



Italy and France are pushing for more spot-based pricing in regulated retail tariffs. Locked in oil-linked long-term contracts, suppliers may bear the brunt as renegotiations with producers are tough.

Availability of cheaper gas on Europe's traded hubs, which up until this spring largely stayed below oil-linked long-term contracts delivering gas to continental Europe, has prompted governments to push for a higher spot indexation in regulated retail tariffs.

Most recently, Italy jumped on that bandwagon with regulator AEEG ruling that the country's regulated retail prices must be linked 100% to the Dutch TTF hub as of 1 October.

For an interim period, from 1 April to 30 September 2013, the proportion of hub indexation in the retail tariffs has already been lifted from zero to 20%.

Meanwhile, in France, regulated tariffs are required by law to reflect the makeup of the long-term contracts held by historical suppliers - GDF SUEZ being the major one - in order to accurately cover the cost of the raw material.

Following a recent audit by the French regulator CRE of GDF SUEZ's supply contracts for this purpose, it emerged that the proportion of hub indexation in the company's long-term contracts are likely to include hub indexation to a proportion of at least 40% during 2013, and that the company already sources 30% of its supply via short-term purchases on hubs.

GDF SUEZ said in December 2012 that it had increased the spot market-indexed component of its long-term contracts to 36% as of January 2013, from 26% previously.

Within GDF SUEZ's supply contracts, the part linked to spot markets is based on a basket of mostly monthly prices, of TTF, Belgian Zeebrugge, British NBP and French PEG Nord prices, according to CRE.

The government has indicated it accepts CRE's suggestion to adjust the regulated tariff formula to reflect the rising level of hub indexation in GDF SUEZ's supply contracts.

The government's desire to capitalise on cheaper hub prices in order to keep retail prices low, however, may not necessarily be matched by the pace of spot-index gas increases in suppliers' long-term contracts with producers.

Although GDF SUEZ and Italian suppliers Eni and Edison continue to work on contract renegotiation, they are behind counterparts in Germany - which also has a far more developed traded hub - in terms of the level of hub indexation they have been likely to achieve in their agreements with producers.

The 40% level of hub indexation due to be achieved by GDF SUEZ this year, is "low in comparison with E.ON, probably with RWE," said Jonathan Stern, chairman and senior research fellow at the Oxford Institute for Energy Studies.

The progress of some of Europe's less liquid hubs depends heavily on the extent to which major suppliers are willing to detach themselves both from oil indexation, and from long-term contract volumes themselves.

Contract restructuring

The level of spot-indexation in GDF SUEZ's long-term contracts revealed by the CRE report was higher than some observers expected.

It also made it possible to make comparisons on the progress made by individual companies in restructuring their long-term agreements and supply portfolios.

The major German wholesalers, E.ON and RWE, have been vocal in their advocacy of hubs during the past few years and by their own account gained high levels of spot-indexation in their portfolios. E.ON said in August 2012 that about half of its gas supply portfolio is no longer oil-indexed, with talks continuing "to convert remaining quick fixes".

E.ON sourced half its gas supply from traded hubs in Q1 2013, according to the company quarterly results.

RWE said in its 2012 annual report that “the proportion of purchases dependant on oil prices has already dropped considerably”. In an earlier presentation, for the first half of 2012, a slide showing the reduction in the oil-indexed share of RWE’s gas purchase portfolio appeared to show a decrease of this proportion to around one-quarter of the total long-term volume in 2013, rising to more than one-third in 2015.

But coupled with this, the overall volume sourced via long-term contracts also appears to be decreasing very quickly.

Wolfgang Peters, head of Supplies Caspian, Central Asia and Russia at RWE Supply & Trading, went as far as saying importers should receive risk compensation from producers for entering into long-term contracts.

Peters told a conference in February: “Why would I take a long-term contract indexed on market prices, if I can just go to the hubs directly and buy it there? I am taking some of the producer’s risk by committing to huge volumes over a long period. So either the producer sells directly at the hubs, or the importer will get risk compensation.”

In the case of both companies, the shift towards more hub purchases is as significant as the push to reduce the level of oil-indexation in long-term contracts.

GDF SUEZ price talks

GDF SUEZ said at 2012 result presentation that 50% of contracts were due to be reopened to negotiation in 2013.

The company told ICIS on 25 April that all the negotiations had already started, but would not specify which suppliers were involved, or give any details of the level of spot market indexation in contracts relative to different suppliers.

“All the negotiations allowed either to increase the market component of the gas formula, or to reduce the volumes based on oil prices, or to decrease clearly and simply the

oil prices which [are] taken into account in the formula,” a spokeswoman said.

“In addition, we have been able to inject, in some of our most important agreements, a yearly adaptation of price structure, to match the market evolutions between two reviews,” she added.

GDF SUEZ listed Norway’s Statoil, Dutch GasTerra, Russia’s Gazprom, Algerian Sonatrach and Italian Eni as suppliers with whom it was renegotiating long-term contracts during 2012. Negotiations with Statoil and GasTerra took place in Q4 2012.

Gas sourced from Norway accounted for 26% of GDF SUEZ’ total supply in 2012, followed by Russian gas (17%), Algerian (11%) and Dutch (10%).

Statoil appears to be the most open of all producers to including spot-indexed prices in its supply contracts.

According to the company, 55% of Statoil’s global gas sales are now spot-linked. Sales in the UK and the US constitute a significant part of the 55%, however, and those are likely to be fully hub-based.

However, with 27% of the total gas supply coming from Algeria and Russia, renegotiations may be tough for the French incumbent. Both the countries’ gas producers, Sonatrach and Gazprom, have been staunchly averse to including or increasing spot-market indexation to their long-term supply agreements.

In the case of Algeria, high domestic demand has put Sonatrach in a strong bargaining position.

“To the extent that [the Algerians] have paid attention to [the spot versus oil-indexation debate], they have less urgency to export gas,” Stern said.

Deals with Sonatrach

Italian suppliers Eni and Edison have also recently reported some progress in contract renegotiations with Sonatrach.

Little is known, however, about whether the agreements entail a larger share of spot-indexation.

On 29 May, Eni announced it has revised some terms of its long-term contract with Sonatrach for 2013 and 2014.

In particular, volume delivered by Sonatrach to Eni, in Italy, is to be reduced by an undisclosed amount. Eni gave no comment as to the price of the contract.

At the end of April, Italy's second-largest gas importer, Edison, won an arbitration case against Sonatrach leading to price revisions with an estimated impact of around €300m on earnings for 2013. Edison did not refer to the role - if any - played by hub-indexation in the amendment of contracts.

Marco Boeri, senior analyst at BNP Paribas, said: "Sonatrach mainly flows its pipeline gas to Italy, where the market is only now experiencing a jump in terms of market regulations. It possibly has been less affected by renegotiations so far, but pressure is likely to come."

Political pressure

France and Italy are among European countries that cling to regulated tariffs in order to keep a lid on gas prices to end users, particularly households (though in France regulated tariffs are available to all end-users).

The French government has also privileged long-term contracts as a means to provide supply security to those end users. Suppliers are required by law to have long-term contracts as a guarantee they have the means to deliver gas to all types of consumers.

According to some industry sources, 80-90% of France's total gas supply is sourced via long-term contracts. LNG, like pipeline gas, is supplied mostly on a long-term basis.

Therefore smaller companies, even if they are not able to deal directly with the big producers, also mainly get their gas from long-term agreements with larger suppliers, such as incumbent GDF SUEZ, or other large foreign companies.

At the same time, French politicians are putting pressure on companies to increase hub link in supply contracts.

The minister for sustainable development, energy and ecology, Delphine Batho, said in December 2012 that the government had asked GDF SUEZ to renegotiate its supply contracts, and that this had enabled a smaller hike in the regulated tariff than could otherwise have been expected from 1 January 2013.

Batho linked the two explicitly when she announced a 2.4% increase in gas tariffs from 1 January 2013.

"We have asked GDF SUEZ to renegotiate its supply contracts, therefore that is what allows us to limit the [price] change to 2.4%. Factoring in the restrictions placed on tariffs under the last administration, the price rise should have been 4%," she said.

In Italy, government pressure on the gas suppliers to renegotiate contracts has been even more acute.

The rapid shift to 100% hub indexation in the retail price formula puts the country's gas suppliers in an unenviable position: they must seek new terms from their suppliers that reduce the oil-linked portion, or face being unable to recoup their costs through regulated tariffs.