LNG TRADING PERSPECTIVES

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EFET Board Member and Gas Committee Chairman

LNG2009
23/24 March, London
LNG TRADING PERSPECTIVES
Structure of talk

Contents:

- Introducing EFET
- Influences on LNG in Europe
- An EU LNG policy?
- The fungibility challenge
INTRODUCING EFET
Our members’ interests in the LNG supply chain

Involvement along (nearly all) the supply chain

- Purchasing cargoes for supply portfolio and sales
- Trading cargoes
- Merchant regas & sale to market
- Purchasing LNG and wholesale/trade at hub
  (And others)
INTRODUCING EFET
The voice of energy traders in Europe

The European Federation of Energy Traders (EFET)

- Represents over 90 trading companies operating in more than 20 countries
- Promotes pan-European energy trading in open, transparent and liquid wholesale markets
- Main activities include:
  - Advocacy for liberalised markets
  - Promotion of energy trading in Europe
  - Standardisation of contracts
INTRODUCING EFET
Why trading energy?

Trade enables flexibility
- allows market participants to adjust positions within and across borders
- provides choice about when and where to buy or sell

Traders make markets more efficient and more competitive

Trading allocates risks efficiently among market participants

Trade increases economic welfare and results in more accurate and efficient prices
INTRODUCING EFET
Our Mission:

“The EFET mission involves improving conditions for energy trading in Europe and fostering the development of an open, liquid and transparent European wholesale energy market”

Through better:

- Information transparency
- Data exchange
- Products and procedures
- Laws
- Regulation
- Taxation
- European Contracts
- Organised market
We foresee energy markets throughout Europe, in which traders efficiently intermediate in the value chain, on the basis of clear wholesale price signals,

thereby optimising supply and demand and enhancing security of supply, to the overall long term benefit of the economy and of society.
INTRODUCING EFET
A wide range of interests – Gas is a core area

- EFET Staff based in:
  - Amsterdam
  - Brussels
  - Berlin
  - London

EFET Members
EFET Deutschland Members

EFET Deutschland Board

EFET Members
EFET Deutschland Members

Secretariat
Media Relations
Board

Business Process Standardisation
Legal Committee

Gas Committee
Electricity Committee

Gas Hub Development
Market Integration
Information Transparency
Capacity PG

German Electricity Policy (GTFE)
German Gas Policy (GTFG)

Gas Hub Development
Market Integration
Information Transparency
Capacity PG

Storage
LNG

EFET Deutschland Board

EFET Deutschland Members

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INFLUENCES ON LNG IN EUROPE
EU political, regulatory and commercial influences

- Governments’ national concerns
- Regulators’ responsibilities for market oversight
- Shareholders’ expectations for growth

Future LNG trading challenges in Europe
- Attracting cargoes in a global market
- Access from ship to trading hub
- Convergence of regulatory and exempt regimes through development of market mechanisms
- Fungibility of LNG with pipeline gas.

- LNG encouraged as a source of diversification of supply (e.g. Poland)
- Increasing influence of National Regulatory Authorities
- LNG expansion provides new trading opportunities, but still mainly for large companies
- Global changes, time for innovation in Europe?
INFLUENCES ON LNG IN EUROPE
Europe is part of an expanding global LNG market

Source: IGU

Main LNG trade routes (current & future)
INFLUENCES ON LNG IN EUROPE
Illustration of the Developing EU Gas Market

LNG Interconnectors
Gas
Regulated, Independent
Network Operators
Demand management
Industrial &
Commercial
Customer
Choice of
Suppliers
Residential
Competing Suppliers

LNG
LNG
HP Transmission
Hub
Trading Hubs set
Market Prices

Competing
Producers

Competing Suppliers

LP Distribution
Storage
INFLUENCES ON LNG IN EUROPE
Old terminals regulated, most new terminals exempt

What will be the future regulatory treatment of LNG terminals – how will the 3rd package affect convergence?

- Exemption from (regulated) access
- Regulated third party access
ENERGY TRADING PERSPECTIVES OF LNG
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AN EU LNG POLICY?
European Commission at 15th Madrid Gas Forum

Context for Commission draft

- 14th Madrid Forum conclusions
- GGPLNG (ERGEG)
- Findings of EC study on LNG
- SER/external energy dimension

- 17 regas terminals in 7 EU countries; capacity c.96 bcm/y
- More intermediate/short-duration contracts
- Share of short-term trading in global LNG sales:
  - 16% in 2006
  - 20% in 2007
  - 40% of new supplies coming to market in 2008/9 flexible

- ‘Policy’ is to monitor the ERGEG guidelines & tackle actions:
  - Tariffs & services
  - Congestion management
  - Information transparency
AN EU LNG POLICY?
EFET views sent to ERGEG & EU Commission

23 January 2008
Comments on ERGEG Guidelines for LNG SOs (GGPLNG)

31 January 2009
Response to EC LNG policy paper presented at 15th Madrid Forum

Available at: www.efet.org
AN EU LNG POLICY?
Basic considerations on LNG for Europe

❖ EU and global LNG market is still evolving
❖ Regulating particular parts of the supply chain based on perceived supply and demand imbalances would be unwise. Better to let the market work
❖ Liquidity will grow, if trading conditions are further improved
❖ Both short term LNG trading and secondary capacity markets should be encouraged as complementary to long term contractual arrangements

Forecast Global Liquefaction Capacity

Source: industry estimates
AN EU LNG POLICY?
Commercial & technical rules; Comparing tariffs

- Detailed technical access rules should not be part of a regulation
- Commercial incentives should ensure that appropriate technical rules are applied
- An overly prescriptive regulatory approach could block innovation
- Although it is difficult to draw meaningful conclusions from comparing tariffs, this should be attempted to enhance understanding and improve choice.
AN EU LNG POLICY?
Third Party Access (TPA) services

- A balance between interests in primary and secondary capacity
- Stimulating continuous delivery of additional primary capacity is an effective way to create associated secondary capacity trading opportunities
- Incentives to stimulate secondary capacity should consider the effect on incentives for investment in primary capacity – not to do so might discourage further capacity investment
AN EU LNG POLICY?
Standardisation of contracts

- Product offerings to different potential capacity purchasers should be non discriminatory

- Not always a standard contract - some purchasers may require different combinations of services offered by an LSO

- Rights purchased under a contract for LNG terminal capacity, should be assignable (free to sell on to third parties not just back to the terminal operator).

  - stimulates secondary trading

- Standard terminology reduces transaction costs, fewer contract management issues, lower legal risks / fees

- Some Harmonisation of trading arrangements at all LNG import facilities to stimulate development of trading on secondary markets
AN EU LNG POLICY?
Bundled and unbundled services

- diversity and choice in products.
- consideration of both bundled and unbundled products
- Unbundled products must not frustrate the offering of bundled product by displacing opportunities for sale of bundled product
- LSOs should consult with shippers about possible new services

- GGPLNG should avoid being overly prescriptive in respect of how bundled and unbundled services should be offered so that no barriers are created to innovation and product differentiation in the market.
AN EU LNG POLICY?
Transparency (Information provision)

- Provision of information is an essential foundation of energy trading
- A lack of information can stop markets from developing
- Improved information provision increases confidence and reduces inequalities, this promoting liquidity.
- Need to define ‘prospective transparency’ in relation to terminal availability.
- Information release needs to be consistent and in a user-friendly format.
- LSO’s should consider what aggregate information they could provide regularly
AN EU LNG POLICY?
Anti – hoarding measures

- maintain a clear distinction between anti-hoarding measures and secondary capacity arrangements

- Anti-hoarding is a backstop measure (needs to accommodate specific terminal circumstances)

- Notification period for making available unused terminal slots is a key factor in ensuring effectiveness

- Full transparency and a good secondary market should make anti-hoarding redundant.
AN EU LNG POLICY?
Secondary capacity trading

- Focus should be on stimulating secondary trading in a way which is **acceptable to both primary and secondary users**

- There should be **freedom to deliver innovative products** to meet demand rather than imposition of prescriptive solutions.

- To facilitate a traded market **some product standardisation is essential**

- It is crucial that LSOs do not create barriers to the development of secondary markets. They must put in place the necessary arrangements to facilitate the market once there is a recognised need.

- Cross subsidies should be avoided
AN EU LNG POLICY?
Gas quality

- No clear net benefit from establishing a minimum gas quality requirement at the entry to EU LNG terminals
- Some argue that a minimum gas quality requirement might be detrimental to security of supply
- Who would pay the bill for quality treatment pre-terminal entry?
- Would it be better to standardise gas quality requirements at LNG regasification terminal exits to TSO networks?
- But gas quality must not become a barrier to trading between LNG and gas in pipeline systems
AN EU LNG POLICY?
Harmonisation with downstream transmission system

The prevailing **entry capacity regime** is a key issue for each relevant market.

**Access to downstream networks** can be a barrier to being able to use LNG terminal capacity.

“If delivering LNG to Europe is to have some competitive advantage over other parts of the world then we need to make it easy for whoever brings in the cargo to monetise it. For traders this means getting the gas from the ship into a local trading hub at a known price for known costs and identifiable risks.”
AN EU LNG POLICY?
Summary of EFET view on EC proposals

długie LNG trading & arrangements for access to LNG terminals must be non-discriminatory & facilitate participation of large/small established/new players

długie Diversity & choice in bundled / unbundled capacity should be encouraged

długie Potential for new LNG trading products & improved contract harmonisation at LNG terminals, but overly prescriptive could frustrate

długie LNG terminal capacity rights should be assignable & free to sell to third parties

długie Improved transparency should provide a stimulus for increased trading, discussion with terminal operators is recommended

długie The notification period for making available unused slots is a key factor, but anti hoarding measures should be recognised as just an extreme backstop

długie The priority should be effective arrangements for trade in secondary capacity
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THE FUNGIBILITY CHALLENGE

Traders' primary concern about LNG is to ensure there is fungibility with pipeline gas.

“It should be possible to buy and sell LNG interchangeably with pipeline gas without any undue physical, commercial or legal barriers.”
THE FUNGIBILITY CHALLENGE
Imperative to avoid bottlenecks downstream

Upstream driver: be sure we can monetise our gas volumes

- Production
- Liquefaction
- Shipping

85-90% of costs

- Regasification
- Marketing & Trading

10-15% of costs

Downstream driver: get gas at the right price for our markets
THE FUNGIBILITY CHALLENGE
Some key questions for value extraction

What price do I get at the gas hub?

What LNG costs/alternatives do I have?

What are the costs and arrangements for using the regas terminal and getting gas to the hub?

What other costs/risks are there?

Flexibility creates opportunities, but also can increase risk
THE FUNGIBILITY CHALLENGE
Some European gas hubs provide clear price signals

Virtual hub (in-grid balancing point)

Physical hub (e.g border point)

Trading hub with little or no price transparency

NB. Not all trading locations are shown
THE FUNGIBILITY CHALLENGE
NW European gas hubs are well correlated

Source: Eon Energy Trading
THE FUNGIBILITY CHALLENGE
Trading at NBP dominates, other hubs emerging

ICIS Heren - Gas Hub Liquidity (max=20)

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2007 traded volumes
average daily in GWh
(Source: Hub operators)

12 year growth in NBP traded volumes

NBP traded volumes
Physical NBP gas demand
THE FUNGIBILITY CHALLENGE

Gas trading may well retain a regional element

- Large (virtual or physical) trading hubs are needed for sufficient liquidity.
- Gas takes far longer to travel than electricity.
- High economic cost of full interconnection across whole of EU.
- EU gas market will be a series of ‘pools’ rather than a ‘copper plate’
- LNG links some pools, as well as pipelines

E.g. IEA view of possible gas market development
THE FUNGIBILITY CHALLENGE
Gas prices in regional grids, LNG provides flexibility

- Transparent price differential brings incentives to ship gas
- Regional System Operators know the available capacities
- Investments can be made with a regional/European overview and dimension
- More effective than static and national measures
- Access to flexibility from other sources, including LNG, even for SE Europe
THE FUNGIBILITY CHALLENGE
Suppliers (& buyers) have choices.

Regional choices across the globe

Choice of terminal within a region
Regional choices across the globe

- Is there access to the market with the best value?
- Can I lock in the price (& costs)?
- Is there firm capacity with guaranteed sendout to match a market price I can lock-in?

Choice of terminal within a region

THE FUNGIBILITY CHALLENGE
LNG traders have choices, but with risk exposure
THE FUNGIBILITY CHALLENGE
Do new entrants have the same opportunities?

Its an open market,
But I was here first.
LNG TRADING PERSPECTIVES
In Conclusion & for Discussion

- Growing **commercial opportunities** for LNG trade; Globally & in Europe the market is still developing

- But, at least for new entrants, **extracting value** is difficult because of structural or regulatory differences and market inefficiencies

- If Europe’s regas terminals link more easily with markets this would **reduce risk**; **would standard options for firm sendout** be a way forward?

- Other suggestions include improved **information provision**, ensuring **capacity is freely assignable** to third parties & stimulating **secondary markets**
LNG TRADING PERSPECTIVES

Thanks for your attention

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