Japan leads global market away from LNG destination restrictions

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The world’s largest LNG importer has decided to end destination restrictions for LNG cargoes in a move that industry observers said will help push the global market to become more liquid.

The Japan Fair Trade Commission recently decided that contract clauses that prevent Japanese buyers from reselling LNG cargoes violate the country’s antitrust laws. Japan has signed up for unprecedented volumes of LNG since the 2011 meltdown of the Fukushima Daiichi nuclear power plant, but as the country works to restart its nuclear fleet, LNG buyers want to be able to send excess cargoes elsewhere.

Language in contracts signed with some major LNG suppliers, like Qatar and Australia, has kept Japanese buyers from reselling those volumes.

“Qatar did this with Japan because Qatar closely controlled its demand,” said Susan Sakmar, a visiting professor at the University of Houston Law Center and author of Energy for the 21st Century: Opportunities and Challenges for Liquefied Natural Gas. “They don’t want anyone else to get the arbitrage opportunity because it erodes the pricing power.”

The U.S. LNG industry, on the other hand, offers buyers such an opportunity. Most contracts with U.S. LNG companies give the reigns to offtakers as soon as the liquid fuel is loaded onto a tanker. “It’s a much simpler contract and it gives the arbitrage opportunity to the buyer,” Sakmar said in a June 28 interview.

With this more flexible contract, if Japan’s market has too much LNG, the buyer can resell its volumes to any other country with access to an import terminal, pocketing any profit on the deal. Japanese buyers have committed to long-term offtake from the Freeport, Cameron and Cove Point LNG export projects under construction in the U.S.

Japan’s decision to move away from destination restrictions was widely expected by the industry, though
there was the possibility Japan’s FTC could have taken a harsher stance by requiring existing contracts be renegotiated to allow for resales.

“They took a relatively moderate approach by only requiring the removal of [destination clauses] going forward, rather than in all existing contracts, which would have been really disruptive,” said David Goldwyn, a former U.S. Department of State special envoy and president of the energy consulting firm Goldwyn Global Strategies.

Qatar will ultimately oblige, Goldwyn predicted, offering destination-free LNG to Japan in contracts that are up for renewal over the next five years. “I think they realize now with the U.S. and Australia rising that they’re in a market-share battle,” he said. “I don’t think they would want to cede that market.”

And with the market’s biggest players changing the way LNG is bought and sold, other buyers will likely make similar demands. “The trend is irrevocable,” Goldwyn said. “In 10 years, if not five years, there will be no destination restrictions.”

That shift benefits the market as a whole, Sakmar and Goldwyn said. With more liquidity in the market, new buyers may be convinced to start importing LNG.

“Ultimately this is good for every LNG seller, because the key challenge that all LNG sellers face before 2020 to 2022 is adequacy of demand,” Goldwyn said. “The more you lower the cost of entry into the LNG market, the more LNG customers you’re going to have.”

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