



25th world gas conference
"Gas: Sustaining Future Global Growth"

The Gas Industry Needs Oil Indexation More Than Ever

CS8.3: PGCC European natural gas at a crossroads:
Where to go from here?

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June 6, 2012
Room 4006/7



Patron



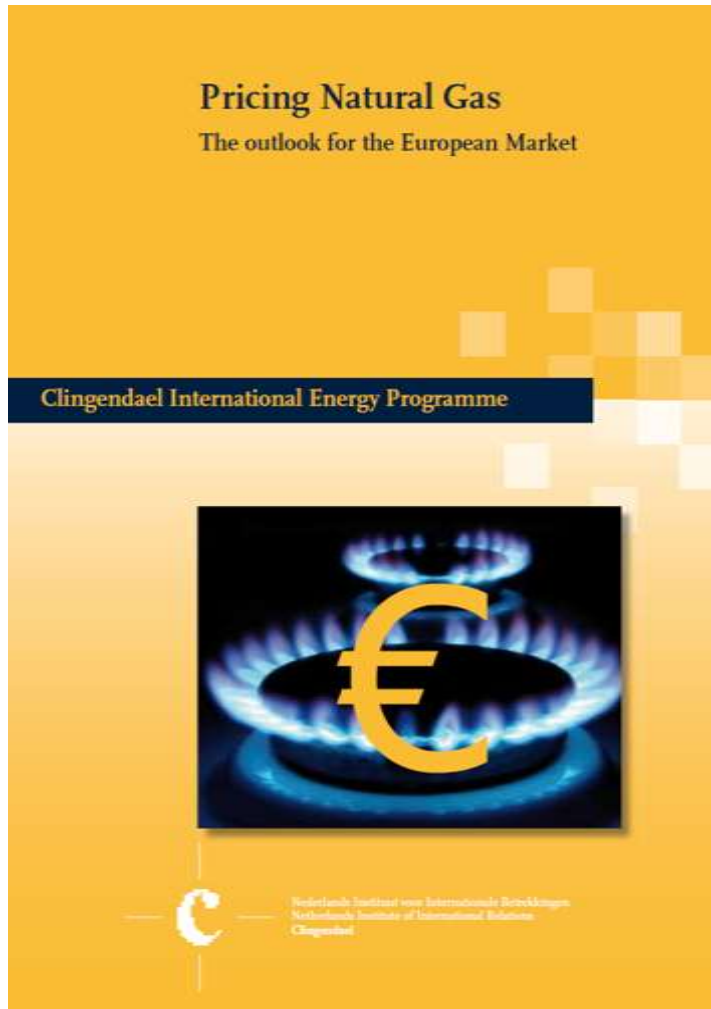
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The Term “Hybrid Pricing System” Originates from Clingendael’s¹ 2008 Research Paper



This paper “concludes that there is no strong evidence that the current hybrid situation, in which both forms of gas pricing co-exist, cannot continue. There are also no overriding reasons to intervene in the market practices of price formation. Both systems have their advantages and disadvantages under different market conditions, and to some extent complement each other in the current markets. Different types of risk and the appreciation thereof by the trading parties will determine particular choices of pricing rules and contracting conditions”.

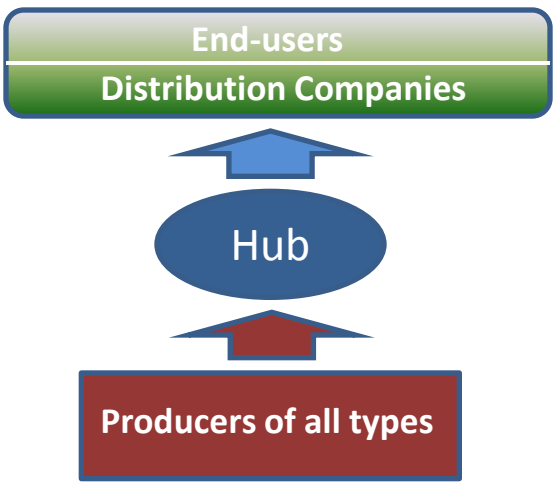
¹The Netherlands Institute of International Relations “Clingendael”

Well-Conceived Pricing Model Options for Continental Europe Gas Market or “Quick Choice, Long Repentance”

Model	Applicable To	Description	Supplier Acceptance
Oil Indexation	Asia	<ul style="list-style-type: none"> ▪ LT contracts ▪ 100% indexed to oil ▪ No hubs 	Yes
Hybrid	Continental Europe	<ul style="list-style-type: none"> ▪ Primarily, LT oil/oil product indexed contracts ▪ Minimal gas-indexed component in LT contracts ▪ Hub pricing 	Yes
Modified	Continental Europe (?)	<ul style="list-style-type: none"> ▪ LT contracts linked to gas indexes ▪ Hub pricing 	No
Hub	North America	<ul style="list-style-type: none"> ▪ Near absence of LT contracts ▪ Pricing based on supply & demand 	Not the best option for Continental Europe

Continental Supply & Demand Does Not Dictate Hub Pricing

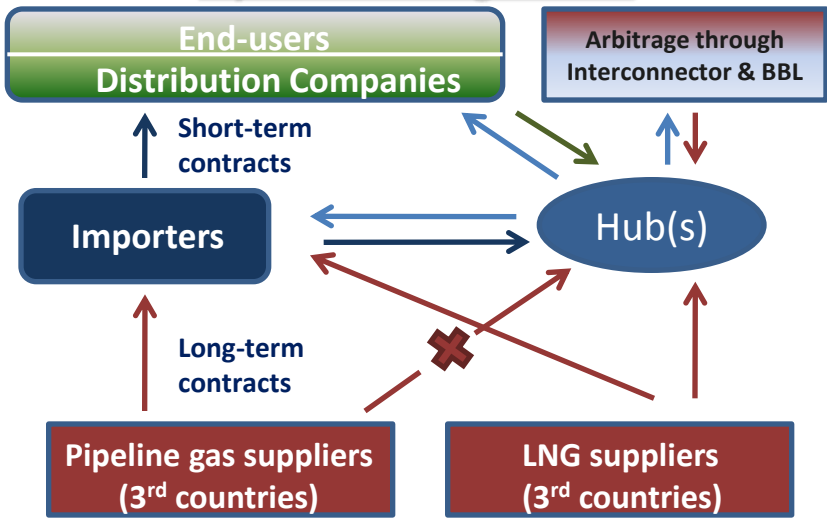
U.S. Pricing Model



PH_{US} – hub price in the USA
 S_{US} – total supply
 D_{US} – total demand

$$PH_{US} = F(S_{US}, D_{US})$$

Hybrid Pricing Model

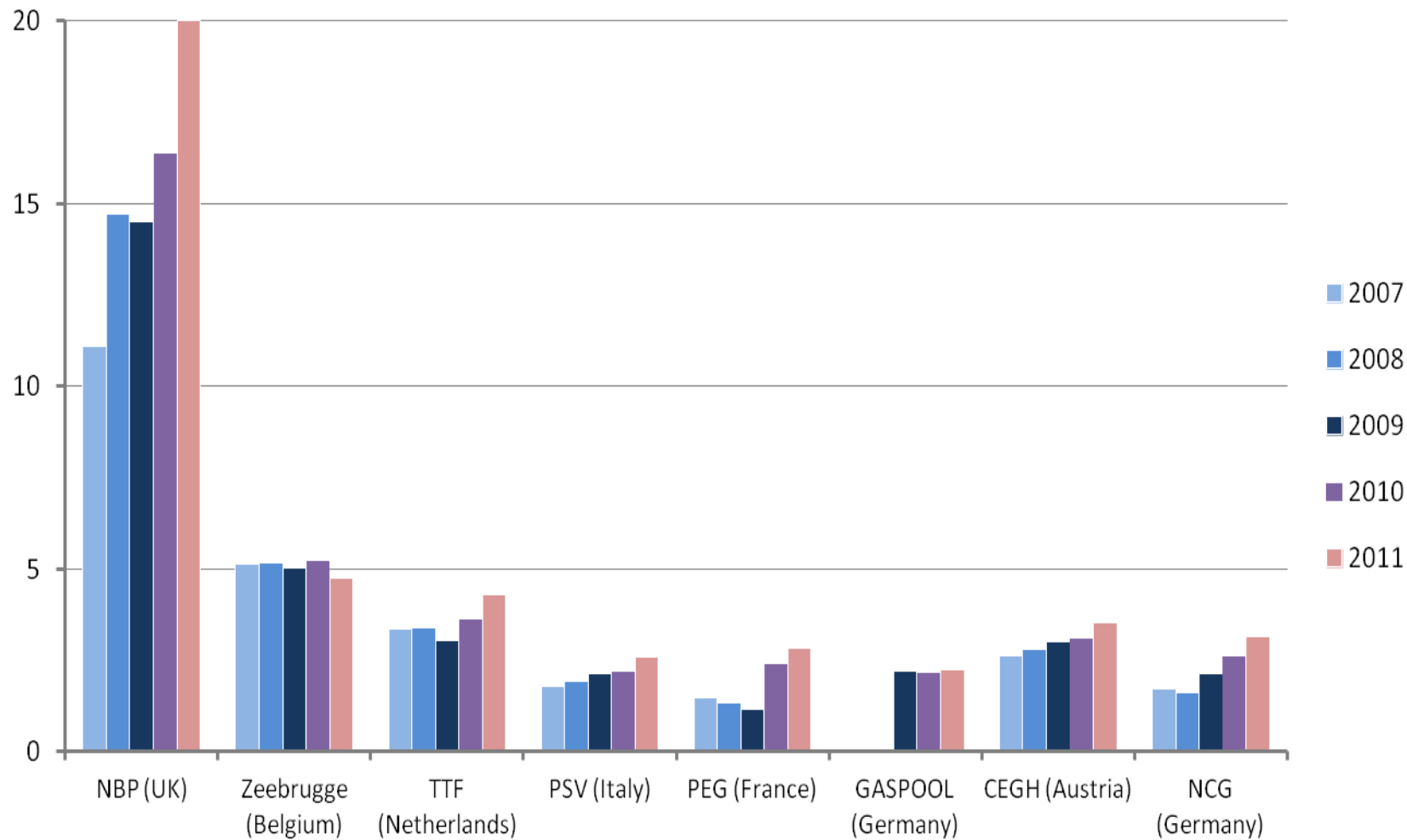


$PH_{CE} \neq F(S_{CE}, D_{CE})$
 PH_{CE} – hub price in Continental Europe
 SH_{CE} – total supply = $SHI_{CE} + SHEU_{CE} + SLNG_{CE} + SUK_{CE}$
 where:
 SHI_{CE} – sales to hubs by importers
 $SHEU_{CE}$ – sales to hubs by end-users (ToP obl.)
 $SLNG_{CE}$ – LNG supply to hubs
 SUK_{CE} – UK supplies through the Interconnector & BBL
 DHI_{CE} – demand by importers for hub gas
 $DHEU_{CE}$ – demand by end-users for hub gas
 DUK_{CE} – UK deliveries through the Interconnector and BBL
 $PH_{CE} = F\{(SHI_{CE} + SHEU_{CE} + SLNG_{CE} + SUK_{CE}), (DHI_{CE} + DHEU_{CE} + DUK_{CE})\}$

Asymptotic Contract and Spot Price Behavior

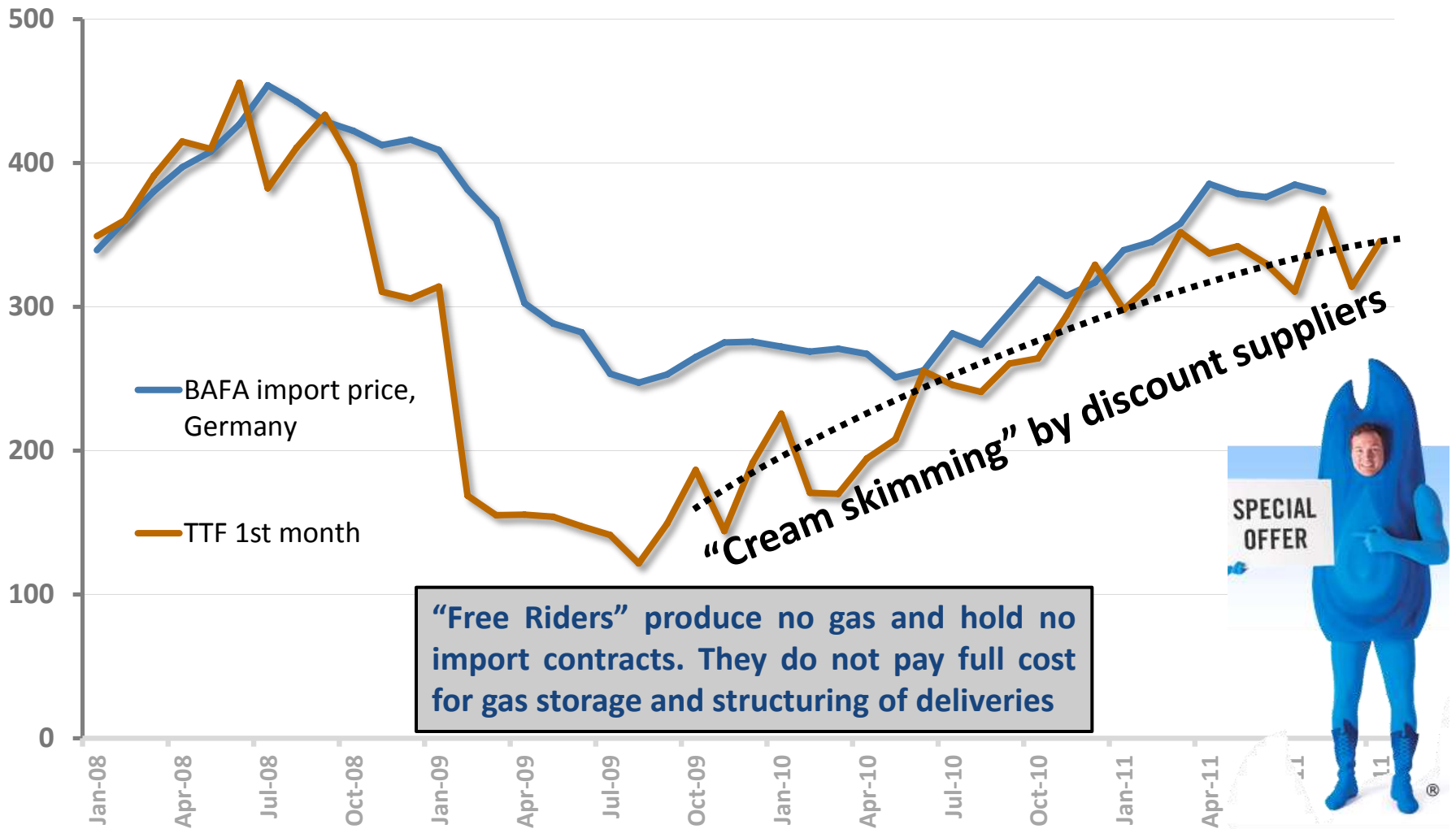


Churn Ratio at European Hubs



Source: IHS CERA

When Reforms Sponsor “Cream Skimming” and “Free Riding” – Competition Becomes Unfair



THANK YOU FOR YOUR ATTENTION!