A Framework for Negotiating & Managing Oil & Gas Industry Contracts

Understanding how to negotiate, draft, and interpret the nitty-gritties of international business agreements, at times when there are increasing number of Oil & Gas cross-border transactions, is of vital importance. Contracts ensure that there are no long and ruinous disputes, and curbs subsequent expensive and complex litigation and arbitration proceedings. This eBook throws light on Gas Pricing principles in different parts of the world and how these principles are built into purchase and transportation contracts, gas sales and transportation agreements, and a significant portion will talk about Litigation, arbitration, and expert determination and approaches to prevent, avoid, control, manage & de-escalate disputes.

Topics to be Discuss

1. Gas Pricing Principles
2. Dispute Resolution
1. Gas Pricing Principles

The price of Gas and LNG varies drastically between global markets. Though oil and natural gas are found and produced using the same equipment and methods, they are priced differently. The below table explains how Oil and Gas are priced differently in different parts of the world.

A. Gas on Gas Pricing

a. In this group, the price of gas directly corresponds to the supply and demand of the gas in the particular region.

b. Gas is traded in open exchanges such as NYMEX and there are established benchmarks where pricing information is transparent, is accessible easily and updated on a regular basis.

c. Has a large network of pipelines and gas storage systems which allows opportunities of import/export on a date in future at today’s price.

d. Being a highly traded system, a newly discovered gas field can be developed and marketed easily because there is a sense of trust that produced gas can be sold at an established price.

e. This group includes sophisticated markets such as US, UK, and Canada which have a developed system of common regulations, standardized contracts, and market liberalization.

B. Prices Indexed to Substitute Energy Prices

a. This consists of areas that have limited but growing gas grid. The prices depend upon other products that produce energy such as oil products and coal which is linked under majority long-term contracts.

b. The suppliers of this group sell gas at a relatively lower price as compared to oil products by ensuring formula based gas at an energy equivalent discount to encourage buyers to switch to gas.

c. As the number of buyers and sellers in this group will increase, the linkage of gas price to oil price will weaken over time and it will shift towards group 1.

d. This group includes markets such as Eastern and Southern Europe, and South East Asia.

C. Oil-Linked Price Markets

a. This is prevalent in traditional LNG markets including Japan, Korea, Taiwan, China, and India.

b. These markets do not have the required infrastructure to import gas by pipeline, which is why all of their gas is delivered via LNG imports.

c. Buyers like India and China are resisting from linking gas prices with oil prices as they have realized that oil prices will rise and gas prices will reduce in future.

d. In the Japanese market, there are few LNG buyers, each operating a single pipeline. There is no single national gas market and there are high inefficiencies in the existing system.

e. In the Taiwan and Korean market, there are few suppliers who monopolize large pipeline grids. They are the ones who buy majority stakes in the LNG imported by the government.

Liberal markets with volatile prices generally not in ‘sync’ with other energy sources.
- Large number of suppliers and buyers.
- Ample storage and transport systems.
- Sophisticated markets with financial instruments.

Gas prices movements in proportion with other fuels (especially oil-based products and coal).
- Limited number of suppliers, many buyers.
- Storage and transport controlled by few players.
- Some financial markets trading gas.

Gas prices linked directly to oil prices. Large proportion of imported gas.
- Limited number of suppliers and buyers.
- Storage and transport controlled by buyers.
- No significant financial markets trading gas.

How Have Gas Prices Evolved Since 2000 & How Will They be in 2040
The selling price of gas depends upon the factors as listed below:

1. Price of substituent fuels such as coal.
2. Volume of gas produced.
3. Terms and conditions of the sales contract.
4. The distance between the gas producing field and the customer.
5. The fiscal policies set by the government of a particular country.
6. Terms and conditions of the transportation agreements.

**Gas Sales & Transportation Agreements**

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5. The fiscal policies set by the government of a particular country.
6. Terms and conditions of the transportation agreements.

**D. Regulated Markets**

a. The countries lying in this region are controlled by the state. The gas prices are nationally set and the state may decide to sell the gas above the set price or below the set price.

b. There is no transparency in prices and the suppliers in the market get very less incentive.

c. Such type of markets are seen in countries of Middle East and Russia where prices vary with political reasons.

Controlled markets with government mandate prices.

- Usually, limited number of buyers and sellers.
- Most infrastructure controlled by state.
- No or limited influence of market forces. Pooled prices often used. Government takes price risks.

Gas Sales & Transportation Agreements

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Production

- **Cost Oil**
  - Contractor’s Share
    - Contractor’s After-Tax Income
    - Total Contractor’s Share

- **Profit Oil**
  - Government’s Share
    - Profit Tax
    - Total Government’s Share
1. **Term**
This decides the longevity of the agreement which can range from a day to the entire lifetime of the gas producing field.

2. **Quantity**
This has two sub-parts, depletion contracts and supply contracts. In depletion contract, the company allows the buyer to take hold of the entire production field, whereas in supply contracts, a seller is entitled to supply a fixed amount of gas to the buyer.

3. **Price Terms**
The price of gas depends upon the price of competitive goods such as oil. There are various types of pricing such as fixed, fixed with escalators, or floating. As far as short-term contracts are concerned, they usually go with fixed pricing system as it uses a set price for the entire duration of the contract. In case of long-term contracts, the ‘fixed with escalators’ strategy is used. Here, the price of oil changes after a fixed duration so that it can remain competitive in the market. In some cases, the price of oil changes due to the data shared by unbiased sources such as newspapers. Hence the price changes after every week or month.

4. **Delivery Obligation**
Delivery obligations bind a seller contractually where they are bound to deliver the specified quantity in the time span mentioned in the document. If not, then the seller becomes legally bound to pay the damages or cover the cost of fuel.

5. **Delivery Point**
The contract clearly mentions the point at which the seller has to deliver the gas to the buyer. This can be an international border, hub of a city grid, interconnection of two pipeline systems, etc.

6. **Quality of The Gas**
The document clearly mentions the quality of gas which includes maximum level of impurities such as CO2, oxygen, water vapour etc. If the seller doesn’t take these things into consideration, the buyer can make claims as mentioned in the agreement.
2. Dispute Resolution

The methods through which disputing parties agree to have a ‘finally determinative’ rather than a ‘temporary disruptive’ outcome, are called binding methods of dispute resolution. Companies should take care of the fact that business activity with the opposing party does not halt, by ensuring the mechanism of dispute resolution. Let’s take a look on three different type of resolution techniques that Oil & Gas companies can opt in such conditions.

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<tr>
<th>Litigation</th>
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<tr>
<td><strong>Merits</strong></td>
<td><strong>Demerits</strong></td>
</tr>
<tr>
<td>a. Both parties are given enough time to present their argument with concrete evidences</td>
<td>a. Though the decision is final, it can be challenged and in some cases, the decision is overturned. This leads to waste of time and money.</td>
</tr>
<tr>
<td>b. Since the verdict is final, one party emerges as the winner and the other as loser</td>
<td>b. Since these cases are open to the public eye, Oil &amp; Gas industries are reluctant to use this method</td>
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<tr>
<td>c. The proceedings are transparent and open to the common masses</td>
<td>c. Although the verdict is enforceable in the said jurisdiction, it becomes difficult to enforce the same in a foreign jurisdiction, unless a contract exists between both the countries</td>
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<td>d. It works as a model for future similar cases</td>
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<th>Arbitration</th>
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<tr>
<td><strong>Merits</strong></td>
<td><strong>Demerits</strong></td>
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<tr>
<td>a. Based upon the complexity of the case, both the parties have the right to choose the arbitrator</td>
<td>a. Though it is less costly and time-saving, it can prolong for even longer than Litigation, if either of the parties is determined to do so</td>
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<td>b. Cases are held privately, away from the public eye. Thus, confidentiality is ensured.</td>
<td>b. This method does not provide a lot of scope to challenge the verdict, once it has been awarded</td>
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<td>c. Usually consumes less time and money as compared to the Litigation technique</td>
<td>c. The decision is yet not enforceable in countries that haven’t signed the 1958 New York Convention</td>
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<td>d. Both the parties can decide the venue for arbitration</td>
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## Expert Determination

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<tr>
<td>a. Involves an industry expert who is well aware of the industry. This gives confidence to the disputants that the case will reach a fruitful conclusion.</td>
<td>a. The final verdict provides a very small room to be overruled.</td>
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<td>b. Here, the outcome is final. It cannot be further challenged</td>
<td>b. This method doesn’t go into the technicalities of the law. It is only to settle issues relating to the financial and technical side of the dispute</td>
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<td>c. It is far less time consuming and cheaper as compared to Litigation and Arbitration.</td>
<td>c. The field expert concludes the outcome based on his own findings</td>
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<td>d. The disputants reserve the power to set their own rules and regulations</td>
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Today, there exist myriad programmes on Oil & Gas Contracts Drafting, Negotiation & Dispute Resolution but unfortunately, most of them are devoid of practice tools, tips and techniques on all key elements that are necessary for drafting, negotiating and interpreting oil & gas and international contracts. The course will also cover both theoretical and practical aspects of the management of oil & gas disputes. The class will be structured to optimize interactivity. In our 3 day workshop, Ian Thomson, will teach you how to sail your way through the nitty-gritties of Oil & Gas Contracts, using presentations/slides, continuous dialogue with the class. We urge you not to miss this opportunity, and take-home expert Contract drafting skills that will benefit your company in the long run.
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