

LONG-TERM AND SHORT-TERM EXPORT CONTRACTS FOR NATURAL GAS SUPPLY

DOI 10.18572/2410-4396-2020-3-103-107



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Natural gas is exported in accordance with the terms and conditions of foreign trade contracts between the seller and the buyer. Research into the execution procedure, terms and conditions of such contracts has both theoretical and practical value. The importance of a foreign trade contract for relations between the parties cannot be overemphasized as its scope determines and legally binds the parties for the achievement of their respective goals. When entering into foreign trade contracts, the parties should consider the impact of natural gas extraction, processing, transportation, storage processes on terms of foreign trade transactions with natural gas. These terms are especially important for long-term natural gas export contracts which are considered to be the traditional form of natural gas trading. However, more recently, forms of foreign trade contracts for natural gas export used to interact with foreign buyers have become more diversified. Natural gas trading under short-term contracts using electronic trading platforms is becoming increasingly important. In this article, the author examines the key peculiarities of such contracts, defines basic advantages and disadvantages of using various contract forms for natural gas export.

Keywords: energy law, legal regime of natural gas as a subject matter of foreign trade transactions, contractual regulation of natural gas export.

Research into the contractual regulation, specific nature of relations between contracting parties is one of the most pressing tasks of energy law. V.V. Romanova proposed a classification depending on the scope of the agreement which may include the delivery, processing, transportation of a certain energy resource, the storage of energy resources,

the construction of a power facility, the supply of power equipment, the development of an innovative product to be used in the energy industry, etc., that can be applied for a legal analysis of contractual regulation in the energy sector [1]. According to this classification, V.V. Romanova divided contracts governing energy resource supply relations into subgroups

depending on the energy resource type. One of these is a gas supply contract [2]. Examining the state of energy law and order in the gas industry, V.V. Romanova noted that the current state of the legal regulation of gas export is distinguished by the specific nature of the legal regime of gas as a subject matter of foreign trade transactions, the specific nature of the parties involved and the legal status of gas exporters, the specific nature of national and international legal regulation [3].

Depending on the stage of the production and distribution cycle, I.P. Marchukov considers the following to be the main civil law structures used for oil and gas distribution: 1) upstream contract structures necessary for access to oil and gas fields prospecting and development, as well as oil service contracts aimed directly at the exploration and development of oil and gas fields, 2) midstream contracts related to transportation, 3) downstream contracts governing processing and distribution [4].

L.I. Shevchenko, I.V. Gudkov proposed a classification of natural gas export contracts based on the supply contract subject matter [5].

As aptly noted by V.V. Romanova, the peculiarities of the legal regulation of export transactions in the energy sector are primarily associated with the specific nature of the energy resource as the main subject matter of export transactions [6]. In transactions for natural gas export via pipelines, this energy resource is natural gas supplied in its gaseous state. Continuous and smooth natural gas extraction, processing, transportation, storage processes are needed to export natural gas in the gaseous form.

For a long time, long-term natural gas export contracts have remained the main form of natural gas export. More recently, natural gas trading under short-term contracts using electronic trading platforms has become increasingly important, supplementing the existing conventional approach to natural gas export using long-term contracts.

Therefore, we suggest, for our purposes, using a classification of contracts by natural gas supply time in order to examine the peculiarities

of contractual regulation of pipeline gas export. In this regard, the author would like to dwell on the key aspects of long-term and short-term natural gas export contracts.

Long-Term Natural Gas Export Contracts

As noted above, long-term contracts are the traditional form of contractual arrangements between the parties in relation to natural gas export via pipelines.

Specific nature of natural gas as a commodity supplied in the gaseous form necessitate creation and operation of a complex, costly infrastructure for its a) extraction, b) processing, c) transportation, d) storage. Natural gas is delivered to the buyer via pipelines that include a set of technical facilities, devices ensuring transmission of natural gas in the gas supply system, first of all, compressor plants and pipes.

Return on gas infrastructure investments can be achieved either by government support measures, e.g., in the form of a temporary exemption from state duty for the exported natural gas for the exporter [7], assistance with obtaining necessary permits and approvals for the construction of gas mains, or using contractual regulation mechanisms.

The need for return on investments in the costly infrastructure has a direct impact on the scope of natural gas supply contracts.

One of the first examples of successful long-term cooperation in natural gas export is the *Deal of the Century* made between the USSR and West Germany in 1970, also known as *Gas–Pipe*. Under this deal, West Germany provided the USSR with large pipes and other equipment for the construction of a pipeline to Western Europe, and the USSR supplied its natural gas in return [8]. The *Gas–Pipe* deal had a major impact on further development of long-term relations in natural gas supply not only with West Germany, but with other European countries as well.

The example above illustrates the value of long-term natural gas supply contracts. Such contracts have a major impact on both natural gas supplier-buyer relations and relations between the states, since the execution of a long-

term contract usually leads to gas infrastructure development, ensures reliable supply to the importer country, thus shaping energy security of the natural gas importer.

In 2005, A.A. Konoplyanik stated that deliveries under long-term contracts accounted for more than 90% of the gas volume imported by the Continental Europe countries, and this mechanism will remain an integral part of the contract structure of the EU gas market for the foreseeable future [9].

Today, long-term natural gas supply contracts still play a fundamental part. Most of the exported natural gas is supplied under long-term contracts. Thus, in 2016, Gazprom, PJSC's portfolio of long-term contracts to supply natural gas in the gaseous form up to 2035 totaled to about 4 trillion m³ [10]. Confirming this assumption, Gazprom, PJSC and CNPC signed a 30-year contract to supply Russian pipeline gas to China via the *Eastern* route [11].

The contract term clause guarantees a long-term partnership between the parties to the foreign trade contract and, along with the quantity and price considerations, makes it possible to return the money spent on infrastructure construction and profit earning under the contract.

We cannot but agree with M.V. Marchukov's statement that the value of long-term contracts boils down to the fact that they are fundamental for the stability and reliability of natural gas supply. Only such contracts can guarantee long-term reliable and continuous supply of an energy resource for the importer and return on multi-billion investments in the implementation of large-scale export projects for the exporter [12].

The legal science lacks clear understanding of what the contract term shall be to consider the contract a long-term one.

According to I.V. Gudkov, the duration of long-term contracts can be determined as follows: by using a fixed term (10 to 25 years) or by linking it to the life cycle of a specific field the gas is to be supplied from under the contract (the so-called *depletion contract*) [13]. This point of view is consistent with the current practice of

long-term contracts which are generally signed for a term of more than 10 years [14].

It should be noted that long-term natural gas supply contracts have their advantages and disadvantages. Large volumes of natural gas are supplied under long-term contracts, therefore, it is in the best interests of the parties to agree upon as many material conditions as possible directly in the contract. Advantages of long-term contracts for the natural gas supplier include the buyer's obligation to collect a certain amount of natural gas, guaranteed currency receipts for a long period of contract validity, while advantages for the buyer include receipt of the natural gas volumes stipulated in the contract. The interests of contracting parties in terms of the supply of the agreed volume of natural gas, on the one hand, and the collection of natural gas, on the other hand, are ensured by certain contract terms specifying the minimum quantity of natural gas to be collected by the buyer and delivered by the supplier, as well as by the *take or pay* clause stipulating that the buyer has to collect the quantity of natural gas exceeding or equal to the quantity stated in the contract, or pay the cost of the uncollected minimum quantity of natural gas to the supplier. Furthermore, the pricing formula of long-term contracts usually takes into account oil product price movement for the preceding 6 to 9 months, thus smoothing sharp price fluctuations in the energy market.

Major disadvantages of long-term natural gas supply contracts are high risks related to changes in the contract terms and conditions, primarily the price terms. Existence of a price reopener clause in long-term contracts according to which either party may request a revision of the contract gas price, if it believes that the market situation has changed to the extent that the contract price no longer matches the actual gas value [15], often resulted in significant financial implications for one of the parties to the contract, especially when the price is revised retroactively, for the preceding delivery periods. Price disputes lead to long-term international arbitration proceedings between the contracting parties. Their outcomes are hard to predict as

the decision depends on multiple factors in each particular case.

Short-Term Natural Gas Export Contracts

Over the past few years, short-term natural gas export contracts have become increasingly important. By using these contracts, we were able to diversify the existing mechanisms of natural gas supply to European buyers.

The years 2015 and 2016 saw extensive use of short-term natural gas supply contracts in the Russian Federation as Gazprom Export, LLC conducted its first *gas auctions* [16]. At the next step of the development of natural gas trading under short-term contracts, Gazprom Export, LLC launched an Electronic Sales Platform (ESP) in September 2018. This platform has been used to sell natural gas batches on a regular basis ever since. Overall, more than 16.5 billion m³ has been sold during the ESP operation from its launch in 2018 up to the end of 2019 [17].

Compared to long-term contracts, short-term contracts are much easier to execute. To do so, one shall register on the Electronic Sales Platform of Gazprom Export, LLC, and submit a respective order. Contract terms are standard. Framework agreements on natural gas supply are posted at the official website of Gazprom Export, LLC's ESP [18]. Natural gas is traded for the day ahead, month ahead, quarter ahead, year ahead.

Trading on the ESP is similar to exchange natural gas trading in that it uses electronic web resources for contracting. However, in this case, there is no specialized institution such as an exchange [19]. Contracts are made directly between suppliers and buyers, while the ESP serves as a venue used to determine the delivery price according to the online auction results and to sign a foreign trade contract for natural gas export. The use of the ESP makes it possible to attract a wider range of natural gas buyers.

Price indices of short-term contracts are for the most part consistent with the current market environment, because natural gas pricing takes into account the market conditions existing at the time of the trade. Thus, the key advantage of short-term contracts is their higher flexibility compared to long-term contracts, manifesting itself in simpler execution and performance, natural gas prices matching the existing market conditions at European spot marketplaces.

The disadvantage of short-term contracts is a relatively small volume of supplied natural gas, lack of long-term commitments to supply and collect natural gas. The overall volume of natural gas sold using short-term contracts remains relatively low as compared to long-term contracts. However, in recent years, this form of natural gas export has proven effective as a much-needed instrument in addition to natural gas supply under long-term contracts. ■

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