

Since we last met: Legal and commercial highlights of 1998 and 1999 — “Industry realignment”

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Abstract

At the time of the last New Zealand Petroleum Conference in March 1998 it was apparent that robust competition was a reality for the major participants in the upstream gas industry and the main wholesalers of gas. It was anticipated that the gas market generally was likely to become much more dynamic. Activity in the New Zealand market since then has vindicated this prognosis.

The paper will comment on the key commercial and legal events that have evidenced this new dynamism and the new roles and positions of the current major players. The paper will thus discuss:

- the position of Contact Energy Limited and the gas contracts it has entered into;
- the radical changes to the gas distribution industry as evidenced by the break-up of Enerco, the sale of the TransAlta gas lines business and the emergence of Nova Gas Limited;
- the new Natural Gas Corporation (NGC) arising from the departure of Fletcher Challenge Energy as a shareholder and the increasing influence of NGC's new major shareholder, the Australian Gas Light Company Limited;
- the discovery of gas at Wairoa and its implication for gas transmission;
- the re-focussing of Fletcher Challenge Energy on its core upstream activities;
- the influence of Kapuni gas; and
- why Maui is still the key influence on the New Zealand gas industry.

Introduction

This is the third paper the writer has presented to the New Zealand Petroleum Conference describing commercial highlights over the two years prior to the Conference. Both the previous papers have had as their main focus the New Zealand gas industry rather than other aspects of the upstream industry and that focus is continued with this paper.

The first paper, in 1996, described the overall interlinked nature of the major gas contracts in New Zealand and, looking back, what stands out is the relative rigidity of that contractual framework which was reflected in the stable market then prevailing. The second paper, in 1998, was subtitled “Competition Emerges” and described some of the new influences on the gas market and predicted a new dynamism within that market place as well-placed participants pursued more effective management of their own gas positions and sought to capture value where they could.

That prediction has been borne out by the reality over the last two years. While much remains the same – for example,

Maui is still, by far, the largest source of gas supply in New Zealand – there have been many changes to the extent that, in some areas, the market is now quite different. However, perhaps the dominating characteristic of this period has been the radical changes to the ownership structures of many of the long-established participants in this market.

What this paper will attempt is a description of the various ownership changes and significant transactions that have reflected the new dynamics and then to comment on those areas where attention is likely to be focussed in the future. For the sake of convenience these transactions have been grouped by participant because it is the participants who have driven the new changes.

Contact Energy Limited

The last paper referred to the position of Contact Energy Limited (Contact) as a gas trader. Contact was created out of the old Electricity Corporation of New Zealand (ECNZ) and acquired the rights held by ECNZ to purchase 42% of the Maui gas entitlements held by the Crown. Over the last two

years Contact has aggressively managed this position such that for the financial year to 30 September 1999 gas revenues amounted to almost 30% of Contact's total revenues, up from 19% for the year to 30 September 1998. However, within that 30% figure the key change is that external gas sales increased by 162%.

In late 1998 Contact purchased the retail gas business of Enerco (a company to whom Contact was the most important and largest gas supplier) and, as a result, Contact now claims to be New Zealand's largest gas retailer based on customer numbers. Contact has retail gas customers in Auckland, Wellington, Napier, Hastings, Palmerston North and other regions. In addition Contact has continued to be an active manager of its wholesale gas position selling gas not just to Genesis Power (Genesis) but as well to Fletcher Challenge Energy (FCE) for the purposes of supplying the Taranaki Combined Cycle power plant. Contact has also used its Maui gas entitlements for its own power plants.

But perhaps the transaction that best illustrates Contact's new position as a large broad based gas trader was the gas sale agreement concluded in 1999 with Methanex. Under this agreement Methanex agreed to purchase, on a take or pay basis, 130 PJ of gas from Contact, over the period between 1 September 1999 and 30 September 2008.

Not only was this transaction significant in its own right, in that it involved a new commercial relationship between Contact and Methanex, it also appears to have substantially solved Contact's take or pay exposures arising out of its contractual gas purchase arrangements with the Crown. As a further result, paid for but not taken gas, which Contact had previously written-off through its accounts, was able to be written back thus enabling Contact to recognise a \$72 million asset into its balance sheet.

Thus Contact is now involved at several levels or areas in the gas market. Not only is it a substantial consumer of gas for its own purposes, it supplies gas to Methanex, supplies gas to other power stations and has a large and active position in the retail gas market.

These transactions have been possible, indeed have been driven by, Contact's entitlements and obligations to purchase over 42% of the Crown's Maui gas entitlements arising under the 1973 Maui gas contract between the Crown and the Maui Mining Companies. These rights and obligations gave Contact both an opportunity but also presented a problem in that the take or pay commitments faced by Contact were substantial. However, Contact has now actively managed that position to the point where, with one caveat mentioned below, its gas purchase entitlements and gas sales arrangements appear to now be substantially in balance.

Many of the initiatives undertaken by Contact during this period occurred while Contact was a company wholly-owned by the Crown. However, in 1999, the Crown sold a 40% cornerstone shareholding in Contact to Edison Mission Inc., a large California-based electricity utility. As part of the same

sale process, the other 60% interest held by the Crown and Contact was sold by way of a prospectus to the public.

Finally, mention should be made of Contact's initiative in proposing to build a by-pass high pressure gas line between Huntly and Auckland; an initiative that got as far as tenders being sought from contractors to build the line. In the face of that threat, Natural Gas Corporation (NGC) agreed to renegotiate its transmission prices over that sector of its network. This was a rational economic response from NGC but, it is interesting to note, a response quite different from that of Orion and TransAlta in the face of the by-pass threats posed by Nova in the Lower Hutt/Wellington area.

Contact has therefore not only transformed large parts of its gas business but its own ownership structure has changed.

Natural Gas Corporation of New Zealand (NGC)

In 1998 NGC occupied (and still does) a major position in the New Zealand gas industry being the owner of all of the high pressure gas transmission network (other than the pipeline used to transport Maui gas from Oaonui to Huntly) and in addition was (and still is) a major participant in the wholesale and retail gas market.

The most significant thing that has happened to NGC over the last two years has been the changes to its ownership. Until mid 1999 NGC was owned as to one third by FCE and one third by the Australian Gas Light Company (AGL) with the remaining third held as publicly traded shares. By the end of 1998 both FCE and AGL had commenced a process involving a proposed substantial restructuring of NGC into various different business units with FCE and AGL intended to have controlling stakes in different of those business units. However, and perhaps because the transaction became too complex, it was abandoned in June 1999. In July 1999 FCE and AGL agreed on a much more straightforward proposal involving FCE's sale of its one third share in NGC to AGL. As a result of some on-market purchases by AGL, AGL now has over 70% of NGC and its influence on NGC is now increasingly obvious.

In the context of the New Zealand upstream industry this represents a significant change in position. For years the shareholding connection between FCE and NGC has meant that, for competition law purposes, FCE and NGC have been treated as one entity, notwithstanding the commercial reality that FCE's one third interest in NGC has been exactly counter-balanced by the one third interest held by AGL. However, the connection between NGC and FCE has now been severed entirely and, irrespective of what may have occurred in the past, the stage is now set for these two major industry players to become active competitors.

Since 1998 NGC has continued to expand into the electricity business and NGC represents part of the worldwide trend towards the convergence of the gas and electricity industries – a subject that will be dealt with by others later in the

Conference. AGL has been an active participant in this convergence market as well. Examples of what has happened in this area include the acquisition by NGC of WEL Energy's electricity retail business in March 1999 and, more recently and significantly, the announced intention to purchase a 78% stake in TransAlta New Zealand Limited, a substantial electricity retailer with over 500,000 electricity customers nation-wide.

But the events about NGC have not been confined to changes in its owners.

The long running contractual dispute with the Kapuni Mining Companies (Shell and Todd), a dispute that has been the subject of discussion at the last two conferences, was finally concluded at the beginning of 1999 with the arbitration for the price payable by NGC for Kapuni gas decided. The entitlements of NGC to Kapuni gas and the price payable for gas processing charges were also finally settled as part of the overall process. Part of these arrangements involved NGC entering into an indemnity gas purchase arrangement with FCE involving an option entitlement for NGC to purchase up to 65 PJ of gas (adjustable according to the assessed quality of Kapuni reserves) over the period between 2003 and 2012. It is not clear yet whether NGC will exercise this option but what is clear is that NGC, unlike Contact, has gas purchase entitlements extending beyond the end of the Maui contract (June 2009). These arise by virtue of NGC's existing Kapuni gas purchase rights and its option to buy gas from FCE.

NGC has also sought to more effectively manage its take or pay position (arising out of NGC's Maui gas purchase obligations and rights with the Crown) by the sale of 25 PJ of prepaid gas to Methanex.

Within the last few weeks NGC has announced contractual arrangements that further underscore the way the old descriptions of wholesale and retail markets are now either irrelevant or obsolete. NGC has secured the right to supply Genesis with 90 PJ of gas for use at the power station owned by Genesis at Huntly. Until this transaction, gas for the Huntly Power Station had been sourced from Contact. It is not clear at what price NGC is supplying this gas but the transaction reflects a determination on the part of NGC to actively manage its own take or pay position. Given that gas supply for Genesis by NGC will be displacing gas previously supplied by Contact, there is room for some conjecture that Contact will now have some surplus gas entitlements which it will be looking to dispose of at an appropriate time.

Finally, and only very recently, NGC has taken advantage of its rights to Kapuni gas and has secured a five year contract to supply gas to the ammonia urea plant near Kapuni involving approximately 35 PJ and lasting until at least 2005.

Fletcher Challenge Energy (FCE)

FCE's exciting news at the 1998 Gas Conference was the possibility that it had discovered substantial reserves of gas at Mangahewa. Regrettably subsequent appraisal drilling

of the Mangahewa discovery has led to a significant downgrade in reserves.

As a result Mangahewa now appears to have reserves of approximately 100 PJ – a far cry from the suggested 2000 PJ at the time of the discovery two years ago. However, there has been no significant development activity at Mangahewa and neither has there been any announcement of sales of Mangahewa gas.

Nevertheless, FCE has continued to be a substantial exploration participant and, as this paper was being written, there were early indications of a reasonably significant gas accumulation located by the offshore well operated by FCE at Pohokura.

FCE has made no secret of its desire to seek out gas reserves around New Zealand and has made gas a specific exploration target. Appraisal drilling by FCE at the McKee field has led to an upgrading of gas reserves in that field – and at a time when McKee gas is almost wholly uncommitted now that NGC's McKee gas purchase entitlements are all but exhausted.

If reasonably substantial Pohokura reserves can be established then FCE, in conjunction with the Pohokura JV, is well positioned to be able to offer significant amounts of long term gas supply from Mangahewa, McKee and Pohokura well into the post-Maui era, a period that is now very much within the planning horizons of all of the large gas suppliers and consumers.

FCE continues to be prosecuted by the Commerce Commission as a result of its purchase of an interest in the Kupe field in early 1997 and the transaction concluded about the same time involving a long-term gas contract between FCE and ECNZ – the so called "generic" gas contract because the contract was not field specific. In my last paper I noted that both ECNZ and FCE had said that they would be vigorously defending themselves in relation to that prosecution. Despite the passage of over two years since the prosecution commenced the wheels of justice have ground on very slowly indeed. The first statement of claim of the Commerce Commission was struck out in early 1999 with the Judge describing that statement of claim in the following terms:-

"There is a failure in a clear, unambiguous, precise and understandable way to succinctly create an intelligible allegation of breach. The present pleading is like an enormous fishing net, thrown out in the hope that in the tangle and jangle of its various strands, lying layer upon layer, it might somehow manage to catch something in its purview".

The Commerce Commission responded by lodging a further amended statement of claim which triggered yet further strike out applications from FCE and ECNZ as defendants. These strike out applications were, in large part, upheld in the second judgement from the High Court but the Commerce Commission is now appealing that judgment. We thus have

a situation where in respect of a transaction concluded at the end of March 1997, the Commerce Commission prosecution (commenced some nine months later) has still not got to the point where either of the defendants have been required to lodge a substantive statement of defence let alone discovery having been commenced or the matter having got appreciably closer to trial.

Meanwhile, as noted earlier, FCE has sold its stake in NGC and FCE's co-defendant, ECNZ, has assigned its interest in Kupe to Genesis, another "baby" ECNZ having been established from the split of ECNZ. The generic gas contract between ECNZ and FCE referred to above was also assigned by ECNZ to Genesis. It is interesting to note that the generic gas contract is now the subject of yet further litigation between Genesis and FCE to determine the validity or enforceability of the contract, and will be the subject of a trial commencing about the same time as the conference. Thus the factual scenario that underpinned the concerns of the Commerce Commission has substantially changed.

In various public announcements FCE has stated its intentions to focus on core assets. The programme of asset sales over the last two years has seen FCE largely exit from all its electricity interests and completely dispose of its interests in NGC. FCE too has changed considerably since we last met.

The retail gas industry

The retail gas industry has similarly seen substantial change. As noted earlier, Contact has acquired Enerco's retail gas business. Enerco, New Zealand's largest established gas retailer for many years and with a substantial business base in Auckland, has effectively been dismembered following its take-over by Southpower in late 1997. From a position where Enerco was considered to be the major player in the retail industry, the remaining parts of the business are now relative bit players only.

In the Wellington region TransAlta has sold its local gas distribution lines business to AGL for over \$110 million. A by-product of NGC's proposed acquisition of 78% of TransAlta New Zealand Limited is that TransAlta's retail gas business will soon be majority owned by NGC – which is in turn majority owned by AGL.

But possibly the most interesting development in the retail gas industry has been the emergence of Nova Gas, a minnow in 1998 with a small gas business based on extracting and selling landfill gas which has, by the beginning of 2000, emerged as a locally important player with total gas sales of over 3 PJ per annum.

The Nova story is a remarkable example of some of the new dynamics at work in the marketplace. Nova has done what should have been economically irrational, namely the construction not just of by-pass lines in various parts of the Lower Hutt, Hawkes Bay, South Auckland and Wellington regions but also the construction in some of those regions of gas distribution lines running parallel to an existing

distribution network. Nova built these lines as a result of its inability to obtain satisfactory terms and conditions for access to the local line distribution network. Quite clearly Nova considered that the line charges proposed by TransAlta and Orion, the owner of those networks, no matter how defensible they might have been to other retail customers or from attack under the Commerce Act, were priced to a point where it was cheaper for Nova to build its own gas lines.

The fact that Nova has proceeded with such an investment speaks volumes about the robustness of the economic models that must have underpinned TransAlta's and Orion's pricing methodologies given the obvious effects on value to an existing line network owner if a duplicate line is created in the same area.

Nova has also flexed its muscles in the area of gas supply and now divides its gas purchase arrangements between NGC, its own sources of landfill gas and gas supplied by the Kapuni Mining Companies. Not only has Nova been active in the market place as such, there have also been changes to its ownership structure. In 1997 Todd Energy acquired a cornerstone shareholding in Nova of approximately 40%. Based on recent announcements in Wellington newspapers Todd and Nova have given notice of an intention to merge Todd's LPG business with Nova. It would appear to be likely that, from now on, Kapuni gas will be the main source of supply for Nova.

All of this activity at the retail level of the marketplace has meant there has been real and active competition for small to medium sized industrial concerns and the smaller co-generation plants. The situation is now quite different from a take it or leave it fixed price.

Wairoa/Westech

Shortly after the last Conference the industry received the exciting news of a new and potentially significant gas discovery in the East Coast region, the Kauhauroa well at Wairoa operated by Westech. Appraisal drilling has since confirmed that discovery and the indications are that total reserves will be about 150 PJ. However, as yet, the discovery remains undeveloped.

The challenge for Westech and Orion, as owners of the field, is locating a market for this gas and transporting either gas to that market or transporting something produced from the gas to markets. This is particularly challenging giving the difficult terrain between Wairoa and Napier, the nearest reasonably substantial gas market.

What will also be interesting is the effect that the possibility of a new source of gas supply to Napier will have on NGC's gas transmission network, in particular the pricing arrangements for that part of the line south of Kapuni and which connects to the Hawkes Bay region. Transmission pricing policies that assume one Receipt Point for gas or that gas will move in one direction only clearly need to be revisited. However, unless and until gas deliveries from

Wairoa to Napier look set to become a reality, any immediate changes in that pricing policy appear to be unlikely.

Todd and Kapuni

At the end of the last conference Todd Energy was an important player in the market holding 50% of the Kapuni field and a 12.5% (6.25% beneficial) interest in Maui. However, Todd was, at that point, not particularly active in its own right – a position that was a direct result of the fixed nature of the Maui and Kapuni contracts. Put another way, at that point, Todd had little gas production that it was permitted to market on its own account. However, a direct effect of the Kapuni litigation has been to allow Shell and Todd to actively market 50% of Kapuni production and Todd's relative quiescence has also changed.

As with NGC, AGL and Contact, Todd as sought out positions in the area of gas and electricity convergence. Shell and Todd now supply significant quantities of Kapuni gas to the Kiwi co-generation plant in Taranaki. These activities are in addition to some more direct investments Todd has taken in the electricity industry.

As noted earlier, Todd acquired a cornerstone shareholding in Nova Gas and has, only very recently, indicated an intention to merge Nova Gas with Todd's LPG business. Todd is accordingly now an active participant in the retail gas market.

However, despite over two years having elapsed since Shell and Todd were granted the right to market Kapuni gas, it remains the case that Kapuni gas has not been the source of any significant or large (>5 PJ per annum) gas supply contracts. Kapuni gas must be processed to remove CO₂ and, in order to be delivered to the key marketplaces, must be

transported through the NGC high pressure gas transmission network. Allegations of inflexible contractual terms and inappropriate transmission pricing policies appear to have been a substantial impediment to Kapuni being in a position of competitive gas supply – especially when compared with the position of NGC and Contact with their rights to purchase Maui gas on a delivered basis at any point along the Maui line. An additional constraining influence on Shell and Todd is the undertaking given to the Court during the course of the Kapuni litigation not to market Kapuni gas for electricity generation purposes or for petrochemical contracts – an undertaking that does not extend to supplying gas for co-generation purposes.

Methanex

Under its various Maui gas purchase arrangements with the Crown the entitlement of Methanex to Maui gas supply progressively commences to run down from 2003 as Figure 1 illustrates.

Methanex is a very large consumer of gas, not just from Maui (over 50 PJ per annum) but as well from Kapuni (between 11-14 PJ per annum). Its two plants at Waitara and Motonui are both world class facilities and represent a substantial sunk investment. From the perspective of any gas supplier, Methanex is in some ways an ideal customer because Methanex needs to consume large quantities of gas on a steady basis and preferably over a reasonably long term. However, as Methanex has publicly stated in many different fora and on a number of occasions, it wishes to place itself at the bottom of the cash cost curve of worldwide methanol producers with the result that, as a matter of overall strategy, it has limited itself as to what it is willing to pay for its gas. Methanex remains determined to continue to be competitive

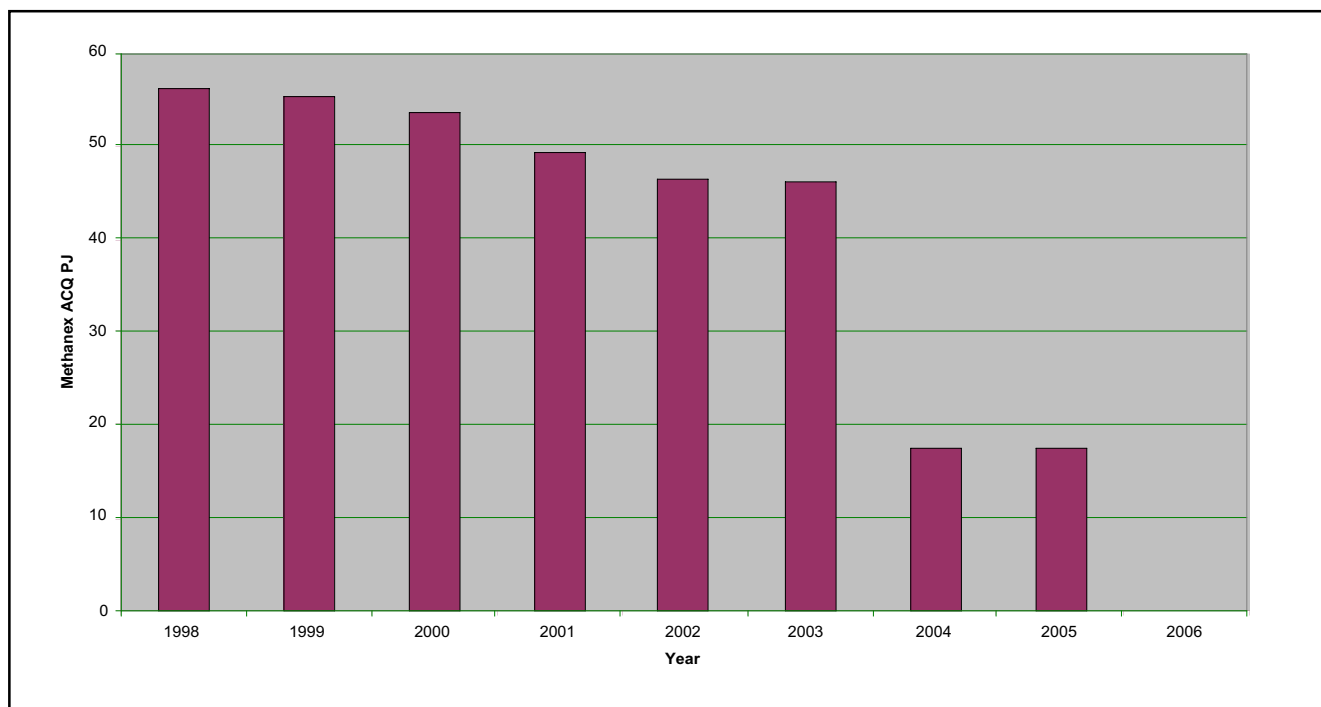


Figure 1: Entitlement of Methanex to Maui gas supply - 1990 contracts.

in the area of international methanol supply and paying high prices for New Zealand gas is not part of its agenda. However, despite these constraints Methanex has been able to secure two new sources of gas supply that will see its plants operate for a little longer namely:

- 25 PJ of gas from NGC; and
- 130 PJ of gas from Contact.

Methanex also continues to obtain quite large quantities of gas (8 PJ pa) from Kapuni.

On the basis of what has been announced it is not clear exactly when gas from Contact and NGC is required to be delivered to Methanex but, given that the agreement with Contact is said to extend to 2008, it is clear that Methanex will be able to continue operating until then.

However, while the new gas supply arrangements with NGC and Contact are significant in New Zealand terms it needs to be borne in mind that they only represent approximately two years gas supply for the two plants and do not address in any way gas supply in the era after Maui.

The challenge for Methanex and potential gas suppliers to Methanex is still to find a large long term source of gas that can be sold at a sufficiently attractive price so as to ensure Methanex continues to receive gas supply in the post-Maui era.

The Maui Mining Companies

The Maui Mining Companies have continued a programme of appraisal drilling and further exploration within the Maui Field. There was considerable hope at the beginning of 1999 that a well in the Maui south region would discover significant new reserves of gas enabling the Maui Mining Companies to sell gas outside the terms of the Maui contract. Unfortunately, the Maui South well was a failure and did not add to Maui gas reserves.

On the subject of Maui reserves, as has been commented upon in previous conferences and as will be the subject of separate papers, the old chestnut of the exact quantity of "Economically Recoverable Reserves" within Maui remains unanswered. There has been no formal redetermination of Maui reserves virtually since deliveries from Maui first commenced. There has been a considerable amount of data exchanged between the interested parties with a view to ensuring a degree of transparency to the calculations that must be acted upon to deduce reserves but no reserves figure settled. The very process of settling that reserves figure, given the different commercial drivers between various consumers of Maui gas (the Crown, NGC, Methanex and Contact) means that it should be no surprise that no formal redetermination process has yet been commenced.

The challenge facing Maui in its declining years is to how to cope with the reality of decreasing delivery entitlements at a time when demand for any form of natural gas is steadily

increasing. One can expect more pressure to come to bear on various parts of the Maui contract in the years ahead.

The oil explorers

Apart from the wonderful news of Swift Energy's oil discovery in South Taranaki and the discovery by Cultus, Shell and Todd of oil at Maari, offshore Taranaki, there has been little else of interest to report in the broader exploration community. Perhaps the main area of interest has been the extensive re-arrangement of interests in the onshore permits within Taranaki and, in the post-Westech discovery on the East Coast, a significant upsurge in interest in that area. However, the recent failures of the Whakatu well in the Hawkes Bay region, NZOG's Hochstetter well and Conoco's deep water well offshore Northland may have dampened enthusiasm somewhat and served as a reminder that oil exploration remains a high risk activity. For all that there have been some new participants to enter the New Zealand market namely EEX New Zealand Limited, Everest Energy Inc, AWE New Zealand Ltd and Gruy LLC.

Plus ca change, plus c'est meme chose

On the basis of the foregoing necessarily general review, we have seen that since March 1998 a number of the major players in New Zealand's upstream gas industry have undergone significant change:

- Contact is no longer a Crown entity and is now a publicly held company with a very large California-based utility, Edison Mission, as a cornerstone shareholder;
- NGC no longer has any connection with FCE but is instead controlled by AGL;
- NGC is rapidly moving into the electricity industry and, following the acquisition of 78% of TransAlta New Zealand Limited, will have more electricity customers than anyone else in New Zealand;
- Enerco no longer exists;
- FCE has refocused on its core assets and, as part of the changes to the Fletcher Challenge Limited letter stock arrangements, FCE can also expect some ownership changes in the next two years;
- Todd Energy is also rapidly moving into gas electricity convergence and seeking to expand its gas trading activities at all levels of the market, wholesale and retail;
- Nova Gas has emerged as a new and aggressive gas retailer which has successfully tackled the transmission pricing regime for local distribution networks.

It was the combined effect of these changes that prompted the subtitle to the paper – Industry Realignment.

Over the last period we have also seen a number of large gas deals concluded such as:

- Contact's sale of a 130 PJ of prepaid gas to Methanex;
- NGC's sale of 25 PJ of prepaid gas to Methanex;
- NGC's commitment to supply 90 PJ of gas to Genesis.

But what is perhaps more interesting is what has **not** happened over the last two years:

- There have been no large long-term gas contracts signed for the period after the end of the Maui contract;
- There have been no new large gas discoveries – Kauhauora notwithstanding. The failure of the Maui South well and the reserves downgrade at Mangahewa may well have dampened some of the optimism that might have been there. Perhaps Pohukura will be that new large gas discovery but it is early days as yet. Certainly nothing has yet been found that is able to match, let alone replace, the delivery capability of Maui.
- Kupe, the perennial bridesmaid of the New Zealand upstream gas sector, remains undeveloped with no development plans announced - again despite the somewhat optimistic statements of various parties with an interest in Kupe.
- Methanex has not secured any long term gas supplies extending after the end of the Maui contract.
- Despite the result of the Kapuni litigation giving Shell and Todd the ability to directly market Kapuni gas, there have been no large new long term sales of Kapuni gas. There have of course been a number of smaller gas contracts. The undertaking by Shell and Todd during the course of the Kapuni trial not to market Kapuni gas to electricity generators or petrochemical utilities is undoubtedly a factor in this.

Accordingly, and to be somewhat biblical about the position, in the end and as it was in the beginning, Maui is still, by far, the largest and most influential source of gas supply in New Zealand – but it is now smaller than it was and getting smaller every day.

In 1996 my paper showed total gas production as in Figure 2.

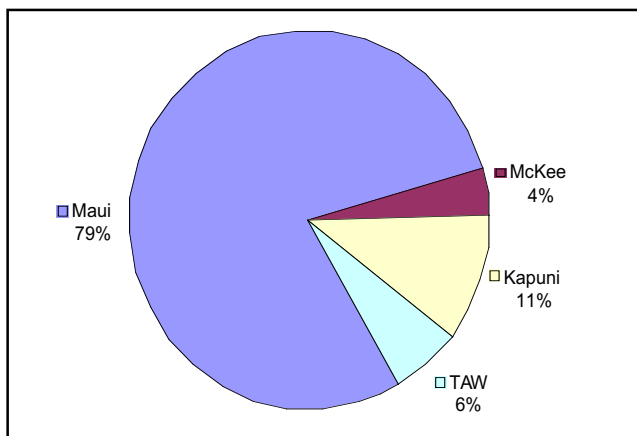


Figure 2: Total gas production by field (1996).

For the year to March 1999 total production is shown in Figure 3.

In short, Maui is still a huge influence in the New Zealand gas scene with the significant increase in Kapuni output the only countervailing influence. The Crown remains, by far, the largest purchaser and trader of gas in New Zealand.

The 1990 contracts by which the Crown has onsold its Maui gas entitlements to each of Contact, NGC and Methanex remain the most important sources of gas supply for each of Contact, NGC and Methanex and their various downstream customers.

Maui gas pricing, and in particular the ability of Maui gas purchasers to buy Maui gas on a delivered basis anywhere along the Maui line, is still the most significant price setting influence in the New Zealand gas market. Indeed, when the large gas transactions referred to above are analysed more closely they appear to have had more to do with management of take or pay positions and how to deal with large balances of prepaid gas rather than wholly new business arrangements. If you like, these transactions represent a rearranging of the deck chairs rather than the building of a new ship.

A prognosis

At the end of my last paper I predicted that the new dynamics in the market place would continue. That has been borne out in practise.

Looking ahead to the next two years it is tolerably clear that at least one or all of the following will occur:

- There will be amounting pressure on various aspects of the Maui contract and the contractual relationships between, on the one hand, the Crown and the MMCs and, on the other hand, the Crown and its purchasers of gas under the 1990 contracts. The over-arching objective the Crown appears to be adopting is little more than a position of hedging its take or pay exposure and avoiding liability however it can. As the contractual pressure continues to mount the Crown is likely to be forced to adopt a more proactive position.

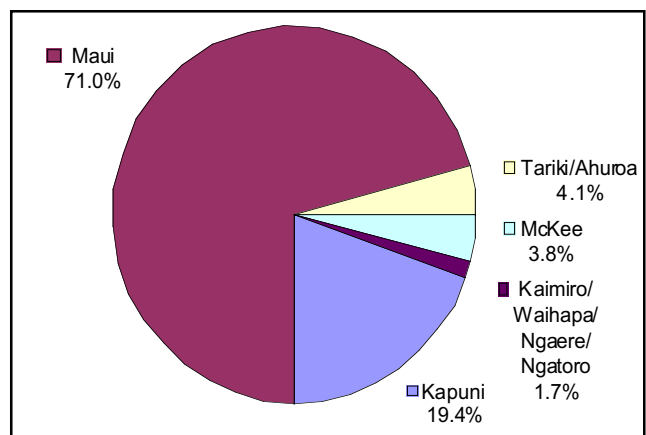


Figure 3: Total gas production by field (March 1999).

- Maui deliverability will increasingly become a major issue and will be one of the leading causes of contractual stress. As delivery entitlements progressively decline it can be expected that the demand will continue at the same level. This can be shown by Figure 4 below of Maui gas delivery entitlement as set out in the Maui gas contract.
 - A result of this declining entitlement path is that there will be an increasing desire on the part of all consumers of Maui gas to take gas at the highest rates they can irrespective of the effect that such levels of take will have on sustainability of deliverability over the longer term.
 - Unless there are substantial new gas discoveries we can anticipate up ward pressure on gas prices especially for contracts extending past the end of Maui. In particular, electricity generators will be under some pressure to secure long term gas supplies for the post-Maui era.
 - NGC's gas transmission pricing policy will also come under increasing pressure as a result of capacity on the Maui line becoming available and the effect of new entrants seeking to introduce gas to the transmission network outside of the Taranaki hub. While we can be reasonably certain that NGC, with the guidance of AGL, will respond in a different way to by-pass threats (as compared to the response of TransAlta and Enerco/Orion in the face of competitive pressures from Nova), nevertheless these commercial pressures are likely to lead to a downward adjustment of NGC's transmission pricing arrangements.
 - The Maui line will be used to transport gas other than Maui gas from new fields to markets north of Taranaki.
 - Finally, and somewhat more dismally, litigation as the stress mounts is more likely than not – indeed as this paper has already noted, litigation is already very much in evidence in various sectors of the upstream industry as the differences between the parties become more intractable.
- All in all we can look forward to interesting times.

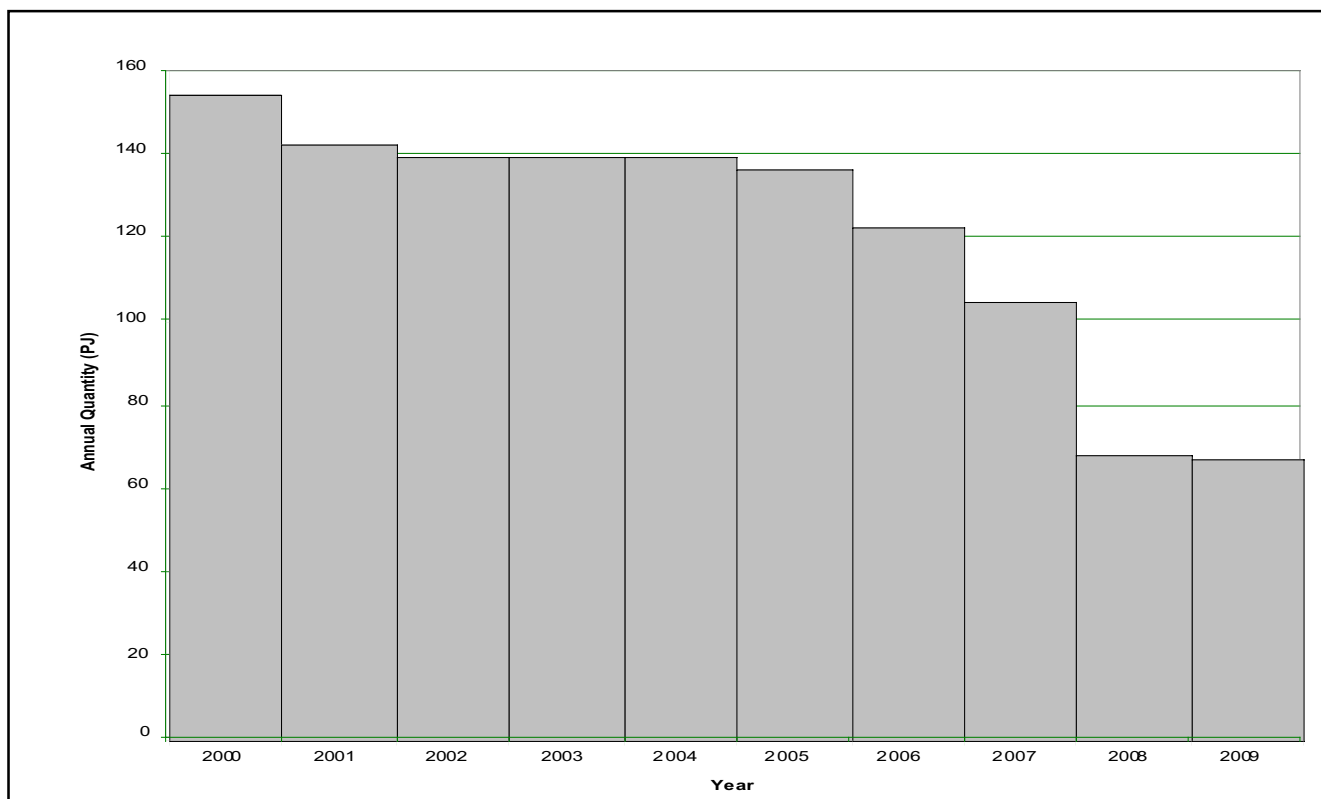


Figure 4: Maui gas contract AQs to contract termination.

Author

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