

## Press Conference

### Gazprom's Power Generation Strategy

June 10, 2009

**Moderator:** Good afternoon, colleagues! Let's continue our work. Today we are having the second Press Conference on Gazprom's Power Generation Strategy. The Conference is attended by:

- **Kirill Seleznev**, Member of the Management Committee, Head of the Gas and Liquid Hydrocarbons Marketing and Processing Department, Gazprom; Director General of Mezhregiongaz;
- **Denis Fyodorov**, Head of the Directorate for Power Sector Development and Marketing in Power Generation, Gazprom; Director General of Gazprom energoholding.

Mr. Seleznev is welcome to begin, later on you'll have a chance to ask him questions.

**Kirill Seleznev:** Good afternoon, esteemed colleagues! As you may know, the Gazprom Management Committee and Board of Directors approved the Company's Power Generation Strategy in April 2007. In line with the Strategy, the major areas of the power sector development by Gazprom are: the acquisition of stakes in power generating companies, the construction of new power generating facilities, the energy distribution business development; as well as the advancement of the Company's own electricity network operator.

Slide 2 shows the map of Gazprom Group's power assets. As it was mentioned earlier, as part of the Strategy approved, in 2007 Gazprom gained control over Mosenergo, WGC-2, WGC-6, and is going to gain control over TGC-1. In addition, as part of the Strategy, new power generating facilities are under construction in the following cities: Kaliningrad (450 MW), Adler (360 MW), Astrakhan (240 MW) and Orenburg (180 MW). The projects for power stations construction in Astrakhan and Orenburg will ensure increasing the energy security and the effectiveness of energy supply to Gazprom Group's gas processing facilities.

It is worth mentioning that all Gazprom's power assets are located in rapidly growing regions with a solvent demand. At the same time, the major heat and power consumers in these regions, primarily in Moscow, Moscow Oblast and Saint Petersburg, are small and medium companies with a low energy component in the prime cost of the final product. This ensures a guaranteed demand for heat and electricity even in case of a considerable tariff upsurge.

The map in Slide 2 does not show Mezhregionsbyt (energy distributor) and

Gazprom energo (electricity network operator) due to the fact that they operate in numerous regions. However, these companies significantly influence the optimization of power consumption by Gazprom's subsidiaries. Let me say a few words about this a bit later.

In August 2008 the Gazprom Board of Directors made a decision to consolidate TGC-1 and Mosenergo shares on the books of Gazoenergeticheskaya Kompaniya (since May 2009 – Gazprom energoholding). Once these assets are consolidated on the Gazprom energoholding's books, Gazprom Group will gain control over the facilities exceeding 36,000 MW in electric capacity.

Slide 4 shows a target-oriented diagram for asset consolidation on the basis of Gazprom energoholding. As part of the Company's Power Generation Strategy, all the assets acquired and new construction projects will be consolidated on the basis of Gazprom energoholding.

Now I would like to speak about each and every stage of the Strategy in detail.

Stage one provides for the investment programs execution by power generating companies.

Within 2007–2008 **Mosenergo** commissioned three combined-cycle gas turbine units with 1,325 MW in aggregate capacity. The energy company's investment program is unprecedented in the contemporary history of the power industry if compared to other wholesale generating companies (WGC) and territorial generating companies (TGC), the facilities commissioned during two preceding years exceeded 500 MW in capacity. Within 2009–2010 the construction of the combined-cycle gas turbine unit (PGU-420) at the combined heat and power plant CHPP-26 will be accomplished. In 2007–2008 Gazprom invested over RUB 55 billion in total. Mosenergo has reserved the equipment required at the fourth stage of the investment program providing for commissioning of 1,260 MW by 2014.

At the same time Mosenergo's activities are complicated by the following factors: the absence of a competitive heat energy market in Moscow leading to ineffective heat consumption in case of combined-cycle production. In 2009 Mosenergo had 30 per cent lower tariffs than those economically viable for the capacity of three new power generating units. Calculated by the Market Council, the capacity tariff of RUB 370 per 1 MW a month does not allow for investments payback with an acceptable rate of return. This has also resulted in RUB 300 million shortfalls in the income gained based on the Q1 2009 results. The shortfall in the income gained by Mosenergo's new power generating units is estimated to exceed RUB 1 billion in 2009.

**TGC-1** is a unique generating company located in the Northwestern Russia, since 50 per cent of power is produced at hydropower plants (HPP). TGC-1's investment program provides for commissioning of over 2,000 MW before 2015. The amount

of finance is estimated at over RUB 100 billion. In 2009 it is planned to commission PGU-180 at the Pervomaiskaya CHPP-14 and high-capacity turbine units at Vasileostrovskaya CHPP-7 and Vyborg CHPP-17. In 2009 upgraded power generating units were put into operation at Volkhov and Svetogorsk HPP.

**WGC-2's** investment program provides for commissioning of over 1,460 MW before 2015. This includes construction of coal-fired units PSU-660 and PGU-400 at Troitsk and Stavropol State District Power Stations (SDPS) and construction of a combined-cycle gas turbine unit PGU-400 at Serov SDPS. The amount of finance is estimated at over RUB 80 billion.

Let me say a few words about the technical condition of the power industry facilities obtained as a result of the RAO UES of Russia reorganization. Slide 9 contains photos, which clearly show the technical condition of the Troitsk SDPS as obtained as a result of the WGC-2 acquisition. Despite a poor financial standing of the company in 2008–2009 the management made much effort as part of the technical upgrading and reconstruction program at the power station. Some results are shown in Slide 10. The power station is still in a poor condition and requires significant amount of investment.

**WGC-6's** investment program provides for commissioning of over 1,270 MW before 2015. This includes the SDPS-24 modernization by adding a gas turbine unit (PGU-420), the Kirishi SDPS modernization on the basis of the combined-cycle technology (PGU-800), the coal-fired TsKS-330 unit construction at Novocherkassk SDPS, and the coal-fired STU-330 unit construction at Cherepovets SDPS. It should be emphasized that the investment projects at SDPS-24, Kirishi and Novocherkassk SDPSs are innovative and unprecedented in the Russian power industry, they impose considerable risks related to construction schedules and costs.

According to the 2008 operating results the total power output of Gazprom Group's power stations exceeded 180 billion kWh and the total proceeds from electricity, capacity and heat sales – over RUB 200 billion.

As a result of the above mentioned investment programs execution Gazprom energoholding will increase the electric power output in 2009–2015 by over 5,640 MW, and the proceeds are estimated to increase more than 2.5 times.

I would like to say a few words about new construction projects.

In 2008 the second power generating unit construction was initiated at Kaliningrad CHPP-2 located in the region of strategic importance. Construction work is to be accomplished within 2010.

In September 2008 an investment contract was entered into by Gazprom energoholding and GK Olimpstroy to construct a 360-MW power station in Adler.

In compliance with the obligations undertaken, Gazprom energoholding is to ensure commissioning of the combined heat and power station before May 2012.

Pursuant to Gazprom's Power Generation Strategy, measures are taken to enhance the effectiveness of energy supply to the Gazprom Group member companies, in particular, construction of power generating units for technological needs. So far, a feasibility study for construction of the power station for technological needs at the Astrakhan gas processing facility. Russian and foreign companies are discussing further project implementation with application of project financing mechanisms. In addition, we are working at the project for constructing a power station for technological needs of Gazprom dobycha Orenburg. The facility is assumed to meet the demand of the Orenburg helium production plant and, probably, new polyethylene and polypropylene production plants of SIBUR Holding. The power plant will have the capacity of some 200 MW and cost approximately RUB 10 billion.

In 2003 Gazprom acquired a 99.5 per cent stake in the Kaunas thermal power plant. A project for increasing the power plant capacity is under consideration now.

Let me say a few words about the activities of Gazprom's energy distribution subsidiary, Mezhregionsbyt. The company was founded in September 2006. So far, it has become Russia's leading electric power supplier with the consolidated turnover exceeding RUB 100 billion and the effective electric power output of some 85 billion kWh. The company is operating in 20 Russian Federation constituents and is a wholesale market player. As part of Gazprom Group's Power Generation Strategy, Mezhregionsbyt pursues major corporate goals. In 2008 the company's activities resulted in: optimization of the Gazprom subsidiaries' costs for electric power exceeding RUB 500 million; preparation of energy services of subsidiary companies for operation under electric power sector reforming; participation in building automated payment systems for energy carriers; increasing the planning and forecasting accuracy.

A few words about Gazprom energo. It is a subsidiary company dealing with network operation. Among the major goals of Gazprom energo I would like to emphasize involvement of Gazprom energo in the general business process of Gazprom; arrangement of operation of the first stage of the automated system for commercial accounting of electric power by branch companies without violation of the planned electric power supply to the Gazprom subsidiaries from the wholesale electricity and capacity market; successful overcoming of consumption peaks in fall/winter period of 2007–2008; ensuring reliable operation of the Unified Gas Supply System. In 2008 Gazprom energo's total income exceeded RUB 10 billion.

In the conclusion it should be noted that as part of Gazprom's Power Generation Strategy the following measures were taken: operating control gained over TGC-1, Mosenergo, WGC-2 and WGC-6; a vertically-integrated holding company was

established – Gazprom energoholding; a corporate energy distribution company was set up – Mezhhregionsbyt – being currently Russia’s largest energy distributor; a subsidiary electric power network operator – Gazprom energo – is being developed; in 2007–2008 Mosenergo commissioned three combined-cycle gas turbine units with the total capacity of 1,325 MW; in addition, Mosenergo continues implementing the CHPP-26 project; in 2009 TGC-1 will commission power generating facilities with 410 MW in the total capacity.

So far, two years after the Gazprom Board of Directors approved the Company’s Power Generation Strategy, Gazprom Group has become the leading electric power producer, the largest electric power supplier and the second largest heat producer in Russia. Gazprom Group accounted for 90 per cent of Russia’s power generating facilities commissioned in 2008, and will account for 50 and 25 per cent in 2009 and 2010, respectively. This is the best proof of the fact that Gazprom is the biggest and the most reliable investor in Russia’s power industry today.

I am ready to answer your questions. Thank you.

**Question:** Lyudmila Kovalevskaya, Stavropolskaya Pravda newspaper. The Stavropol Krai court is hearing a case on the so called golden parachutes. This refers to the ex-management of WGC-2. I would like to find out the latest developments in this case. In fact the second case refers to WGC-2 as well – the investments in Stavropol SDPS, this refers to one of the general contractors which, actually, failed to perform its obligations. Can you comment on this issue in detail?

**Kirill Seleznev:** You see, in fact WGC-2 has paid golden parachutes without legal grounds. This was the reason for claim filing against those who received the golden parachutes and those who paid them in favor of WGC-2. As for the Stavropol SDPS construction: you are right, Group E4, being a contractor failed to perform its obligations during the entire period. Therefore, WGC-2 canceled contractual relations with this general contractor and sued it to get back the advance payment made for the benefit of the general contractor. Today we are at the legal proceedings stage.

**Question:** Alexey Grivach, Vremya Novostey newspaper. How much did Gazprom spend on the power generating assets acquisition and the holding creation? How will you settle the conflict of interests between Gazprom interested in minimization of costs for electric power purchasing and the holding interested in high prices? Have you completed the analysis of the acquired assets yet and what bottlenecks have you found? Are you going to optimize the holding by selling certain stations?

**Kirill Seleznev:** I’ll tell you something about the funds spent by Gazprom for the power generating assets acquisition. As you know, Gazprom is the holder of a 10.5 per cent stake in RAO UES of Russia, and the acquisition, owing to detachment of these assets from RAO UES of Russia, was generally carried out

with due regard to this stake. Additional funds were only spent for follow-on offering of WGC-2, WGC-6 and TGC-1 shares, which is not pretty much if compared to the stake value.

**Denis Fyodorov:** As I see it, there is no conflict of interests. Gazprom has always been interested in the acquisition of energy assets at minimum costs. As for the energy asset swap deals – we are holding talks.

**Moderator:** Are we going to optimize the holding by selling any stations?

**Denis Fyodorov:** Negotiations are underway, however, no results have been obtained so far.

**Question:** Eugenia Sokolova, RIA Novosti. May I come back to the subject of the previous question, legal proceedings which are ongoing in relation to bank guarantees? Don't you think it is necessary to provide government guarantees to various contracts, since energy companies are of strategic importance?

**Kirill Seleznev:** We faced a situation when the Bank of Moscow guarantee turned out to be null, therefore availability of this guarantee or its non-availability today means nothing for us. In case there were government guarantees for contractors' obligations, this would be the most optimal option for us. However, this situation was actually faced by all the energy companies. This exemplifies that the Bank of Moscow guarantee is null.

**Question:** Ignat Krivchenko, Premier newspaper, Vologda. Could you, please, say why coal-fired power stations will be built by WGC-6? Previously, they said that gas was considered as more beneficial for construction. Something has probably changed, some technologies, may be?

**Denis Fyodorov:** We inherited the approved investment program of RAO UES of Russia. Speaking of WGC-6, there is a single unit of the Novocherkassk power station based on the circulating fluidized bed technology – an absolutely novel one for Russia, we have never constructed such units, we are gradually moving toward the project implementation. As for the Cherepovets SDPS – it is a PSU-330, typical coal-fired power unit, it was also part of the program implemented by RAO UES of Russia, initially. Gazprom, the Russian Federation Government and the Russian Federation President have always been saying that it is necessary to diversify Russia's fuel balance. We need to develop nuclear and coal energy in order to decrease the share of gas in the national fuel balance. We are progressing in these fields.

**Question:** Andrey Farutin, Karelia newspaper. You have mentioned that you basically rely on small companies which are capable of paying for energy tariffs, even in case of a significant increase. Meanwhile, from the beginning of the year,

Karelia was not the only region to face a wave of protest against the procedure of payment for the redistributed electric power provided by major producers and unconsumed. The procedure is currently being revised. How will the energy holding establish relations with consumers, regulate tariffs, pursue the policy, and take measures against non-payers?

**Denis Fyodorov:** Unfortunately, or fortunately, we are not regulating tariffs. The Federal Tariff Service and the Market Council are in charge for that. The situation we faced in relation to a tariff upsurge in a number of regions is related to a sudden drop in electric power consumption and the absence of a clear and complete methodological base in relation to the transition of wholesale prices to retail consumers. We are not to blame. Private generation has no relation to it. You have to ask the Federal Tariff Service and the Market Council. Fortunately, if you consider the economics, we made no contribution into such a sharp upsurge in the tariffs for ultimate consumers as private generation did. Today we may not influence the decision making process related to tariffs.

**Question:** Ekaterina Chernakova, REN TV broadcasting company. I have the following question: gas is a key fuel for Gazprom; however, there is a number of alternative fuels, for example, peat. Peat pellets are produced in the Kostroma and Tver Oblasts. Is Gazprom planning to use peat pellets as an alternative fuel? If it is, what are the economic benefits?

**Kirill Seleznev:** We are certainly investigating this matter. The Leningrad Oblast holds quite rich peat reserves. The existing peat utilization technologies are not efficient enough. Therefore, we are discussing the issue with our foreign counterparts. However, this is not necessary today.

**Question:** Ekaterina Golubkova, Reuters news agency. Gazprom was planning to obtain control over TGC-7 and was holding talks with IES that was controlling the assets. What is the status of the negotiations?

**Kirill Seleznev:** We are really negotiating the issue of taking control, together with IES, over TGC-7. The negotiations have not been accomplished therefore it's too early to give comments.

**Question:** TGC-1 shareholder. Why has not Gazprom provided a mandatory offer for share purchase to the rest of the TGC-1 shareholders in compliance with the legislation in force? When will the mandatory offer be made to the TGC-1 shareholders and what prevented Gazprom from making such an offer?

**Kirill Seleznev:** No offer has been made since we are not obliged to do that. So far, we are controlling only 28 per cent of TGC-1 shares.

**Question:** Xenia Bachmanova, RBC information agency. Let me come back to the Stavropol SDPS. Could you, please, specify if there is a final decision on the unit

construction by 2015, will the construction deadline be rescheduled? As for E4 Group, could you please comment on the position voiced by the Group itself? This refers to the fact that within a certain period of time they have not received from WGC-2 the construction documents, which gives them grounds to believe that their omission to construct was justified, they were waiting for the documents from

WGC-2. You have announced potential joint construction activities with E4 Group at another site – could you, please, specify the site and when the contract is to be signed?

**Denis Fyodorov:** We have quite clearly expressed our position on the matter. The decision on suspension, or a letter of suspension, was sent in November. No work had been performed before November. A full package of the documents related to the site allocation, submission of the required data to E4 was prepared jointly. All the documents are undersigned by the E4 Group representatives. The extrajudicial procedure of this dispute settlement is preferential for us, however, life will show, the negotiations are ongoing.

As for the deadlines rescheduling – it is reasonable, nothing happens on the site. The money is in E4 Group, respectively. In order to start up the investment project we need to get this money back, hold a tender and implement the project.

**Kirill Seleznev:** All the documents were submitted to E4 on the basis of the delivery certificates; therefore, it is actually a deceit to say that some of them were not submitted. Out of the total advance payment only 35 per cent of expenditures are witnessed by documents. The rest of money has simply disappeared in E4 Group. No confirmation of the purpose of expenditures has been provided by E4 Group so far.

**Question:** Ekaterina Kaznina, Sovetskaya Chuvashia newspaper. Are the negotiations on TGC-5 underway? Are you planning to hold them, at least? Thanks.

**Kirill Seleznev:** As for TGC-5, the negotiations are not held and the configuration of assets available for Gazprom Group is optimal for us today.

**Question:** Anna Shirayevskaya, Platts information agency. Let us know about the plans on electric power generating assets acquisition in Europe. Gazprom was considering potential acquisition of a number of stations in Italy, UK and Germany. Have these plans changed due to the crisis in relation to a drop in demand? Which of these projects are of top priority?

**Kirill Seleznev:** I can say nothing about the energy assets acquisition in Europe as we have not broadened our strategy that far, and the available projects were just at the stage of discussion, that's it. No investment decisions on these projects were taken. I believe no one will be taken in the near future.

**Question:** Sergey Kononov, Cherepovetsgaz. Due to the construction of a new unit at Cherepovets SDPS is Gazprom planning to acquire any coal assets?

**Kirill Seleznev:** Coal-fired generation is currently available within the framework of the assets owned. I would not link the acquisition of coal assets with the construction of this unit. We'll definitely consider all the interesting and feasible offers, and acquire such assets.

**Question:** Nikolai Khrenkov, Gazprom Journal. Mr. Fyodorov, you have recently noted that you are going to approach the Central Bank with regard to the situation related to the Bank of Moscow guarantee, which is null. Have you done that? What decision do you think the Central Bank is likely to make? Can you speak about the energy saving measures taken at the assets newly acquired by Gazprom? Thank you.

**Denis Fyodorov:** We are currently preparing all the necessary letters. We have received a notice stating that from June 15 the Accounts Chamber will start working. We are requested for submission of all the documents. We compile and send them in the established procedure.

As for energy saving, our major efforts are currently aimed at re-equipment of power stations and investment programs execution. Many stations are in quite a difficult situation, therefore energy saving issues are not a top priority there. At the same time, in every program for all the companies there is an individual line devoted to energy saving, though this line is not so big.

**Kirill Seleznev:** The major energy saving measures are upgrading of the existing capacities; replacement of turbines with the new ones, modern machines with a higher efficiency ratio; such minor measures as installation of gas expanders and others. The most important one is reconstruction of the existing generating facilities.

**Question:** Olga Kvashina, WGC-6. The people involved in power generation had their own employment benefits, payroll size. Now we are Gazprom. Have you compared the level of social protection of employees in former RAO UES of Russia and Gazprom? Are you expecting any improvements: an increase in salary, social protection of the business – the issues that are widely discussed on the Government level and beyond?

**Kirill Seleznev:** Gazprom is a socially responsible company, that's for sure. Your question is absolutely justified. Today we are quite actively working with trade unions. We are analyzing what has been done in RAO UES of Russia, what is going on, the collective agreements made with the energy companies, we are planning to elaborate a unified social policy in relation to Gazprom's energy sector employees by the year end. This will be done with regard to Gazprom's experience and the programs available in Gazprom.

**Question:** Citibank. Will the follow-on offering of WGC-2 and WGC-6 shares be held?

**Kirill Seleznev:** It will, however, I am not sure when it will be held as the most effective moment should be determined and there should be enough funds available. Today the Gazprom investment program does not stipulate for a follow-on offering of WGC-2 and WGC-6 shares. The Gazprom investment program will be adjusted according to the mid-year results. If we can allocate these funds in the investment program, then the follow-on share offering will be carried out in compliance with the corporate procedures.

**Question:** Anna Peretolchina, Vedomosti newspaper. I have two clarification questions. The first one is related to TGC-1. When the minority shareholders shall finally expect the put option? According to the Company's statement, in 2009 you are going to consolidate the controlling stake and arrange the put option. In addition, the Board of Directors meeting held in autumn even allocated funds for the share acquisition. The second question is related to TGC-7. Taking into consideration the fact that your partner in this transaction experienced financial hardships, is Gazprom examining the option of acquiring a stake in TGC-7 with no partner? If it is, what is the stake size? What deadlines? Thanks.

**Kirill Seleznev:** As I have already mentioned, today Gazprom holds a 28 per cent stake in TGC-1 and the Company is not obliged to make a mandatory offer according to the legislation in force.

As for TGC-7 – we do not know about the hardships our partner may experience in relation to our joint participation in the managerial process, in obtaining control over TGC-7. As I said before, we are holding talks. According to the results of these talks we'll clearly understand the configuration of our future bargain.

**Question:** When will the TGC-1 shares be consolidated?

**Kirill Seleznev:** We are working on that. I can not tell you when. We are working on that – it's our objective. You understand the difficult financial position of the energy companies, as well as other energy market players, don't you? Therefore, we are working on that.

**Question:** Roman Filkin, representative of portfolio investors, Prosperity Capital Investment Company. Could you, please, specify if there are plans to switch over to a unified share and simplify the corporate structure? And the second question is related to the potential prolongation of the timeframes for investment projects, could you, please, give comments on that?

**Kirill Seleznev:** So far, we have not tackled the issue of a transfer to a unified share. We make efforts to streamline the management of these companies, to eliminate the duplicated structural units in these companies that will lead to certain

cost-saving.

As for a transfer to a unified share – this issue will probably be tackled later on, and the pre-requisites are the follow-on offering of WGC-2 and WGC-6 shares, to be followed by this issue in order to streamline the corporate structure. Moreover, we need to answer the question on what is more beneficial for us today: the trade shares of separate companies or a unified share. We are still not ready to answer this question. Time will show.

A few words about the prolongation of timeframes for investment projects execution. We are actually working on the prolongation of some investment projects jointly with the System Operator. We believe we are having quite a constructive dialogue. Our proposals are submitted to the System Operator, they are partially supported. There are certain matters where they are probably not supported; however, we are working on that. Once a decision is made, we are ready to voice the exact facilities and the exact timeframes.

**Question:** Roman Zakurdaev, 100 TV broadcasting company, Saint Petersburg. I would like to ask you about the prospects for the TGC-1 investment program implementation? Will it be cut due to the crisis or any other reasons?

**Kirill Seleznev:** Today we are sticking to the obligations undertaken. The TGC-1 investment program will be performed in full. However, as I have previously mentioned, we consider the potential carry-over of deadlines for some capacities. This is mainly required for technical reasons, with a drop in demand in certain locations. Therefore, as soon as we have any information, we'll provide it to everybody, be sure; however, today we stick to the obligations undertaken.

**Question:** RBC, South-Urals branch office. I would like to ask a question about TGC-9. Can you clarify the information on whom the company belongs to and are there any plans related to it?

**Kirill Seleznev:** As far as I know, TGC-9 belongs to IES Holding. There are no plans.

**Question:** I would like to ask about prices as well. Does the gas price for the energy companies comprising Gazprom Group differ from the gas price for the rest of the energy sector companies?

**Kirill Seleznev:** No, it does not. Gas is supplied at the same price, and this is closely monitored by the Federal Antimonopoly Service. We do not violate the antimonopoly legislation.

**Question:** Larisa Andriyevskaya, Pronskaya newspaper, Ryazan Oblast. Traditionally, the city-forming enterprises in Russia were power stations. What can you say about the social policy in relation to satellite towns? How will it be

pursued? Thanks.

**Kirill Seleznev:** There is no satellite towns supporting program. We are ready to consider and solve specific issues related to our facilities in a certain region, if there are any. However, there is no satellite towns supporting program so far.

**Moderator:** Thank you! The Press Conference is over.