EDITORIAL

Introduction - OGEL Special Issue on "Changing LNG Markets and Contracts"

Agnieszka Ason

OGEL has a strong track record of building LNG scholarship, starting with the very first OGEL articles published in the early 2000s. In 2006, a Special Feature on LNG, focusing on terminal projects and shipping and edited by Philip Weems and Stéphane Gauducheau, was included in a regular OGEL issue.[1] The first OGEL Special Issue on LNG followed in 2017 and was prepared by Aikaterini Florou and Kim Talus, the OGEL Editor-in-Chief. It covered a wide range of topics from domestic regulatory frameworks to LNG trading and disputes.[2]

The key objective of this OGEL Special Issue on "Changing LNG Markets and Contracts" is to collect insights on the recent developments in the global LNG industry. In December 2019, the COVID-19 outbreak added an unexpected angle to the project.

This Special Issue contains 13 contributions from 23 authors who are based across the globe[3] and bring a wealth of expert knowledge and relevant experience.[4] All contributions are briefly introduced below and can be divided into articles on (i) LNG markets, (ii) LNG contracts, and (iii) book reviews. Several articles discuss the impact of the current COVID-19 pandemic on the LNG industry. We expect, and welcome, further papers to be added as an Addendum.

The Special Issue opens with three articles on LNG markets. Liliana Diaz discusses the role of LNG in Brazil, looking at both LNG import projects and potential exports of pre-salt LNG. Loukia Kopitsa and Anastasis Voskos assess the current status of the Greek LNG market and describe proposals for new LNG facilities in Greece, which include small-scale LNG (ssLNG). Ana Stanić and Sohbet Karbuz focus on the region of the Eastern Mediterranean (East Med) and identify the key commercial challenges facing East Med gas production and LNG exports.

The next eight articles discuss LNG contracts, with the first two articles looking at novel LNG contract structures. Ruchdi Maalouf discusses the growing importance of portfolio sale and purchase agreements (portfolio SPAs) in the context of LNG portfolio optimization and LNG marketing. Kirk Kinnear submits an idea of ‘Brentrification’ - modifying the Brent crude oil model to create a global LNG pricing benchmark with standardized contract terms.

Three articles address LNG price reviews. Konstantin Christie, Mino Han and Leonid Shmatenko examine the interplay between price review, force majeure, change of circumstances and hardship clauses, including in the context of the current COVID-19 crisis. Steven Finizio, John Trenor
and Jared Tan discuss trends in Asian LNG supply contracts and pricing disputes and identify factors that may lead to an increase in LNG price reviews and arbitrations in the Asia Pacific region. Andrej Pustišek, Christoph Merkel and Michael Karasz formulate lessons learned over decades of gas and LNG price reviews and arbitrations in Continental Europe which may be relevant to Asian price reviews.

The last three articles focus on non-price terms in LNG contracts. Kim Talus, Scott Looper and Luke Burns examine the past, present and future of take-or-pay agreements, including 'after COVID-19' and in relation to alternatives like ship-or-pay. James Atkin discusses destination flexibility in LNG sales contracts and highlights the role of third-party access in the process of achieving global LNG destination flexibility. Luis Agosti and Boaz Moselle describe several categories of LNG disputes ‘beyond price reviews’ and address potential force majeure disputes arising from the coronavirus outbreak.


The editor would like to thank all the contributors for their fascinating articles, Kim Talus for the opportunity to edit this Special Issue, and the OGEL publisher for their excellent support.

Kingston, May 2020


[4] All Author profiles can be found on the OGEL website.

Liquefied Natural Gas (LNG)

LNG Markets

Fate and Reform Catalyze Expansion of the Brazilian Natural Gas Market and Open Up Opportunities to LNG

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Abstract

Brazil is rising as a potentially large natural gas player thanks to both fate and reform. Recent “closer to shore” significant deep-water discoveries add to well-publicized offshore potential in the pre-salt area. These less logistically challenging discoveries coupled with Petrobras’ increasing retrenchment along the value chain, herald the arrival of a vibrant and competitive domestic market. Increased associated offshore production will even hold the promise of opening the export market. While liberalization is still a work in progress, recent efforts to overhaul the market design and enhance competition have paved the way for further market expansion.

This article details what those efforts are and why they gained momentum. The development of domestic demand beyond coastal states and in foundational sectors such as power generation, where LNG imports are to play a key role in the short to medium term, are essential for Brazil to fulfill its natural gas potential.

γ Full article here

Greek LNG Market: Current Status and Future Developments

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Abstract

Greece commenced LNG imports in 2000, and since then the Greek LNG market has grown exponentially. LNG plays a crucial role in the country’s transition to clean energy. The growth of its import capacity is expected to continue well into the 2020s. The key objective of this article is to offer an overview of the Greek LNG market, addressing its current status and future developments.

In particular, the article identifies the main Greek LNG projects and explains the regulatory framework for LNG facilities. It also discusses the prospects and main steps taken for the creation of a gas hub in Greece.
The article concludes that, primarily due to significant investments in both LNG and pipeline projects and the launch of a gas exchange, Greece is likely to become an important gas hub in Southeast Europe in the coming years.

Full article here

The Commercial Challenges Facing Eastern Mediterranean Gas

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E&A Law Limited

Dr. Sohbet Karbuz
Bilkent University Energy Policy Research Center

Introduction

The region of the Eastern Mediterranean holds enormous natural gas reserves. This has sparked interest from international energy majors and made the region one of the favourites for future gas exploration. However, in order to exploit and export these resources numerous technical and commercial, security, legal and political challenges need to be overcome.

Focussing on the commercial challenges which will need to be overcome for the region to become a significant producer and exporter of gas this article is divided in five sections. Section 1 assesses the region’s natural gas resource endowment and shows that it is comparable to that of the North Sea. Section 2 provides a brief overview of gas exploration and production activities in the region to date and Section 3 discusses the possible routes for the export of East-Med gas. Section 4 highlights the key commercial challenges facing gas production in the region. Finally, Section 5 concludes that, although Turkey would be the best outlet for the gas in the region, there are legal and political obstacles that stand in the way of securing the future of gas production in the Eastern Mediterranean.

Full article here

LNG Contracts

The Portfolio SPA: A Tool of Portfolio Marketing

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Abstract

In order to discuss portfolio SPAs, it is necessary first to clarify the terminology used; a portfolio SPA is a type of an LNG SPA and a form of portfolio sale, the other being a multi-cargo sale under a master LNG SPA. Portfolio sales are conducted as part of portfolio marketing by a portfolio operator, or for LNG portfolio optimization by a party with an LNG portfolio.

Historically, the LNG industry has evolved from a small club of producers and importers, to a complex industry with different layers of parties involved. As spot and short-term markets grew, portfolio sales became more sophisticated, up to the point where portfolio marketing has become the key tool for some of the major LNG sellers.

Because of its characteristics, the portfolio SPA is not a variation of the project SPA. Key differences appear in particular in language relating to the source of LNG, force majeure, certain operational clauses, failures to deliver and to take, specifications, contract duration and termination for prolonged force majeure.

This paper discusses the portfolio sale and purchase agreement (portfolio SPA) in the context of LNG portfolio optimization and LNG marketing. After providing an overview of terminology and some historical background, the growing importance of portfolio SPAs will be examined with a focus on typical clauses.

Full article here

Brentrification: Modifying the Brent Crude Oil Model to Create a Global LNG Pricing Benchmark with Standardized Contract Terms

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Executive Summary

Cleaner burning natural gas is gaining global energy market share and will likely become the fossil fuel bridge to a renewable energy future. To satisfy growing gas demand in regions beyond the reach of producer pipelines, increasing volumes are being transported as liquefied natural gas (LNG) aboard super-cooled tankers. Worldwide LNG processing capacity is expanding rapidly, yet the marketplace where the physical cargoes trade reflects an earlier time.

The lack of a transparent future LNG price discovery mechanism and standardized contract terms for trading cargoes is a growing problem. When facing similar challenges 30 years-ago, the oil industry responded by launching benchmark contracts for Brent crude cargo and futures trading. This paper will explain why Brentrification is the solution to streamline LNG trade and establish highly liquid and transparent global natural gas benchmark contracts. Details of the futures, physical forward and short-dated swap instruments used to generate the benchmark will be presented, and the patented GPD process which seamlessly links the standardized contracts will be introduced.

Full article here
Executive Summary

This article discusses the impact of recent developments in the global LNG trade on the key terms in long-term LNG supply contracts (LNG SPAs) in different regions, particularly in Asia. After outlining the most salient clauses of LNG SPAs, the authors provide an analysis of several ways by which parties to such contracts anticipate and confront some of the risks associated with the sale and purchase of LNG, based on the price review clause mechanisms and the concepts of force majeure, change of circumstances (and hardship). The article then analyses these mechanisms and concludes with (or: offers) certain practical considerations for negotiators of such contracts from the perspective of the authors’ disputes resolution practice. Finally, it highlights some topical issues with respect to the force majeure declarations in China following the COVID-19 crisis.

Full article here

Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region

Steven Finizio
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Jared Tan

Wilmer Cutler Pickering Hale and Dorr LLP

Introduction

The Asia Pacific region includes the largest import markets for LNG in the world, as well as some of the world’s leading exporters. In many countries in the Asia Pacific region, demand for LNG is increasing because of growing energy needs and greener energy policies, among other reasons. At the same time, the landscape of the gas markets in the Asia Pacific region is changing. State-owned or incumbent gas companies and electricity utilities continue to import the majority of LNG, but new entrants have also emerged as a result of the steps taken to liberalize these gas markets in various countries in the region.

Although long-term LNG supply contracts have historically been a foundation of the industry and continue to play a defining role in LNG trade in the region, the volume of short-term and spot trades is increasing each year, presenting opportunities and challenges for sellers and buyers. Long-term contracts in the Asia Pacific region have historically contained oil-indexed price formulas, but the inclusion of additional contract price elements, including different indexes, has grown over time, as contract price formation in the Asia Pacific region evolves. Similarly, the clauses agreed by the parties to long-term LNG contracts in the Asia Pacific region to review and potentially revise the contract price formulas have evolved. These and other developments in the region, as well as the effects of dropping oil prices and the COVID-19 pandemic, may contribute to a continued increase in the number of price reviews and even arbitrations to resolve disputes between parties on pricing terms.

This article provides an overview of LNG trade in the Asia Pacific region, describes different types of LNG supply contracts and transactions, outlines key terms in long-term supply contracts, describes price formation mechanisms in LNG contracts, and then focuses on price review provisions and pricing disputes under long-term LNG supply contracts in the region. It concludes with a discussion of the future of price reviews in the Asia Pacific region.

Full article here

Natural Gas Price Reviews: Commercial Lessons Learned in Continental Europe

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Dr. Christoph Merkel
Merkel Energy GmbH

Michael Karasz
THE ENERGY HOUSE GmbH

Executive Summary

Long-term natural gas supply contracts (delivered by pipeline or LNG) often have a value of several billions of US dollars. Price clauses in such contracts are thus of particular importance. However, they may require additional amendments, in particular if the value of natural gas in the market is no longer appropriately reflected by the contract price. To this end, parties to long-term gas supply contracts typically include price review clauses allowing each party to request a price adjustment.

In the past decades, price review clauses have been applied successfully in European contracts, in particular using the common three-year interval. Based on these clauses, parties have renegotiated prices and eventually transferred the case to arbitration or ordinary courts. In some renegotiations, parties also agreed to amend other non-price terms in their contracts. Starting in the 2000s, more and more cases have been brought to arbitration.

Arbitral tribunals worked fast and efficiently but the costs were not negligible. The main consequence of renegotiations and arbitral decisions was that prices of many long-term gas sales agreements have been changed from oil
indexation to gas-hub indexation. European experience in price review renegotiation and arbitration may be useful in other markets - to avoid pitfalls and achieve the desired results.

Full article here

Long-Term Take-or-Pay Agreements in Natural Gas Industry: Past, Present and Future

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Introduction

Many large natural gas projects, including LNG projects, are financed on the basis of long-term contracts containing take-or-pay provisions. These contracts help provide the backbone of the financing structure for projects with high capital costs and long payback periods where financing is tied to project revenues because the promise of de-risked long-term revenues on the basis of such take-or-pay provisions comforts investors. The take-or-pay provisions in these long-term contracts are intended to mitigate pricing and demand volatility as well as other market risks by setting a "floor" - both in terms of price and volumes - for the offtake of gas by the counterparty-customer of such a project. Today, the market uncertainties created by COVID-19, and the related negative demand shock, are one example of a situation where take-or-pay provisions in long-term contracts shore-up the continued viability of debt service of certain ongoing LNG or gas projects to existing lenders in the face of such a situation.

A take-or-pay clause in a long-term LNG or gas contract typically obligates the buyer of LNG or gas to take and pay for such LNG or gas, or otherwise pay an agreed price on a heat-content or volumetric basis for any LNG or gas not taken. Take-or-pay obligations are typically pegged to a daily, monthly, quarterly or annual timeframe, but is also sometimes on a cargo-by-cargo basis in the LNG context. Take-or-pay clauses are typically not absolute and may include flexibility mechanisms that allow the buyer to adjust the contracted volume or quantity in a limited way. For example, this flexibility may obligate the buyer to only 70% to 90% of the applicable contract quantity. Take-or-pay clauses often also include certain agreed situations where the buyer is excused from its performance of the take-or-pay obligation. These may include force majeure, non-delivered gas volumes (where the seller is responsible for the non-delivery) and gas or LNG refused for quality reasons.

Full article here

Destination Flexibility in LNG Sales Contracts

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Abstract

The speed with which the LNG market has evolved is remarkable. It is perhaps unsurprising that LNG sales contracts executed in the late 1990’s did not anticipate such changes. However, as the LNG market continues to evolve, destination flexibility is now a key issue. In this article we will examine how the key gas consuming markets of Europe and Japan have sought to promote destination flexibility in LNG sales, and whether such efforts are likely to achieve a global, flexible and transparent LNG market.

Full article here

LNG Disputes Beyond Price Reviews

Luis Agosti
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Compass Lexecon

Abstract

(Note: Will be added shortly.) In this article we describe several types of commercial disputes in liquified natural gas ("LNG") long-term contracts that are not directly related to the more common price review type disputes. LNG trade has increased at double digits in the last three years, and LNG markets have become increasingly complex over the last decade, with more diverse market players and more varied forms of contractual arrangements.

One notable development has been the growth of spot and short-term LNG trading. As of 2019, spot and short-term contracts made up 34% of all LNG trade, up from less than 20% in 2010. However the majority of LNG is still traded under long-term contracts indexed to oil or to US hub prices. The difference between long-term and short-term prices at times gives rise to large arbitrage opportunities. In our experience many LNG disputes arise precisely because buyers and sellers cannot agree how to allocate the value of such arbitrages.

After a brief introduction to LNG markets and contracts, we describe in this article some (anonymised) examples of such disputes. Finally, we also discuss potential disputes related to force majeure events arising from the coronavirus outbreak as some LNG buyers in China have notified force majeure that have been rejected by sellers, leading potentially to a new wave of disputes.

Footnotes omitted from this introduction.

Full article here

Dr. Kim Talus
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Introduction

This book review will not provide the "normal" outline of the book with some discussion on the contents of each chapter. Instead it will highlight certain parts of the discussion, which at least the author of this book review found to be most interesting. Admittedly, this means that the selection of issues raised reflect primarily the interests of this author, not the authors of the book itself.


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Introduction

The volume edited by James Freeman and Mark Levy and published in April 2020 came as a much anticipated Easter present for anyone with a professional interest in gas price reviews. The book is a sequel to the highly regarded, and practically speaking 'must-have', first edition of the Gas Price Arbitrations handbook dating back to 2014 and edited by Mark Levy. The second edition, now addressing both Gas and LNG Price Arbitrations, rightly anticipates the rise of LNG pricing disputes in the coming years. Unexpectedly, the volume was published amidst the oil price war and the coronavirus pandemic. The new edition could not have been more timely considering that gas and LNG price review arbitrations are set to proliferate in response to recent market events.

OGEL 4 (2017) – Liquefied Natural Gas (LNG)
OGEL 2 (2017) – Brexit
OGEL 1 (2017) – Oil and Gas Law and Policy in West Africa

OGEL 4 (2016) – Regular issue
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