



View of EU businesses on the Constraints and Opportunities of the Russian Energy Sector

As formulated by the Energy Committee of the Association
of European Businesses in Russia.

Groningen

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Aims of the Presentation:

- 1. To show the constraints in the spheres of Oil, Gas and Energy Efficiency in the Russian Federation;**
- 2. To identify practical measures aimed at easing these constraints;**
- 3. To show the potential benefits of these measures.**



EU-Russia Energy Dialogue

Four Thematic Groups:

1. Infrastructure
2. Energy Efficiency
3. Investments
4. Trade



Infrastructure

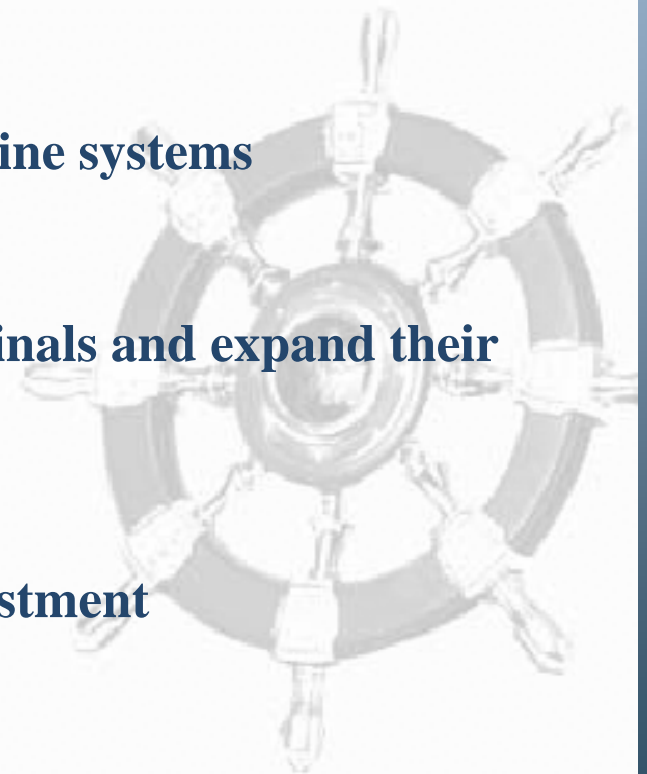


ISSUES:

- 1. Increased export of crude oil constrained by limits in:**
 - A. Pipeline capacity (Railway transports adds 5-7\$ per barrel)**
 - B. Network location (no connection to East Siberia)**
 - C. Existing export destinations (no pipeline to Asia Pacific)**
 - D. Shipping routes**
- 2. Increased export of gas constrained by:**
 - A. Limited pipeline capacity and gas transit capabilities**
 - B. Limited export routes**
- 3. New field development constrained by location of existing oil and gas pipeline networks and limited access of producers to the network**
- 4. Monopoly rules constrain private investment and availability of the transportation network for customers**

Suggestions:

1. **Trunk Pipeline bill should be revised to allow:**
 - A. **Public private partnership**
 - B. **Private owner / operator**
 - C. **Investor rights**
 - D. **Fair rules of access and operation of pipeline systems**
 - E. **Transparency and equity of tariff setting**
2. **Diversify the number of export routes and terminals and expand their capacities without increasing debt burden**
3. **Consider Volumetric Metering system**
4. **Consider Quality Bank for crude oil value adjustment**



Benefits:

- 1. Increased foreign investment in Russia**
- 2. Increased export volumes and higher revenues from Oil and Gas**
- 3. Expanded exports through development of new markets for Oil and Gas**
- 4. Secured export deliveries through diversification of markets for Oil and Gas**
- 5. Increased Pipeline capacity through PPP**
- 6. Extra revenues from incremental transit volumes**
- 7. Increased market price for oil eliminating discount to Brent Price and Siberian Light**

Energy Efficiency



ISSUES:

- 1. High energy intensity of the Russian economy**
- 2. Inefficiencies in the entire energy value chain from generation to end user**
- 3. Energy losses also result in negative impact upon the environment**
- 4. Increasing energy deficit in Russia**
- 5. Rising energy tariffs**
- 6. Cross-subsidized internal Russian energy tariffs**
- 7. Energy sector and communal housing sector needs reforms**
- 8. Lack of motivation to remedy the situation: Direct economic and strategic incentives in Energy Efficiency are relatively modest compared to Oil, Gas and Electricity related interests.**
- 9. Energy generating, transmitting and end use facilities are mostly obsolete and require replacement anyway.**

Suggestions:

1. **Establishment of venture investment fund for energy efficiency**
 2. **Consider increasing energy prices and thus increasing margins for Energy savings as well as proper institutional organization**
 3. **Creation of guarantee / insurance mechanisms addressing non-commercial risks**
 4. **Creation of a mechanism of reciprocity of EU investments on Energy Efficiency in Russia**
 5. **Creation of institutional and legal framework for dealing with projects under Kyoto Protocol**
 6. **Further liberalization of the market**
 7. **Creation of fiscal incentives at consumer level and of legislative framework favoring EE and E saving in the entire energy value chain**
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Benefits:

1. **Capitalization of large EE potential in Russia and increasingly large potential for financial savings**
2. **New area of business opportunities in liberalizing market**
3. **Good market opportunity for projects with short payback period**
4. **Positive, not politically / economically charged area for EU-Russia cooperation**

Investments



ISSUES:

- 1. After 5 years of annual oil production growth at 6 + %, 2005 growth rate is likely to drop to 2-3% and exports is witnessing a plateau or slight decline. Age of “Easy Oil” is close to its end. Brown fields are highly depleted, production has to shift to complex satellites with low productivity in traditional provinces and to green fields in remote new ones and offshore.**
- 2. Current tax leaves little cash flow for investment by companies in :**
 - A. Greenfield development**
 - B. Maintenance and replacement of equipment, e.g. Russian rigs**
 - C. Efficient oil exploration and enhanced oil recovery**
- 3. More than one year pause in issuing of new licenses & risk of revocation existing licenses**
- 4. Development of new subsoil legislation not yet in place**

Suggestions:

1. Consider tax reduction to provide sufficient cash flow for new field development and maintenance of production at existing ones
2. Create incentives through introduction of differentiated royalties (minerals extraction tax) for marginal of “Difficult Geology” fields
3. The open issues of the subsoil legislation should be clarified and resolved as soon as possible and the legislative process should be expedited
4. Clarification of the role of foreign companies/investors in Russian energy sector and admitted territories and proportions of cooperation with Russian partners
5. Revision to PSA law should be made to encourage and create incentives continental shelf and frontier development
6. Simplification and standardization of the approval process

Benefits:

- 1. Extension of the life of existing or difficult fields**
- 2. Increased opportunities for new fields development both on- and offshore**
- 3. Increase in development of independent oil and gas producers**
- 4. Preservation or increase production levels and related income**
- 5. Improvement of HSE performance of the petroleum industry and bringing world-class standards to Russia**

Trade



ISSUES AND SUGGESTIONS:

- 1. Contractual structure and market instruments for energy trade, including**
 - A. long-term supply and sales contracts (balancing the risks);**
 - B. spot market for physical contracts;**
 - C. enabling derivative financial instruments (futures and options).**

- 2. Reciprocal access to domestic markets as long-term target:**
 - A. removing barriers and limits, creating a single gas market in the EU and a domestic gas market in the RF, internal markets for petroleum and other upstream products and also a single electricity market in the EU and domestic power market in the RF.**

- 3. Development of wholesale energy trade hubs in Russia including a wholesale electricity market, and Oil exchange and Gas trading hubs.**

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