

POSSIBLE IMPLICATION ON DESTINATION CLAUSE REMOVAL FROM LNG CONTRACTS IN ASIA-PACIFIC

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Overview

Asia-Pacific economies are the major LNG buyers in the world. Japan, South Korea, and Chinese Taipei are the main consumers for the past decades in the region. The LNG market has been further intensified with rising demand from China and India. As LNG trade is projected to continue to increase in the future, the LNG market is expected to be more robust.

To create a more robust and liquid LNG market, many gas market experts agreed removing destination clause or territorial restrictions is one of the key factors. In the past, destination clause helps to guarantee the financing of large initial investment for the producers. For buyers, it helps to ensure stable supply although it limits the ability of LNG buyers to optimize their supply arrangements over time.

In June 2017, Japan Fair Trade Commission (JFTC) released a report Survey on LNG Trades: Ensuring of fair competition in LNG market. The JFTC found that most LNG contracts heading towards Japan have destination clauses which limit the ability of the buyers to freely resell the cargoes to third-party acquired under the contract. However, other LNG importers such as Korea, China, and Chinese Taipei are yet to be seen to make the same move as Japan did. Among factors that may contribute to the “wait and see” approach of these economies are the supply security and lack of enthusiasm to engage as LNG reseller. As for producer, the destination clause is a way to limit competition in the market as letting buyers become resellers means more competitors in the market.

Methods

The main objective of this study is to look into the possible effect of removing/limiting destination on LNG pricing, the creation of gas/LNG hub in Asia and to some extent the supply security for importers. On top of that, this paper will touch lightly on the possibilities of the LNG consumer in removing such clauses in their future contracts and the effect on their future supply continuity.

The study will look into the past cases such as in EU for literature review, data analysis based on past price movement that may happened due to removal of destination clause, as well as interviews with gas experts from Japan, Chinese Taipei, Korea and China (buyers group) as well as Malaysia and possibly Australia (producers group).

Besides literature review and interviews, this study will utilise the results of trade projections from APEC Energy Demand and Supply Outlook 7th Edition which is expected to be released in early 2019.

Results

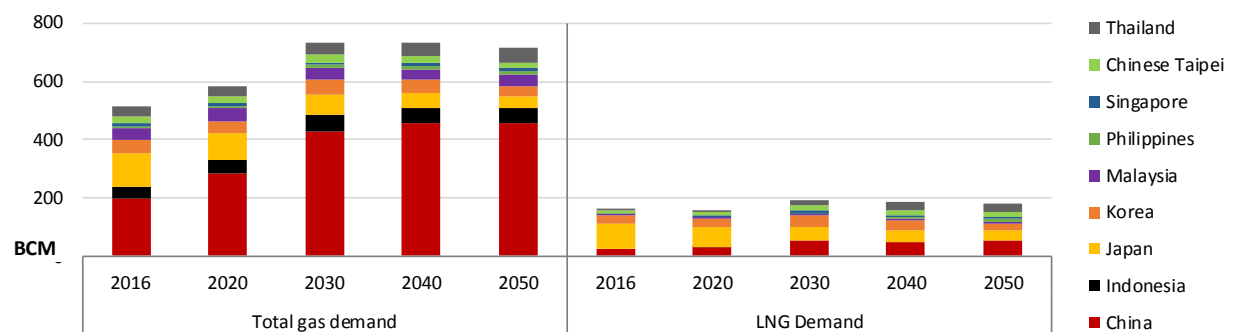
The results will look at the price changes in Europe and Asia whenever the issues of destination clause or territorial restriction were solved by competition commission in the respective area. The creation of LNG hub depends on

various factors rather than destination clause alone. Therefore, this study will examine further Asia's gas hub creation and its correlation to destination clause. The results will provide insights from interviews that have been conducted.

In 2016, APERC and IEEJ released a publication *LNG in Asia-Pacific: Favoring trade and rational market development*. This publication listed three main challenges to LNG trade and 15 key recommendations to address the challenges. Three of the recommendations are related to destination clause removal: steer structural shift in the natural gas and energy industries, explore alternative LNG business models, advance new LNG contract features.

On the other hand, by 2050, gas demand in 9 Asia Pacific economies is projected to increase by nearly 40% from 2016 level. Gas demand in China will be more than double in 2050, of which 63% of the demand will be supplied by local production, followed LNG imports at 27% and pipeline gas at 10%. South-East Asia is projected to become the frontier destination for LNG exporters due to higher LNG demand as gas production decreased, particularly in Indonesia, Malaysia, and Thailand. The Philippines will become one of the LNG importers in 2021.

Figure 1: Gas and LNG demand in selected Asia-Pacific economies (preliminary results), 2016-2050



Source: APERC Analysis

Conclusions

Based on preliminary findings, the study found that some LNG importers are not so keen to remove the destination clause from their contracts due to supply security reason. On the other hand, most producers are open to make contract changes as requested by the consumer, provided that their initial investment in building LNG terminal are covered (Reuters, 2017).

As total gas demand is projected to increase, it will help producers and consumers to strike a balance between securing markets and market flexibility, so that buyers can ensure the investment of liquefaction terminal can be recouped, while buyers are not forced to take LNG cargo when it is not needed and able to resell it to third parties.

References

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