

REGIONAL POLICY CONCEPT

I. General provisions

The structure of Russia's gas industry is characterized by centralized management of the Unified Gas Supply System, provision of gas supplies primarily by a single company – OJSC Gazprom – and a wide geography of process facilities spanning numerous constituent entities of the Russian Federation. The backbone of Gazprom's territorial structure is made up of regional gas production, gas transmission and gas marketing subsidiaries (hereinafter the "subsidiaries").

An extensive network of gas trunklines and gas distribution pipelines brings gas to consumers in 66 constituent entities of the Russian Federation. As of January 1, 2003, the gas grid covered a total of 638 cities and towns, 782 urban-type settlements and 19,700 rural settlements.

The pattern of interaction established between Gazprom and the constituent entities of the Russian Federation ensures that the existing production, financial and organizational issues are addressed with sufficient effectiveness. At the same time, the experience acquired in interacting with the regions, along with the changing sociopolitical and financial-and-economic conditions, including the liberalization of the gas market, call for an adjustment of the key principles and areas of activities of Gazprom in this sphere.

The regional policy is the main tool for addressing the objectives of interaction arising between Gazprom and the constituent entities of the Russian Federation.

The Regional Policy Concept (hereinafter the "Concept") and the activities undertaken by Gazprom in line with the Concept will foster the implementation of the key provisions of the Federal Law on Gas Supplies in the Russian Federation.

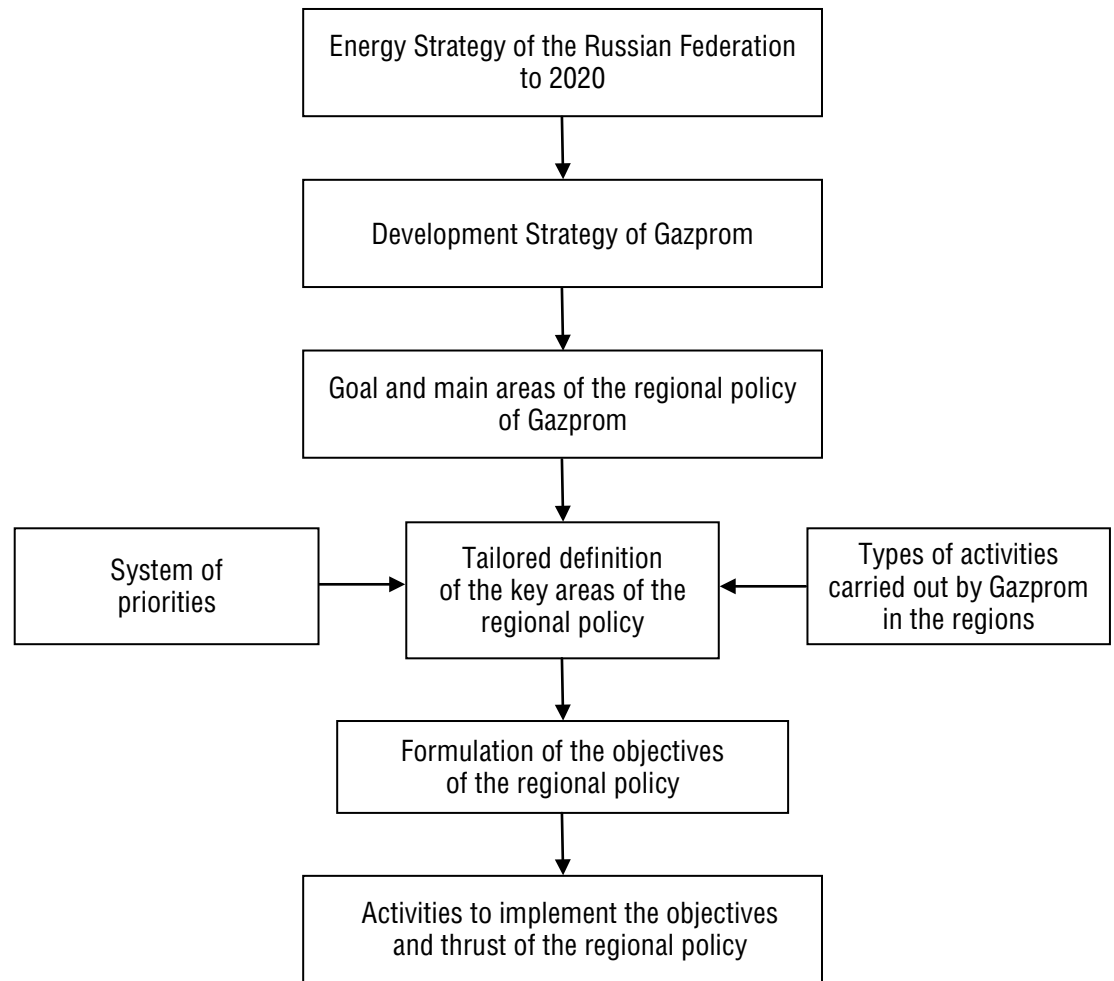
II. Methodological approaches

The regional policy of Gazprom is drawn up on the basis of the key lines of the energy strategy of the Russian Federation and the development strategy of Gazprom. As one of the tools for implementing the general development strategy of Gazprom, the regional policy is a combination of goals, objectives and activities the composition and content of which depend on many factors, including the level of interaction established with the constituent entities of the Russian Federation and the specifics of sociopolitical and economic development of individual entities of the Russian Federation.

Complementing other tools to implement the general development strategy of Gazprom, the regional policy of Gazprom is designed to ensure a due balance between the interests of Gazprom and those of the constituent entities of the Russian Federation in terms of production, financial, investment and other activities, as well as to coordinate the activities of the subsidiaries of Gazprom in the constituent entities of the Russian Federation. Active implementation of the regional policy is based on mutually beneficial cooperation established by Gazprom with the authorities of the constituent entities of the Russian Federation, on the one hand, and the enterprises and organizations that carry out their business activities in the corresponding regions, on the other hand.

The mechanism employed to implement the regional policy is a combination of procedures and activities that make it possible to achieve the key objectives of the regional policy of Gazprom (see the chart below).

Basic flowchart for determining key areas, objectives and activities under regional policy



The activities performed by the structural subdivisions and subsidiaries of Gazprom to implement the approved regional policy in the constituent entities of the Russian Federation are coordinated by the Regional Policy Commission of Gazprom (hereinafter the “Commission”). The Commission ensures that favorable economic, regulatory and organizational conditions are created for the successful implementation of the recommendations on the allocation of gas supply limits, capital investment in gas infrastructure expansion and construction of cultural and welfare facilities, financing of sponsorship and charitable programs, and regulation of property relations between Gazprom and the constituent entities of the Russian Federation. The Commission also reviews issues pertaining to the relations between Gazprom and the constituent entities of the Russian Federation with regard to the tax sphere and the pricing policy of Gazprom in the constituent entities of the Russian Federation.

Working groups may be established to pursue individual areas and objectives of the regional policy. Specialists of structural subdivisions and subsidiaries of Gazprom, as well as representatives of the authorities of the constituent entities of the Russian Federation and business entities take part in such working groups in order to elaborate individual tasks and prepare relevant draft decisions.

The activities of the subsidiaries of Gazprom in the constituent entities of the Russian Federation can be coordinated through regional centers established by Gazprom to ensure the consistency of the Company’s policy. One of Gazprom’s subsidiaries in the corresponding region can function as a regional center.

III. Principles for drawing up and implementing regional policy

The regional policy of Gazprom is underpinned by the following general principles:

- target-oriented approach: the activities being implemented must ensure the achievement of the main goal and priorities of the regional policy;

- long-term view: the prospects of gas industry development must be taken into account;
- liberalization of the gas market: conditions must be created for the development of the gas market through making a rational distinction between the regional activities of Gazprom that are monopolistic in nature and those implying potential competition;
- corporation-oriented approach: the corporate interests of Gazprom must have a priority over the interests of its individual subsidiaries;
- partnership: partner relations must be established with the authorities of the constituent entities of the Russian Federation, business entities, regional elites, non-governmental and other organizations that have an influence on the main areas of the work carried out by Gazprom in the constituent entities of the Russian Federation.
- mutual benefit: it must be ensured that the constituent entities of the Russian Federation and Gazprom have a mutual interest in achieving the set objectives;
- focus on specifics: the unique features of the economic and sociopolitical development in the constituent entities of the Russian Federation must be taken into account, and adaptation to particular conditions must be ensured, with prompt adjustment in the event of any changes in such conditions;
- social responsibility: employees of Gazprom and its subsidiaries must be provided with decent working and living conditions, and Gazprom must take part in addressing the social challenges that exist in the constituent entities of the Russian Federation.

IV. Goal, main areas and objectives of regional policy

The goal of the regional policy is to create the economic, regulatory and organizational conditions required for the successful implementation of the major orientations established under the general strategy of socioeconomic development of Gazprom and its subsidiaries in the regions of the Russian Federation, including the conditions for the reliable and high-potential functioning of the Unified Gas Supply System on the basis of mutually beneficial cooperation between Gazprom, its subsidiaries and the constituent entities of the Russian Federation.

The key areas of the regional policy are as follows: structural-and-economic (production), financial-and-economic, social, environmental, legal, organizational, and corporate & image.

The structural-and-economic (production) area of the regional policy provides for establishing an optimal structure of gas production and consumption in the constituent entities of the Russian Federation, creating conditions for reliable supplies of natural gas to consumers against the backdrop of gas market liberalization and setting up a reliable production base for profitable activities of Gazprom and its subsidiaries, as well as for potential replenishment. The objectives to be achieved in this area are as follows:

- to determine the scope of operations of Gazprom in specific constituent entities of the Russian Federation and the viability of expansion of the scope of such activities taking into account the establishment of regional gas markets;
- to provide a reliable feedstock base for natural gas production and ensure efficient and environmentally acceptable use of subsoil and territories allocated to gas facilities;
- to obtain support from the constituent entities of the Russian Federation in the matters of subsoil use and conclusion of license agreements on mutually beneficial terms (including with regard to safeguarding the interests of Gazprom when subsoil use licenses are issued to third-party subsoil users for any territories adjacent to the production fields of Gazprom), as well as during the registration of land plot allocations;
- to interact with the constituent entities of the Russian Federation in order to take account of development programs for the mineral resource base and the oil and gas transmission systems, as well as existing timeframes for the exploration of fields and for bringing them into development during the preparation of socioeconomic development programs by corresponding constituent entities of the Russian Federation;
- to include the subsidiaries of Gazprom into the List of profit-making organizations that are participants of the federal (national) wholesale market of power (capacity) which is annually approved by the Government of the Russian Federation;

- to develop in the interests of Gazprom the territorial distribution of the industries that manufacture equipment and other products for the gas industry;
- to elaborate jointly with the constituent entities of the Russian Federation the measures aimed at enhancing regional fuel-and-energy balances through a wider use of energy sources (primarily, local energy sources) as an alternative to gas;
- to transfer social facilities and infrastructure of Gazprom and its subsidiaries into municipal ownership with support from the authorities of the constituent entities of the Russian Federation;
- to take account of regional specifics during the provision of research and design support for the activities of Gazprom and its subsidiaries.

Since gas infrastructure expansion plays a significant role in the socioeconomic development of the constituent entities of the Russian Federation, the expansion of gas grid across the constituent entities of the Russian Federation and the efforts aimed at achieving more efficient use of gas are identified as a separate line within the structural-and-economic area of the regional policy. The main principles, goals and areas pursued by Gazprom in this regard are outlined in the Concept for Gazprom's participation in gas infrastructure expansion in Russian regions approved by the Chairman of the Gazprom Management Committee on April 5, 2000.

Gazprom works to achieve the following objectives during gas infrastructure expansion in the constituent entities of the Russian Federation:

- to enter the market of end consumers of gas;
- to take part in the construction and operation of gas distribution networks;
- to optimize the utilization of the existing gas pipeline branches, expand gas grids, and increase gas sales;
- to implement regional programs for the use of gas as a vehicle fuel;
- to determine jointly with the constituent entities of the Russian Federation the sources of financing for gas infrastructure expansion and the methods to be used for attracting financial resources;
- to implement the national policy for gas saving and increased efficiency of gas use;
- to develop and adopt high-performance gas-using equipment, as well as highly efficient and resource-saving technologies and equipment for the construction and operation of gas supply systems;
- to implement cutting-edge tools for measuring gas flow rate and quality, as well as for regulating gas consumption;
- to optimize the prospective fuel-and-energy balances of the constituent entities of the Russian Federation;
- to develop general schemes for gas infrastructure expansion and gas supplies to consumers in the constituent entities of the Russian Federation;
- to consider jointly with the constituent entities of the Russian Federation the issues related to leasing (sub-leasing) Gazprom-owned distribution pipelines to Regiongazholding and gas distribution organizations operating in the territory of a given constituent entity of the Russian Federation;
- to improve the regional gas sales market by transferring the functions of consumer gas sales from the subsidiaries of Gazprom to regional gas selling companies;
- to develop a mechanism to support the regional and municipal utility companies which adopt energy control and saving technologies;
- to arrange activities aimed at agreeing the specific rates of gas consumption for heating purposes with due consideration of technological and climate conditions.

The financial-and-economic area of the regional policy provides for creating favorable financial and economic conditions for the activities of Gazprom in the constituent entities of the Russian Federation. The objectives to be achieved in this area are as follows:

- to take account of regional aspects during the implementation of major investment projects pursued by Gazprom and its subsidiaries;
- to obtain economic support from the constituent entities of the Russian Federation in the territory of which facilities related to their gas infrastructure expansion and other gas facilities are located and built, including support in the form of tax reliefs in line with the

current legislation, and creation of favorable economic or other conditions at the regional level for the organizations which design, build and operate said gas facilities;

- to satisfy the demand for natural gas with due consideration of expected gradual increase in gas prices;

- to optimize the relations of Gazprom with the budgets of the constituent entities of the Russian Federation and local budgets based on the progress of current payments and agreements on the amounts and deadlines for repayment of the debts owed by gas production and gas transmission subsidiaries to said budgets, as well as the progress of repayment of debts for supplied gas owed by consumers which receive financing from budgets of all levels;

- to study the changes in the capacity to pay demonstrated by industrial gas consumers and general population in the constituent entities of the Russian Federation;

- to analyze the influence exerted by changes in gas prices on the budget expenditures of the constituent entities of the Russian Federation (in connection with changes in the prices for gas consumed by the organizations that receive funding from such budgets) and the budget revenues of such entities (occurring due to changes in tax revenues), as well as on the economic performance of industrial consumers and utility expenses incurred by the population in the constituent entities of the Russian Federation;

- to improve the financial-and-economic relations between Gazprom and the constituent entities of the Russian Federation, including through establishing a reliable system of settlements that ensures timely payments for gas supplies;

- to interact with the constituent entities of the Russian Federation with the aim of timely adjustment of retail prices for gas sold to the population in order to ensure that the economically justified costs incurred by suppliers are covered, as well as to set economically justified prices (tariffs) for utility services rendered by the subsidiaries of Gazprom to consumers, including the local population of the constituent entities of the Russian Federation, to ensure that said activities are loss-free and no cross-subsidization occurs in this sphere;

- to streamline the interaction with budgets of different levels with due consideration given to the development of mutual relations on the basis of state and municipal contracts for gas supplies to the organizations which receive financing from the corresponding budgets and taking into account the gradual transition to the treasury system of budget execution as regards payments for gas supplies;

- to reduce the debts for gas supplied to consumers which receive financing from budgets of all levels;

- to effectively organize financial flows and their bank servicing on the basis of comprehensive interaction of the subsidiaries of Gazprom with authorized lending institutions;

- to develop substantiations for the provision of investment loans by the constituent entities of the Russian Federation to the subsidiaries of Gazprom which carry out their activities in the corresponding constituent entities of the Russian Federation;

- to enhance relations with the constituent entities of the Russian Federation in the matters of pricing policy;

- to elaborate relevant programs for selecting optimal financing sources for regional investment programs and gas grid expansion in Russian regions;

- to take part in the development of an incentive mechanism to encourage large regional consumers to switch to long-term contracts.

The social area of the regional policy provides for improving the living conditions of the employees of Gazprom and its subsidiaries and aims at achieving the following objectives:

- to provide social support to the employees of Gazprom and its subsidiaries with due consideration of the socioeconomic specifics of individual constituent entities of the Russian Federation (taking into account the dynamics of the consumer price index);

- to analyze regional labor markets with a view to enhancing the pattern of employment at the subsidiaries of Gazprom;

- to incentivize the work of the employees of Gazprom and its subsidiaries with due consideration of socioeconomic specifics of the constituent entities of the Russian Federation;
- to assist in achieving a rational distribution of the network of educational institutions for the training and development of gas industry personnel;
- to create, or take part in the creation of, a network of social infrastructure facilities (health resorts, healthcare, educational and cultural facilities, etc.) in the constituent entities of the Russian Federation;
- to settle, jointly with the constituent entities of the Russian Federation, the matters of relocation of the employees of Gazprom and its subsidiaries, including retired ones, from the Far North and equivalent areas, as well as from temporary accommodations and accommodations unfit for habitation;
- to arrange healthcare infrastructure for the protection of the health of employees of Gazprom and its subsidiaries, to optimize the mechanisms aimed at accumulating funds for the medical insurance system, to take part in the development of the healthcare systems of the constituent entities of the Russian Federation in the territory of which the subsidiaries of Gazprom carry out their activities, as well as the professional personnel selection system for the gas industry.

The environmental area of the regional policy provides for establishing a system of measures to ensure environmental safety of gas facilities and implementing a set of activities to reduce man-made impacts on the environment and population, as well as taking part in the restoration of the traditional habitat of indigenous minorities of the Far North in northern regions.

The objectives to be achieved in this area are as follows:

- to implement eco-friendly technologies used in the gas industry;
- to reduce chemical effluents and greenhouse gas emissions in the course of production, processing, underground storage, transportation and use of gas;
- to reduce the discharge of pollutants as part of effluents into the surrounding natural environment;
- to treat contaminated effluents and, whenever possible, ensure their subsurface disposal;
- to ensure compliance with industrial safety and modern environmental safety requirements during the design, construction and operation of gas industry and gas supply facilities;
- to organize medical-and-environmental research and analyze the risk of adverse consequences of man-made impacts on the environment and population;
- to improve land restoration methods;
- to preserve ethnic communities jointly with the constituent entities of the Russian Federation and develop the traditional forms of labor and cultural activities of indigenous peoples of the North residing throughout the areas of intense activities of Gazprom and its subsidiaries;
- to carry out jointly with the constituent entities of the Russian Federation environmental monitoring activities in the areas where gas facilities are functioning;

The legal area of the regional policy provides for establishing the required regulatory framework at the federal and regional levels. Accordingly, the objectives to be achieved in this area are as follows:

- to interact with the persons and bodies that have the right of legislative initiative in order to prepare draft federal laws and other regulations which facilitate the implementation of the gas supply policy of Gazprom;
- to interact with the constituent entities of the Russian Federation on the matters of regulations governing the activities related to regional gas supplies;
- to develop and sign agreements with the constituent entities of the Russian Federation with regard to specific programs and types of activities in such regions;

– to develop proposals on streamlining the legislation of the constituent entities of the Russian Federation with due consideration of mutually beneficial interests of such entities and gas companies in the sphere of taxation, subsoil use and environmental protection.

The organizational area of the regional policy provides for addressing the following objectives:

- to provide organizational and information support to the areas and objectives of the regional policy of Gazprom;
- to interact with the constituent entities of the Russian Federation on the matters of development and implementation of flow measurement accuracy standards and gas quality parameters to be used at industrial facilities;
- to ensure joint control by Gazprom and the constituent entities of the Russian Federation over the implementation of existing mutual cooperation agreements and contracts concluded in their furtherance;
- to develop a consolidated position of Gazprom and its subsidiaries for their interactions with the constituent entities of the Russian Federation;
- to interact with the constituent entities of the Russian Federation in order to address relevant matters of the regional policy of Gazprom, including revision of retail gas prices for the population and setting economically feasible prices (tariffs) for utility services;
- to interact with the organizations which carry out their business within the territory of the constituent entities of the Russian Federation;
- to achieve coordination in addressing the matters of subsoil use and issuance of licenses.

The corporate & image area of the regional policy provides for addressing the following objectives:

- to create an effective corporate communications mechanism for Gazprom and its subsidiaries;
- to coordinate the activities of subsidiaries as regards mass media coverage of the official position of Gazprom and news about the activities of Gazprom which are published by them in the constituent entities of the Russian Federation;
- to ensure that stakeholders can receive reliable information in order to make competent decisions about the investment attractiveness of Gazprom;
- to organize and conduct on the part of Gazprom meetings, conferences, and exhibitions with the participation of partner organizations, and to arrange for the participation of Gazprom and its subsidiaries in similar events held by other companies.

Appendix 1.

System of medium-term priorities of regional policy

The Commission shapes the system of priorities for the regional policy on the basis of Gazprom's socioeconomic development plans for specific areas of the regional policy taking into account the Company's primary objectives and the conditions of economic and sociopolitical development in the constituent entities of the Russian Federation.

The priorities of the structural-and-economic (production) area of the regional policy are as follows:

- implementation of the main focus areas of domestic gas market development in the constituent entities of the Russian Federation;
- enhanced production and integrated use of hydrocarbon feedstock;
- consideration of issues pertaining to the procedure and timeframes for the registration and use of land plots in the areas where fields are undergoing development, as well as the standards and methods of calculating compensations for lost profit to entities that employ primarily local workforce, such as reindeer herding enterprises;
- implementation of the Program for comprehensive development of hydrocarbon fields in the Yamal Peninsula and adjacent water bodies;

- interaction with the constituent entities of the Russian Federation on the exercise of the coordinating functions assigned to Gazprom by the Russian Government, i.e. coordinating the implementation of the Program for developing the gas reserves of Eastern Siberia and Russia's Far East to create a gas supply system for eastern Russia and provide a unified export channel for entering the markets of the Asia-Pacific region and the projects under the Program;

- facilitation of the construction of the Yamal – Europe gas pipeline and implementation of the North European Gas Pipeline project;

- engagement of conversion enterprises in Gazprom's projects on the Arctic shelf.

The priorities of the financial-and-economic area of the regional policy are as follows:

- optimization of Gazprom's relationships with the budgets of the constituent entities of the Russian Federation and local budgets via complying with agreements on the amounts and deadlines of current payments and repayment of debts of Gazprom's gas production and gas transmission subsidiaries to the aforementioned budgets, as well as repayment of debts for gas supplies owed by consumers which receive financing from budgets of all levels in line with the existing laws of the Russian Federation;

- participation in the drafting of proposals during the development of regional and local budgets with a separate budget line for gas payments and gas transmission for the entities and private consumers using concessionary rates to pay for the gas consumed;

- provision of integrated banking services on a regional level, coordination of interfaces between the subsidiaries of Gazprom and the regional network of authorized banks during the servicing of financial flows of Gazprom, partners, and gas consumers;

- participation in the development of a cost compensation mechanism for social construction in connection with license agreements between Gazprom and the constituent entities of the Russian Federation.

The priorities of the social area of the regional policy are as follows:

- handling of social issues at the subsidiaries of Gazprom located in the Far North and equivalent areas;

- implementation of the program for the relocation of employees of the subsidiaries of Gazprom from the Far North and equivalent areas to regions with favorable climate conditions and generating jobs for these employees;

- promotion of the shift work method at the subsidiaries of Gazprom during the development of gas fields in the northern territories of the Russian Federation;

- outlining of the procedure and timeframes for the transfer to municipal ownership of the social facilities which were built at the expense of Gazprom.

The priorities of the environmental area of the regional policy are as follows:

- establishment of cooperation with regional environmental bodies in order to develop and implement joint environmental programs.

The priorities of the legal area of the regional policy are as follows:

- participation in the development of draft documents taking account of Gazprom's interests to shape the legislative framework on taxation, subsoil use and environmental protection;

- participation in the development of a package of regulatory acts governing gas transportation processes.

The priorities of the organizational area of the regional policy are as follows:

- establishment of constructive cooperation with the authorities of the constituent entities of the Russian Federation, including regions in Eastern Siberia and Russia's Far East, on the matters of implementation of relevant state-run programs and major gas projects;

- establishment of the organizational and methodological framework for interaction with the offices of plenipotentiary representatives of the President of the Russian Federation in federal districts;

- cooperation between Gazprom and federal districts, constituent entities of the Russian Federation, and major economic entities in order to analyze the socioeconomic condition of the constituent entities of the Russian Federation and forecast energy demand;

- organization of interaction between Gazprom and regional gas sales companies;

- participation in the outlining of the procedure and timeframes for the state expert environmental review and state cadastral registration of land plots;
- advancement of cooperation with regional representatives in the State Duma and the Federation Council of the Federal Assembly of the Russian Federation on legislative activities of mutual concern;
- interaction with public organizations representing the interests of indigenous populations.

The priorities of the corporate & image area of the regional policy are as follows:

- shaping of the vertically integrated structure of PR services at the subsidiaries of Gazprom;
- joining of the communication efforts of Gazprom and its subsidiaries to provide information support for the main areas of Gazprom's regional policy;
- streamlining of sponsorship and charitable activities of Gazprom and its subsidiaries in the constituent entities of the Russian Federation.