UNIVERSITY OF CAMBRIDGE | Energy Policy Research Group

Markets and long-term contracts: The case of Russian gas supplies to Europe

EPRG Working Paper 1524

Cambridge Working Paper in Economics 1542

Chi-Kong Chyong

Abstract Different hydrocarbon producer sales strategies have widely divergent implications for the value of Gazprom’s gas exports to Europe. In particular, hydrocarbon producers have commonly pursued two alternative sales strategies: (i) pure commodity production (border sales) and (ii) integrated supply, trading and marketing (ISTM). The impact of these two strategies on Gazprom’s export profits are examined under three sets of scenarios: (a) the possible entry of low-cost producers, (b) oil price dynamics and (c) the future of LTCs (pricing and volume structure). We also analysed how Statoil shifted its sales strategy in light of structural changes in European gas markets and conclude that the company began employing an ISTM strategy when the market in North-west Europe became liquid.

Thus, when a market is mature, with an increasing number of buyers, the best sales strategy for a large hydrocarbon producer should be based on flexibility and increasing its use of market trading to maximise the value of its commodity. We conclude that an optimal export strategy for Gazprom should involve both a substantial and increasing portion of uncommitted volumes that can be traded in markets (gas hubs) and, if needed, some form of bilateral forward contract with a minimum take-or-pay level to secure infrastructure finance.

Keywords Long-term contracts, vertical integration, market trading, gas, Gazprom, Statoil, gas pricing, equilibrium energy modelling

JEL Classification **L140, L130, Q47, Q48, Q410, P28, O13**

Contact kc335@cam.ac.uk
Publication December 2015
Financial Support EPRG Energy Policy Forum

www.eprg.group.cam.ac.uk