Pricing & Competition In Mature & Liquid Markets

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Senior Research Fellow

Flame – 14 May 2018
## Gas markets work

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Market Results</th>
<th>State intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Fukushima: 7% of global LNG rerouted to Japan</td>
<td>Higher prices in Asia and Europe with demand destruction</td>
<td>No</td>
</tr>
<tr>
<td>2014</td>
<td>US Polar Vortex</td>
<td>Short-lived higher HH prices with fuel substitution in power generation</td>
<td>No</td>
</tr>
<tr>
<td>2015</td>
<td>Groningen cap: loss of 9% of European supply</td>
<td>Lower prices</td>
<td>No</td>
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<tr>
<td>Winter 2016/2017</td>
<td>Cold weather &amp; nuclear shortages in France</td>
<td>Short-lived higher prices in Southern Europe</td>
<td>Greece and Italy declare alert</td>
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<td>12 Dec. 2017</td>
<td>Baumgarten blast</td>
<td>Very short-lived spike mainly in Italy</td>
<td>Italy declares emergency</td>
</tr>
<tr>
<td>Jan 2018</td>
<td>US cold bomb cyclone</td>
<td>Short-lived spike in New York (First Yamal LNG cargo to Boston)</td>
<td>No</td>
</tr>
<tr>
<td>Feb 2018</td>
<td>Siberian weather in EU</td>
<td>Short-lived spike in EU</td>
<td>No</td>
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EU sentiment changes vis-à-vis gas...

- Gas demand growing since 2014
- Gas infrastructure is the batteries of the new energy system
- Complete electrification will not work
- Gas is not just a bridge fuel for renewables, but it has its own future in Europe
- EU hasn’t stopped already all public funding for new interconnections
... But Europe’s schizophrenia remains

<table>
<thead>
<tr>
<th>Policy makers</th>
<th>Energy managers</th>
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</thead>
<tbody>
<tr>
<td>On a foreign policy side, Russia is not an EU friend...</td>
<td>...but on the energy side Gazprom is the cheapest gas supplier than can, on top, provide any additional gas we may need.</td>
</tr>
<tr>
<td>EU Commission focus on consumers benefits (unbundling or roaming charges in telecoms)</td>
<td>Traditional energy managers focus on today’s P&amp;L (integration, etc.)</td>
</tr>
</tbody>
</table>

With increased interdependency, how is Europe’s schizophrenia going to evolve?

Who’s going to decide?
Gazprom exports and Europe dependency (2017)

Source: Gazprom Export, JODI est., thierrybros.com
#FactCheck

<table>
<thead>
<tr>
<th>Facts</th>
<th>Fake News</th>
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<tbody>
<tr>
<td>If global gas markets were to tighten, Russia could quickly ramp up pipeline gas exports to Europe and displace some LNG there that could then be re-routed to alleviate shortages elsewhere.</td>
<td></td>
</tr>
<tr>
<td>Thanks to several comparative advantages, primarily the size of its reserves, the proximity of its current markets, its spare capacity (…) Gazprom is in a position to deploy strategy designed to create uncertainty about the price of gas.</td>
<td>✗</td>
</tr>
</tbody>
</table>
Gazprom doesn’t flood EU

Source: Gazprom, Entso-E, thierrybros.com
3 options for Russia to manage prices

- **High**
  - 7.5$/Mbtu min
  - Tightening supply - Increasing producers’ rent
  - Demand destruction but no impact on exports
  - 2012-2013
  - Prompted new FIDs

- **Med.**
  - c.6$/Mbtu
  - Swinging supply
  - Since 2014
  - Most profitable in the long term

- **Low**
  - 4.5$/Mbtu max
  - Use of spare capacity
  - Price war to shut in US LNG
  - Lower revenues
  - Can be done sporadically
Month-Ahead Gas Prices

Source: Argus Media, thierrybros.com
Preservation of competition

- **US Sherman Antitrust Act 1890**
  - “An act to protect trade and commerce against unlawful restraints and monopolies”

- **ACER 2017 Report on the Results of Monitoring the Internal Markets**
  - “Markets in NWE tend to score better on metrics related to diversity of supply and upstream concentration. This results in better performing hubs”

- **EU DG Competition**
  - “Competition policy in Europe is a vital part of the internal market. Its aim is to provide everyone in Europe with better quality goods and services at lower prices. Competition policy is about applying rules to make sure companies compete fairly with each other. These are the reasons why the EU fights anticompetitive behaviour and encourages liberalisation.”

![Overview of EU MSs AGTM market health metrics – 2016](image-url)
What to do with our diversification metric?

• Either the diversification of supply rule is relevant and must be enforced. If this entails too much work for energy regulators, perhaps the EU’s Directorate-General for Competition should take a more active role.

• Or the rule is irrelevant and must be cancelled.
Restriction of competition

Sept. 15 • Gazprom, BASF, E.ON, Engie, OMV & Shell sign shareholders agreement to construct Nord Stream 2

Nov. 15 • Change in Nord Stream 2: Engie moving up from 9 to 10%; Gazprom moving down from 51% to 50%.

Dec. 15 • Application sent by Gazprom and its 5 European partners to Polish Office of Competition and Consumer Protection (UOKiK) to approve the creation of Nord Stream 2 joint-venture

July 16 • UOKiK issue objections to a concentration as it might lead to restriction of competition
• Companies have 14 days to present their views on the objections

Aug. 16 • Companies withdraw their merger control notification in light of UOKiK objections

Apr. 17 • European companies provide long-term financing for 50 % of the total cost of the project (€9.5bn)
• Gazprom is and will remain the sole shareholder of Nord Stream 2

May 18 • A lack of response to competition authorities doesn't mean restriction of competition doesn't exist
• UOKiK against Nord Stream 2
Thank you

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