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Gas Pricing

The Role of the Regulator

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Introduction

- No single global price for gas
- Fragmented gas markets
- Multiplicity of prices – indexed, netback, weighted average, cost-plus etc
- Who gets to set gas prices?-Markets, Government or Regulators?



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Pricing Gas Under Different Contract Regimes

- Concessions
- PSC/PSA
- Service Contracts
- Buy Back Contracts
- LNG
- Wholesale markets



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Concession

- IOC bears risk, owns both field and production, operates field
- How IOC is compensated – not known
- Price likely to be market-driven



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PSC/PSA

- PSC/PSA – started by Indonesia. Investor bears both financial and exploration risk
- Cost Recovery first charge on sale proceeds
- Profit shared between operator and host govt
- Profit share a biddable parameter
- Price of gas determined through mutual negotiation at arms-length or through the market



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Service/Buy Back Contract

- Venezuela, Kuwait, Bolivia, Ecuador, Mexico, Turkmenistan/Iran
- Compromise arrangement - Sovereignty concerns over natural resources & Need for foreign technical knowhow
- Risk shared by NOC & IOC
- Ownership and control of mineral rests with host govts, operatorship maybe.
- Foreign oil company gets a fee for services
- Pricing could be market-driven or govt-controlled



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Where Does Regulator Come In?

- When the statute expressly empowers the regulator or is wide enough in remit to cap gas price
- When there is a Single Buyer Model and govt policy favours price caps through regulation
- When there are multiple sources of supply regulator can impose prudence on gas purchase costs through price caps



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Price Cap – RPI-X

- UK, simplified versions in France, Ireland
- Retail Price Index – X Factor
- Incentive Regulation – incentivise the firm to cut costs/improve efficiency and retain part of the gain by allowing a lag
- Duration of lag critical
- One dollar increase in costs will produce a less than one dollar increase in revenues



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Price Cap

- The pass-throughs- Regulator's fee, taxes paid by utility and even gas price!
- What is controlled? All components of transmission tariff – capex, cost of capital, size of asset base, opex, outperformance
- Re-opening mechanism to address risks
- What is not controlled – anything that is amenable to competition - storage, metering, billing etc; in some jurisdictions, gas price
- How to determine X factor?



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Factors Impacting Price Cap

- Statutory framework
- The degree of independence of the regulator, role of government
- Political and cultural environment of a sector
- Historical approach to regulation,
- Industry structure in terms of ownership
- Vertical/ horizontal separation



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Thank You