

## ***A dynamic price corridor on natural gas – Key elements of the proposal***

1. Main **objectives** of the proposal:

- Mitigate inflationary pressures.
- Deter and reduce speculation.
- Manage expectations and provide a framework in case of potential supply disruptions.
- Limit excess profits in the sector.

2. Key design features:

- The corridor would operate at the **wholesale**, not the retail level.
- The corridor would apply to **all wholesale transactions**, not limited to import from specific jurisdictions and not limited to specific use of natural gas.
  - A cap only on **Russian gas**: i) would not have positive impact on consumer prices; ii) would have potential negative impact on security of supply; iii) would be discriminatory (e.g. versus other imports via pipeline or domestic productions, which would be allowed for higher prices); iv) would pose market challenges (e.g. the importer would be allowed to buy at the cap, and resell at higher internal exchange prices); v) should be adopted by the same Act foreseen for sanctions.
  - A cap **only on gas used for electricity**: i) ignores 2/3 of the gas market, which is in industry and buildings; ii) creates a liability with no clear outward bound (e.g. since the import price can keep rising, requiring more resources to maintain the cap); iii) creates disincentives for lower prices (importers will be compensated for whatever price they pay); iv) if the gas cap is too low, it will trigger too much additional demand, possibly including coal-to-gas switching; if too high, it will likely need to be complemented by additional support at the retail level to keep prices affordable.
- The price should be **high enough** to let the market function. It should act as a circuit breaker and disincentive to speculation. It is not meant to suppress prices at an artificially low level.
- The corridor should be high and **flexible** enough to allow Europe to attract the required resources – enabling, if necessary, transactions above the corridor.
- The corridor should be high enough to preserve the incentive to **save energy** and/or switch from gas.
- The corridor should be **complemented by strengthened voluntary demand reduction** measures.
- The corridor **should affect existing long-term contracts** which tend to be priced in relation to key benchmarks. This is preferable to waiting for new benchmarks to develop—which will take time (sometimes even major benchmarks can have low liquidity—for e.g., the JKM for spot LNG in Asia is typically priced off 1-2 transactions a day).

3. Any proposal should consider and be differentiated across **3 different scenarios**:

- a) **No physical shortage**: market can clear in the corridor levels (supply and demand can match).
- b) **Potential physical shortage**: price nearing or at the top of the corridor level, requiring transactions above the cap for the market to balance.

- c) **Physical shortage**: supply shortages at regional or EU wide level in spite of emergency measures. In this case, we are under major disruption, falling within provisions under Reg (UE) 2022/1369 rather than under the dynamic price corridor proposal.

**Scenario a), no physical shortage** (as we have been experiencing during the last few months).

4. **Two key dimensions** of the proposal:

- The **“dynamic corridor”**: a central value for the dynamic corridor can be set and regularly reviewed taking into consideration external benchmarks (e.g. crude oil, coal and/or to gas prices in North America and Asia) allowing for fluctuations (e.g., 5%) around the central value inside the corridor.
- The **application** of the corridor:
  - The central value of the corridor would represent a cap that can be placed on a benchmark hub (like TTF), or it can be placed on multiple hubs (PEG, PSV, ZEE, to avoid arbitrage), or better it can cover all transactions (whether on an exchange or OTC).
  - Fluctuations around the central value would be possible in order to provide price signals to move gas across MS, in case multiple hubs achieve the cap.

**Scenario b), potential physical shortage**: supply matching demand through the adoption of emergency measures.

5. Under this scenario, for any circumstances the supply (at the upper bound of the price corridor) cannot match the demand (after the voluntary demand reduction measures).
6. In this scenario, the **dynamic price corridor would be complemented** by:
- **Mechanisms to procure additional marginal resources** above the corridor (e.g., Contract for Differences for spot LNG, or allowing importers to procure and re-sell above the corridor over the counter and/ or through a supplier of last resort).
  - **Reinforced demand reduction** and solidarity schemes.
7. A **Contract for Difference** mechanism could be introduced to refund importers of the potential difference between the import price for LNG and the upper bound of the corridor.
- a. The expected volumes and the required compensations would be low (only marginal resources) while the benefit would impact the entire wholesale supply.
  - b. The EU Joint Procurement Platform can be leveraged for coordination of this task.
  - c. The compensation may be introduced by MSs, preferably without affecting their budgets.
8. **Once supply/ demand is balanced** again through these emergency measures, gas would keep on flowing across MS following the price signals of the corridor. As an alternative, temporary transport tariffs at a fixed value establishing an ex-post compensation for the relevant TSOs.

**Scenario c), physical shortages** at regional or EU wide level occur in spite of emergency measures (major disruption occurring) falling within provisions under Reg (UE) 2022/1369 (rather than under the dynamic price cap proposal).

9. In this scenario, regardless of the application of a price corridor, CfD and demand management mechanisms, a **major disruption** may impede a Region or entire Europe to attract enough gas to match the demand (e.g. a disruption of a main pipeline supplying EU, even outside EU boundaries).

10. A **coordinated framework** (independently from the introduction of the dynamic corridor) is needed in this scenario in order to allocate the resources across countries.
11. The framework will include: i) **demand** reduction according to provisions under Reg. (UE) 2022/1369 (the definition of art.4<sup>1</sup> of the Regulation could be amended to include this scenario); ii) **solidarity measures** under agreements signed according to art.13 of Reg (UE) 2017/1938, including fair compensations listed in para 8, established in bilateral agreements between MS in the same regional gas corridors, to be established in advance for the payments of internal flows in case of application of solidarity measures. The Commission should establish guidelines for these agreements and compensation measures, building upon the agreements already subscribed by some MS, to be adopted by all MS under provisions of art.13, para 12, of Reg (UE) 1938/2017; iii) **market based mechanisms** to efficiently allocate the residual scarcity across MS.
12. The decisions related to these measures could be taken after discussion in the **Gas Coordination Group**, which is already foreseen under the provisions of the SoS Regulation.

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<sup>1</sup> Article 4 Declaration of a Union alert by the Commission: The Commission may declare a Union alert when there is a substantial risk of a severe gas supply shortage or an exceptionally high demand of gas occurs, for which the measures in Article 3, as reported on according to Article 8, are not sufficient, and which results in a significant deterioration of the gas supply situation in the Union, but where the market is still able to manage that disruption without the need to resort to non-market based measures. The Commission may declare the Union alert at the request of at least two competent authorities that have declared an alert at national level pursuant to Article 11(1) of Regulation (EU) 2017/1938, or on its own initiative.