

**“Formation of the European Union’s internal gas market under Third Energy Package: how to make it workable with due consideration of the fair concerns of non-EU gas exporters”**

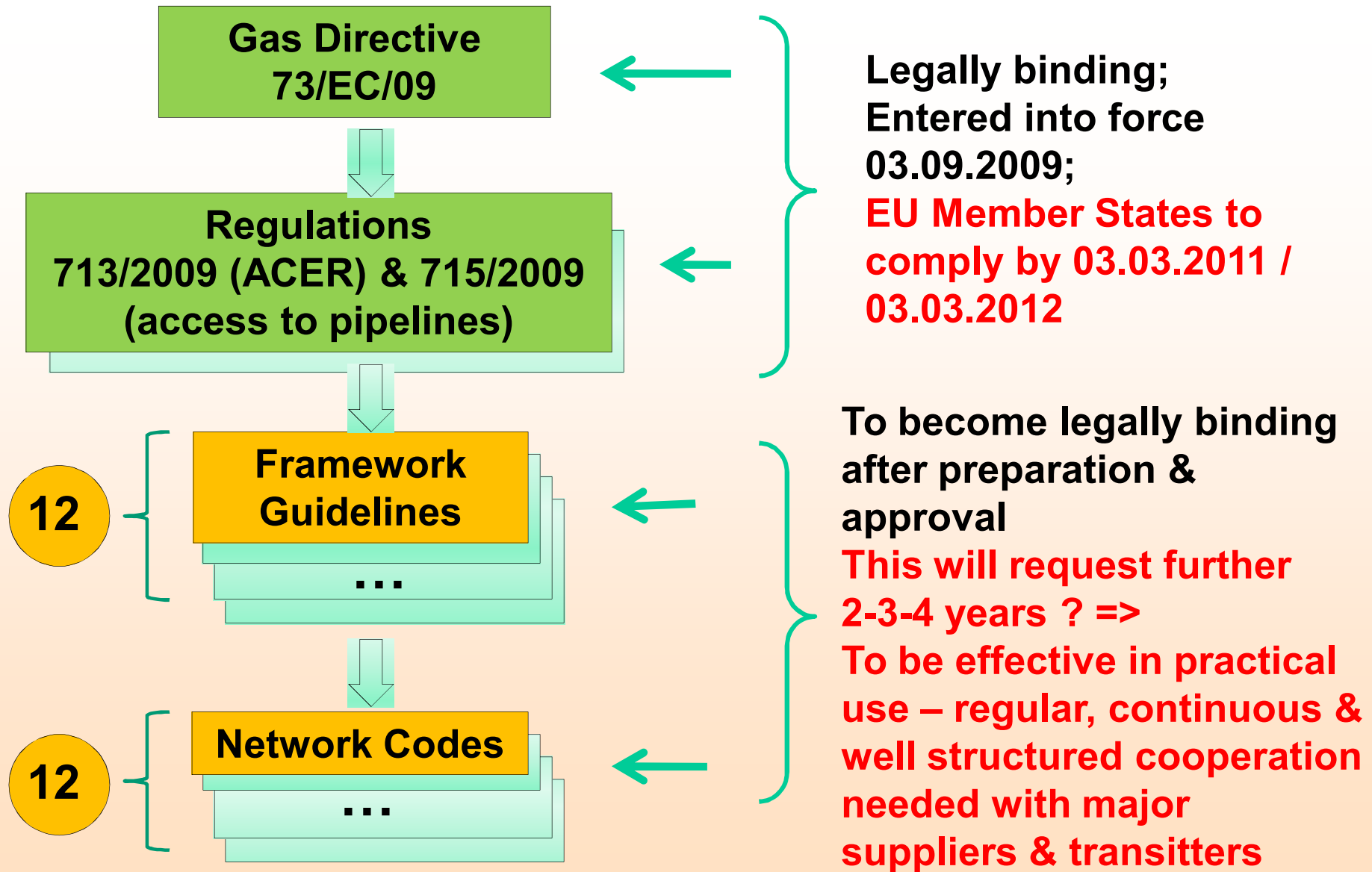
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**Presentation at Energy Delta Convention 2010  
“Gas fuels Energy Transition” Conference,  
Martiniplaza, Groningen, Netherlands, 23-24 November 2010**

# Table of Content

- **Future architecture of the EU internal gas market according to 3<sup>rd</sup> EU Energy package (2009)**
- Some key problems of the 3<sup>rd</sup> EU Energy package – and possible solutions:
  - Contractual mismatch problem – to provide long-term access to transportations capacity
  - Conflict with project financing principles – derogations from MTPA
  - Gas pricing: total spot/futures pricing – or slow adaptations of LTGEC pricing formulas

# Third EU Energy Package (gas)

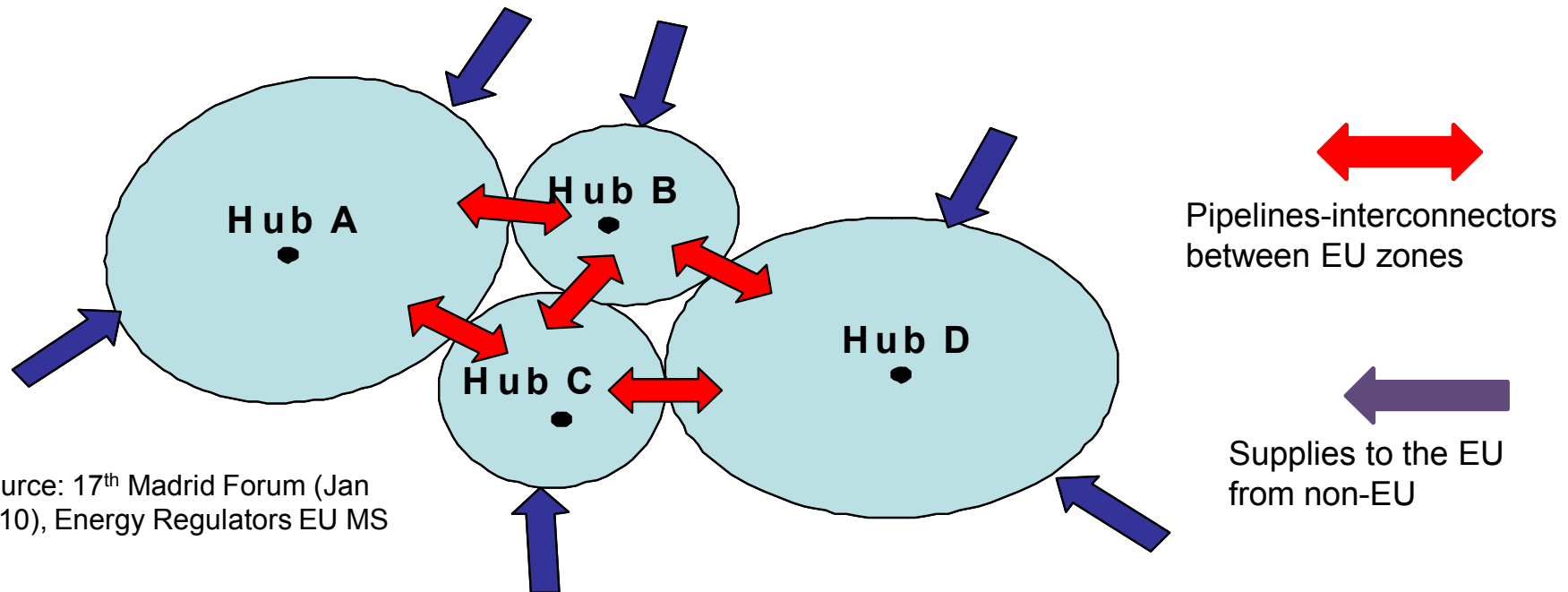


# Future organization of the common internal EU gas market according to 3<sup>rd</sup> EU Energy Package

- No single (homogenous) internal EU gas market in the near future even as an economic model  
- All market areas to be organized as **entry–exit zones** with **virtual hubs** => Towards uniform capacity allocation mechanisms (“**bundled products**”) & gas pricing mechanisms (“**liquid hubs**”), but:

(1) Capacity allocation: **short**-term vs. **long**-term? At zone borders? At hubs? Bundled products – only on volumes (of throughput capacity) or on duration of access as well? How to overcome inconveniences of the 3<sup>rd</sup> Package ? (f.i.: long-term = (1 year+) => “contractual mismatch” problem)

(2) Gas pricing at hubs: on **all** gas volumes or just on a **portion** of gas supplies? When hubs would become really liquid? All or only few of them? Which ones?



Source: 17<sup>th</sup> Madrid Forum (Jan 2010), Energy Regulators EU MS

Dr.A.Konoplyanik, Energy Delta Convention Gas Conference, Groningen, 23-24.11.2010

# Key provisions of the EU Gas Directives (1998/2003/2009) and the problems they created

Key CEC/DG COMP assumption: *"The more competition (number of players / intermediaries) – the better it is for end-users"* (???) => the policies:

- **Segmentation of VIOC (unbundling)** – splitting gas business between "competitive" (production / consumption) and "monopolistic" (transportation / distribution) spheres of activity,
  - Mandatory third party access (**MTPA**) to gas transportation infrastructure,
  - Switch from LTGEC to **spot trade**, etc.
- => In result: **incremental risks** (trade + investments), incl. problems:
- "Contractual mismatch",
  - Bankability of investment projects (project financing),
  - Price volatility / predictability (guidance for long-term & capital-intensive investment decisions)

# Instruments for implementing key provisions of EU Gas Directives outside the EU

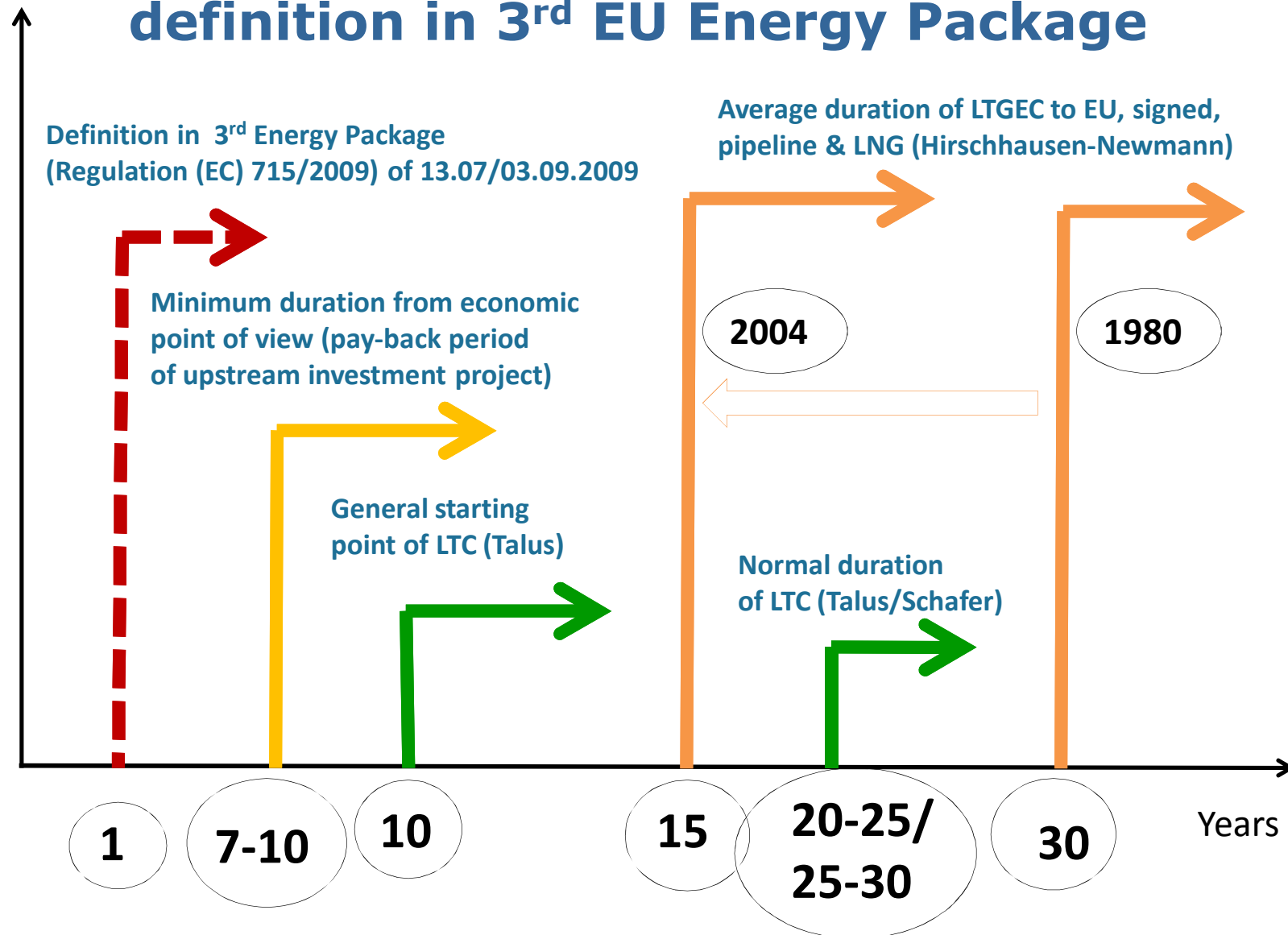
Export of EU «acquis communautaire» through:

- *First EU Gas Directive (1998)* => Energy Charter Treaty (1994/98)
- *Second EU Gas Directive (2003)* => Energy Community Treaty EU-SEE (2006)
- *Third EU Gas Directive (2009)* => “Third party clauses” of Directive 73/EC/09 + sanctions for violation of Directive’s provisions (up to 10% of global turnover of mother company) => **legal collision (?)**: how EU law (acquis communautaire) corresponds with international law provisions (ECT, etc.)

# Table of Content

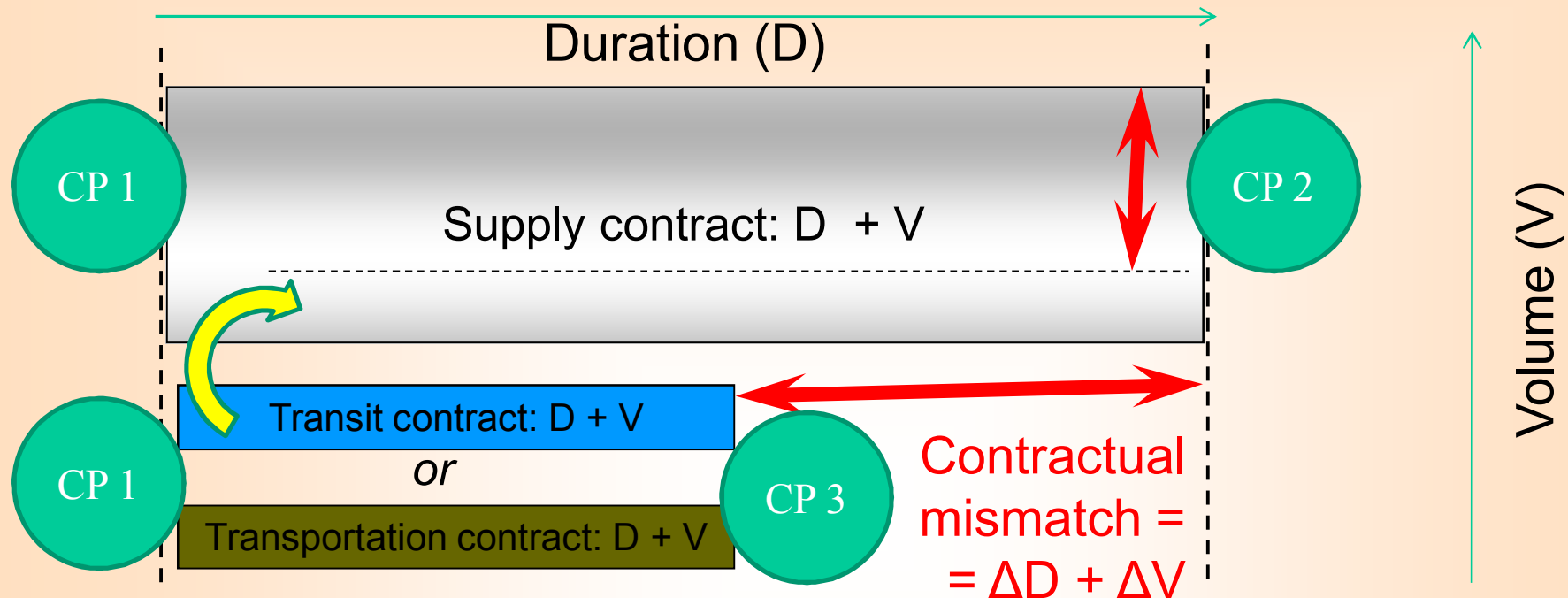
- Future architecture of the EU internal gas market according to 3<sup>rd</sup> EU Energy package (2009)
- **Some key problems of the 3<sup>rd</sup> EU Energy package – and possible solutions:**
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# “Long-term” (gas export contracts): different durations in historical European practice & its definition in 3<sup>rd</sup> EU Energy Package





## Contractual Mismatch Problem (Draft TP Art.8)



**Contractual mismatch:** between duration/volumes (D/V) of long term supply/delivery contract (LTGEC; CP1-CP2) and transit/transportation contract (CP1-CP3); the latter is integral part to fulfill the delivery contract => risk non-renewal transit/transportation contract => risk non-fulfillment supply/delivery contract.

**Core issue:** guarantee of access to/creation of adequate transportation capacity for volume/duration of long term contracts

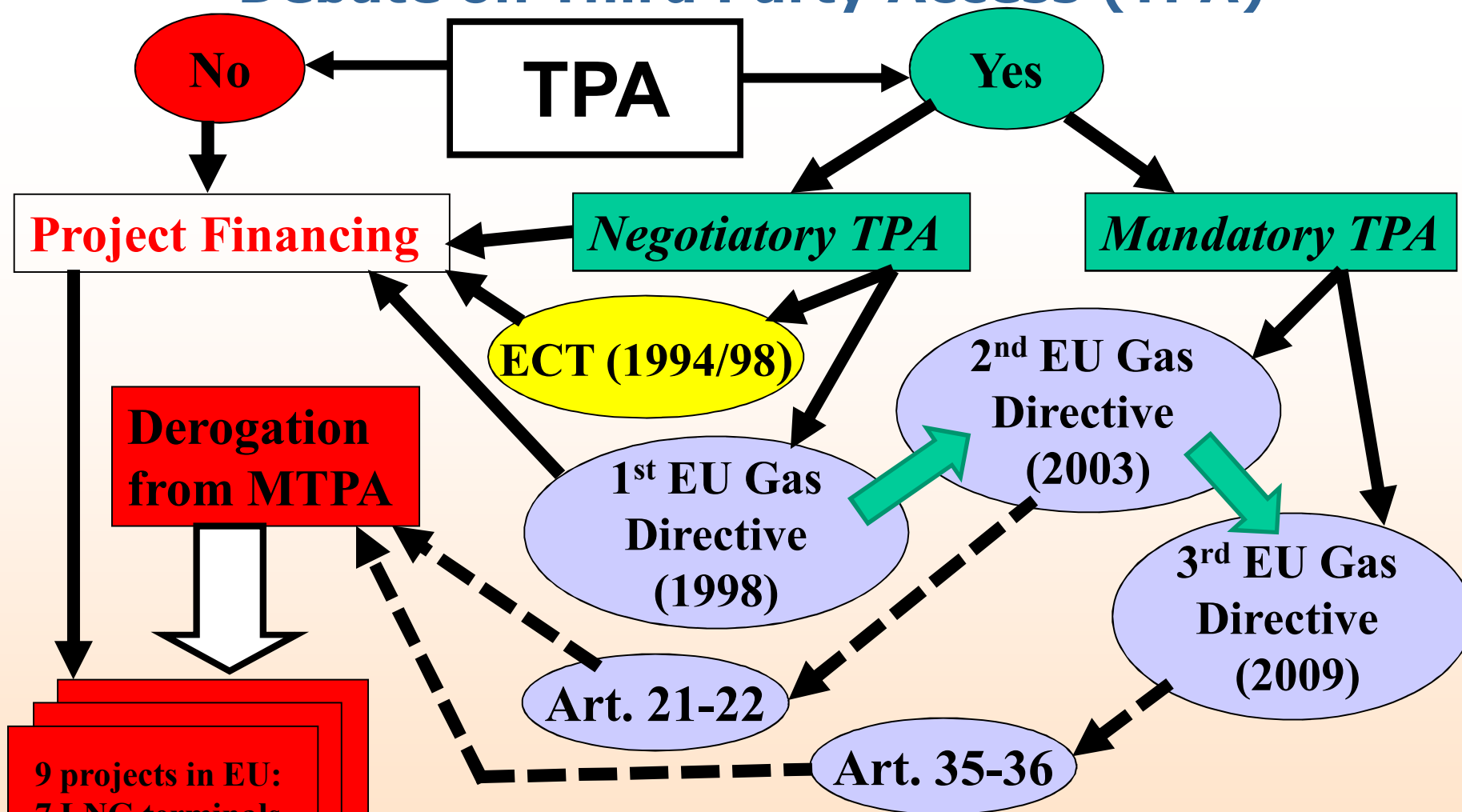
# Long-term vs short-term capacity allocation: problem & draft solutions

- **Problem:** in 3<sup>rd</sup> package “long-term” = 1 year+ (Regulation (EC) 715/2009) => this will de-stipulate long-term investment supply projects which are to be supported by long-term contracts (duration to be long enough to guarantee pay-back of long-term upstream investments)
- Two draft **solutions:**
  - “Right of First Refusal” (if available only short-term capacity products) => appropriate for suppliers, but as if incompatible with EU acquis - due to RF-EU bilateral informal consultations on Energy Charter Protocol on Transit in 2004-2007,
  - To provide long-term capacity allocation products => “bundled capacity products” to refer NOT only to **volumes**, but to **durations** as well => two-dimensional model of “bundled capacity product” (volume & duration) to escape *contractual mismatch* problem => draft procedure jointly developed by RF & EU experts during RF-EU informal bilateral consultations on Energy Charter Protocol on Transit in 2004-2007

# Table of Content

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# Debate on Third Party Access (TPA)



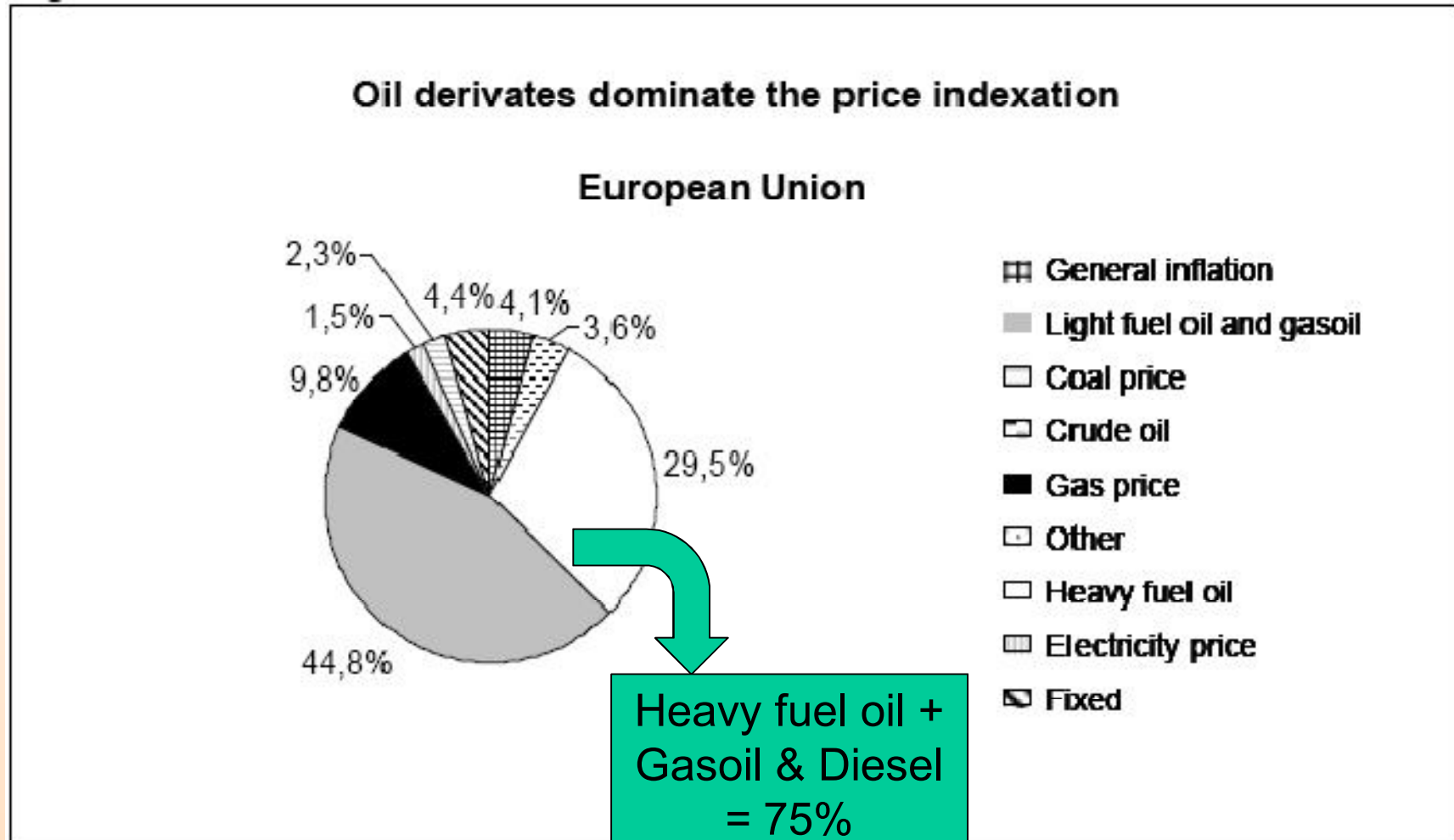
**9 projects in EU:  
7 LNG terminals  
+ 2 pipelines-  
interconnectors**

**NABUCCO:** Time-period to receive all permissions to derogate from MTPA = 28 months (during this period Turkmenistan-China pipeline was built) => collision "competition vs investments" in the EU Law leads to declining competitiveness, incl. both EU projects & companies

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# Price indexation structure in the EU



Source: Energy Sector Inquiry 2005/2006

# Liquidity of European gas hubs, Q4-2009

- **United Kingdom:** National Balancing Point (NBP) **14.9**
- **Belgium:** Zeebrugge (ZEE) **4.9**
- **Austria:** Central European Gas Hub (CEGH) **3.2**
- **Netherlands:** Title Transfer Facility (TTF) **3.0**
- **Italy:** Punto di Scambio Virtuale (PSV) **1.9**
- **France:** Point d'Echange de Gaz (PEG) (av.2009) **1.9**
- **Germany:** NetConnect Germany (NCG) **2.4**

For comparison:

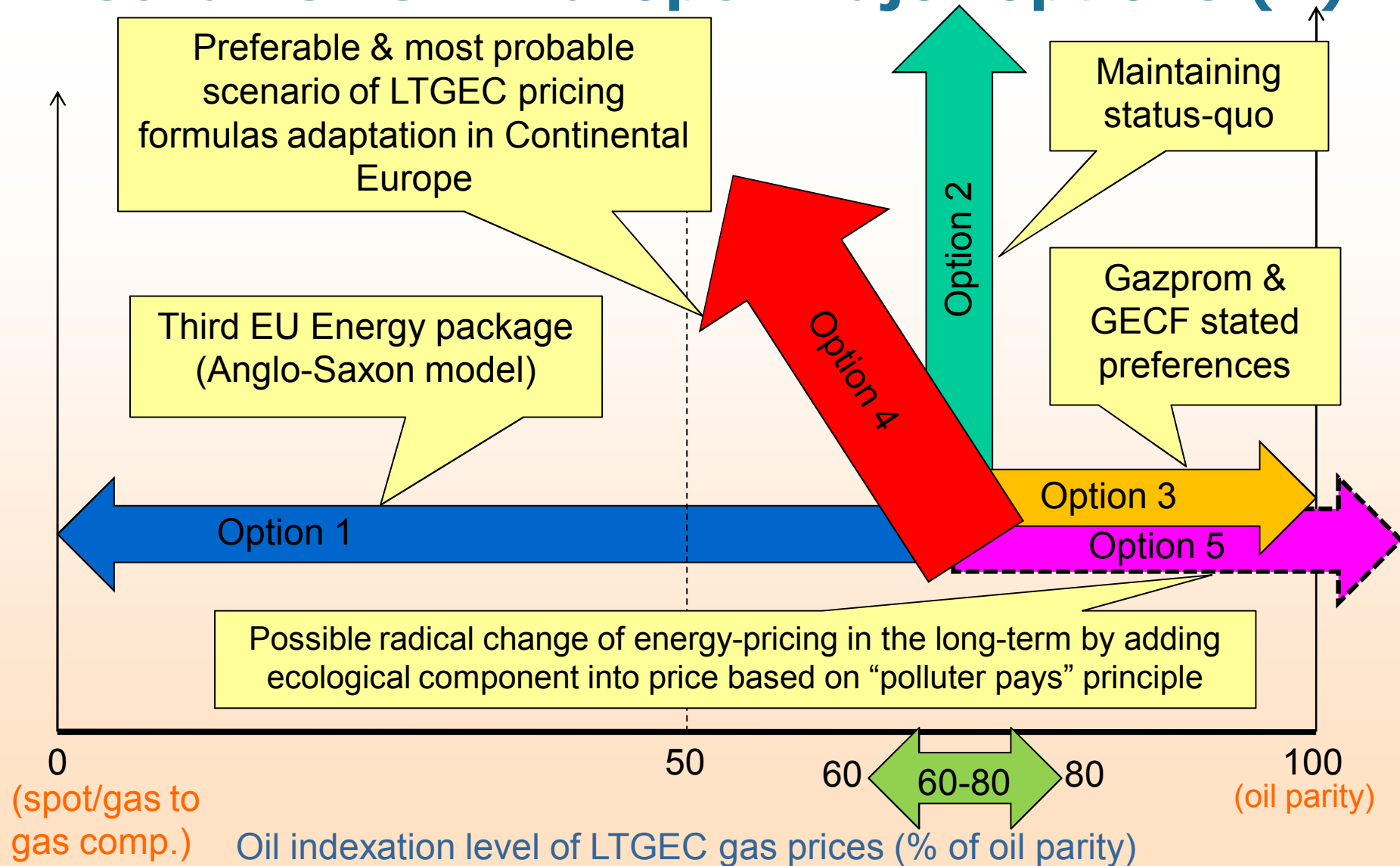
- **USA (oil):** NYMEX (WTI) (Feb.2010) **1680-2240**
- **UK (oil):** ICE (Brent) (Feb.2010) **2014**
- **USA (gas):** NYMEX Henry Hub (av.2009) **377**

**Break-even churn level for liquid marketplace **15****

*Churn* is the commonly used parameter for measuring liquidity level of marketplaces & is defined as the ratio of traded volumes to physical gas deliveries after trades

Source: "Gas Matters", IHS-CERA, M.Kanai (ECS)

# Evolution/adaptation of gas pricing mechanisms in Europe: major options (1)





## Evolution/adaptation of gas pricing & contractual mechanisms in Europe: major options (2)

- **Option 1:** to substitute gas price indexation in LTGECs by spot/futures quotations => **NO**
- **Option 2:** to maintain status-quo (LTGEC with dominant oil indexation) => **NO**
- **Option 3:** to maintain oil-indexation within LTGEC and to move to oil parity => **NO**
- **Option 4:** to adapt mostly oil-linked gas price indexation in LTGEC by pricing formulas linked to broader spectrum of parameters & non-oil gas replacement values => **YES** (long-term capacity allocation *must* be available to exclude contractual mismatch problems - supply vs. transportation):
  - **Long-term supplies (basic/base-load)** : more flexible LTGEC (n x 1 year) + "modified" gas replacement value formulas (price indexation *not* limited to oil-pegging);
  - **Short-term supplies (supplementary/peak- & semi-peak load)** : short-term (< 1 year)/spot contracts + futures quotations
- **Option 5:** to develop new pricing concepts leading to exceeding oil parity by gas prices (LTGEC + new indexation ingredients, like comparative ecological (dis)advantages of different fuels, etc.) => **NOT NOW**

# Thank you for your attention

Views expressed in this presentation do not necessarily reflect (may/should reflect) and/or coincide (may/should be consistent) with official position of JSC Gazprombank, its stockholders and/or its/their affiliated persons, and are within full responsibility of the author of this presentation.

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