

EU Market Interventions: Impacts of Price Caps, LNG Benchmarks and Joint Gas Purchasing on World LNG Markets

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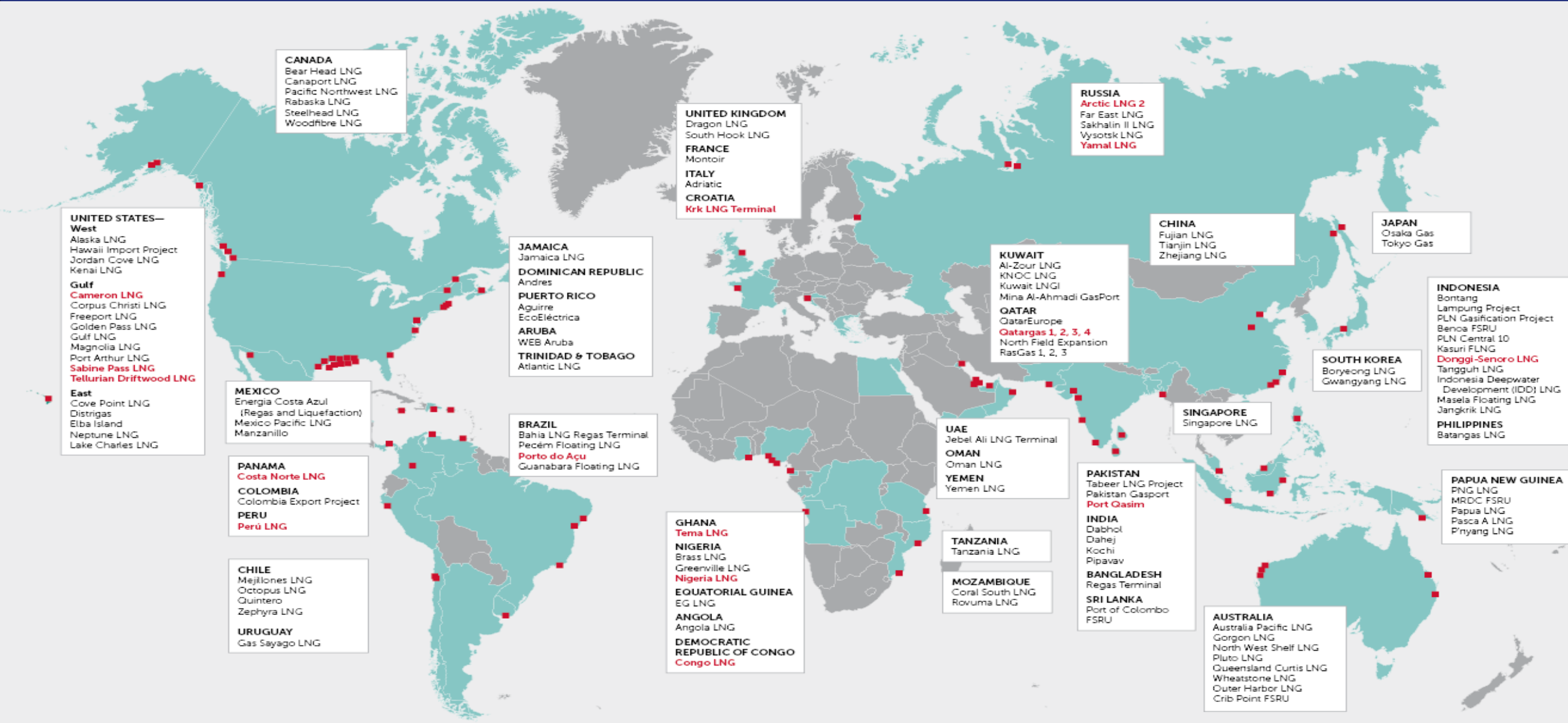


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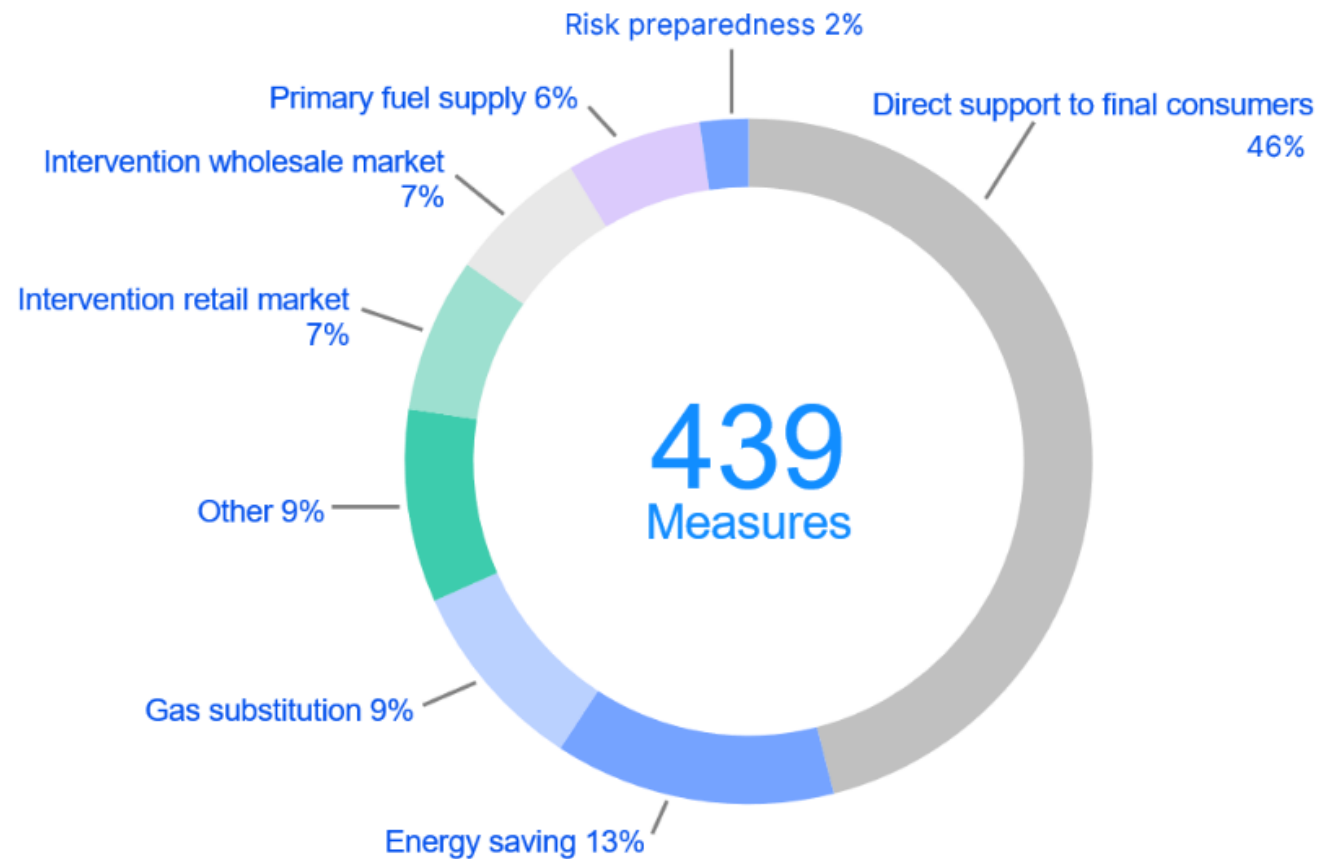


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EU 2022 Emergency Energy Measures



Source: ACER

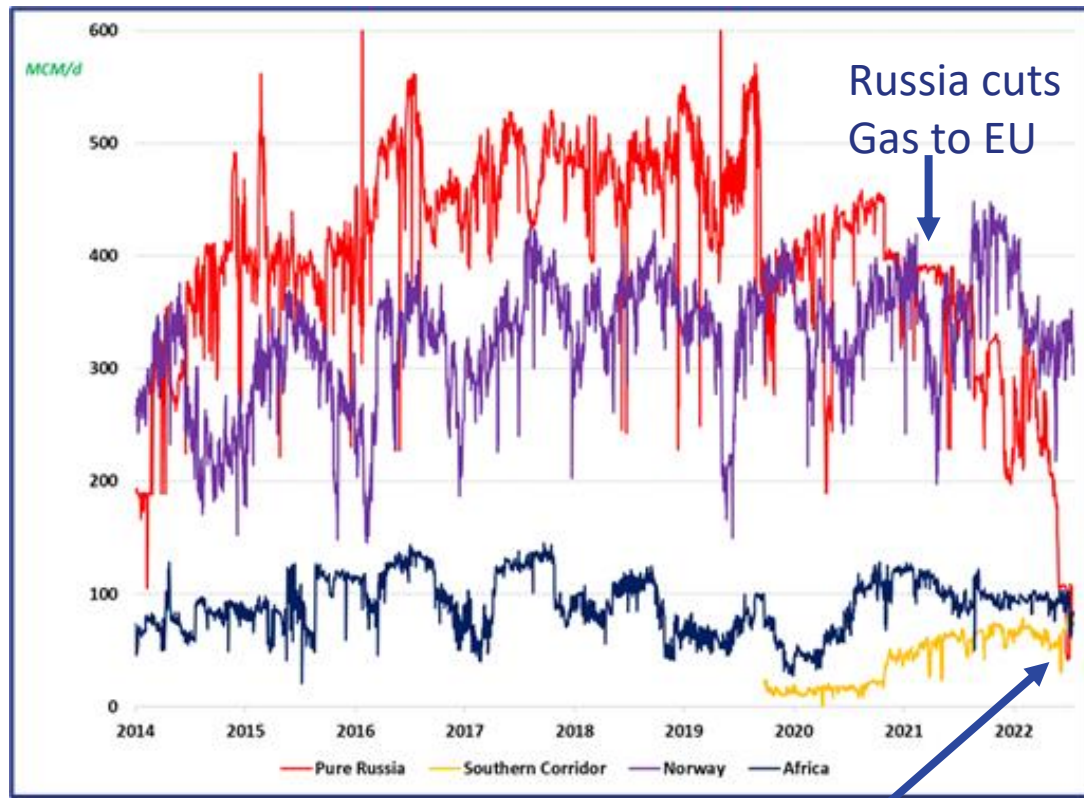
What Actions is the EU Taking?

In December 2022 the European Council (EC) adopts a series of measures intended to protect EU citizens and businesses against high energy prices.

1. **“Market Correction Mechanism”** (MCM) to cap wholesale natural gas prices at the Title Transfer Point (TTF) :
 - MCM is activated if front-month TTF derivative settlement price (ICE Endex B.V.)
 - Exceeds EUR 180/MWH for 3 working days, AND
 - Is EUR 35 higher than the Reference Price calculated by ACER based on global natural gas markets
 - Once MCM is activated, TTF prices are capped at the Reference Price + EUR 35 (but not less than EUR 180).
2. A new daily **“LNG Benchmark”** price providing for greater market transparency based on mandatory data reporting. Parties may use the benchmark voluntarily. Benchmark “to reflect real-world prices for LNG”.
3. A new **“Joint Purchasing System”** for natural gas and LNG. EU buyers mandated to commit $\geq 15\%$ of the gas they will need to fill 90% of their storage before winter to the joint purchasing consortium. These quantities will be aggregated and then submitted to the public tender. Additional volumes may be included on a voluntary basis. Some countries and some large gas buyers are reticent, believing they can obtain better terms.

What was pressuring the EU to “correct” the Market?

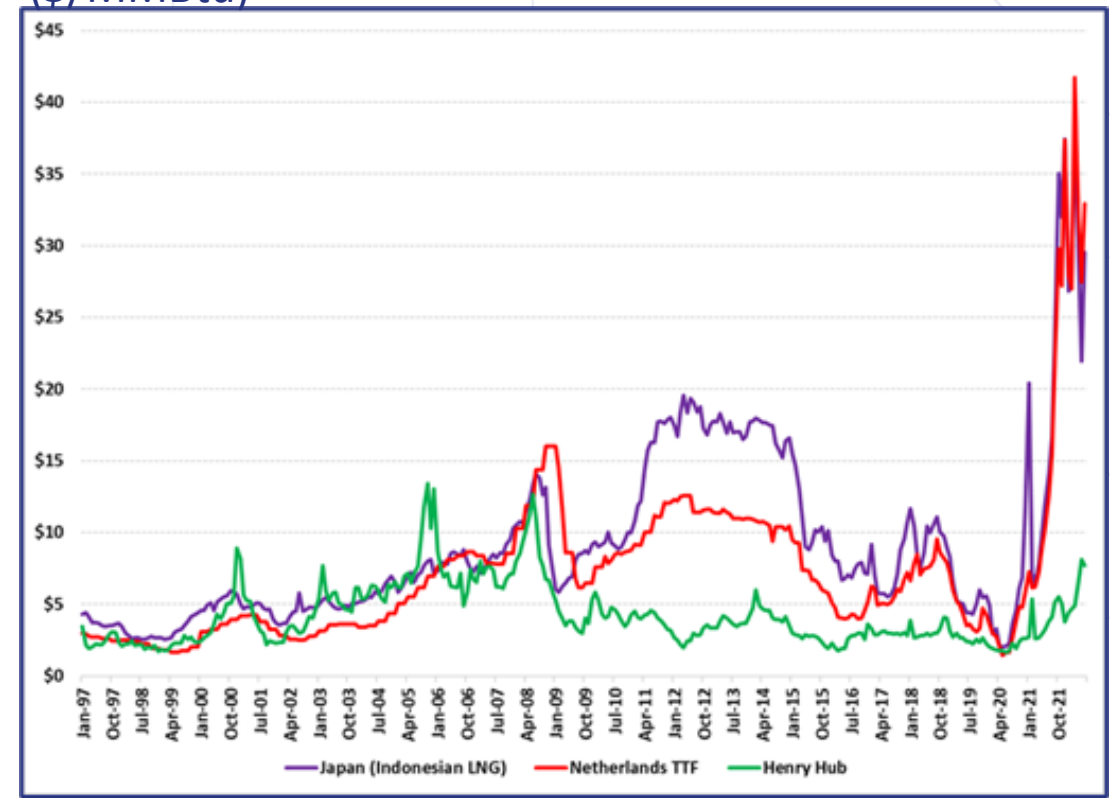
Pipeline Gas Supplies to Europe (MCM/d)



Source: ENTSOG, Baker Institute analysis

Russia invades Ukraine

Natural Gas, LNG Prices in Asia, Europe, US (\$/MMBtu)



Source: ENTSOG, Baker Institute analysis

And about those High Prices...

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Who's To Blame For Exorbitant Natural Gas Prices In Europe? Hint: Maybe Not Who You Think.

October 26, 2022 | Steven R. Miles, Anna Mikulska



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Prices of natural gas in Europe have skyrocketed to levels scarcely seen before 2021. European governments, especially those soon up for reelection, are understandably concerned about the future. That future is undermined by the economic hardship being caused by high energy prices. Not surprisingly, there is a search for the culprit, beyond Russia of course! After all, someone is experiencing a windfall in profits for natural gas as the price of the fuel in Europe is many times higher than prices in countries exporting gas to Europe in the form of liquified natural gas (LNG). Some, like German economy minister **Robert Habeck, have begun to criticize the US and other "friendly" LNG supplier countries, of profiting from "astronomical prices."** French President Emmanuel Macron, not to be outdone, accused the US of a **"double standard" because "American gas is 3-4 times cheaper on the domestic market than the price [of LNG] at which they offer it to Europeans.**

While US LNG exporters are doing well by any measure in the recent market environment, they are not the ones reaping most of the benefits of tight markets and exorbitant prices

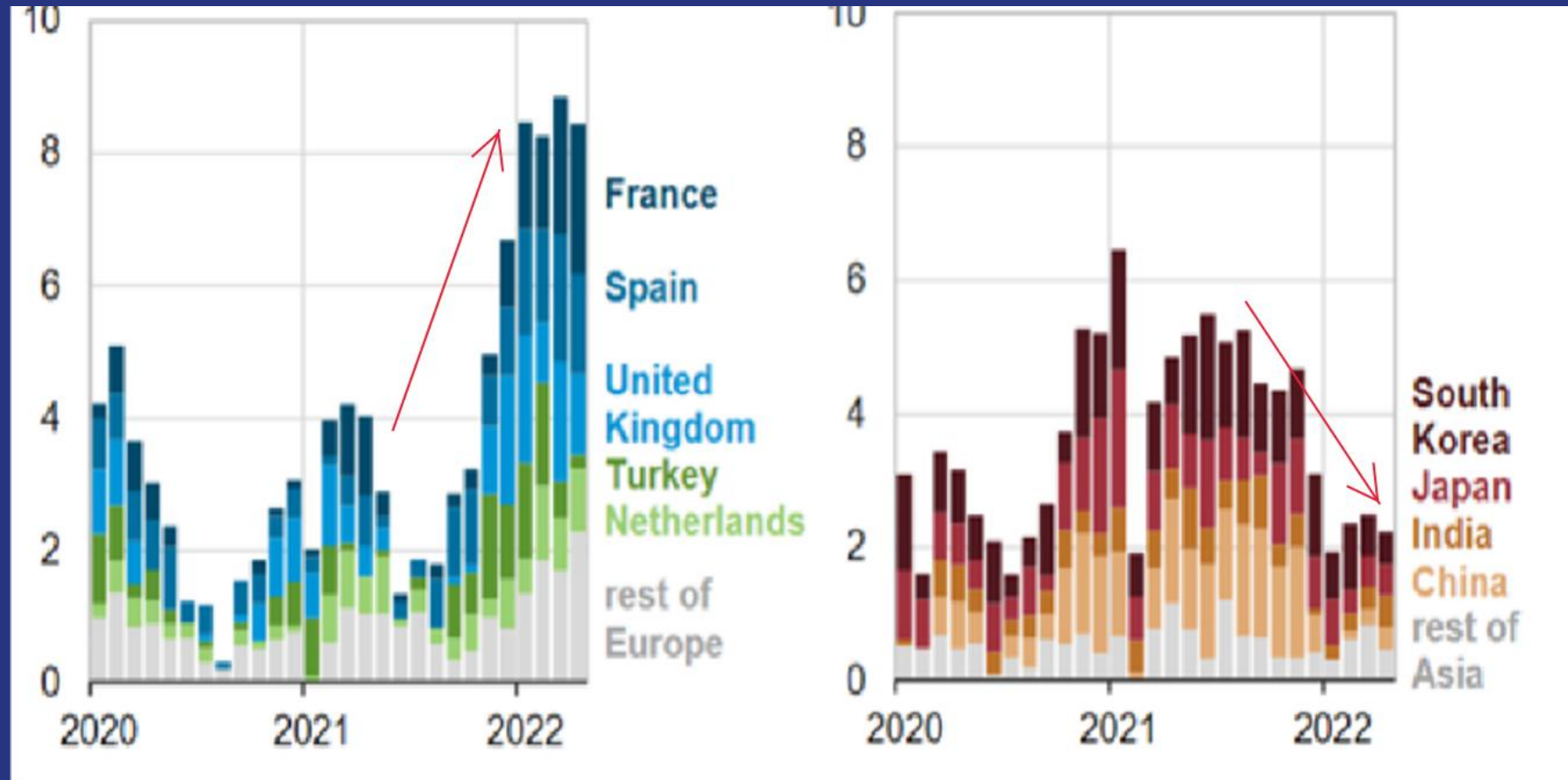
European Agencies Raised Concerns

Concerns about the MCM raised by the EU Agency for Cooperation by Energy Regulators (ACER) and the European Securities and Markets Authority (ESMA) included:

1. Price caps in Europe could push LNG cargos to higher-priced markets when Europe needs them most
2. TTF Futures trading could be pushed “off market” to ICE, CME or other markets unaffected by the price cap
3. Price caps might send negative signals but not be necessary as prices were already falling before the price caps went into effect

Higher Prices Helped Swing Cargoes to Europe in 2021-22; Could the MCM Reverse that Flow?

Monthly US LNG Exports by Destination, Jan. 2020 - April 2022 (bcfd)

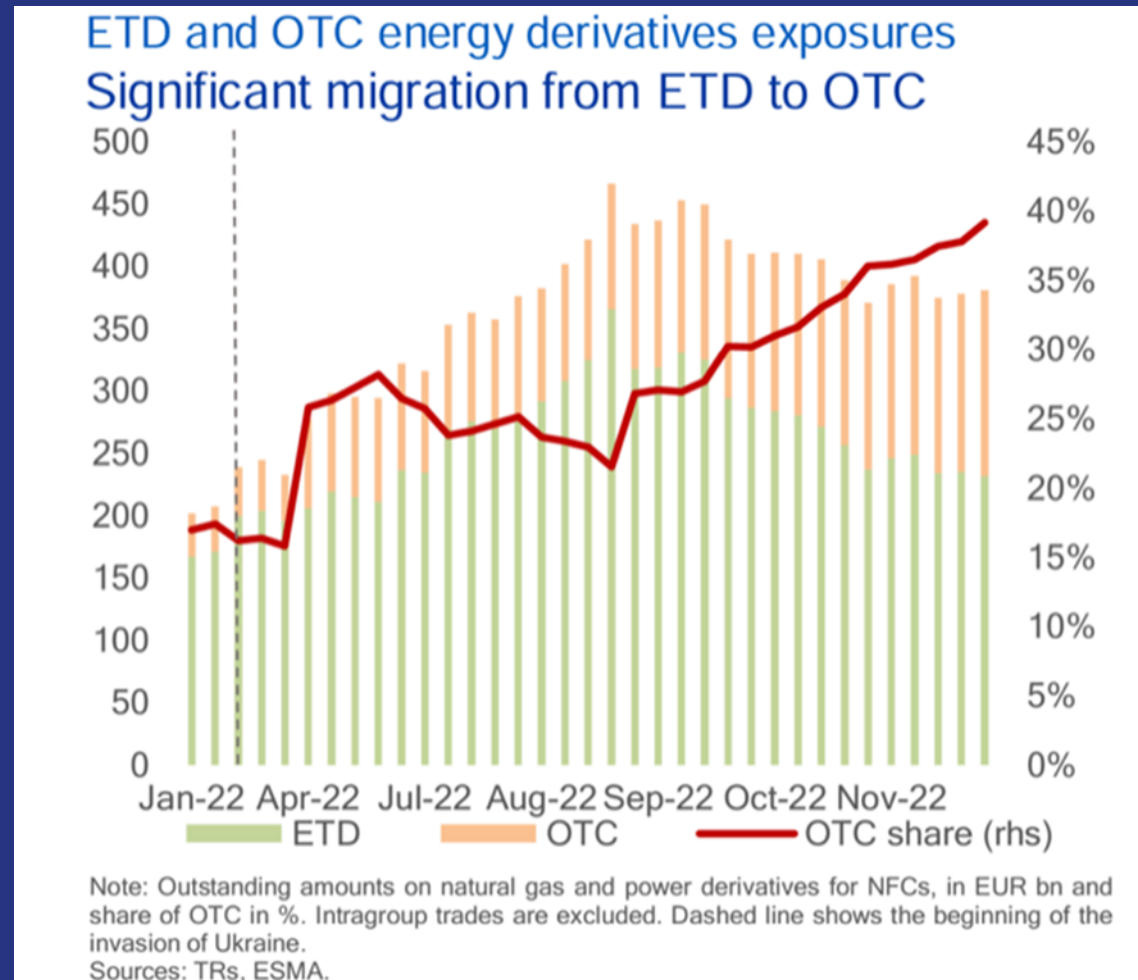


Source: EIA, Baker
Institute analysis

And What Collateral Impacts will Occur?

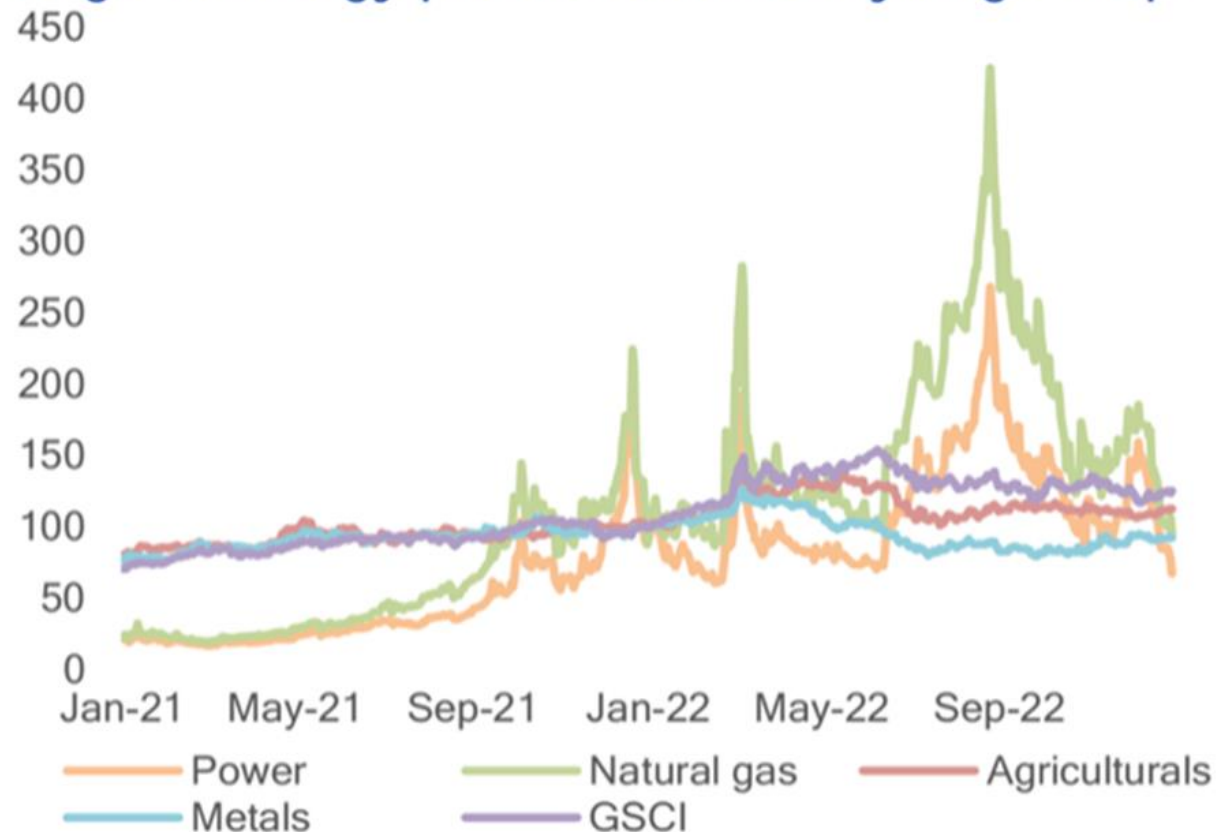
TTF is used for both LNG and natural gas contract futures and hedging. What are the impacts of government manipulation of this market index?

“Since end-August the migration to OTC has accelerated with OTC accounting for close to 40% of gross exposures end-December. Such mitigation presents risks as OTC markets are less liquid and transparent.... The migration of OTC may also reduce liquidity and price discovery“ on public exchanges. ESMA, 23 Jan. 2023



But is this a Remedy to a Problem that was Already Being Resolved?

Surge in energy prices, followed by large drop

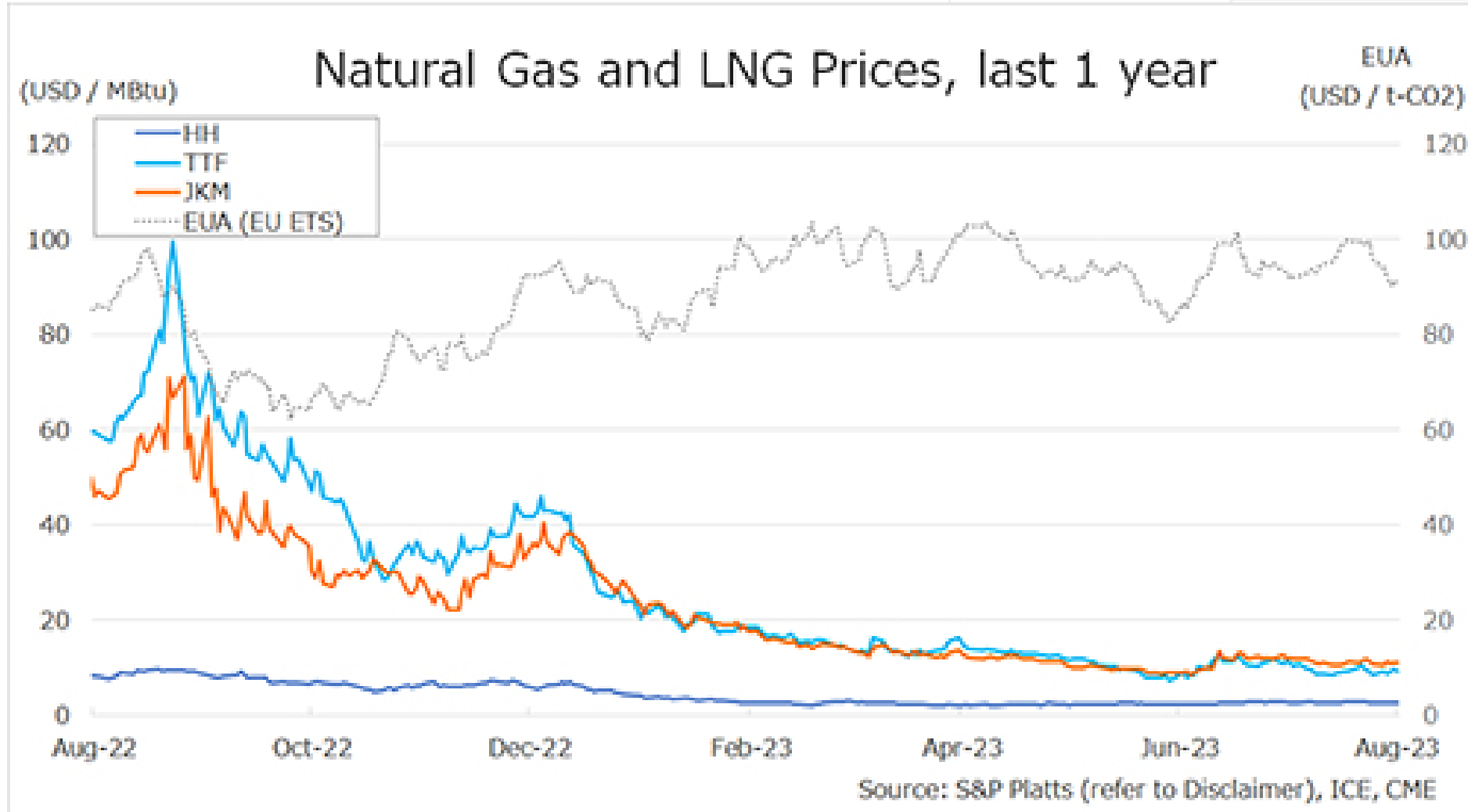


Note: Commodity price indices rebased at 1/1/2022=100. S&P GSCI indices for global commodities, agricultural products and metals, ICE Dutch TTF futures for natural gas and EEX Phelix futures for power.

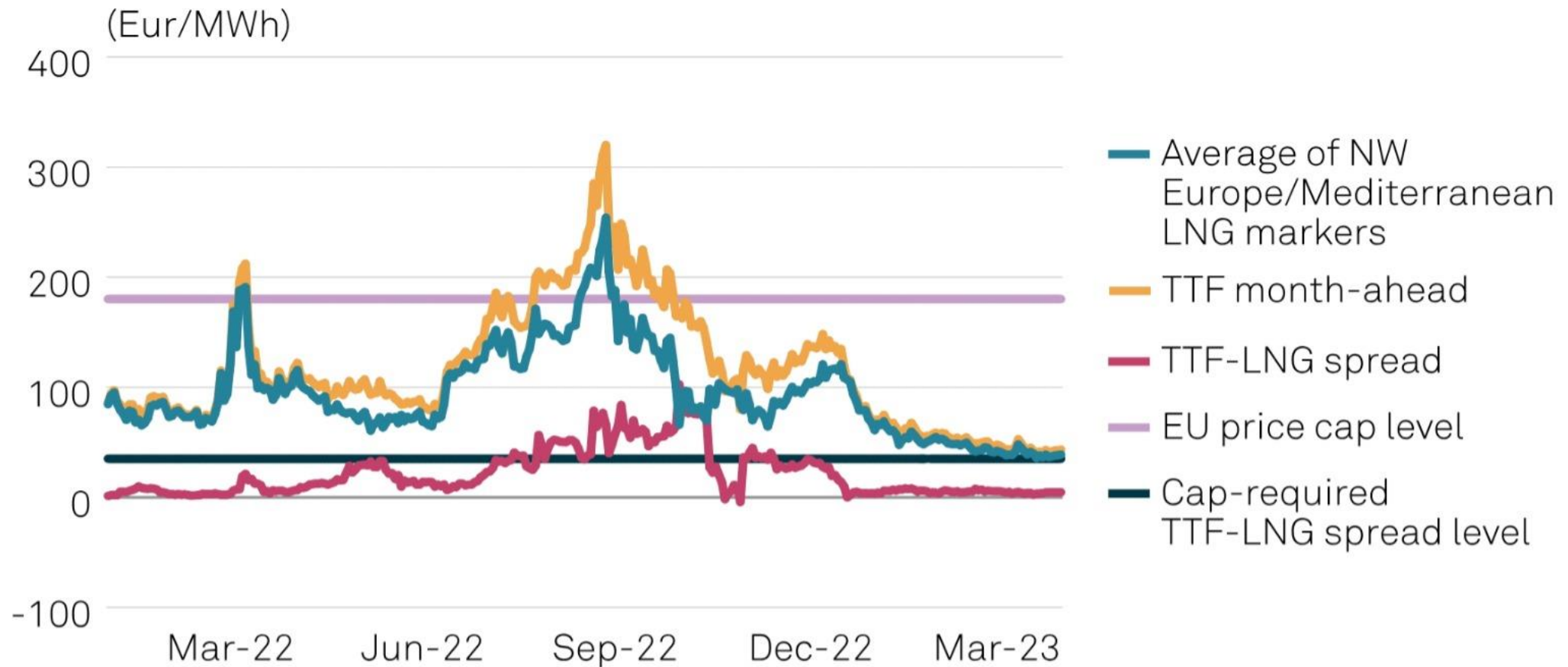
Sources: Refinitiv EIKON, Datastream, ESMA.

So What Impacts have we seen in World Markets Since the EU's Market Interventions?

World Wide LNG Prices Have Largely been Flat



TTF price still well below Eur180/MWh cap level



Source: S&P Global Commodity Insights

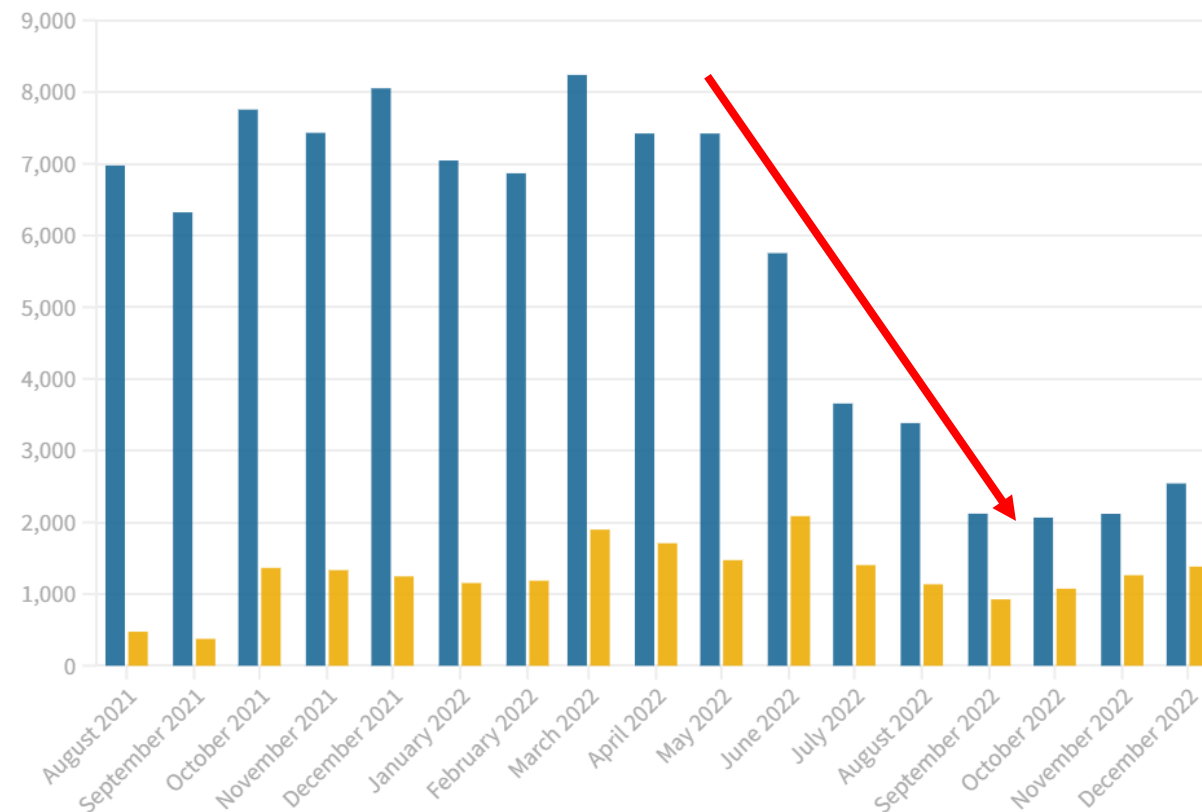
Does this Mean the Risk of High Prices is Over for Europe?

EU loses ≥ 100 bcma
of gas from Gazprom
2021 Cutbacks &
2022 Russian invasion
of Ukraine

EU imports of Russian gas

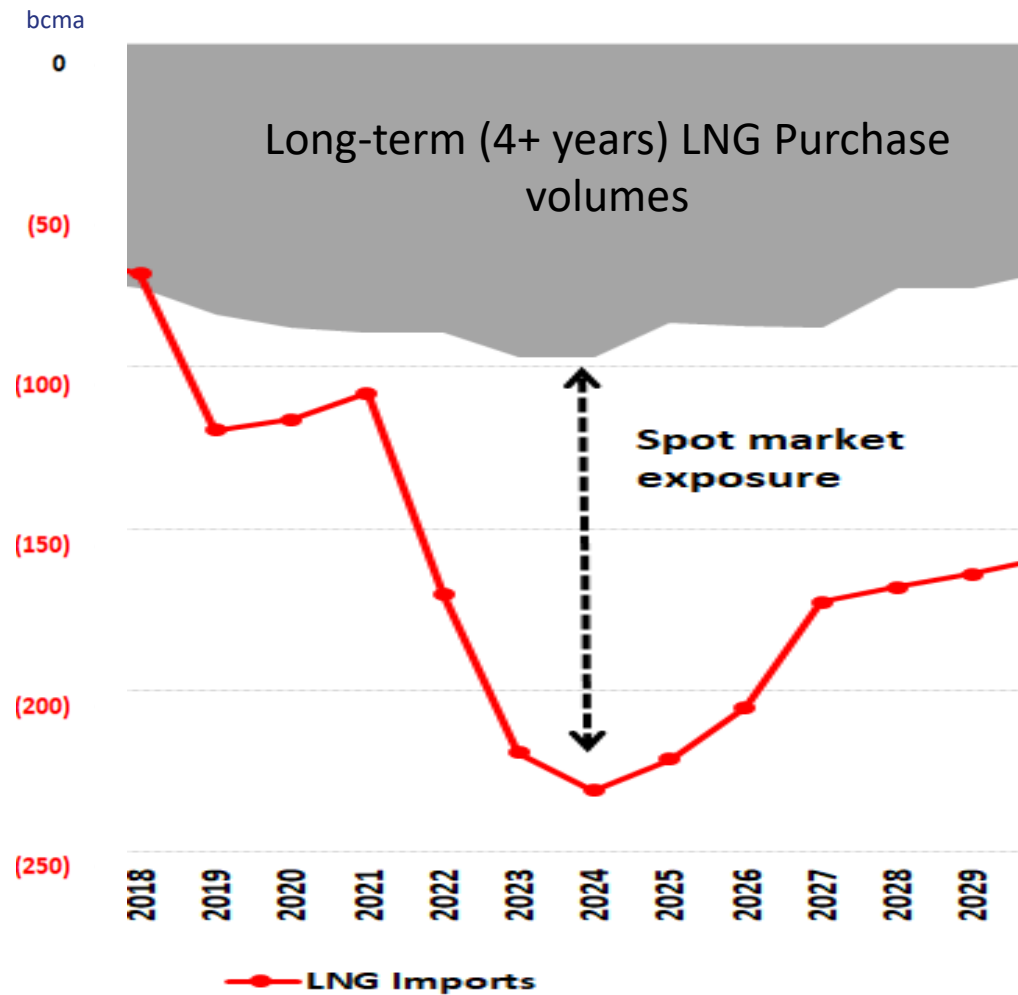
In million cubic metres

■ Natural gas ■ Of which, Liquefied Natural Gas



Europe's Looming Uncontracted Gas Supply Gap

Europe has not replaced Russian gas with long-term contracts. Spot market exposure



Source: Bloomberg, GIIGNL, Company Reports, Energy Institute Statistical Yearbook of World Energy, Baker Institute analysis

With Price Caps at Home, Does this Matter?

Some comments from EU LNG buyers at LNG2023 in Vancouver in July:

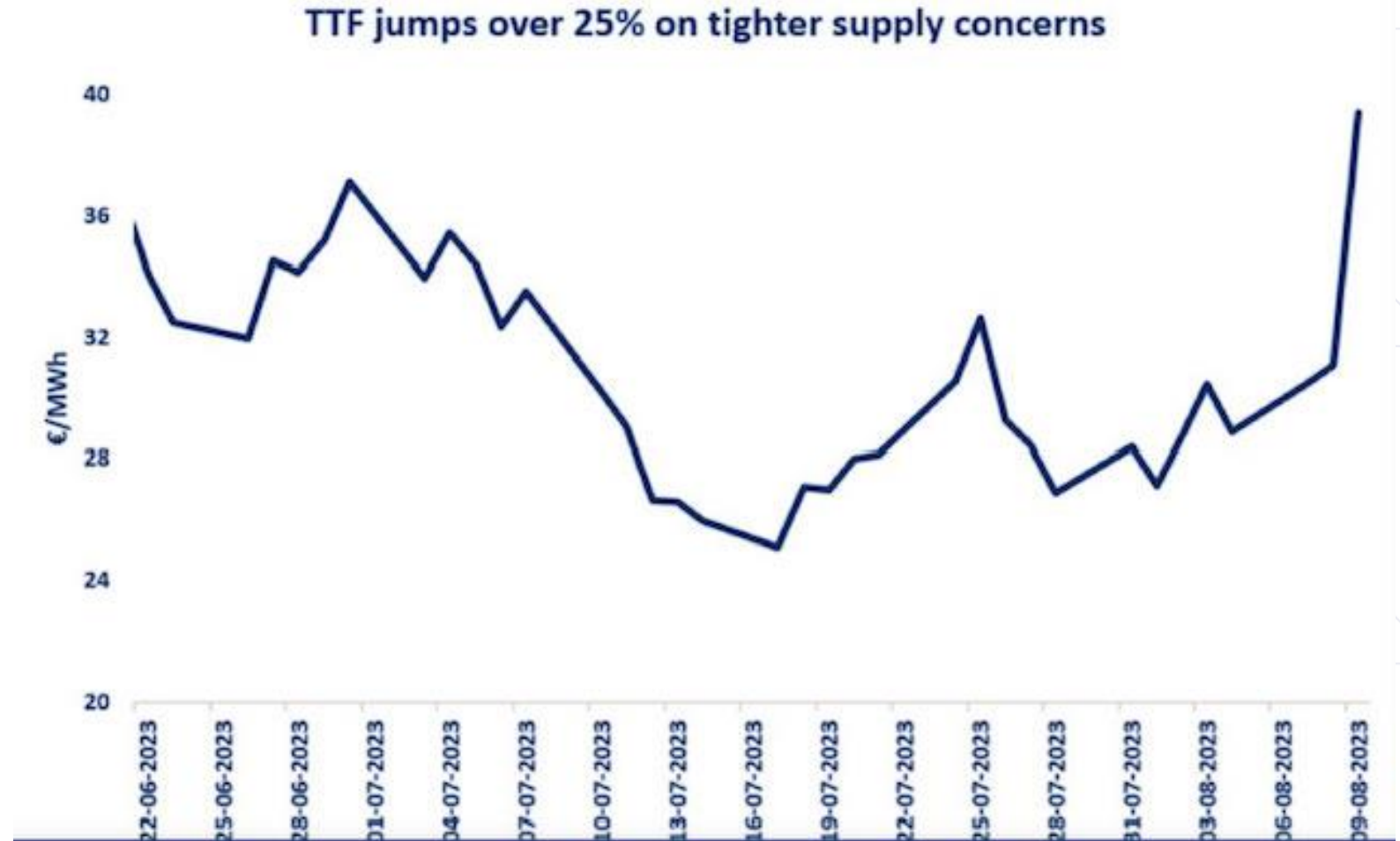
- Loss of Russian gas was not a problem for Europe because “Markets Worked,” bringing LNG to Europe when needed. EU buyers said EU’s current 80% storage and depth of world LNG market meant security of supply was not an issue for Europe.
- When asked about the risk of Europe relying on the volatile spot market for 60% of its gas, some EU LNG buyers remarked “we will outbid” everyone for whatever cargoes Europe needs. Price is not an issue.

And with supplies high, storage full, weather mild, and interruptions few, these comments seemed plausible....

Talk of a Possible Labour Dispute in Australia Sends TTF prices surging

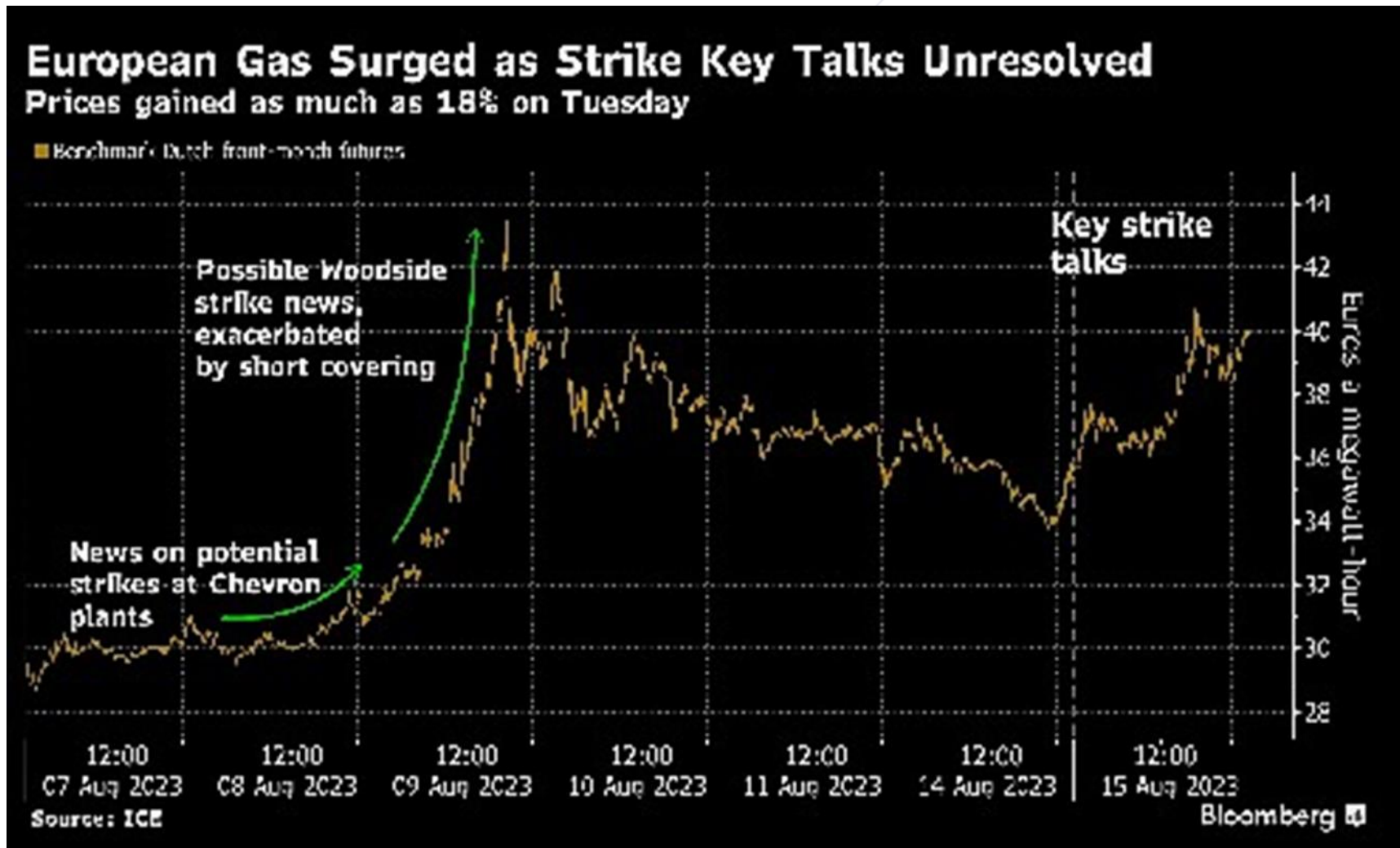
“European Gas Prices Soar on Australia LNG Workers’ Ultimatum”
- *Bloomberg*

Even completely full inventories, which is possible by October, do “not provide much buffer against the prospect of continual price spikes.”
- *Bloomberg, quoting Morgan Stanley analysts*



Source: European Gas Hub

TTF Continues Rising, even though...



Source: Bloomberg, ICE

Only 3 of Australia's LNG Projects are Directly Affected



Source: Bloomberg

Australia does not Sell LNG to Europe



Conclusions

- EU's market interventions coincided with reductions in market prices for natural gas and LNG
- Concerns expressed by EU Agencies about redirection of LNG trade flows and financial products have yet to be fully tested, due to market prices substantially below TTF caps
- Europe has not replaced lost Russian gas with long-term supply from other sources, resulting in 50-60% reliance by Europe on uncontracted "spot" market supplies
- Spot supplies are both insecure and highly volatile in price
- The combination of domestic price caps and volatile LNG spot prices creates unusual risks
- Recent announcements of a potential labour strike at Australian LNG facilities, though insufficient by themselves to trigger the TTF cap, are illustrative of the volatile impact on European energy prices due to Europe's heavy reliance on the spot market even though no strike had yet occurred and Europe does not buy LNG from Australia.

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