Abstract

The netback value is a price mechanism approach for determining prices in long-term contracts. This method consists in ensuring that gas remains competitive with competing fuels by setting the border in each long-term sale contract below the weighted-average price of the cheapest alternative fuels across all sectors, including industry, residential tertiary, transportation and electricity generation. This price mechanism is used in Continental Europe because the gas does not have captive uses and it can be replaced by other energy in all sectors such as the coal in the electricity generation sector.

This price is then indexed under long-term contracts to the main competing fuel. This pattern of indexation allows avoiding volatility and the use of market power but some actors really want to change this method of indexation. Indeed, the power sector represents the main source of incremental demand growth for gas in the recent years and therefore, indexation to coal is conceivable. Moreover, the economic crisis contributes to lower the gas market price, opening a gap between the spot and the long-term contract prices. The spot price and the long-term price are currently at nearly the same level but during the winter, the long-term contract price should be normally lower.

More and more Combine Cycle Gas and Turbines (CCGT) are built in Europe and the investors would like to include the gas value of the electricity generation in the calculation of the weighted Netback value. Some key factors such as the construction of the coal plant cost, the fuel cost and the CO2 cost have a significant impact on this Netback value for electricity generation.

The CO2 Capture and Storage (CCS) is also a promising technology regarding the share of fossil fuel in the energy mix. However, the netback value found with the CCS coal plants must be viewed with some caution regarding the uncertainties around the capture costs, the transport costs, the distribution of storage sites and the learning rate.