



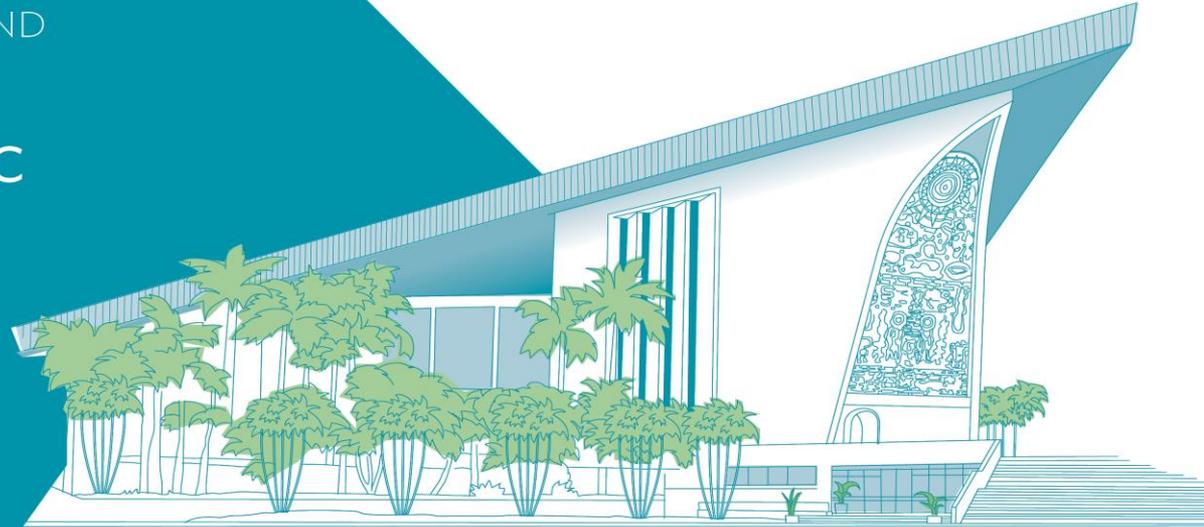
WILMER CUTLER PICKERING HALE AND DORR LLP



INTERNATIONAL MEDIATION AND  
ARBITRATION CONFERENCE

# 2nd South Pacific International Arbitration Conference

25–26 March 2019  
Stanley Hotel, Port Moresby  
Papua New Guinea



## Gas Supply Transactions and Disputes

Steven Finizio

Wilmer Cutler Pickering Hale and Dorr LLP

26 March 2019

This is not an ADB material. The views expressed in this document are the views of the author/s and/or their organizations and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy and/or completeness of the material's contents, and accepts no responsibility for any direct or indirect consequence of their use or reliance, whether wholly or partially. Please feel free to contact the authors directly should you have queries.



# Overview of Gas Supply Transactions

- ▶ **Three general phases to the gas supply chain:**

- Gas production and processing (where natural gas is extracted, purified and broken out into its component hydrocarbons)
- Sales from gas producers (exploration and production companies or states) to the wholesaler in a particular market
- Sales from wholesalers (directly or indirectly) to end users of gas.

- ▶ **These phases can be international or domestic**



# Overview of Gas Supply Transactions

## ► Who is involved?

- **Sovereign governments** – own the resources in the ground, and enter into agreements with producers to develop gas resources
- **Producers** – enter into agreements with sovereign governments to extract gas, before selling that gas to wholesalers (or, sometimes, direct to end users).
- **Wholesalers** – purchase gas from producers and supply it to end users (sometimes via resellers).
- **End users** – i.e., consumers such as power plants, petrochemical plants, retail and residential customers

A dark grey arrow points to the right from the left edge of the slide. Below it, several thin, curved lines in shades of blue and grey sweep across the left side of the slide.

# Gas Supply Transactions

► **Three stages of gas supply after exploration:**

1. Production and processing
2. Sales from the producer to the wholesaler in a particular market
3. Sales from wholesalers to end users



# 1. Production and Processing

## ► Gas extraction

- Gas is generally extracted by drilling gas wells
- Producers often enter into drilling contracts with an oilfield services contractor

## ► Processing

- The producer enters into a gas processing contract with a processor
- The producer constructs the processing facilities itself

After processing, gas is ready to be transported and sold.



## 2. Sales from Producers to Wholesalers

- ▶ Transportation

- By pipeline
- As LNG

- ▶ Gas Supply Agreements Between Producers and Wholesalers (e.g., GSPAs)

- Historically, supply has been via long-term contracts (typically 10-30 years in duration).
- Increasing use of short and mid-term contracts



## 3. Sales from Wholesalers to End Users

- ▶ Once gas has been delivered from producer to wholesaler, the next stage is for the wholesaler to sell on to end users.
  - Sometimes wholesalers sell on to resellers, who then sell to end users. Some large end users (e.g. power plants) also purchase directly from producers
- ▶ Gas is supplied by wholesalers via a transmission (pipeline) grid



# 3. Sales from Wholesalers to End Users

- ▶ Depending on how liberalized the market is, there can be many different gas supply transactions at this stage, including:
  - Agreements for sale of gas
  - Transportation
  - Storage



# 3. Sales from Wholesalers to End Users

- ▶ The nature of the market substantially impacts the transactions at this stage
  - **Monopoly** – one entity is responsible for supplying, transporting and storing all gas
  - **Limited competition** – more than one supplier in a market, each with their own transportation and storage infrastructure
  - **Fully liberalized** – wholesalers, transportation systems and storage operators all separate companies



# 3. Sales from Wholesalers to End Users

## ► Agreements for sale of gas

### ► Range of different possible transactions

- Wholesalers directly supply all end users (e.g., large industrial users, power plants, small retail, residential customers)
- Wholesalers sell to further intermediaries (resellers), who can then sell the gas onwards
- End users purchase directly from producers or gas hubs, thereby bypassing wholesalers completely

## ► Transportation – can be highly regulated

## ► Storage – can also be regulated



# Gas Supply Disputes



- ▶ **Huge range of gas supply transactions Correspondingly broad range of disputes that can arise, including:**
  - a) Gas price review arbitrations
  - b) Disputes over supply failures
  - c) Competition law and regulatory issues
  - d) Disputes regarding transportation infrastructure
  - e) Storage disputes
  - f) Construction disputes
  
- ▶ **Supply contracts usually include dispute resolution provisions (litigation, arbitration, expert determination)**



# a. Gas Price Review Arbitrations

- ▶ Long-term supply agreements often contain price review provisions
- ▶ Price review provisions usually contain arbitration clauses, for when parties cannot agree on a revision to the formula
- ▶ Recent years have seen a wave of gas price review arbitrations in certain parts of the world
- ▶ Price reviews can have very significant financial consequences (even a small change in the price of gas can have huge financial implications, given the volumes of gas supplied under some long-term agreements)



# a. Gas Price Review Arbitrations

- ▶ **Factors leading to rise in disputes in Europe include:**
  - Liberalization of the European gas market and development of gas hubs in Europe
  - “Decoupling” of oil prices and market prices for gas available at gas hubs in certain markets in the late 2000s
  - Growth for renewable energy
  - Global financial crisis beginning in 2008
  - Development of U.S. shale gas and shift of LNG supply to Europe
  - Fukushima disaster in Japan and greatly increased demand in Asia
  - Dramatic decrease in oil prices since mid-2014



## b. Disputes Over Supply Failure

- ▶ E.g., claims that the seller (producer, wholesaler or reseller) has not supplied the contracted volume of gas
- ▶ Reasons for supply failures include:
  - Political issues (e.g. dispute between a gas-producing and gas-receiving country)
  - Commercial dispute (e.g., belief that no obligation to supply under the contract)
  - Circumstances allegedly outside seller's control (often coupled with claim for force majeure)



## c. Competition Law and Regulatory Issues

- ▶ Party claims that actions of the counterparty violate competition law
- ▶ Alternatively, a regulator may investigate whether the terms in a gas supply contract violate anti-trust or competition laws



## d. Disputes Regarding Transportation Infrastructure

- ▶ **Disputes include commercial disputes** – e.g., breach of framework agreement)
- ▶ **Disputes relating to government regulation** – e.g., a tariff reduction on the use of gas transportation infrastructure to boost gas exploration and development



## e. Storage Disputes

- ▶ **Wide range of issues** – including issues about title to gas following removals or additions of gas



## f. Construction Disputes

► Two common types of claims in construction disputes:

- Delay claims (facilities were not constructed within the contractually-required time)
- Defect claims (facilities were defectively constructed)



# Looking Forward



- ▶ Importance of gas to increase due to the threat of climate change, which demands a switch to comparatively cleaner gas
- ▶ Transactions for production, transport and sale will grow
- ▶ Increasing use of spot and shorter term transactions
- ▶ Aspects of extraction, processing, transporting and storage are technically challenging and expensive
- ▶ Disputes about terms of gas supply and related agreements to increase



**Steven Finizio**

[steven.finizio@wilmerhale.com](mailto:steven.finizio@wilmerhale.com)