

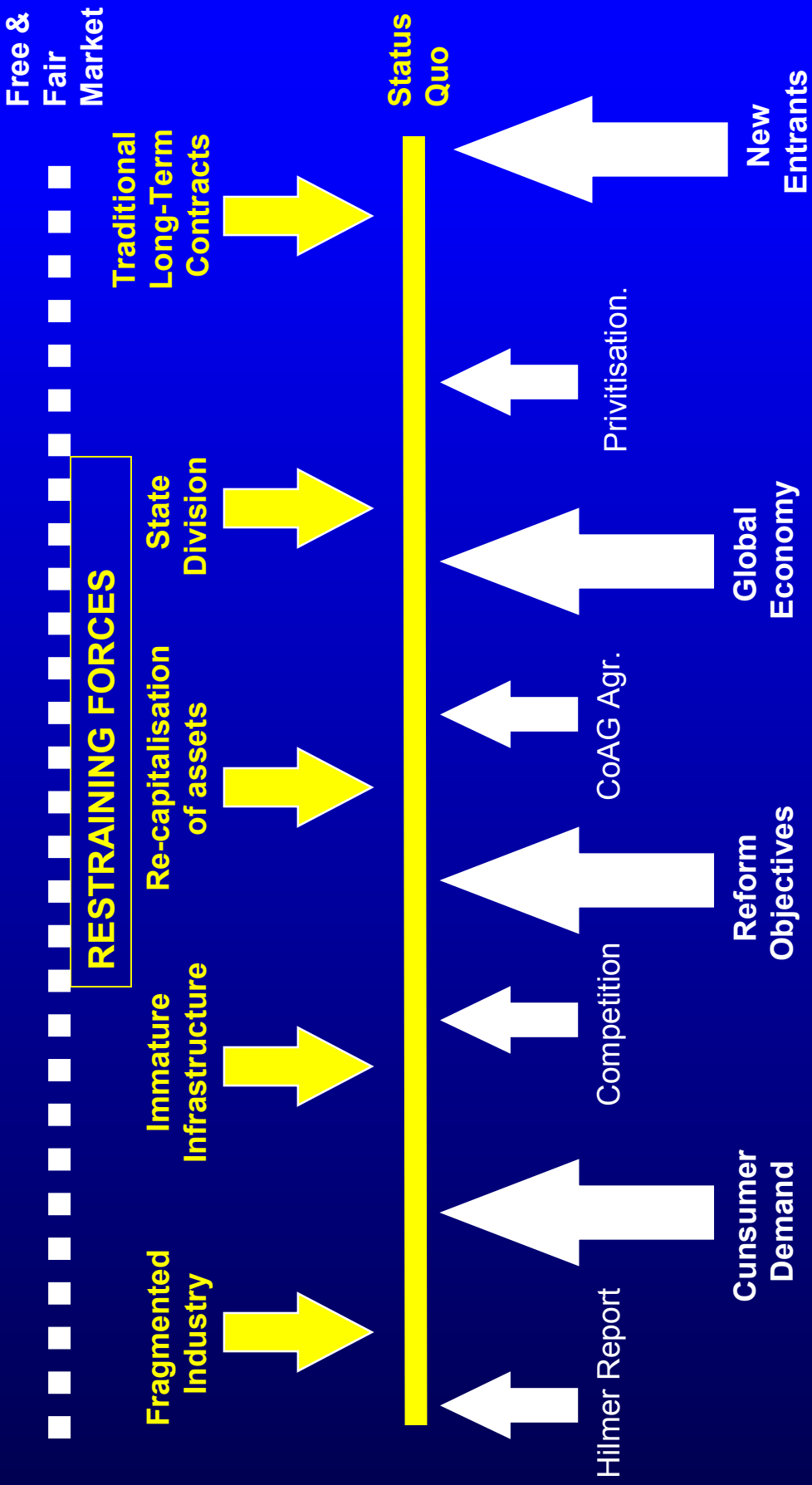
**Existing Long Term Gas Supply  
& Transportation Contracts  
- a Major Barrier to the Emerging  
Gas Market**

*By  
Glen Gill, General Manager  
Energy Supply & Market Development*

# Outline

- Gas Reform Report Card
- The Divergence of Gas from Electricity in Australia
- What a Gas Market looks like
- Long Term Gas Supply Contracts - Traditional Versus Contemporary
- Win Win Solutions

# Change Force Field



# Gas Reform Report Card

# Market Myth

- **The Myth:**
  - Australia has a natural gas market
- **The Report Card:**
  - The gas industry of Australia has yet to exhibit any of the characteristics of an openly traded commodity market

# Gas Reform - Agreed Upon

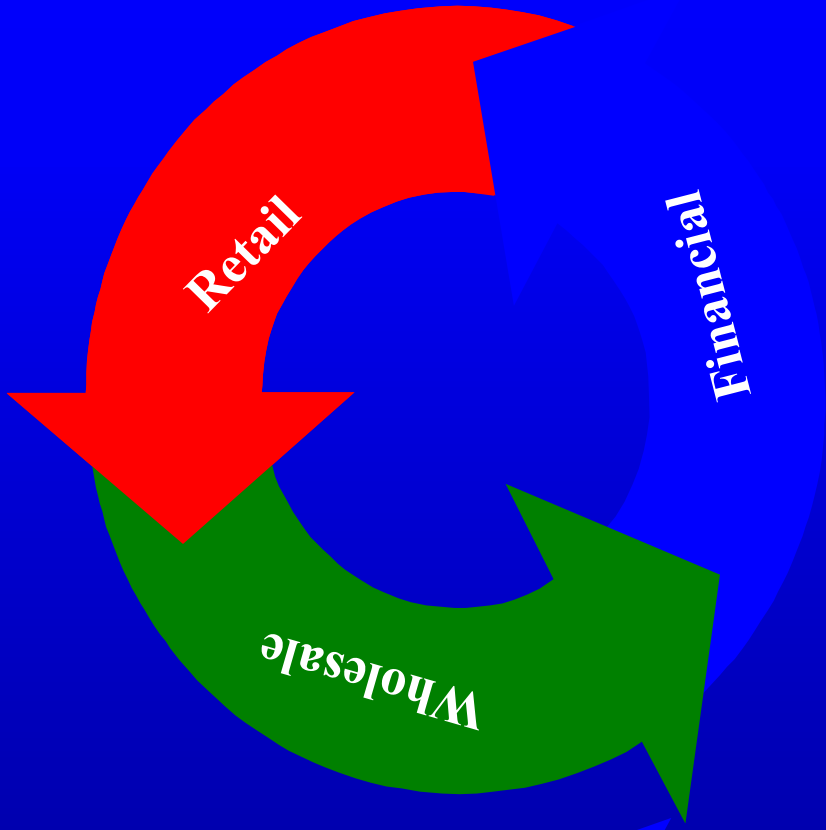
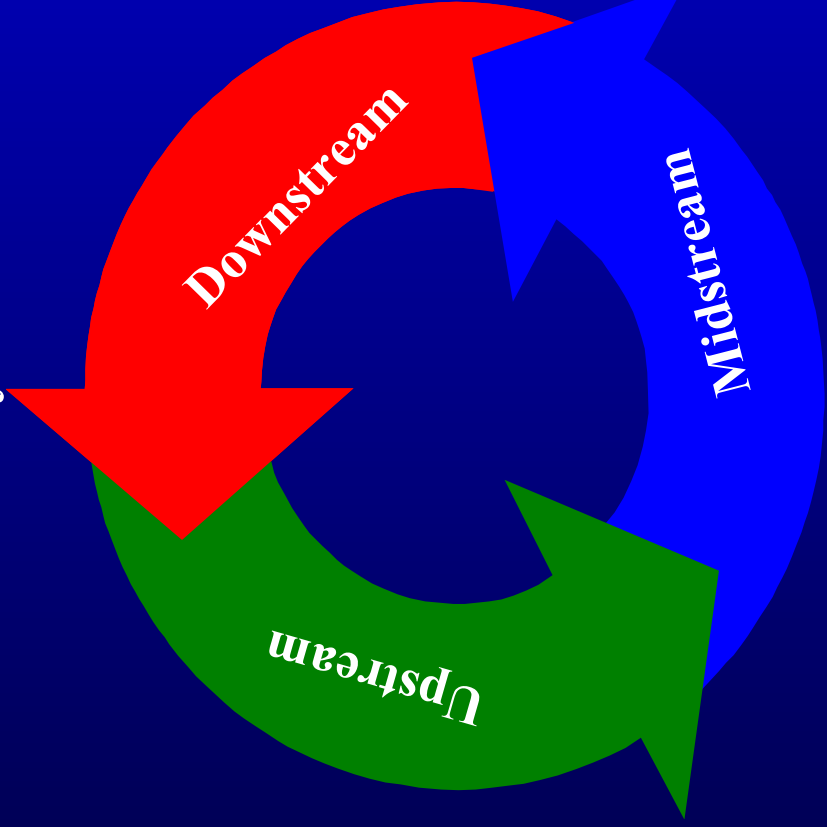
But .....

# *Not Yet Implemented*

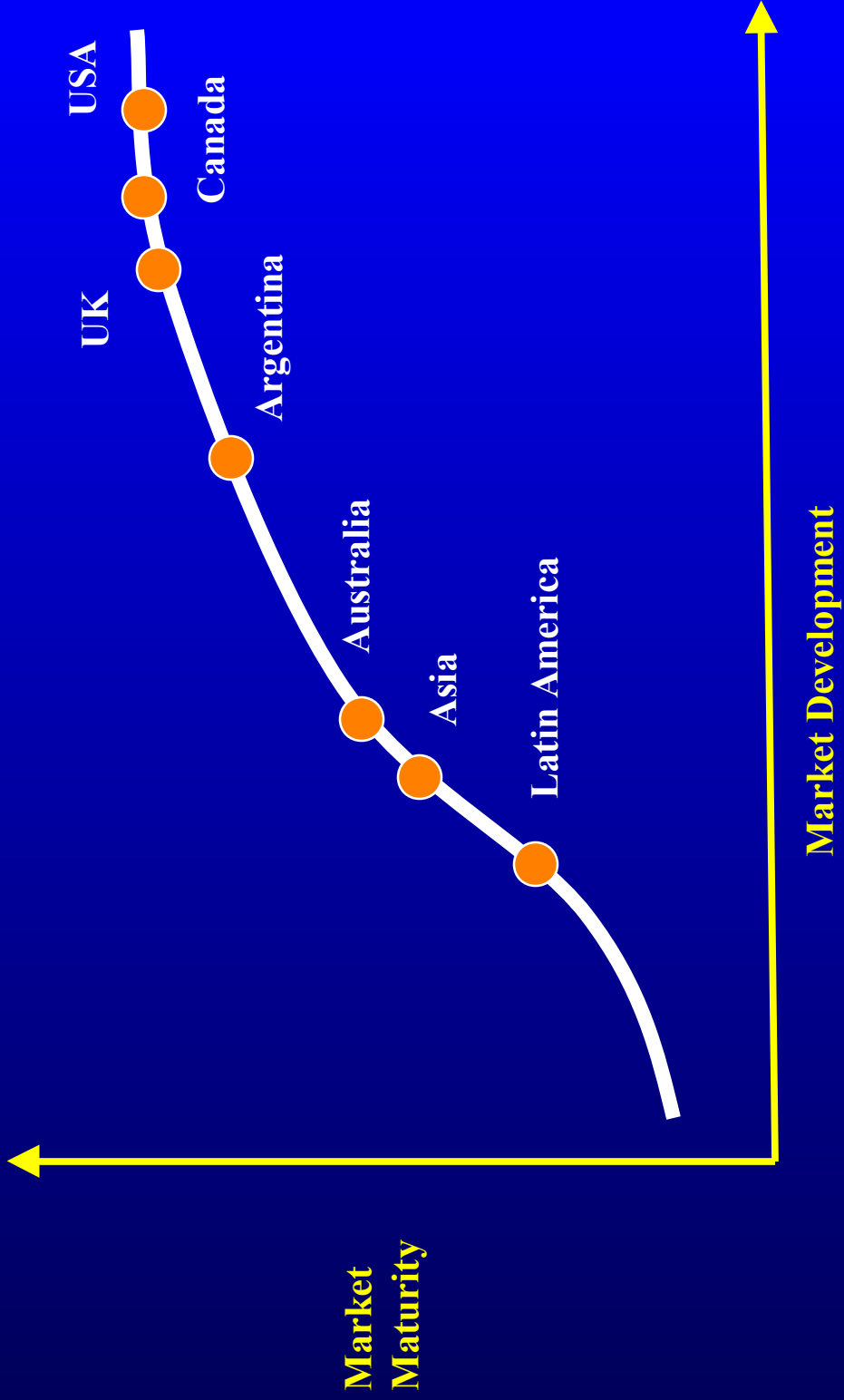
# Systems Thinking Solution

Industry Structure

Market Structure



# Gas Industry Maturity Cycle

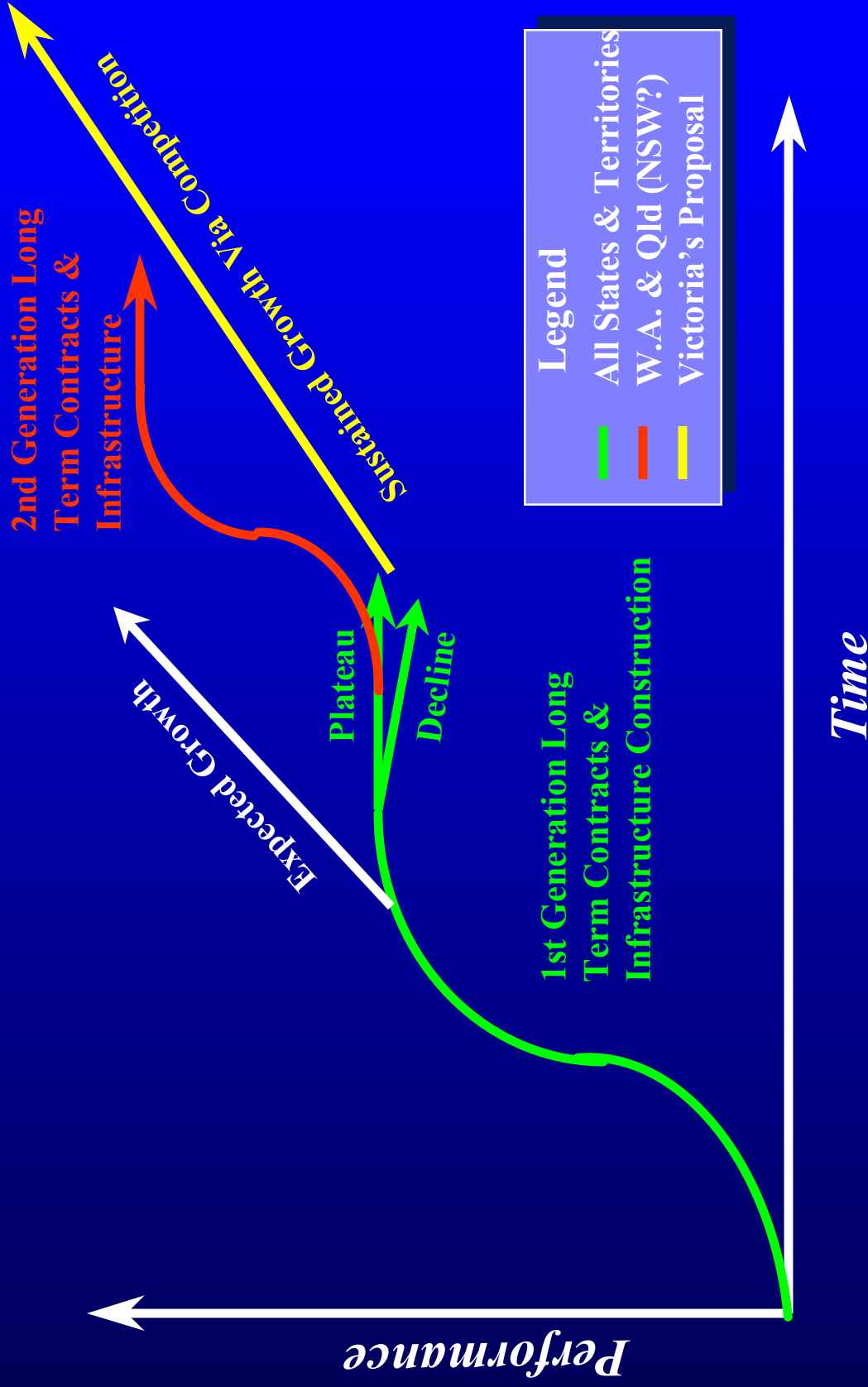




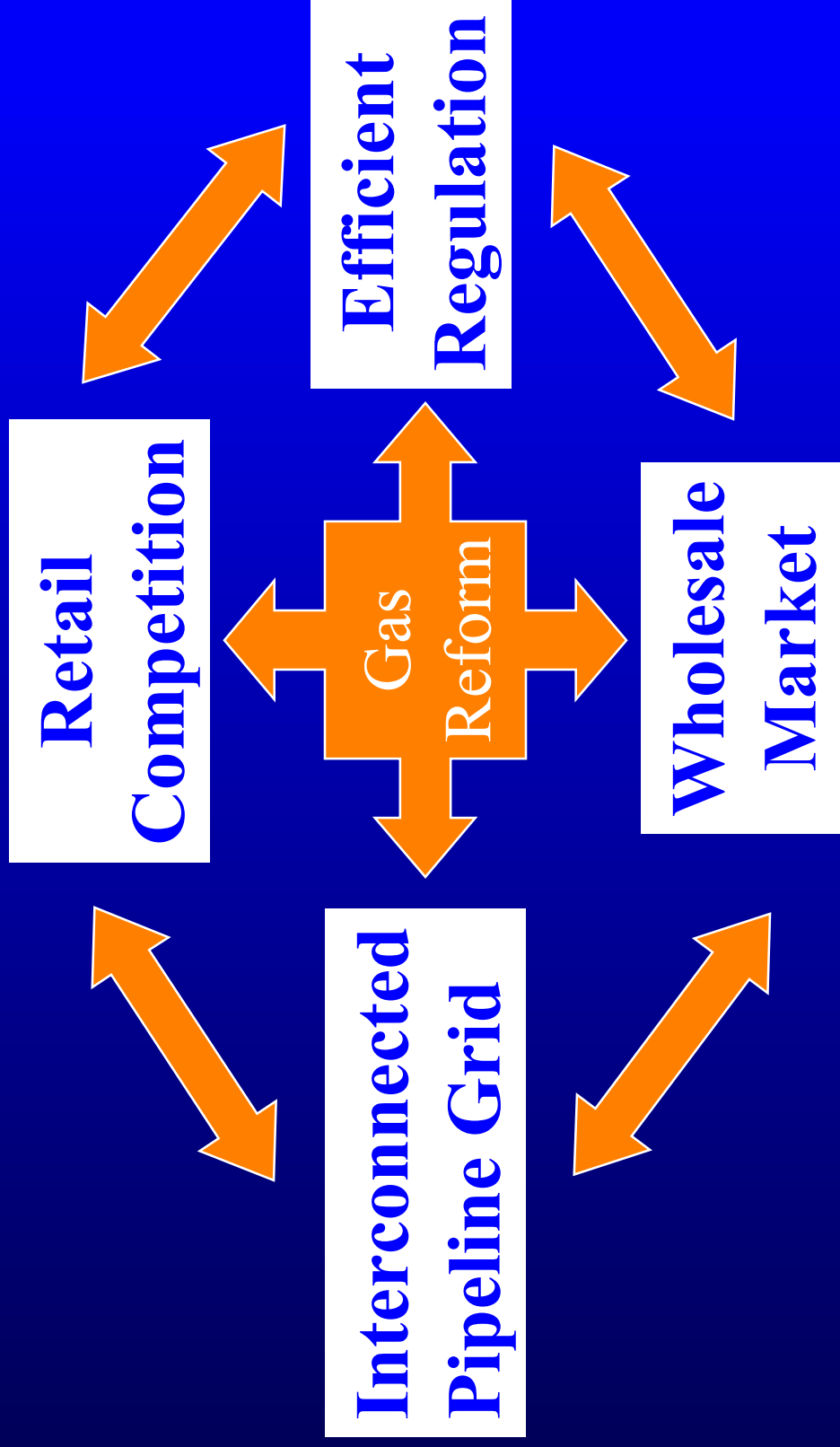
# Overseas Experience

- The 80/20 rule
  - Emphasis on greater competition upstream of city gate delivers 80% of the benefit
- Stranded Costs must be dealt with
- Competitive Neutrality is essential
- Wholesale competition pre-requisite to retail competition

# Gas Market Maturation Cycle



# Translating Vision & Strategy



# Report Card

High Distinction    Distinction    Good    Satisfactory    Poor  
Distinction

?

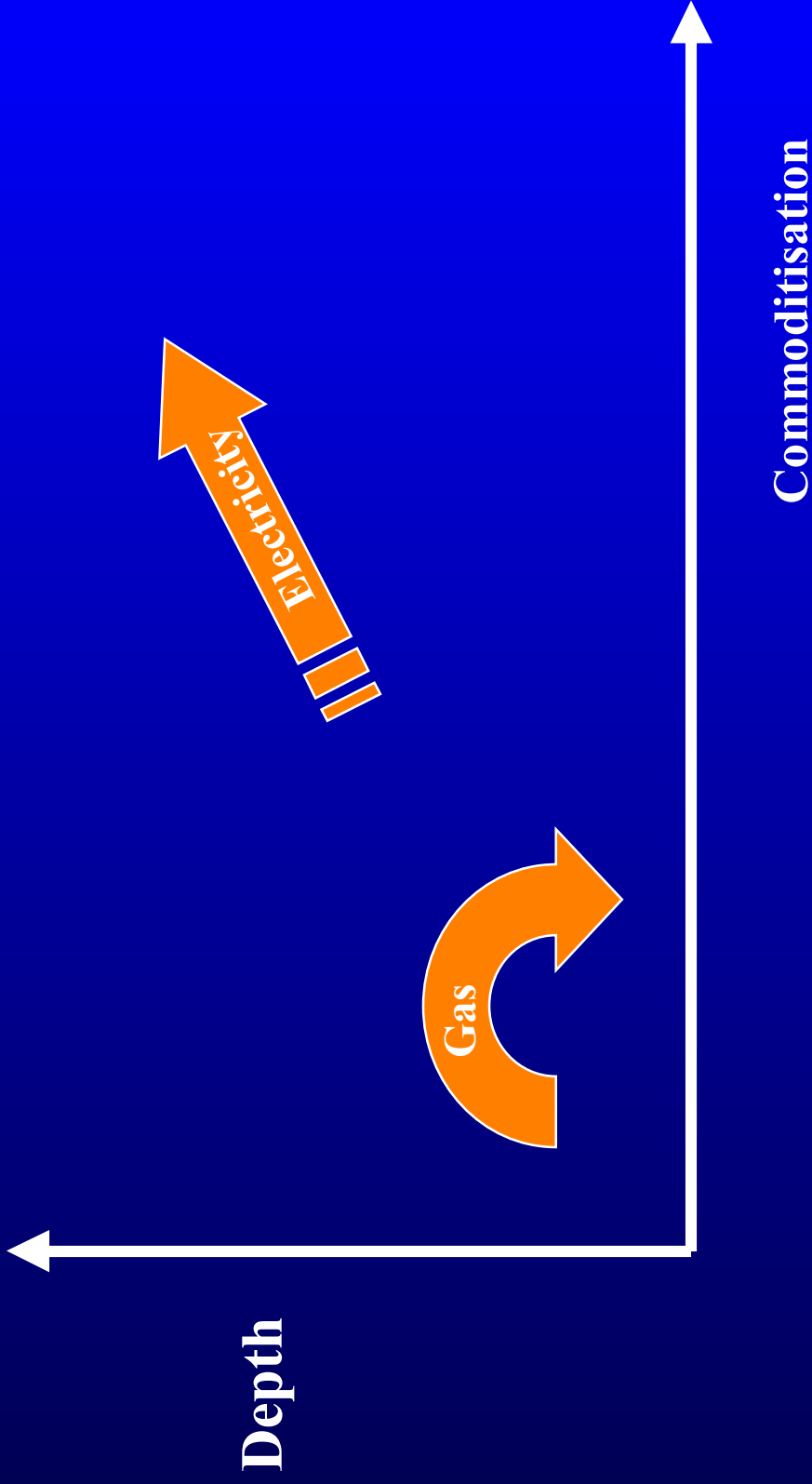
- Unbundling
- Open Access
- Retail Competition
- Wholesale Competition
- Effective Regulation
- Industry Buy-in

# Divergence of Gas and Electricity

# Common Reform Objectives

- Liberalise the market
  - commodity and capacity trading
- Common, user pay, & fair rules
  - transmission and distribution

# Convergence?



# The Gas Market Stalls!



# The Electricity Market Powers On!

# Gas Reform Lagging Electricity

- Private sector ownership
- Upstream price cartels and anti-competitive sale agreements - Exempt from the ACCC
- Gas pipelines are predominantly intra-state and not historically regulated in terms of tolling and services provided
- Gas utilities have long term contracted gas supplies
- No spot market

# What does a Gas Market looks like?

# Free & Fair Trade Objectives:

- Producers and consumers buying and selling gas in any State or Territory on commercial terms across an integrated pipeline network
- Promotion of gas exploration and infrastructure development
- Gas on gas competition within and between basins
- Gas on electricity competition

*Source: Gas Reform Implementation Group*

**Lots of  
Buyers & Sellers  
frequently entering  
& exiting the market**

# Benefits of a Spot Market

- Liquidity
- Price Discovery
- Risk Management
- Efficient Transactions

# The Birth of a Market

Contract  
Restructuring



Spot  
Market



Forward  
Market

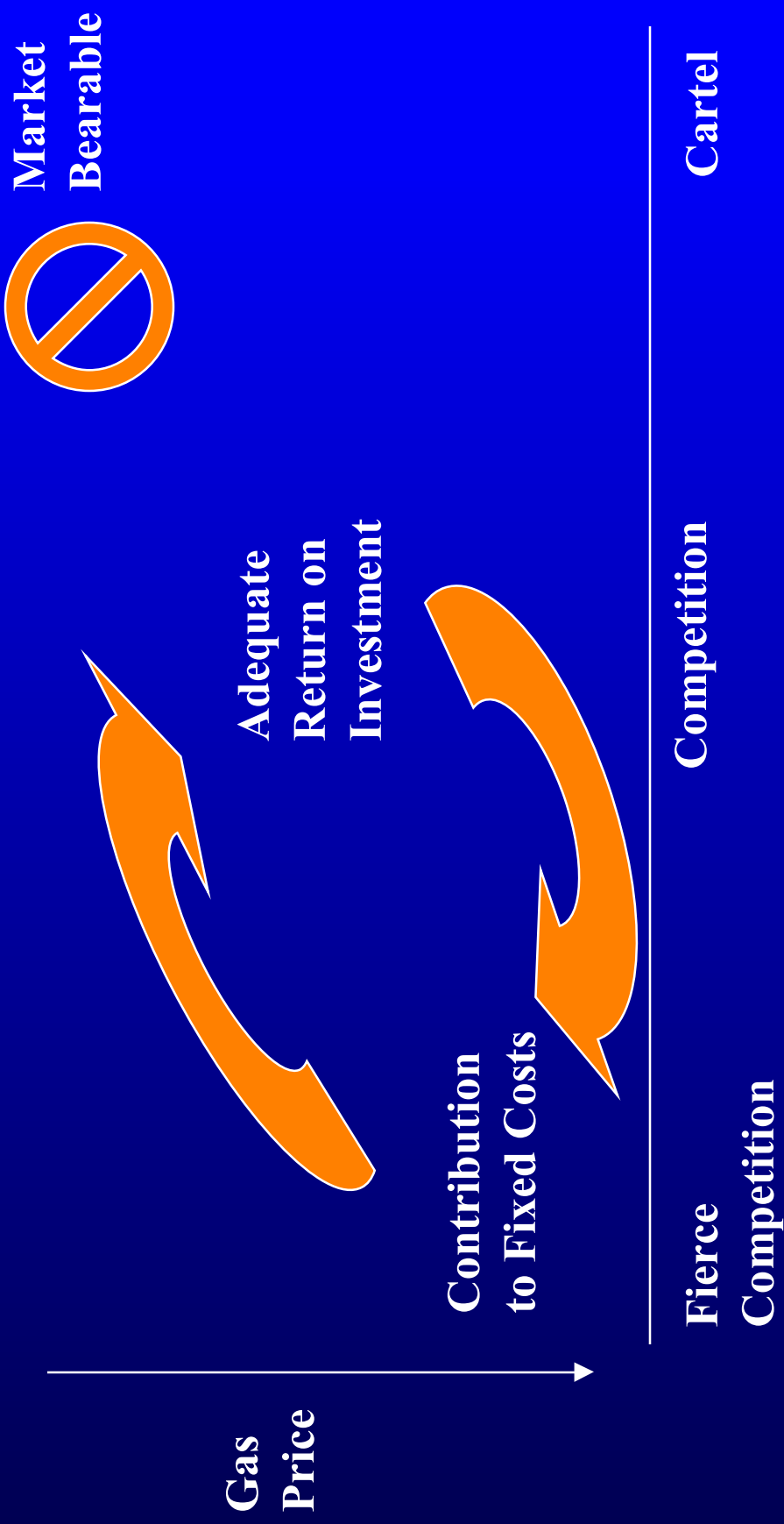


Paper  
Market

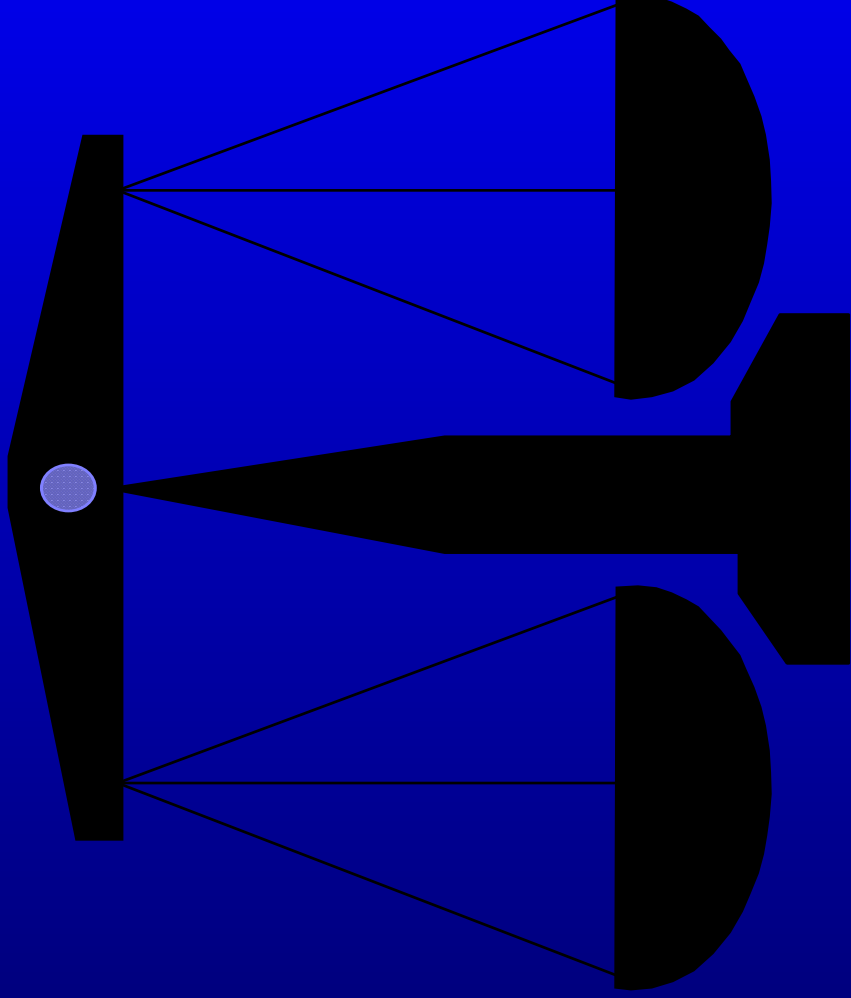
**It's better to  
be at Market  
than to be ...  
wrong!**



# Gas Pricing Methodologies



# Competitive Neutrality?



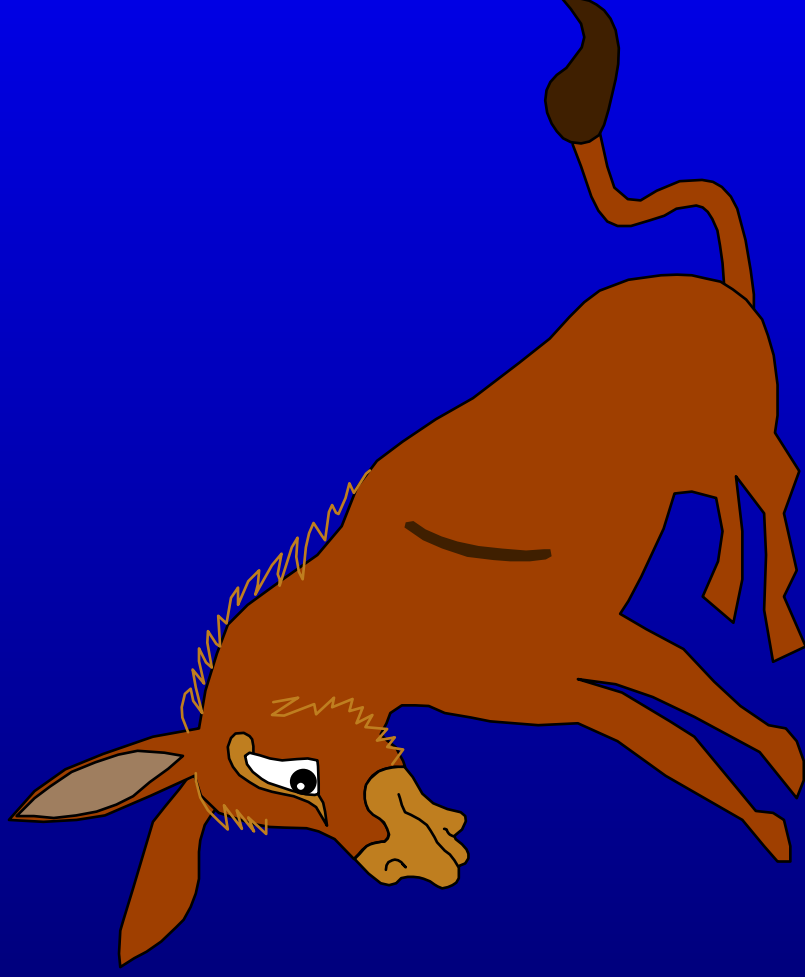
# Long Term Gas Supply Contracts

# Traditional Versus Contemporary

# Contractual terms

- Price
- Market Risk
- Security of Supply
- Term

# Incumbent Producer Position?




# Win Win Solutions

# Balanced Scorecard

- Producers
- Government & General Public
- Pipeline & Distribution Companies
- Wholesalers, Retailers, & End Users



# Much is at Stake!

- Progress is doing it right, and an Aussie twist is good; but don't ignore first principles
- Competitive Neutrality is essential
-  Stamp out Resistance to Change

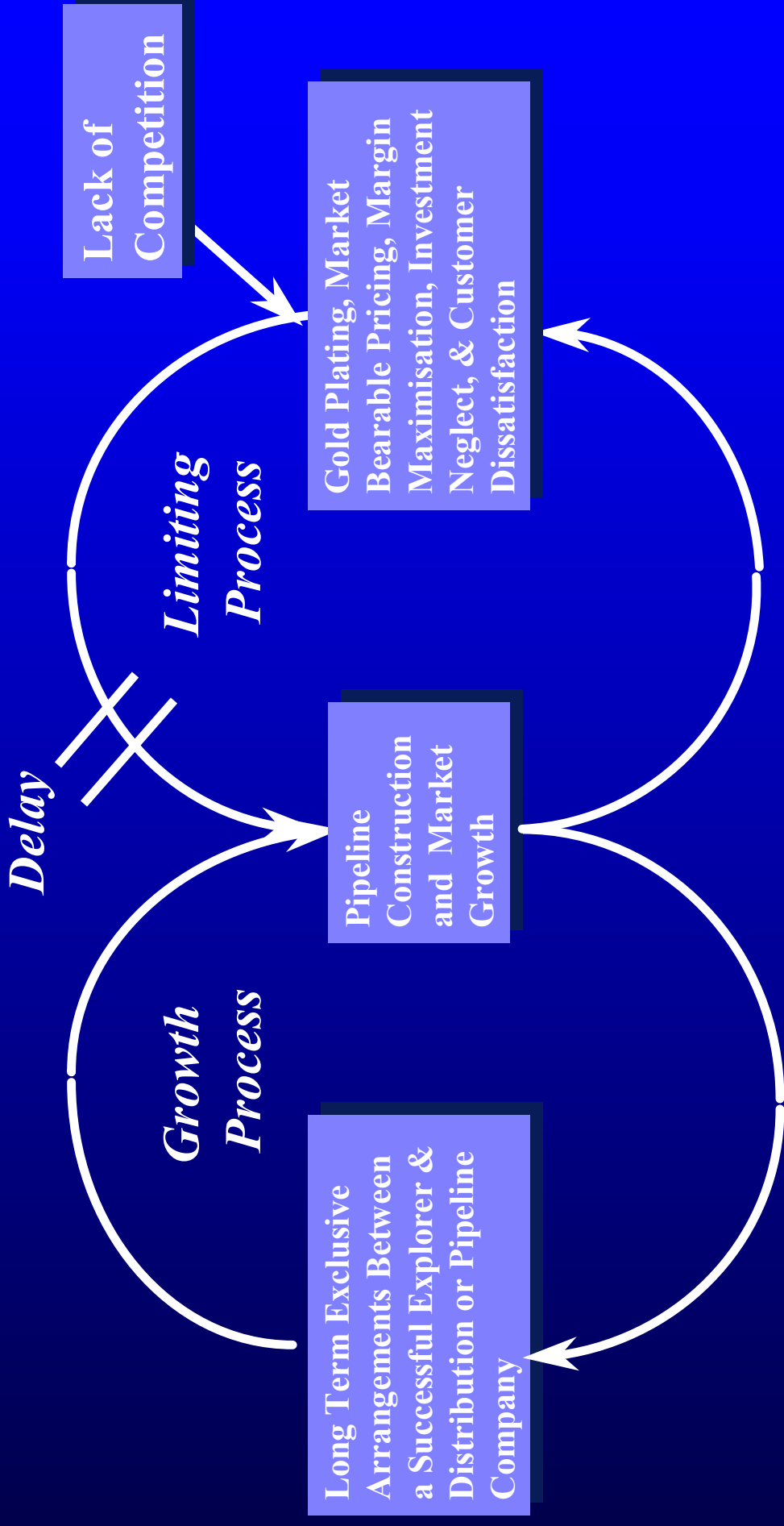
# Thank-you

# The Value of Various Contractual Terms

Contractual Term	Commercial Reality	Value in the Old World	Value in the Brave New World
Long Term	Replaces faith in a demonstrated market for the underpinning of capital investments; inventory costs for gas are substantial (up to \$0.60/GJ). Provides supply and market security in a dysfunctional market	high	low
Take or Pay	Transfers market risk to buyer; if combined with fixed prices can become a death spiral in an open market	Medium	low
Bi-lateral Fixed Prices	Leads to hostile negotiations, price arbitrations, and win/lose, but provides revenue certainty to seller if combined with take-or-pay	Medium	low
Take Flexibility	Physical option	High	low

<b>Contractual Term</b>	<b>Commercial Reality</b>	<b>Value in the Old World</b>	<b>Value in the Brave New World</b>
<b>Floating Price</b>	Fair market value given a working spot market	Low	High
<b>Delivery Point</b>	Control of market channels; freedom to manage value chain costs	Low	Depends
<b>Reserve Dedication</b>	Transfer of supply risk to buyer	Medium	Low
<b>Liquidated Damages</b>	Clear cash out cost for temporary non-performances associated with firm contractual obligations	Low	High
<b>Capacity or Supply Release</b>	Damage control under a prolonged non-performance associated with long term contracts	Low	High
<b>Reservation or Demand Charges</b>	User pays principles – recovery of fixed costs associated with stand-by service	Medium	High
<b>Pricing Re-openers</b>	Frequency of at the money prices	Medium	High
<b>Counter Party Credit</b>	A transactional deal ultimately becomes merely a financial deal	Low	Medium to High

# “Limits To Growth” Systems Archetype



# The Gas Reform Agenda

## Genesis of Industry

- Trapped Resources
- Many Local & Shallow Markets
- Upstream Cartels
- Few Pipelines
- Long Term Contracts
- Utility Dominated Market
- Latent Demand
- Large Barriers to Entry
- Little Inter-state Trade
- High Government Ownership
- Little to No Customer Service
- Incumbents Are The Sole Players



## Free & Fair Trade

- Low Barriers to Entry
- Multiple Sellers / Multiple Buyers
- Upstream Competition
- Pipeline Grid - Regional, if not National Market
- Demand Growth
- Midstream & Downstream Asset Regulation
- Deep Commodity Market
- Inter-state Trade Abounds
- Good to Excellent Customer Service
- Winners & Losers Vary Pending Market Forces

# Interaction Between the Spot Market and the Financial Market

