LNG SPAs

Contracting in an unpredictable world

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OVERVIEW

Table 3.1 • LNG contracts' evolution

	ACQ (bcm/y)	Average length (years)	Price indexation		Destination clause		Shipping mode	
LNG contracts signed until 2009	1.75	18	Oil-linked Gas to gas	76.0% 24.0%	Fixed Flexible	67.0% 33.0%	DES FOB	59.0% 41.0%
LNG contracts signed since 2010	1.55	13	Oil-linked Gas to gas	49.5% 50.5%	Fixed Flexible	49.0% 51.0%	DES FOB	46.0% 54.0%

Note: y = year; FOB = free on board.

QUANTITY

- Generally smaller quantities for individual contracts - buyers have increasingly diverse sources of supply and sellers have multiple offtake options

- Take-or-pay still standard in long term agreements

- Surplus quantities and upward/downward flexibility (buyer or seller)

  – giving the buyer a right to available surplus quantities above the ACQ or to increase or decrease the ACQ from year to year may relieve ToP pressure and allow greater flexibility but that flexibility comes at a price

  – sellers may also want their own upward or downward flexibility or to sell surplus quantities elsewhere

TERM

- Shorter terms and spot sales

- Why?
  - **Sellers** - different sources of finance, developing own marketing capability and get a better price for shorter term deals (some going for mixed arrangements)
  - **Buyers** - new classes of buyers including traders
  - **Market** factors - oversupply, price diversity between markets (arbitrage opportunities)

- Terms will often be extendable with a clear option to extend on notice or extension on terms to be agreed - N.B. the latter is only an ‘agreement to agree’ and does not create an enforceable right

PRICE

- **Price formulas**
  - Movement away from oil linkage in traditional regional markets where buyers are now pushing for entirely gas hub indexed pricing (e.g. National Balancing Point (NBP), or Title Transfer Facility (TTF))
  - Mix of pricing offered in some cases e.g. first 5 years hub indexed and the rest oil or a hybrid formula combining the two
  - Where oil is offered, the price percentage is getting lower
  - Ceilings and floors - traditional utility buyers also de-risk purchasing by eliminating floor price and a ceiling may be put on oil prices
  - Sellers may accept a lower price where buyer financing offered
  - Rise of FSRUs has opened up new markets including Pakistan, Jordan, Egypt and Ghana - more Middle Eastern markets are expected to follow
- **Price reopeners**
  - Mechanism for parties to review the LNG price formula triggered by the occurrence of a scheduled event (e.g. every 5 years) or the occurrence of one or more subjective or objective events
  - Relevant to long term contracts particularly with an oil-linked price to de-risk
  - These clauses are frequently litigated indicating the importance of clear drafting and specifying the parameters of any decision reached by an independent third party if the parties can’t agree – e.g. Gas Natural v Atlantic LNG

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DESTINATION

- A seller may want to prevent a buyer from being able to deliver cargoes to other destinations (e.g. Qatar banning FOB offtakers from delivering to its own long term markets in Asia) and the destination may be limited to a defined geographical area or areas

- Sellers may offer buyers the right to divert outside of these markets but, where they do so, any mark-up on the price received at the alternative destination may be split between the buyer and the seller

- There may also be more general restrictions on destination to avoid LNG being sold into e.g. sanctioned regimes

- Destination restrictions and related issues of profit-sharing, re-exporting, and source flexibility under long-term LNG SPAs have been subject to recent disputes and investigations by the European Commission, who have ruled that such provisions are not permitted in contracts for the sale of LNG to European buyers - a trend now extending to Asia (see recent JFTC ruling)

SUPERVENING EVENTS – FORCE MAJEURE

- Relieves party prevented from performing its obligations, by circumstances beyond its control, from liability for failure to perform
- Could affect gas supply to LNG facilities – e.g. BG in Egypt, Shell/Eni in Nigeria or deliveries from LNG facilities themselves e.g. Yemen LNG
- Contractual rights and also subject to provisions of local law (e.g. Qatari Civil Code gives wide discretion to the courts to look beyond the express terms of the contract)
- Ensure force majeure provisions are aligned in up and downstream agreements to minimise exposure and carefully negotiate the list of events which should be relevant to the contract

18 FORCE MAJEURE

18.1 Relief from Liability

Subject to Clause 19.3, the Seller or the Buyer shall be relieved from liability for failing to perform any of its obligations, in whole or in part, or for otherwise being in breach of any covenant or undertaking hereunder to the extent that the performance of such obligation is prevented, impeded or delayed by an occurrence of an event of Force Majeure.

18.2 Force Majeure Events

"**Force Majeure**" means any of the events listed below, to the extent that such event is beyond the reasonable control of the Party affected thereby, and any other act, event or circumstance, or combination of acts, events or circumstances, which is beyond the reasonable control of the Party affected thereby, or the effects of which could not be prevented or overcome by such Party taking all reasonable steps to minimize such effects, acting as a Reasonable and Prudent Operator:

18.2.1 with respect to the Seller's Facilities:

(a) fire, flood, atmospheric disturbance, lightning, storm, typhoon, tornado, earthquake, landslide, tsunami, tempest, soil erosion, subsidence, washout or epidemic and quarantine restrictions, shipwreck, navigational and maritime perils or other acts of God;

(b) war (whether declared or undeclared), riot, civil war, blockade, insurrection, acts of public enemies, civil or military disturbances, acts of terrorism (or serious threat thereof), invasion, embargo, trade sanctions, revolution, rebellion, sabotage or piracy;

(c) radioactive contamination or ionising radiation;

(d) strike, lockout or other industrial disturbances;

(e) loss of or damage to or failure of any of the Seller's Facilities;

(f) loss of or damage to or failure of the Natural Gas reservoirs, or the depletion of the proved remaining recoverable reserves in the Gas Supply Area that can economically be produced for purposes of this Agreement; or

(g) acts of governments, or compliance with such acts, that directly affect the Seller's ability to perform its obligations hereunder, but excluding any such acts that are discriminatory towards the Buyer (with respect to governmental bodies or agencies, "acts" include the promulgation of laws, rules, regulations, decrees or orders or other exercise of a Competent Authority); and

18.2.4 The following events or circumstances shall not constitute Force Majeure:

(a) financial hardship or the inability of a Party, and/or any Affiliate of a Party, to make a profit or achieve a satisfactory rate of return resulting from performance or failure to perform its obligations under this Agreement; or

(b) failure or inability to pay the Contract Price or any other sum due and payable under this Agreement.

18.2.5 For purposes of this Clause 18.2, the words "beyond the reasonable control of the Party affected" shall be interpreted in accordance with applicable law, but in no event shall these words be interpreted to impose a standard of care on the Party affected higher than that of a Reasonable and Prudent Operator.

SUPERVENING EVENTS - TERMINATION

Termination during performance

- by agreement with consideration/by deed
- **contractual** - via an express termination clause
- **common law -** the remedy for
  - frustration (covered by FM in a contract)
  - some breaches of contract (including fundamental/repudiatory breach)

Steps to terminating a contract: guidance

1. Assess the **contractual** and **common law** grounds for termination, consider statutory implications and foreign law impact
2. Consider the practical and procedural implications including transitional arrangements and duties on termination. What alternative sources of gas/LNG are available (if terminating party is the buyer) and what alternative customers are available (if terminating party is the seller). Would affirmation or trying to renegotiate the contract be more profitable in the long term?
3. Comply with any procedural requirements under a contractual right or at common law e.g. notice requirements
4. Document the grounds and process of termination clearly
5. Continue to observe on ongoing duties following termination

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24 TERMINATION

24.1 Events of Default

The following events shall each, in respect of a Party, constitute an "**Event of Default**" (unless such event is due to (i) Force Majeure or (ii) a breach or default of the other Party):

(a) a material breach of this Agreement by a Party which breach is not remedied within sixty (60) days after notice from the other Party, stating the nature of the material breach and that it is continuing, and demanding remedy;

(b) a failure by the Buyer to pay any amounts due in respect of LNG delivered to the Buyer or not taken by the Buyer under this Agreement within ten (10) Business Days of the Due Date for payment;

(c) if, in the event the Seller draws down on the Standby Letter of Credit, the Buyer fails to restore the Standby Letter of Credit within seven (7) Banking Days;

(d) any institution involved in supporting the Standby Letter of Credit falls below the Acceptable Credit Rating; or

(e) Insolvency of a Party.

SUPERVENING EVENTS – DISPUTE RESOLUTION

- Resolution by arbitration under established rules (e.g. UNCITRAL, LCIA, ICSID)
- Expert determination for technical issues
- Provisions governing e.g. the appointment of arbitrators and waiver of sovereign immunity
- Other issues to think about
  - New York Convention/BIT protection
  - Domestic and international laws (e.g. UN Convention on Contracts for the International Sale of Goods)
  - WTO

CONCLUSION

- Consider the numerous contractual mechanisms used to protect sellers and buyers from gradual changes in the market and more abrupt supervening events
- Model the contract against a range of circumstances
- Ensure that drafting stands up to scrutiny