

# Gas hubs jockey for position

The Bunde-Oude natural gas hub on the German-Dutch border is the most likely candidate to become the Henry Hub of Europe, according to a survey of European natural gas experts conducted by Maycroft Consultancy Services

Continental Europe is still far from being a mature energy market, despite the proliferation of natural gas hubs in the region. The European Commission directives passed so far – while positive steps – have not done enough to create a standard framework for trading such as that of the US or UK.

Which is why Amsterdam-based Maycroft Consultancy Services has published a research report, *Towards a competitive European natural gas market*, that focuses not only on the situation on the European continent, but also the US and UK markets.

The research is based on in-depth market analysis and several interviews with industry experts concerning the development of the European gas trading market (see box). Especially interesting are their views on which hubs and exchanges will be the likely winners and losers.

## EuroHub v. Hubco

The most talked-about hub at present – Bunde-Oude, on the Dutch-German border – is the connection point of several pipelines from Holland, Norway and Russia and has substantial storage capacity. Hence, it has many significant participants, such as Statoil, Gasunie, Ruhrgas, BEB and Wingas. Despite its excellent position, this region faces two major problems that could hinder its development.

First of all, two competing hubs service the area: EuroHub and Hubco, which split liquidity. Some of the experts interviewed for the survey even believe the integrated German firms that own Hubco set up an alternative deliberately to hamper EuroHub's development.

The second problem is that the German market is far from fair and competitive and is dominated by a few fully integrated natural gas companies. This seems to be the main reason for EuroHub's unwillingness to cooperate or merge with Hubco.

Yet having two competing markets for the same region is nothing new. In electricity, there were two electricity exchanges in Germany: one in Leipzig and one in Frankfurt. The market forced them to merge. The simple fact is, if the two hubs don't merge, the market players will just pick the one they believe to be better, and liquidity will concentrate there.

Alternatively, market liquidity will concentrate in a hub in a different location. A merger of the two hubs is only possible if the EU and the German government solves the problems in the German market resolves its problems.

A positive step is the plan to set up a regulator in Germany by July 2004. If the government were also to unbundle the integrated companies, a fully independent hub could transform the northwest European natural gas market – it would boost trading opportunities from the UK through Zeebrugge on the Belgian coast and into Bunde.

EuroHub's commercial affairs director, Rob Mulder, says that in two or three years a well developed and liquid spot market will exist in the Bunde-Oude region. "As soon as the regulator in Germany introduces an entry-exit system, this may indeed become reality," Mulder says.

But experts foresee a further danger

to Eurohub's development. At present, trading in the Netherlands is focused on the Title Transfer Facility (TTF) point, a virtual trading point for delivery in the Netherlands, similar to the national balancing point (NBP) in the UK. This situation seems likely to be self-strengthening, as the growing liquidity attracts more and more traders. Yet at the same time a sound national TTF may well stimulate trading at the international hub, since it creates a certain flow and familiarises participants with a well functioning market system.

## Other hubs

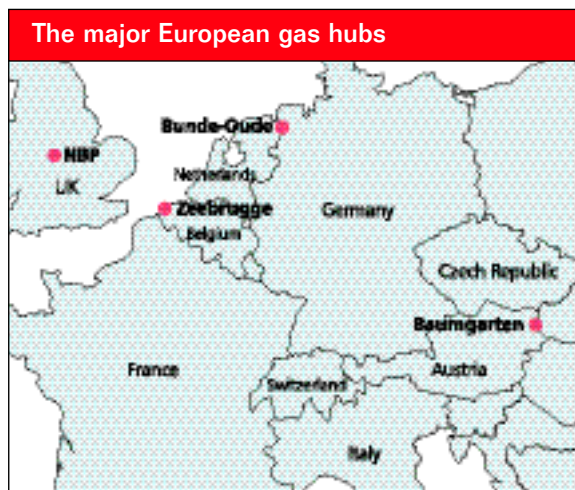
If the two hubs in the Bunde-Oude region cannot benefit from their advantageous position, there are other likely candidates for becoming the leading international hub: Zeebrugge, Baumgarten on the Austrian-Slovak border or the NBP in the UK.

For the time being, Zeebrugge is the most heavily traded hub in continental Europe. It has 52 participants, of which 40 trade at the hub on a daily basis. Yet most experts see Zeebrugge as an extension of the NBP and therefore feel it is unlikely that Zeebrugge will become an international hub.

Only if Zeebrugge can stay ahead of its competition by being the first to offer short-term trading, financial instruments and clearing and, most of all, by attracting liquidity, can it cash in on its first-mover advantage. It could certainly help that it has a liquefied natural gas terminal, is working on more sources of supply and that Loenhout's 1 billion cubic metres of storage capacity for third parties, with published tariffs, will open soon.

The NBP is not the most logical location for an international European natural gas trading hub. There just aren't enough sources of supply there, even though more connections are being built, including one to Norway. However, the NBP is the only hub that already operates in a mature market.

Experts believe that the NBP becoming the leading trading hub in



Europe would depend on two factors. The first is the time it takes to transform the continental European natural gas market into a fair competitive one. The longer it takes, the better are the chances of the NBP becoming an international hub. The second factor is how quickly the new pipelines will be in operation.

Baumgarten in Austria is very well placed as the gateway for Russian gas into western Europe. While many experts believe Baumgarten has good opportunities to become the second market for natural gas, behind Bunde-Oude, there seems to be one major hindrance for its development. That is the dependency on the major supplier, Russian utility Gazprom.

Only if Gazprom were to release a lot of natural gas for the short-term market at Baumgarten would short-term trading develop and, eventually, a spot market originate. But Gazprom is unlikely to give up some of its market power without an incentive.

Europe's energy exchanges are following the gas trading developments with interest. London's International Petroleum Exchange (IPE) says it is most likely to index Bunde-Oude in the future. An IPE spokesman says his exchange and the London Clearing House (LCH) will bring their expertise and services to the continent.

### How gas trading is developing

The liberalisation of natural gas prices and increasing flexibility in the gas market promotes the development of market centres and hubs. A hub is a point where major connections of natural gas pipelines meet and form a market. Many buyers and sellers at this point trade in natural gas and in the location of the delivery of this gas. Hubs in the US and UK are increasingly extending their services from the physical transfer of natural gas to storage, processing and trading services.

The concentration of trading in markets and hubs will in turn promote the development of natural gas spot markets. A well functioning spot market could lead to the development of a financial market. The development of financial gas trading is important, because it allows non-

gas players, such as banks, institutional investors and pure trading firms, to enter the market and take on gas-specific risks. This risk is easily diversified away in their overall portfolios, but may weigh heavily on gas firms.

Financial gas contracts are used to manage two types of risk in the natural gas market: price and basis risk. Price risk is generated by the volatile spot market prices of natural gas. Basis risk is the risk of change in the price differential between locations, time periods, and qualities of natural gas deliveries, and between natural gas and other commodities.

Transparency and liquidity are the fundamentals for success for a natural gas trading hub. For this to originate there are a lot of operational and commercial requirements.

The LCH wants to do the clearing for both over-the-counter and exchange gas trading in continental Europe. Hence, LCH has already partnered with Endex, an Amsterdam-based clearing house for the Benelux region, to offer clearing services in electricity and with the intention of offering gas services in the future. But the two firms will face stiff competition from the European Energy Exchange (EEX), Amsterdam Power Exchange and Paris-based Powernext, among others. Most experts believe the EEX is the most likely candidate to attract

the liquidity in financial contracts.

The Maycroft report's authors, Kasper Walet and Cyriel de Jong, believe that if trading takes off, it might not take long for a mature market to develop. It is mainly up to EU states' governments to create the right conditions for such a market. [EPRM](#)

Condensed from *Towards a competitive European natural gas market: Lessons from the United States and United Kingdom* by Kasper Walet and Cyriel de Jong of Maycroft Consultancy Services. [email: office@maycroft.com](mailto:office@maycroft.com)

**Zeebrugge: the Belgian hub is one of the main rival hubs to Bunde-Oude**

