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EU-RUSSIA INTERACTIONS

While the ongoing political tensions and the COVID-19 pandemic continue to affect EU-Russia energy relations, the energy transformation (or energy transition) is actively gaining momentum. The EU commitments to achieve climate neutrality by 2050 (the so-called “Fit for 55” package), the law on reducing greenhouse gas emissions, the Concept for the Development of Hydrogen Energy approved by the Russian Government, and other upcoming legislative initiatives (for example, the introduction of quota purchases in Sakhalin Region) are intended to stimulate the innovative development of cooperation between the EU and Russia in the field of energy. However, this is accompanied by certain challenges.

The AEB firmly believes that a constructive dialogue involving all interested parties will promote the achievement of mutually beneficial goals.

OIL AND GAS

The growing gap between gas production and consumption, along with political instability surrounding a number of infrastructure projects, makes the prospects of a reliable gas supply from Russia to the EU more uncertain. In addition, the unprecedented spike in gas prices in the European market is giving all consumer groups cause for concern. The diversification of supply sources and routes, as well as demand and supply security, is vital for ensuring that consumers receive gas in the volume required.

RECOMMENDATIONS

- It is possible to keep using natural gas until renewable energy sources become more universally accessible. It is extremely important to continue discussing agreements on guaranteeing the continuity of gas supply to European consumers, while also moving toward the designated climate goals. The recently completed Nord Stream 2 gas pipeline can have a positive impact on shaping gas prices.



- › The role that gas is to play in Europe's future energy balance is currently uncertain, which could negatively impact energy infrastructure projects. The growing concern about the carbon footprint of methane use is driving Europe's need for stricter regulations in the field.
- › Natural gas will retain its role in the EU's energy balance over the next few years, meaning that the EU will remain a major market for Russian gas. Proven to be a stable, safe and affordable energy source, natural gas is also driving innovative solutions for a low-carbon economy in the long term. It can be used for producing hydrogen, the widespread use of which leaves a minimal carbon footprint. The existing gas transportation infrastructure can be adapted for moving hydrogen across borders. With innovative technology, the carbon footprint from the use of natural gas can be reduced, and carbon-neutral gas production can be facilitated. We propose promoting joint research programs in relevant fields, in particular, through specialized technological alliances.
- › The introduction of cross-border carbon regulation in the EU may have a significant impact on Russian industrial exporters.
- › It is important to maintain a constructive dialogue, aimed at achieving a balanced solution that would take into account both the EU Green Deal and the interests of Russian industrial manufacturers. By ratifying the Paris Agreement, Russia showed a serious commitment to playing its part in achieving the goals on the climate agenda. Along with potential problems for the Russian industry, the change in European regulations may also speed up the transition to a low-carbon consumption enterprise structure and the rise in industrial energy efficiency.
- › The government of the Russian Federation is continuing to promote a new taxation system for oil and gas companies, along with testing and improving new tax modes.
- › Making taxation in the oil and gas industry more predictable, ensuring tax stability for long-term projects, and treating all investors fairly is vital for the successful completion of major investment projects.
- › Federal Law on Restricting Foreign Investments in Strategic Industries and amendments to mining law present an important concept for investing into businesses with licenses to mineral deposits of federal significance.
- › Any company that carried out geological exploration under a valid license must receive guarantees that it will participate in the development of the respective deposits, should any be discovered. If the deposit discovered is classified as one of federal importance, this calls for new rules and procedures that will eliminate the risk of license withdrawal. Subsoil users should have the right to start exploring and

drilling at the deposit before the geological survey is complete.

- › Restrictions on sharing geological data abroad hinders the efficient operations of foreign companies and joint ventures in Russia.
- › To provide incentives for executing joint projects, it is necessary to amend the current licensing procedure for the export of unclassified geological data obtained by subsoil users as a result of analyzing and processing initial information, as well as to permit the export of geological data not subject to the Decree No. 1203 of the President of the Russian Federation, dd. November 30, 1995, specifically data that does not constitute a state secret and was obtained by companies legally and at their own expense.

HYDROGEN

The adoption of national hydrogen strategies in the EU countries creates opportunities for the export of Russian fuel to the EU, which can positively affect economic ties and improve the trade potential of bilateral relations.

Russia recently approved a new Concept for the Development of Hydrogen Energy and is already taking steps to follow through. Russia's enormous production potential and increased global interest in the development of hydrogen energy is opening up new opportunities for the Russian energy sector. Russia has what it takes to produce hydrogen for a competitive price. The development of hydrogen projects in Russia is stimulated by the country's proximity to the most promising export markets and possession of an export infrastructure that can be repurposed for hydrogen export.

POWER GENERATION SECTOR

Russian Government Decree No. 43, dd. January 25, 2019, changed the Rules of the Wholesale Electricity and Capacity Market, thus building a regulatory foundation for selecting modernization projects. The projects that passed the selection process are highly competitive and attest to the efficiency of this way of stimulating investments into power generation equipment overhaul. That said, the deployment of the modernization process does display certain setback that prevent the efficient completion of the entire range of its intended tasks.

The current rules do not allow projects involving the transition of power generation facilities from the steam power cycle the steam-gas cycle to properly compete with other projects. The transition of significant share of power generation facilities in the Russian Federation to modern technological solutions will, in the long term, not only contain the rise in electricity prices, but also ensure a stable demand for gas turbines and other products of the domestic power engineering industry. This makes it highly important to adjust the rules for selecting modernization projects if we are to encourage the rise in the share of steam-gas cycle projects.

Furthermore, the increase in prices for metal products and building materials, which has been observed since 2020 and significantly exceeds the inflation rate, has a highly negative economic impact on modernization projects that are already at different stages of completion.

RECOMMENDATIONS

Taking into account the previous experience with the selection of thermal power plant modernization projects, along with the sharp deterioration of macroeconomic conditions, we propose amending Section 20 of the Rules of the Wholesale Electricity and Capacity Market, by:

- ▶ Designating an annual quota for steam-gas cycle projects (in the amount of ~2 GW) with the possibility to expand the quota at the cost of unused/saved funds from previous selections.
 - ▶ Increasing the maximum capital expenditures for steam-gas cycle projects, similarly to the selection of innovative turbines (65-80 MW: 100 thousand roubles per kW, the rest: 73.44 thousand roubles per kW).
 - ▶ Canceling minimal requirements for the operating time of steam turbines used superstructural projects before the steam-gas units.
 - ▶ Making it possible to move steam-gas site launch to a later date (within 24 months) without any fines (only applicable once).
 - ▶ Amending the rules of indexing capital expenditures on modernization projects, specifically ensuring the indexing of capital expenditures by the same year when the capacity supply is set to start, by the amount of total inflation between the selection year and the supply start year.
- ▶ In order to ensure that all interested investors can compete on equal terms and that the principles of free competition are followed, it is necessary to consider the timely adoption of relevant amendments to regulatory legal acts, which need to be published no later than 90 days before the bidding starts.
 - ▶ In 2021, a program for the development of renewable energy sources in the Russian Federation was approved for the 2025–2035 period. We are also currently seeing an active climate agenda development, specifically concerning requirements for low-carbon power generation; nonetheless, the approved volumes of investment resources do not allow for the full-scale development of the renewable energy industry, especially given the increased requirements for production localization and for export to third-party countries.
 - ▶ We consider it expedient to expand government support measures for renewable energy projects in 2025–2035 (equaling at least 10 more GW in the wholesale electricity and capacity market), while maintaining the principle of competitive project selection and a operating a mechanism for stabilizing cash flows.



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