Analyses OSW

CENTRE FOR EASTERN STUDIES 11.07.2012 www.osw.waw.pl

Negotiations between Germany's E.ON and Gazprom result in lower gas prices

Konrad Mazur

E.ON, Germany's largest energy company, announced on 3 July that a compromise had been reached with Gazprom concerning a reduction in price in the long-term contracts for the supply of Russian gas. This agreement was signed by Alexander Medvedev, deputy head of Russia's Gazprom, and Klaus Schaefer, head of Germany's E.ON.According to this announcement, the agreement provides for another gas price reduction for E.ON and a retroactive amendment of the price conditions to be applied from the last quarter of 2010. Its'ok The details of this agreement are subject to the trade secret act. The agreement is set to come into force in the fourth quarter of this year.

Commentary

- The agreement is a success for E.ON. It ends the dispute which had been in place since 2010 in the court of arbitration in Stockholm. This compromise was reached outside arbitration, and the suit brought by E.ON against Gazprom was a form of pressure on the Russian monopoly. E.ON is another energy company to have succeeded in reducing gas prices in long-term contracts with Gazprom. E.ON had a good negotiating position, given the possibility to diversify its supplies and the fact that it is the largest importer of natural gas to the German market (it accounts for over 50% of German gas imports). The favourable conclusion of the negotiation for E.ON is partly a consequence of the fact that these two companies have long-standing common interests in gas production and transport from Russia to Germany (Nord Stream, for example).

- E.ON estimates that the successful negotiations resulting in a lower price for Russian gas will contribute to an improvement in the company's results by approximately 1 billion euros in the first half of 2012 alone. This means that the German company has managed to reduce its price by 7–10%. As the agreement was signed, E.ON modified its financial forecasts: its profit before tax will grow from approximately 9.6 billion euros to 11 billion euros in 2012. Last year, German companies paid approximately US$380 per 1,000 m^3 for Russian gas, which is still much less than the price the companies from Central and Eastern Europe have to pay. Negotiations are also being continued between Gazprom and

Germany's second largest energy company, RWE, which wants a 10% reduction; this would allow it to compensate for the losses sustained in connection with its activity on the German gas distribution market.

- The debts of Germany's largest energy companies, E.ON and RWE, increased by approximately 2 billion euros each in the first half of 2012 as a consequence of the unfavourable contracts with Gazprom and the introduction of the energy transformation by the German government. In addition to this, Russian gas supplied as part of the long-term contracts was becoming increasingly expensive in comparison to the free market gas prices, and the companies were forced to sell gas at a loss. Furthermore, their debts were also growing due to losses incurred as a consequence of the decommissioning of the nuclear power plants in Germany. The companies embarked on a restructuring and modification of their strategies, which are still ongoing. These involve selling less profitable assets (for example, gas networks), debt repayment and the accumulation of capital, and investments in renewable energy and on markets with higher growth potential (E.ON is, for example, investing in Turkey and Brazil).