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Italy's Eni Inks Landmark Non-Indexed Gas Supply Deal With Gazprom

By The Moscow Times

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MILAN/ST. PETERSBURG — Italy's Eni struck a landmark deal with Russia's Gazprom that abandons a 50-year old system of indexing gas supplies to oil prices, setting a precedent other European buyers may be able to use in negotiations.

The agreement, signed by the groups' chief executives in St. Petersburg on Friday, sets "an important change" in the price-indexation mechanism in the contracts to align them fully with the spot market, Eni said in a statement.

Gazprom has for years defended oil-indexed gas sales as a cornerstone of its business, even while high costs relative to spot gas prices have forced its European clients to swallow multi-billion euro losses.

The backlash against oil-linked contracts has gained ground in recent years as waning demand for gas and economic recession across Europe have forced utilities to defend dwindling profit margins.

German utilities E.ON and RWE, Gazprom's biggest customers, have spearheaded efforts to bring down Russian gas prices, although other suppliers such as Algeria also insist on oil-linked prices.

"The discount Eni won is a positive signal that Gazprom is doing things in an efficient way and supporting Eni," said Jason Kenney, an oil analyst at Santander.

"It is working with the company flexibly," he added.

The shift to a link with freely traded spot gas prices at European hubs is likely to bolster profits at the oil major, Italy's biggest company.

Sanford Bernstein analysts estimated the deal would lift the operating profit of Eni's Gas and Power division by 560 million euros this year alone.

The deal may also help Eni put pressure on its other gas suppliers, Algeria and Libya, to convert to spot market pricing and away from oil-indexation.

Statoil the First

Europe's second-biggest gas producer, Statoil, was the first to offer its clients gas supplies fully priced according to spot market rates.

Eni, one of Europe's biggest gas wholesalers, last renegotiated its contracts with Gazprom in 2013, securing a price cut estimated to be under 7 percent.

Its head of exploration and production, Claudio Descalzi, took over as chief of the Italian oil major earlier this month.

Some analysts have expressed concern over costly gas contracts with Russia, given growing tensions in Ukraine. The crisis between Europe and Russia has driven some European gas importers to seek alternatives to what they view as an uncertain Russian supply, with much of its pipeline running through Ukraine.

On Wednesday, Gazprom sealed a long-delayed gas deal with China in a major pivot of Russia energy flows to Asia.

The arrangement with Beijing will affect prices in Europe, the chief executive of the Russian company said.

Italy, which imports about 90 percent of its gas needs, received some 40 percent of its imported gas from Russia last year.

State-controlled Eni said the terms of the agreement with Gazprom would be backdated to the start of 2014.

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