

From Win-Win to Zero-Sum

Changes on European Gas Market Affecting Supplier / Importer Relationships

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*Views expressed in this presentation are the author's sole responsibility
and do not necessarily represent those of Gazprom Export

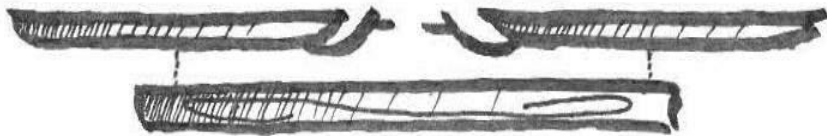
Price risk

Supplier

Importer

Lack of cash flow to support investment cycle

Inability to resell gas to end-users with a profit



Volumetric risk

Supplier

Importer

Fines for undersupply

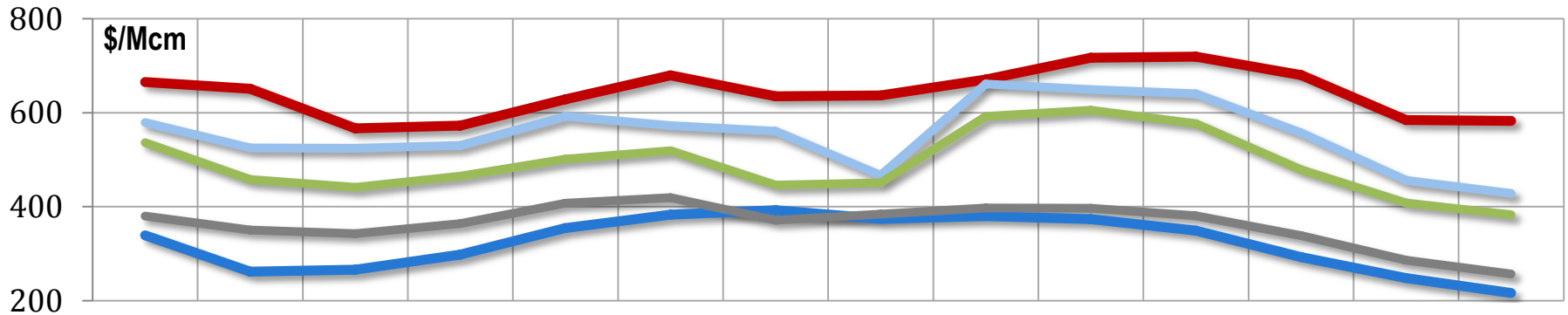
Take-or-Pay



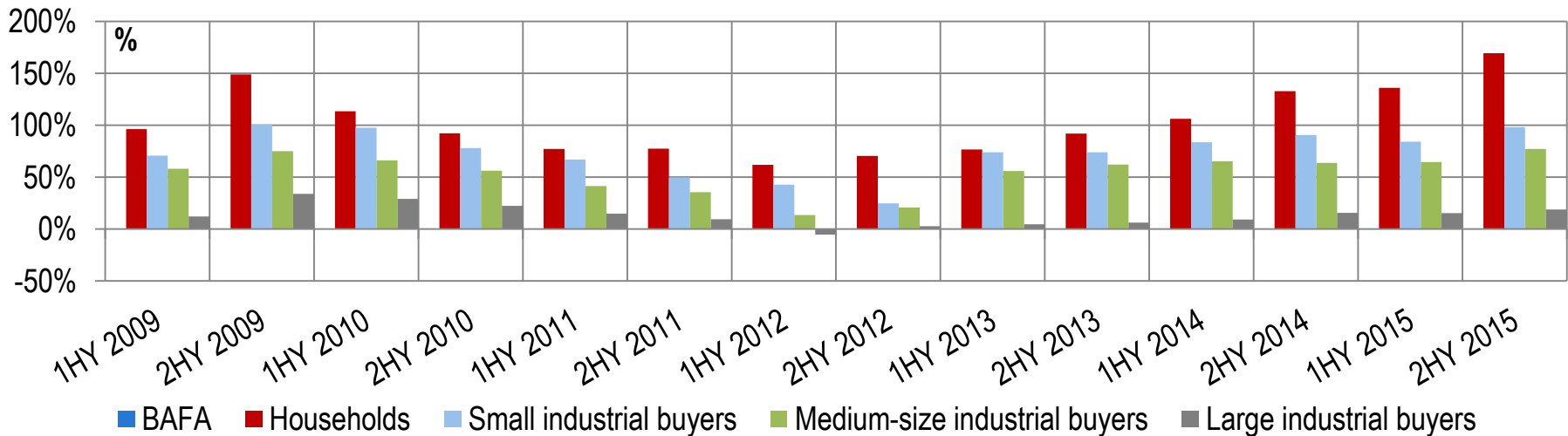
Fine for Undersupply in Conventional LTCs

Fine for Undersupply in Percentage to Price	1 to 5		5 to 20		20 to 50		Over 50	
	Winter	Summer	Winter	Summer	Winter	Summer	Winter	Summer
1991	42%	21%	52%	31%	84%	52%	104%	84%
1992	43%	21%	53%	32%	85%	53%	107%	85%
1993	39%	19%	49%	29%	78%	49%	97%	78%
1994	37%	19%	47%	28%	75%	47%	93%	75%
1995	39%	19%	49%	29%	78%	49%	97%	78%
1996	37%	19%	47%	28%	74%	47%	93%	74%
1997	33%	16%	41%	25%	65%	41%	82%	65%
Average	38%	19%	48%	29%	77%	48%	96%	77%

BAFA compared to end-user prices by category, without taxes



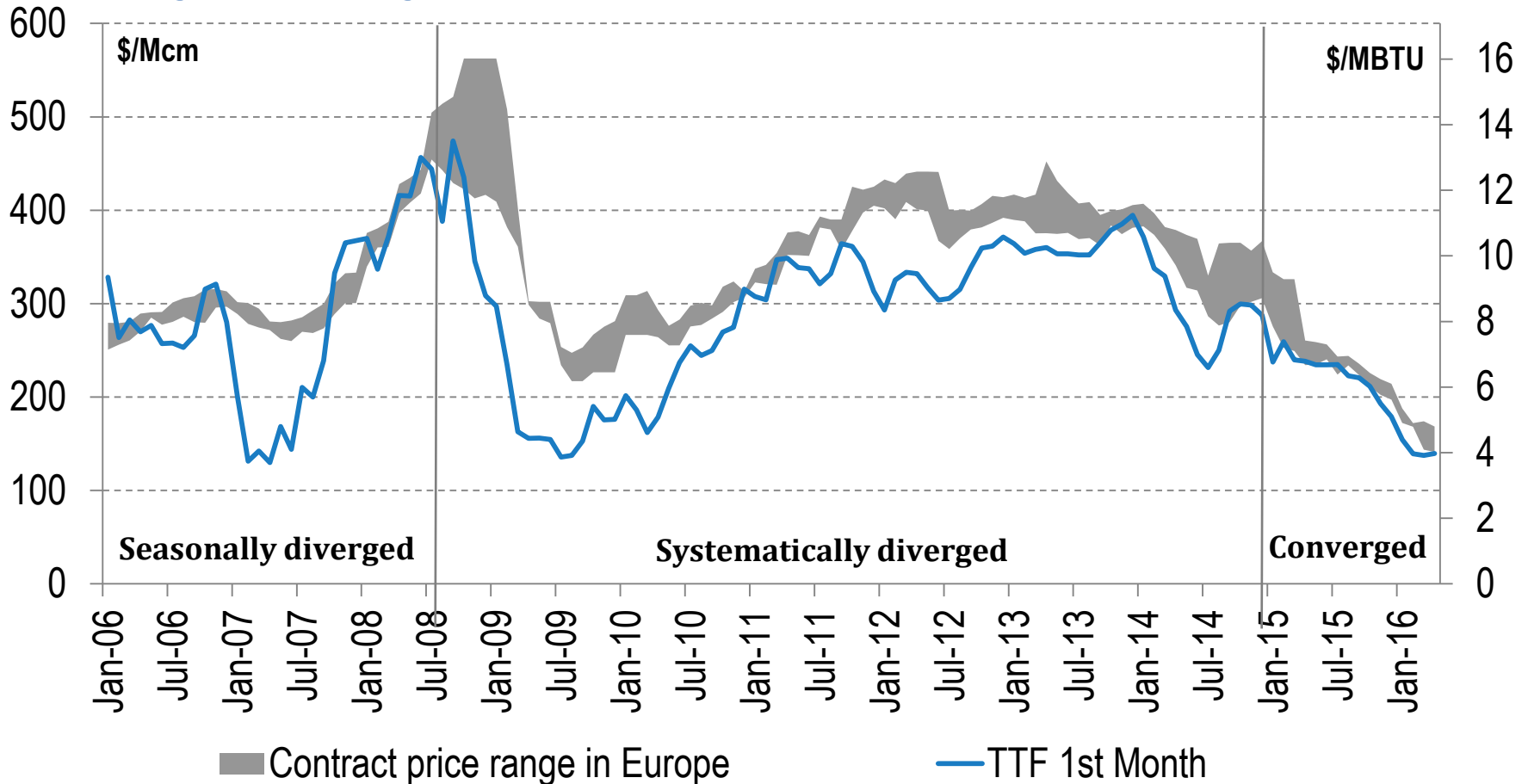
Price difference to BAFA



Source: BAFA, Eurostat

LTCs Set Ceiling for Prompt Prices which Creates Tension in Relations of Suppliers with Midstreamers Leading to Contract Price Downward Revisions

Hub prompt prices are derivatives of the LTC prices although with a negative premium embedded in them



Source: BAFA, Bloomberg, IEA, IMF, World Bank

Conventional long-term gas supply contract versus new American type of LNG contract

LT Gas Supply Agreement

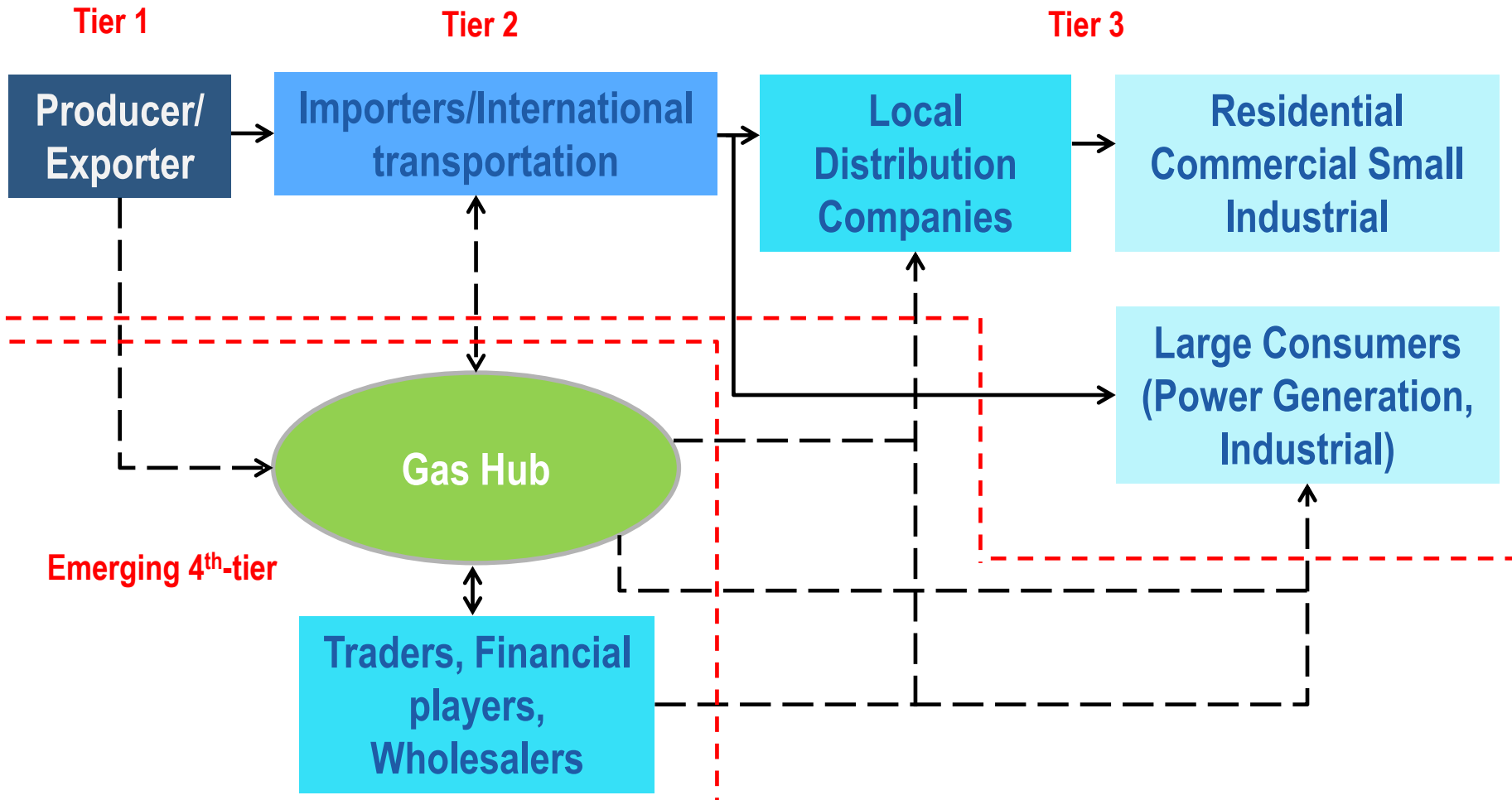
- ✓ Seller brings gas to the country's border or to the hub
- ✓ Gas price is formed on a substitution principle, which allows to place gas at the market with a profit
- ✓ No fee for the nomination of different volumes within the flexibility range. Seller guarantees investment return using «take-or-pay» clauses. In this case buyer is entitled to off-take «make-up» gas during the course of the contract
- ✓ Regular revisions following gas market changes

VS

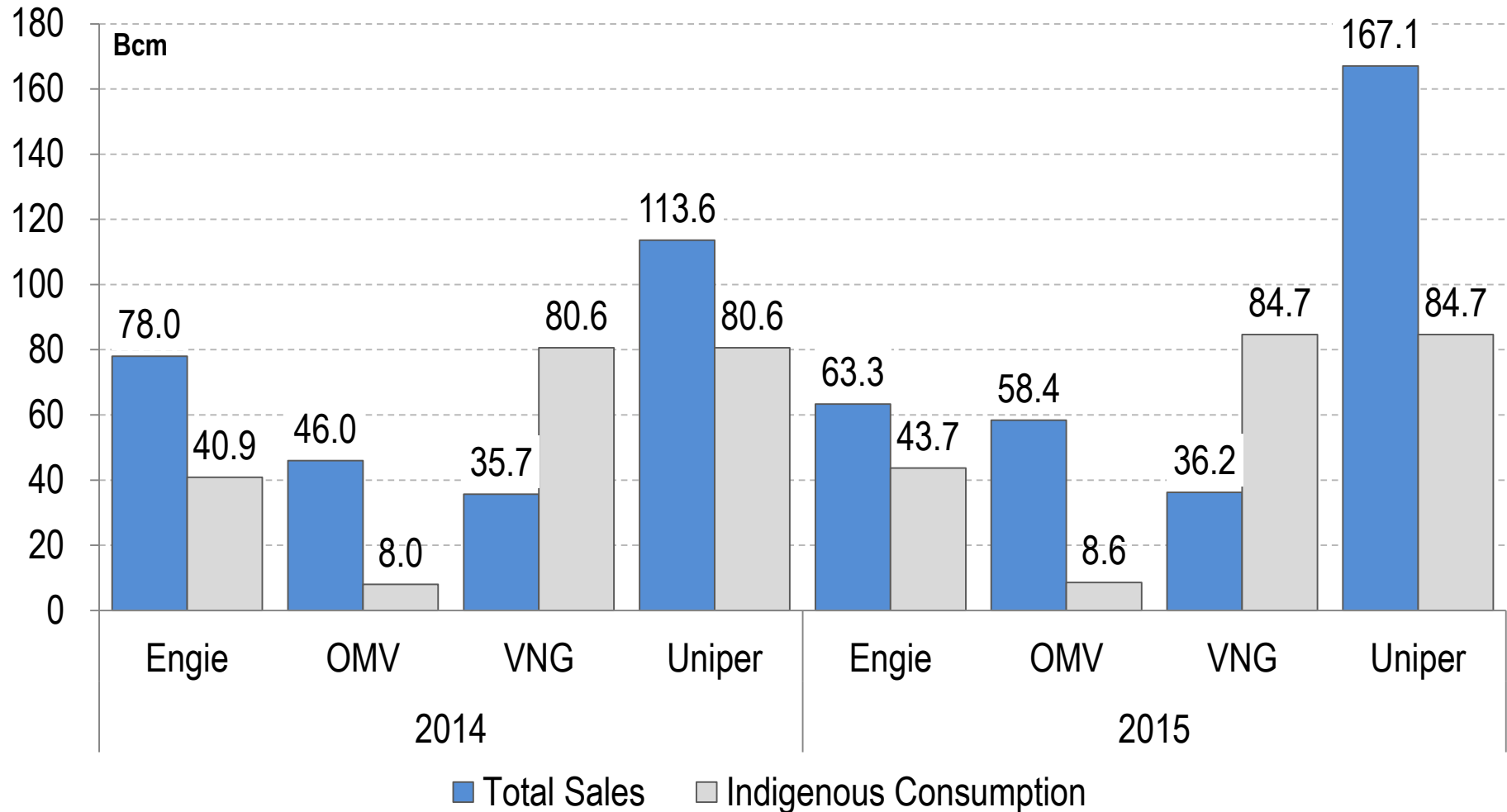
American LNG Contract

- ✗ Gas is delivered FOB at the liquefaction plant
- ✗ Risks of price movements at different markets with different background are incurred by the buyer
- ✗ 100% “liquefy-or-pay” commitment of the buyer. LNG project operator always covers its costs and justifies investment
- ✗ No contract terms' revision is allowed. No possibility of adaptation to the changing market environment

Traditional 3-tier European gas market structure

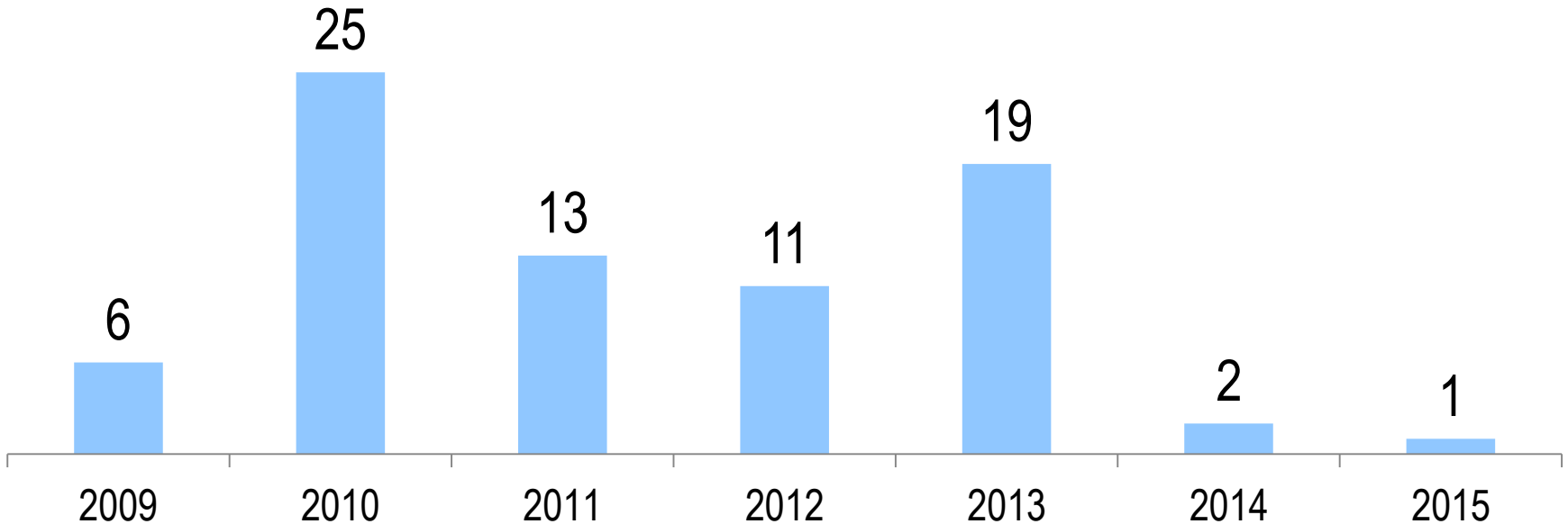


Trading Volumes by Utilities/Midstreamers are Higher than Gas Consumption in the EU Countries



Source: IEA, Companies' Annual Reports

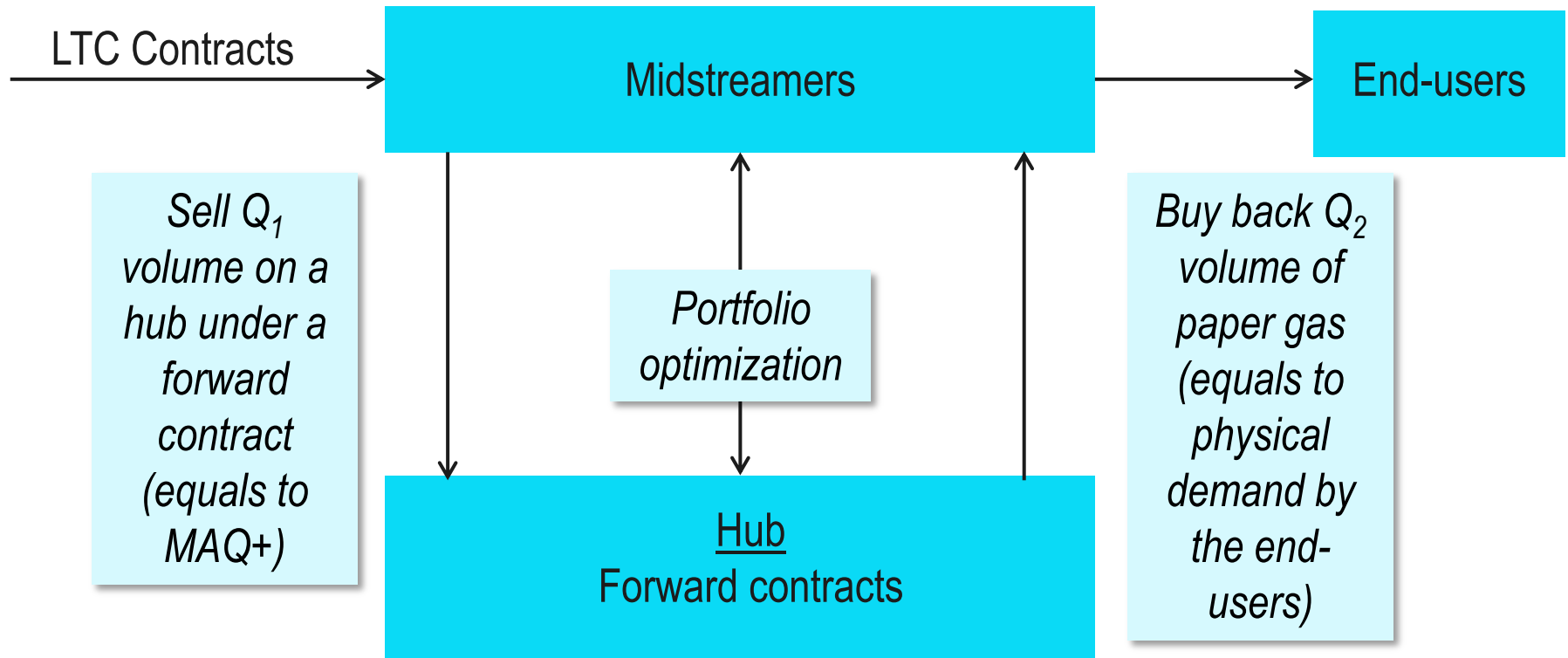
Number of contract revisions



Action undertaken

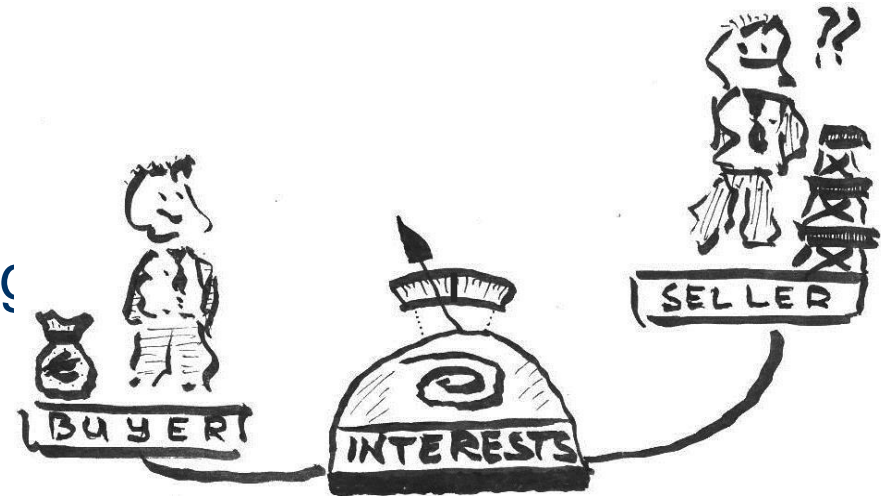


Traditional GPE Partners Forfeit End-User Deliveries in Chase of Trading Profits



Under current market conditions:
 $Q_1 > Q_2$

1. Price degradation mechanism may lead to below the cost prices of gas deliveries
2. Importers/midstreamers may have interest in artificially low prices as it increases their margin & selling opportunities
3. Suppliers are not getting fair reimbursement for contract flexibility making it an instrument of market manipulation



Current market environment requires a profound redesign of the Groningen-type LTCs

Price revisions are not sufficient enough to upgrade existing contracts to the 'New World' challenges. Ignoring supplier interests will have destructive consequences to EU energy security

