

Speech "CONNECTIONS ARE CRUCIAL" by Bert Panman (IGU) at the conference "RUSSIAN GAS 2005" (Third International Conference), 29 November, Moscow

time: 9.30 – 11.00 6 speakers

Sequence:

Dimitri Medvedev (Chairman of Board of Directors OAO Gazprom)

Victor Khristenko (Minister of Industry and Energy of the Russian Federation)

Alexey Miller (Chairman of OAO Gazprom Management Committee)

Bert Panman (Chairman IGU's Coordination Committee; replacing George Verberg, President IGU)

Victor Vekselberg (Executive Director for Gas Business Development of TNK-BP Management)

slide 1: "Connections are Crucial"

Good morning ladies and gentlemen; I would like to thank the organization of the congress for the invitation to address you on behalf of the International Gas Union. Our President mr. George Verberg sends his regrets not being able to be present and wishes you well.

My name is Bert Panman and I am Chairman of the Coordinating Committee of IGU

slide 2: International Gas Union

- map with 67 member countries;

slide 3: IGU mission

- long time (1931) standing worldwide organisation promoting the interest of gas
- Organizes every three year a World Gas Conference

Contribution of Russia:

- Russian Federation is a long standing and active member since 1958;
- Russia is represented and active in many IGU Committees
- For the next World Gas conference in June 2006, Amsterdam, IGU has received 82 abstracts from Russia on a total of 540 abstracts. Russia is the country that issued the largest number of abstracts and Gazprom is the company who's employees have turned in most abstracts; 40 abstracts have been accepted for presentation at the conference either as a speech or at a poster session. *(As this time IGU has received so many abstracts from all over the world, only half of the received abstracts could be incorporated as a paper in the Experts Sessions at the WGC)*

The title of my presentation "Connections are Crucial" was chosen because in the energy world of today and tomorrow, connections of several kind are very important to keep the economy sustainably fuelled by energy.

We can think of not only the physical connections of reserves and markets by pipeline, shipping routes, rail and road but also:

- Inter-company connections that serve the efficiency of use of technology, capital and labour
- Connections between Governments and Companies that govern the business activities necessary in the energy market;
- Government to government connections to
- Networking connections

And many more...

In the next couple of minutes, I will address some topics where the above mentioned connections play an important role.

Slide 4: Energy Consumption in Perspective

As we all know, energy fuels our economies and although the specific use of energy is improving, the world needs an impressive amount of energy. Population rises, the economies grow and the standards of living improve.

Slide 5: Total Energy Demand by Region

The use of energy is very high in some places of the world and only in the start-up phase in other regions. The International Energy Agency predicts that energy consumption goes up worldwide, also in countries where the standards of living are already high.

Slide 6: China's hydrocarbon demand

China is often seen as the country that will influence the future oil and gas flows heavily, but when we look at the IEA-projections their energy import needs, judged on a global scale are relatively modest as they China is expected to primarily exploit their own coal reserves.

Slide 7: Global Energy Demand

Natural gas seems to be the most wanted fuel, especially in power generation as gas combines positive features like fast construction, lowest CO₂ emission and highest efficiencies possible today. Gas has long been the preferred fuel from an economic point of view, but with the current gas prices its position could be weakened in spite of the fact that alternatives like coal and nuclear take time to get build as their permit procedures will last long and the acceptance from an environmental point of view will be more cumbersome than will the case with natural gas fired power stations. Time will tell which alternatives for gas are really available for the power plants that have to be build in the coming years in order to secure the supply of electricity. In the World Gas Conference in Amsterdam in June next year much attention will be paid to the projections of gas for power generation.

Slide 8: World Gas Reserves 180 trillion cubic meters

The demand for gas brings us to an other type of connections, the relationships between companies. We see in the gas and oil business that exploitation of new gas and oil discoveries is getting more complex because the resources are found in a harsh climate or in deep water. In Russia, you have experience with producing gas under difficult circumstances in the Siberian fields and if we take a look at the Shtokman project, it is clear that even more challenges have to be overcome. It is almost inevitable that all knowledge available in the world needs to be mobilized to accomplish those projects.

What I mean is, it is unlikely that one company on its own can handle these challenges effectively and efficiently: you will need the experience others have gained. I refer to what I interpret from the announcements in the press; from the shortlist it looks like that several parties bring assets to the table to make a successful project.

A look on the map shows the area's that possess large hydrocarbon reserves.

Slide 9: Position RF Oil and Gas

Russia is in this respect in a very luxury position; largest gas reserves, second in coal and seventh in oil.

However, for the large traditional gas consuming markets like the USA, the European Union, Japan and Korea, the uneven distribution of resources over the globe means they will stay importers and their import volumes will rise. Also the distances fuels have to travel will get larger.

Slide 10: LNG trumps: decreasing costs

Fortunately, for LNG value chain the costs have decreased due to technological developments: larger liquefaction trains, larger ships keep the costs in hand, even get the costs down.

Slide 11: LNG paves the way to global competition?

It is often heard that LNG will pave the way for a global gas market, where gas is traded like oil. IGU thinks this might be the case for limited volumes, but as LNG is still only less than 10 percent of the global gas market, there is a long way to go. And LNG projects are so expensive that investors will only decide to spend their money if - besides the technical train from liquefaction to regassification, also the commercial 'train' has been arranged and sound in contracts: there should be a guaranteed sales market to cover the costs.

So for many years to come, we expect that the backbone for these projects will be a set of long term sales and - purchase contracts, just like today.

We should not forget the financial side of projects: enormous investments require risk sharing, which is done usually by inviting partners to take a share in the projects. Mostly other gas and oil companies take a share, financial institutions lend their money to these companies which results for them in lower risks and thus in less capital costs for the project altogether.

According to the estimates of the IEA in its World Energy Outlook 2004, investments in Russian oil and gas need to be on average 24 billion dollars per year in the period until 2030. Although the amount of money sounds impressive, a joint effort of Russian and international companies will be able to cope with the challenge, provided the conditions are right for all stakeholders.

Slide 12: Market Models

Consumer markets move to a sentiment based on the Anglo-Saxon model. In the USA, later in the UK and nowadays in the European Union, the assumptions are that the end customer is served best with more competition in the market resulting in the lowest price possible for the customers. By unbundling services, the traditional relationship between gas production, gas marketing, gas transport and storage is disrupted. Companies have been and are forced to separate trading and transport activities and house them in new companies.

Opening the networks to third parties, will enhance competition, potentially leading to lower prices for the customer. One aspect of this market model however is, that long term contracts are under suspicion. The right use of long term contracts to ensure sustainable supply from distant reserves will remain crucial.

The competitive market model is functioning well in the USA and the UK, as long as the (long term) security of supply were guaranteed. Large gas buyers like industries benefit from this system. The advantage for the small customers is limited as on the wholesale level, prices are determined by the spot market and by the limited number of large producers offering gas to that specific market segment. And more over, on the continent of Europe, prices consist for a growing part of taxes and duties.

The debate yet among politicians about the impact of this advocated market model on the perspective of security of supply is getting momentum.

Presumably in the future the real competition will take place between the large consumer markets North America, Europe and Asia. When the forecasters are right and demand for gas will continue to be high during many years to come, those regions will compete for gas, mostly LNG, sold by Qatar, Australia, and Russia. Will the gas buyer that offers the best price to the producer will get the gas? This would be the case in a spot market. But as we believe that long term contracts will remain basic in trading LNG, the best way to get the gas to your country is to offer conditions that convince the producers of a continuous cash flow. This will not be easy if entering into long term purchase and transport contracts is difficult to arrange or legally not allowed. The gas producer

could come in a position where he has to sell his gas at the border of a country on a short term basis, bearing all the risks. The Energy Charter has not yet brought a solution to this and the European Union for instance does not have a common energy policy to handle the security of supply issue.

I think that security of supply is of special interest to the relationship between the European countries and Russia. As long as pipeline transport is the common means to move gas, Russia is the natural partner for the European Union and of course this is also true the other way around, as the gas seller cannot simply choose another market to sell its goods.

Slide 13: RF exports 2004

The EU is the main gas export market for Russia and Russia is the main single supplier to the EU.

Slide 14: Diversification of gas export

Producers can and will diversify their sales and buyers can and will diversify their purchases to balance their risks. Examples are the development of Russian LNG sales to the USA and Asian countries, I mention the Shtokman and Shakalin projects, and the options to produce LNG at the Turkish coast and the marketing of gas to end customers in the UK and other countries in Western Europe.

Recently it was mentioned that Gazprom also has the ambition of obtaining 10% of the French end user market.

Slide 15: Impacts on price: Sellers or Buyers Market?

For gas buyers it is far from easy to diversify their purchase portfolio in a sellers market. In many cases, they have to take what they can get and should not have the illusion that they are in the drivers seat the coming years. This means also that prices probably will not return to the pre 2004 level.

The nature of the market may change a bit after 2010 when large LNG projects that are under construction or in the planning phase have come on stream.

To conclude:

- For many decades there seems to be plenty of natural gas
- The dominant reserves are at great distance to the major markets
- The need to create incentives for all players in the market to actually capture the market is of great importance

The challenge that comes with a sustainable and competitive supply of natural gas to attractive markets will not be dealt with adequately without people who cooperate and ensure that the connections are right.

We at IGU think that IGU is a great platform to meet each other and the coming World Gas Conference in June 2006 is pre-eminently the place where people from our business can share their thoughts.

I have come to the end of my presentation, and I call upon you to visit the World Gas Conference next year in Amsterdam.

Slide 16: Thank you for your attention
