

# THE RUSSIA – UKRAINE CONFLICT: IMPACT ON ENERGY SECURITY IN ASIA

**It can be difficult to imagine how strongly events in Russia and Ukraine could impact on energy markets in Asia. The reality, however, is that the world's energy markets are so globalised and regionally interlinked that even mildly significant changes in one region can have a huge effect in another.**

## Context

A number of background factors come into play here. Many countries – including in Asia - have sought recently to move away from burning low net calorific value energy coal as the core of their national energy supply. This is for a number of reasons, including better air quality experienced during COVID lockdowns; the weight of nationally determined contributions for greenhouse gas emissions reductions under the Paris Agreement; and the challenges now associated with seeking regulatory approvals or financing for coal production projects.

Under its One Belt, One Road project, the PRC had been incredibly active in constructing coal-fired power stations along the land belt, in nations such as Pakistan and Bangladesh. However, some of those states began to turn their backs on the new power stations almost immediately. Pakistan and Bangladesh recently vowed to join other Asian nations such as Japan, Korea and Taiwan in moving away from coal as a core energy source and to increase their use of alternative energy sources such as liquefied natural gas (LNG). As a result, the PRC changed tack and indicated last year that it would not construct any further coal-fired power stations abroad, representing a significant departure from its previous long-term strategy.

Whilst also a hydrocarbon fossil fuel which is certainly responsible for the generation of greenhouse gases in its production, transportation, storage and consumption. LNG is nonetheless significantly less environmentally unfriendly than older generation fuels such as coal or oil. In addition, recent technological developments (particularly in respect of floating storage and regasification units, or FSRUs) have considerably reduced the cost of installing technically complex LNG receiving terminal infrastructure. These factors have led to LNG becoming the 'interim' fuel of choice for energy transition purposes in Asia, and beyond.

It is now widely anticipated that LNG will continue to bridge the gap between 'dirty' hydrocarbons and 'clean' energy sources that are not yet sufficiently advanced to meet global energy requirements. This transitional role looks likely to last – by design or by necessity - for many years to come, as borne out in practice by many Asian nations including Pakistan, Thailand, Sri Lanka and the Philippines looking to construct new complex and expensive LNG receiving facilities to alter their national energy mix going forward. This can only reasonably be viewed as a medium to long term investment strategy, given that such facilities cost hundreds of millions to billions of dollars to construct or assemble.

## Impact of the Russia-Ukraine conflict

Against this backdrop, there are many ways in which the Russia-Ukraine conflict has had a significant impact on energy security challenges in Asia. We consider a few below.

- Russia was widely anticipated to be one of the world's largest future sources of production and supply of LNG. Global sanctions imposed on Russia have had a significant effect on its technical and financial ability to proceed with the construction and implementation of scheduled gas liquefaction projects.
- While many Asian states have not necessarily implemented energy sanctions against Russia themselves, many other states, or blocks such as the EU, have. This has had a significant impact on parties' ability to either produce or lift LNG cargoes in Russia, as well as on the construction of liquefaction facilities. Such processes are complex and may well require the involvement of third parties that are subject to sanctions, including international survey companies; vessel owners and operators; and banks necessary for the establishment of the high value security

instruments commonly used in international LNG sale and purchase. As such, even where Asian parties are legally free and clear from applicable sanctions and want to lift Russian cargoes, doing so is not necessarily that simple.

- Some Asian market participants are struggling with the potential reputational impact of continuing to purchase Russian LNG, or of participating in Russian upstream LNG projects. The impact on those projects of the Russia – Ukraine conflict is still playing out but as a minimum, intended purchasers from them, or parties retaining equity stakes in them, may be subject to significant scrutiny from the international community and risk a potential reputational impact or, worse, international counterparty boycotts, or sanctions breaches. It is still too early to assess the full effects of this situation; time will tell.
- Europe is now diversifying its own energy mix and moving away from what has been shown to be a significant overdependence on Russian pipeline gas. This is likely to involve the construction of new LNG receiving terminals (including many FSRUs) across coastal Europe, capable of receiving LNG shipments from North Africa, the USA, the Middle East, or further afield.

In simple terms, all this (and more) has led to a scramble for LNG. This is most obviously reflected in the market price of LNG, which has rocketed, with spot prices rising more than 1,800% in the last 18 months. Asian states that were previously heavily reliant on coal and oil are looking to sign up to long term LNG sale and purchase arrangements. Europe is looking to do the same. There is potential for a major energy security issue to arise for many Asian states, in circumstances where global analysts had anticipated an oversupply of LNG for the next few years or even decades. We have seen the brutal reversal of that assumption in a tremendously short period of time. (Against this backdrop of sudden and surging demand for LNG and growing energy security concerns, it is interesting to note that despite its announcement last year, the PRC has in fact continued to build overseas coal-fired power stations.)

Other, broader LNG market developments have added to the legal complexity of some trades and shipments. These include the move away from traditional 'tram line' production facility to end buyer trade routes, and the influx of proprietary traders in the LNG space. It is now not uncommon for an individual LNG cargo to be traded multiple times on the water. The LNG space has become a fertile one for disputes, as borne out by the significant range of issues on which we have, increasingly, assisted our clients over the last few months and years.

From a legal perspective, aside from the sanctions issues which will undoubtedly remain relevant for some time, the consequence of all this is that significant disputes are now emerging in the global LNG markets. These may relate to participation in upstream production projects; shortfalls in supply; or non-performance of individual cargoes. The exponential growth in the value of individual LNG cargoes means that such disputes are too big for parties not to contest them. In the same way, pricing disputes under long-term LNG sale and purchase agreements are set to increase in both volume and value, with many more of these likely to be submitted to price review arbitration globally.

The Russia – Ukraine conflict has significantly exacerbated existing issues with the result that increasing energy security concerns and challenges in Asia will give rise to greater complexity and more disputes in the LNG space going forward.

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