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« Energy Dialogue Russia-EU, Gas aspect »
Reconciling Market Trading with Long-term Partnerships
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IGU President

Mr Valery Yazev, *Deputy of the State Duma of the Federal assembly of the Russian Federation, President of the Russian Gas Society;*

Distinguished Panellists;

Ladies and Gentlemen;

I am delighted to have been invited by the Russian Gas Society and Eurogas to present the viewpoint of the International Gas Union at the 8th International Conference. I am aware of the importance and significance of this conference as a pathfinder for a renewed dialogue between Russia and the EU, at a time when the geopolitical and commercial aspects of gas trade are entering into a new era.

I would like to acknowledge the presence of my friends and colleagues from the Russian Gas Society attending to the conference, who are also members of IGU and contribute so actively to the development and notoriety of our organization.

IGU is an independent and non-profit body with a long-standing experience in the inter-relation between producing and consuming countries. We know, in particular, that even if gas exchanges form part of the conventional world trade, they cannot be reduced to mere commercial terms and values.

The gas chain, whether we consider pipeline gas or LNG, is a highly capitalistic venture that rests as much on the mutual confidence between the parties, from the wellhead to the final consumer, than on the strength of its commercial arrangements.

In particular, I consider the security of supply and the security of demand not as conflicting issues between the upstream and downstream ends of the gas chain, but as the two sides of the same coin. The necessary overlap of the respective

interests of the seller and the buyer is an invariant cornerstone of our industry and whatever changes occur in the organization of the markets do not write it off; they just modify the nature of the answers that have to be brought by the actors of the chain.

Therefore, the challenge is to update the model of cooperation between actors of the chain with a view to maintaining this overlap notwithstanding the changes occurring in the regulatory and economic environment.

I would like to illustrate this viewpoint by making a few suggestions on how to promote a renewed mutually beneficial way forward for the Russia-EU dialogue and relationships on natural gas, in the context now prevailing after the deregulation of the EU market.

Firstly, the EU's security of gas supply should now be regarded as fairly satisfactory, on four main grounds:

Slide 1

- The diversification of EU's imports, both by pipeline and LNG, as well as by countries of origin, has been considerably enhanced over the last 20 years;

Slide 2

- The EU's supplies are far less concentrated than 10 years ago, since no single source now accounts for more than 35% of the overall supply;

Slide 3

- The export potential from the present supply sources seem quite sufficient to cover the long-term natural gas and LNG requirements and new potential resources are available from the Caspian region, the East Mediterranean gas province and LNG imports from the USA, which will contribute to a higher degree of geographical diversification;

Slide 4

- The import capacity by pipeline and LNG has been considerably enhanced over the last 10 years. The pipeline capacity at the border of EU countries now exceeds 400 Bcm/year, and 19 LNG terminals, with a total capacity of nearly 200 Bcm/year are in service. The EU has now a sizeable over-capacity at its entry points, which contributes not only to the security of supply but also to the daily and seasonal balancing needs of the networks, thus adding to the flexibility provided by the underground storages. The development of interconnectors in the North Sea and the installation of reverse flow facilities on the main trans-European pipelines are also widely mitigating the systemic risks of the interconnected EU gas grid.

Secondly, Europe is facing the challenge of remaining competitive in the context of global economy. The energy security for Europe has now switched from the traditional emphasis on the physical reliability of supply to the ability of acquiring energy at affordable prices. It is a real challenge since Europe is

impacted by its labour costs and has to pay for the extra cost of staying ahead of the pack in promoting green forms of energy. Therefore, the issue of having access to inexpensive primary energy sources has become a more important challenge than facing the traditional risk of supply disruption.

Slide 5

This pricing constraint is obvious for power generation, which is the only fast growing sector of energy consumption in Europe. To offset the impact of the high cost of renewables and reach an affordable average price of their electricity production, EU's power operators are massively switching from natural gas to coal, with the recent mothballing of about 5 000 MW of CCGT and the building of more than 10 000 MW of new coal fired power plants.

Furthermore, it seems difficult for the EU consumers to bear the cost of a carbon taxation that would be set at a level making natural gas competitive with coal for power generation, such level being of about 60 to 70 Euros/ton of CO₂, against less than 5 Euros/t presently.

Slide 6

Altogether, this results in global gas market conditions that have changed abruptly: European demand remains stagnant. The IEA predicts that in 2020, the EU's total gas consumption will be only 540 Bcm, which is only 4 Bcm higher than in 2010.

On the contrary, the Asian markets, and in particular China and India have huge potential requirements for natural gas, particularly in the power generation sector, mainly for imperative environmental reasons, and Russian gas competes on the Asian markets with long term LNG contracts at oil related pricing conditions.

My feeling is that it should be possible to take advantage of this situation in the best interest of both Russia and the EU. However, it requires combined efforts and innovative schemes at the upstream and downstream ends of the gas chain:

- On the upstream side, it is advisable that Russia endeavours to curb the upward trend of the production cost of the pipeline gas resources allocated to the EU market. I would be much presumptuous in proposing ways and means for achieving it, but some options would be worth considering by Russia:

Slide 7

- Reports indicate that Russia is not only a giant in terms of conventional natural gas resources. The IEA special study on recoverable unconventional gas estimates that Russia has 8 Tcm of Shale Gas, 20 Tcm of Coal Bed Methane and 7 Tcm of Tight Gas. Due to its large conventional resource base, the development of these resources has not been a priority for Russia, although these might be both closer to Europe and less expensive to develop and exploit than Yamal or Stockman. EU companies would likely be interested in sharing the risks and potential profits of these new activities;

Slide 8

- In the competition for access to the Russian gas, Asian countries are geographically better located than Europe and should be in a position to compete for the potential resources of East Siberia.

Slide 9

We note that Russia envisages exporting 70 to 75 Bcm of natural gas to Asia by 2030 and we think it possible for Russia to achieve this ambitious but realistic target.

- On the downstream side, it seems that new forms of cooperation between the Russian and European stakeholders of the gas chain have to be contemplated:
 - For power generation in the EU, which represents a major commercial challenge, it would be useful for the actors to see whether they should not form partnerships or joint ventures. Under such schemes, the price of natural gas becomes notional and the producer receives the actual netback value deriving from the sales of electricity. In such schemes, the producer shall receive at any time, through the processing of electricity, the maximum netback allowed by the power market in the EU. I know that Russia, and naturally Gazprom, have already a strong record of success in the joint development of pipeline infrastructures with EU companies like EON, GDF Suez, EDF. Extending the scope of such cooperation to power generation should be beneficial for all concerned. It can also be reminded that EU companies, like EON and ENEL are already electricity producers in Russia.
 - I also believe that the competitiveness of natural gas has to be ensured not only in pricing terms but also through the opening of new market niches created through innovation and technological progress. Our industry has an immense potential still under-developed in new domains like micro cogeneration, NGV, fuel cells, smart grids and many other fascinating R&D subjects.

I am convinced that joint ventures and partnerships can be engaged successfully between the Russian industry and the EU's most technologically advanced industries and that it would eventually much contribute to fostering the growth of the gas market, both in Russia and in the EU. This is one of the major goals set for the 2013 to 2015 triennium of IGU and our organization is an active stakeholder in this process.

Once again, I would like to thank the Russian Gas society and Eurogas for having given to me this opportunity to present a few remarks in the course of this extremely lively conference.

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