted by discriminatory or protectionist measures.

We believe that in this case the **environmental and economic** benefits of natural gas can adequately help to **plan** the volumes of its consumption, and thus ensure **in advance** the future demand by concluding the **agreements** regarding future secure supplies.

On the other hand, **the basis of security of supply** in my understanding is to **ensure continuity of the investment cycles** of the gas industry, starting with the security of payment for gas by the end customers.

Payback period of major gas projects is rather long, for example, for gas transmission system or LNG it is usually more than **seven-ten years**.

With a significant decrease in revenues, for example due to an **unexpected** decline in demand, **during the investment cycle** of a certain gas project its development usually becomes more complicated.

In my opinion, **dear colleagues, the basis** to resolve interdependent issues of security **of supply** and demand are the **long-term** contracts **with predominance of oil products** in the structure of setting binding gas prices.

Due to under-investment in exploration and gas transportation projects in the future, **consumers may experience a shortage of gas** at the most inconvenient times and would be forced to **buy the missing volumes at higher prices**.

For all its known shortcomings, such a mechanism of international gas trade allows you to **plan long-term investments**, and in the course of long-term contractual relationships to support mutually acceptable sharing of risks by **adapting** some of its provisions in the event of significant changes in the market factors.

This is the model of the gas business that we offer to our foreign customers, and as a rule, **the benefits of long-term relationships** based on **clear** terms of delivery and **mutual interests** make us reliable partners for each other.

We are not against the use of new approaches to pricing, but they should be **balanced and mutually beneficial**, and not undermine the investment attractiveness of gas projects. Long-term contracts linked to oil are like living organisms that constantly adapt to the current market situation in the form of constantly ongoing negotiations between the involved parties. They provide both **flexibility and confidence** in the future for all participants in the chain from exploration to gas burners or gas turbine in modern power plants.

In other cases, the displacement of the main **risks** to only on one of the parties calls for **necessary** diversification of the risks and undermines the partnership.

Diversification of Russian gas export

The concept of diversification of gas exports has **always** been on our agenda, so a **significant shift** of the burden of risk on gas suppliers, which occurred in the **European Union**, did not become **critical for Russia**.

Now we are taking active steps to fulfill this concept with **specific** content, primarily, to strengthen the "**Asian vector**" of gas exports.

As you know, in May last year, Gazprom signed a contract to supply gas **to China**. Contracted volumes of the long-term contract account for more than one **trillion** cubic meters. Annual supply of **38 bcm** of natural gas has **Yakutsk and Irkutsk gas production centers** as the resource base. **The new pipeline is "The Power of Siberia" ("Eastern route")**.

Despite the impressive volumes, this is only a quarter of the current needs of China and less than **10%** of the projected demand for 2020-2025. That's why **now** there are already discussions of the prospects of Russian gas supplies to China through the "**Western route**", which will be provided by the resource base of **Western Siberia**.

Diversification of gas exports also contribute to the steps taken for the development of Russian **LNG** production using **geographical advantages** of the Russian fields.

In particular, in addition to the expansion of existing LNG project **Sakhalin-2** in the east of Russia and **Vladivostok LNG** which is focused on the main LNG market in the Asia-Pacific region, **Gazprom** is preparing a new

project **Baltic LNG** with an initial capacity of **10 million** tons per year mainly for the supply of the Atlantic basin countries as well as for the bunkering purposes.

In addition, **NOVATEK** together with foreign partners is implementing the **Yamal LNG** project with the resource base of the South Tambayskoye field. First phase will lead to the annual production of **16.5 million** tons of LNG and it will be supplied mainly to Asian markets.

In addition, **Rosneft** is preparing **Far East LNG** project with the resource base of the **Sakhalin-1** project.

Thus, the **options** of getting natural gas from Russia for our **existing and potential customers** are **expanding**. In addition, our country has growing prospects for entering new markets and giving more flexibility to the export portfolio.

About the sanctions

Of course, the implementation of such high-tech projects **could be another platform to strengthen international trade and economic relations** and solidify positions of the leading international suppliers of technology, equipment and materials in the Russian market.

A good example is the above-mentioned pipeline project **The Power of Siberia**.

The scope of the project is huge with its length more than **4 thousand** kilometers. The first line of the pipeline will require **1.7 million tons** of pipes, a significant amount of **gas pumping** units, different **valves and fittings**.

However, part of the **global** manufacturers of this equipment, our foreign partners cannot participate in this project now due to the **sanctions**.

Now we are seeking for additional resources to develop programs for **imports replacement**, and, **dear colleagues, we are implementing them**.

Nevertheless, I remain confident that **policy of sanctions and ultimatums is counterproductive**. We all need to seek to **eliminate restrictions**, to overcome more quickly current and **very short-term**, disputes and develop multilateral cooperation.

In all fields of the international relations Russia always has been and remains moving towards building a constructive and mutually beneficial cooperation, and gas sector is no exception.

On the Asian gas market

We anticipate the highest growth in export volumes in gas markets of China and other countries in Southeast Asia. According to most conservative estimation, by 2030 additional demand for gas in the Asia-Pacific region will reach **500-600 bcm** per annum, and this region is likely to become the new leader in the world gas market leaving North America behind.

Southeast Asia economies will use gas more actively to **ensure** their growth.

In 2013, according to International Monetary Fund estimates, GDP grew by 7.7% in China and 5% in the ASEAN countries. It is almost twice as much as the world average (about 3%). Meanwhile, even in the developed countries of the region - Japan and Korea - gas **has 15-20% share of the energy mix** and has good prospects to replace oil and coal. I don't even mention the most populated countries in the world - China and India, where the **share of gas is only 6-8%**.

We witness a very **rational** approach of these countries to the widespread use of gas, including **electricity generation and transportation**, the use of the **advantages** of natural gas as a cleaner fuel in comparison with conventional coal and oil, to solve their environmental problems.

Here I might add that considerable interest for us lays in the opportunities that open up in the Asian markets of **gas as a motor fuel**, such as China, India, South Korea, Vietnam and Thailand. There is no doubt that this sector of the gas market is going to grow, and the Russian gas and the **experience** of our company in this field will be very much in demand.

The gas market in North America

Another potentially interesting market for us has been for a long time the energy market in **North America**; and we are still watching because of its weight in the world economy.

Until recently, the availability of gas in this market **was maintained** due to the shale production. However, it is clear that the growth prospects for its

production are far from unlimited, and it is probably safe to say that it has reached a **limit** now.

It is very likely that in the next 10-20 years, the North American market will **hesitate** between **hopes** for self-sufficiency in gas resources and **fears** of eliminating its energy security due to **exporting its own gas and coal**.

Long-term prospects for the development of shale resources are still poorly understood and are characterized by a high level of **speculation**. Moreover, the current low oil prices and gas contracts with oil bounds significantly **undermine the economy** of shale and LNG export projects from the United States.

The European gas market

I would like to discuss in detail the European gas market. It has been and still remains our main export market in the long term.

Two weeks ago in Austria (Vienna) at the 8th European Gas Conference there was a discussion of relations between Russia and the European Union in the gas sector. It's a pity that there was lack of activity from representatives of the European Commission, and some questions were left without proper explanation.

In my opinion, the main feature of the European gas market now is a high level of uncertainty in relation to expected long-term demand for

natural gas volumes. This is due to significant differences in the estimates of experts on:

- The rate of post-crisis **recovery** of the Eurozone economy,
- Price flexibility of gas **demand**,
- Further **selection** of environmental priorities between **subsidizing** renewable energy due to the gas price discrimination and the use of environmentally "dirty", but cheap coal.

It is a pity for us that the source of this **uncertainty** is some of the decisions of the European authorities, economic justification of which is doubtful. One might say they are **too politicized**, in the sense that they serve the interests of the European politicians rather than citizens of the European Union (EU), who **pay for the results** of those decisions.

Gas demand in the EU has been declining for the fourth year, after a record year of 2010, and in total, the demand has decreased according to preliminary estimates by 120 bcm (almost 23%).

In comparison with 2013, it fell down by about 50 bcm, or about 11% of the market. This is more than the **annual consumption** of Ukraine or France, and **exceeds more than twice** supply of gas to Europe through gas pipeline from Algeria.

We can all agree that under such **a decline in the security of demand**, when the market can fall in one year by a capacity equal to the capacity of **Nord Stream**, it is very difficult to plan long-term investments.

Natural gas imports to the EU have declined. However, due to reduced domestic production, the **share of imports** has remained **at 68%** of consumption, and because of reduction in supply from all major sources

(Russia, Norway, Algeria and LNG), **the share of Russian gas remained at 29%** of the consumed volumes. Thus, it was equal to the record set by Russian gas exports in 2013.

Unfortunately, dear colleagues, the complexity of the European energy market becomes even more complicated because of the destructive influence of some of European regulations.

I would like to remind you that, for example, the **Third energy package** was adopted almost **6** years ago. **4** years ago it came into force, but the vast majority of **network rules**, that should regulate the operation of the market in accordance with the new requirements, **has not been accepted yet**.

Such **uncertainty** weakens confidence in the work within the European market as a whole and causes significant **concerns** about the long-term **security of gas supply** to Europe in particular.

In addition, as I have already noted, the European reality means that **most of the risks** have been shifted to the side of the gas suppliers.

In particular, the situation with the **Opal** gas pipeline, a continuation of **Nord Stream**, looks like a pure **discrimination against gas producer and investors**, including European ones, purely for **political** reasons.

Over three years, the pipeline, which completely removed transit risks of gas supply of Germany, the Czech Republic and even partly Austria and

Slovakia, was forced to work only at **50% of its capacity**, simply because it supplies only Russian gas and **no other gas could be supplied through it**.

Another example of the **doubtful influence** of the Third Energy Package **on the interests of the European countries** was that today **Gazprom** together with the Turkish partners had already started the technical implementation of the gas pipeline to **the borders of the European Union**, instead of a gas pipeline across the Black Sea to the **European Union's members**.

As you know before that **the South Stream project** included of four pipelines in the Black Sea from Russia to Bulgaria and the construction of more pipelines in the European countries territory to supply gas to Bulgaria, Serbia, Hungary, Slovenia, Italy with possibility to supply Austria.

In Russia **we are already implementing** the **South Corridor** project for the future supply of the export pipeline with enough volumes of gas.

We tried to find an acceptable compromise with our European partners **for six years**, but **in the last two years** we faced more and more **their rejection of reasonable consideration of the interests** of the Russian side as **the gas supplier**.

We were denied from receiving the construction's permission until we guarantee the compliance with the **Third Energy Package** to reserve the half of the capacity of the pipeline **for an unknown gas of unknown gas suppliers**.

That means that we **would have to build** the gas transportation infrastructure **which would significantly increase the energy security of**

Europe and **abandon the possibility** of its effective use even during the period of **return** on investment.

I believe that **such high** level of risks would be unacceptable to any **responsible investor** and we were forced to change already **fully structured** project.

Now **Gazprom** started technical implementation of a **different** project. It will also start on the Russian shore and receive gas from the **South Corridor** but its sea part will come **to Turkey** and then the gas will be transported to the **border** of the European Union.

It is planned to start gas supplies to our Turkish partners less than in **two years**, and **after 2019** to bring the new gas pipeline system to full capacity of **63 billion cubic meters**.

I would like to note that when making a decision to change the route of **our** export pipeline across the Black Sea, we took into consideration that the European Union was preparing an **Energy Union** with the so-called "**single buyer**" of gas. **In fact the outcome of European Commission activities for liberalization and the creation of a single competitive gas market in the EU is supposedly the creation of a cartel!** Thus the foreign suppliers will **not have place** in the domestic markets of member countries of the future **Energy Union**.

So the question is: "Did European countries **win** from our compliance to **all** the requirements of the European **politicians**?". Unfortunately, the answer is far from obvious, taking into account that now our European partners need to take care of the gas transportation **from the**

border to consumers in the EU.

It can be stated that the European results of recent years are **discrimination** of gas as a fuel, **ignoring** the interests of producers and suppliers (*especially Russia, though Europe has never had **more reliable** partner in the energy sector, and it is difficult even to imagine a more reliable partner for Europe*), **confusion** in the energy market and **among** its participants creating the long-term **goals**.

The Russian Federation is interested in the predictable European gas market with clear and equal rules for all.

We wish to continue **almost half of a century** of mutually beneficial cooperation with European partners in the gas sector. We are concerned with regrettable fact that EU policy put **under a big risk the fundamental basis** of development of the gas component of European economies – **the parity distribution of risks between all participants of value added chain of the gas price**.

In conclusion of the European market issue, let me note that this market **is the main market** for us, and we are **strongly determined**, openly, patiently and smoothing out the rough edges, to seek for **mutual** compromise in our energy cooperation.

About GECEF and IEF as the most important participants of the global gas market

Dear colleagues, as you can see, the Russian Federation is committed to principles of maximum transparency of its foreign trade gas strategy and seek for transparency its conditions. An important role in this belongs to constructive participation of Russia in the International Energy Forum and other international platforms.

For example, the difficult situation in the European gas market has become worse both in terms of **the institutional conditions** and in terms of **volatility of demand** because the oil price since last autumn, **going up and down**, and this price is the basis for gas prices in **most** supply contracts.

In last December, I attended the **16th Ministerial Meeting of the Gas Exporting Countries Forum**. World's leading gas exporters on the meeting agreed that **the swing of oil prices** with their rapid drops from **100 dollars and more** per barrel down to **50 dollars and below** and then back is an **abnormal** phenomenon.

Moreover the current **low** oil prices are **harmful** not only for the producers who are now in need to support the investment cycle of gas industry but also for the consumers **who are at risk to face gas shortage in the future** and abnormally high prices.

As a result of the discussion, GECEF member countries, including Russia,

came to **a single position** that **the long-term** interests of each participant of the gas market is the "**golden middle**," that is not "too high" or "extremely low" prices, but **reasonable prices** without sudden big jumps.

With regard to the role of the international organizations in **market influence** I would like to note that in the world energy, interests of consumers are defended by **a number** of organizations and associations.

In the gas sector there are global and regional organizations **uniting suppliers and consumers** of natural gas such as the **International Gas Union and Eurogas**.

But in my opinion, the role of the **International Energy Forum** is one of the most important at the international energy stage.

IEF as a **neutral** party which promotes development of informal open dialogue between countries-producers of energy and energy consuming countries and also engage in such dialogue **transit countries**.

Russia **appreciates** all opportunities offered by the IEF and actively participates in its activities.

Meanwhile the **Gas Exporting Countries Forum** (GECF) had become **the only** industry is intergovernmental organization that **provides** an opportunity for gas **exporting** countries to discuss current trends and challenges as well as to contribute to the sustainable development of the gas industry and international gas markets.

As the GECF countries possess **two-thirds** of the world's proven reserves and provide about **half** of the world's gas exports, they serve as a **guarantee** of

long-term security of gas supply for the world economy.

Of course, this will support its future sustainable **growth** and its corresponding **social** development, because the **prosperity** of people in many countries of the world and the progress in the common goal to **eliminate** energy poverty are **directly** related to the gas.

Expressing the opinion of the Russian Federation on the **activities** of the GECF, I would like to note that we can see how the Forum is **dynamically** developing and actively **communicating** with all stakeholders of the energy market. In particular we believe that the **JODI-Gas** initiative jointly launched by IEF and GECF last year, will make an important contribution to the development of **transparency** and stability of the international gas trade.

In the declarations of the two past GECF summits which were held in Doha in 2011 and in Moscow in 2013, the leaders of the GECF countries expressed their common commitment to **market** principles of international gas trade, on terms of **parity** distribution of risks among all stakeholders.

The most important tool of GECF for promoting consolidated positions of its members is to build a transparent dialogue between all players in the energy market. I see **in this** the prospect for constructive **development** of relations between the GECF and IEF.

The Russian Federation has a positive consideration for such prospect. We believe that it is necessary to move forward **together** on the way of achieving

the most **objective** picture of the current situation and **related** conditions for further development of the global energy market.