

THE LNG SALE AND PURCHASE AGREEMENT:

GETTING TO GRIPS WITH THE EMERGENCE OF SINGAPORE'S ENERGY MARKET?



Since the opening of Singapore's first Liquefied Natural Gas (LNG) terminal in May 2013, the city state has been set to become a regional LNG hub, and the LNG market a major economic driver for the Singaporean economy. Providing a means of transporting natural gas over long distances when pipeline transportation is not feasible, the growth in Singapore's LNG trade is a game-changer for not only industry practitioners, but the legal community.

Consequently, the LNG sale and purchase agreement brings with it a unique set of challenges and considerations, which can be the source of additional difficulty to those interested in becoming involved in this growing industry. This Briefing identifies the key features of an LNG sale and purchase agreement, and considers some of the issues connected to it that the advisers must be aware of.

Risk and delivery

It is not infrequent in LNG sale agreements for the delivery point to become an area of dispute in negotiations, often a result of the parties' failure to agree at the original time of contracting whether delivery is to take place at the loading terminal or the receiving facility. It is important to settle this at

the start of the contract process, as the question of delivery has an important bearing not only on the apportionment of risk during transit and in ensuring that facilities at the receiving terminal may be adequate, but also to the question of title to the cargo as well. Consideration should also be given to the degree of cover provided for by each parties' insurance, specifically ensuring there is adequate cover in place to deal with, in particular, the event of an accident caused by the delivery vessel's negligence, or due to adverse weather conditions, often an issue in some of the more remote production areas.

The buyer in an LNG sale agreement should also exercise caution when entering any agreement to on-sell the LNG, paying particular attention to their exposure to liability for failing to deliver the LNG, despite the problem being outside of their control. In order to avoid this situation, the buyer should consider including express provision for the recovery of lost profits from the subsequent sale of the LNG directly from the seller.



Dispute resolution and jurisdiction

Referred to as ‘midnight-clauses’, the provisions regarding dispute resolution and jurisdiction are frequently last minute additions to the LNG sale and purchase agreement. Commercial parties, particularly those involved in the energy trade, generally prefer to think of the rewards of partnerships rather than the risks connected to its breakdown. Accordingly, parties to an LNG agreement are often surprised at the effects of these clauses, and commonly complain that what is recorded in the agreement does not seem to match their original expectations.

Often, the choice of governing law and the rules for resolving any disputes, as well as the method and venue in which the dispute will be heard, are not properly considered, leading to a situation which may be wholly unsuitable to one of the parties. This is an unwelcome complication when the parties are already in a state of dispute.

It is recommended that, before entering into any LNG transaction, both parties consider whether they are truly comfortable with the agreement’s chosen law and accept the risk of any challenges which may arise from the choice of venue for court proceedings or arbitration. Ambiguous jurisdiction and dispute resolution provisions are frequently used against a claim to extend proceedings, escalate costs, challenge enforcement or otherwise pressure a claiming party to settle, and so careful consideration ought to be afforded to their drafting.

Precisely because of the importance of relationships in the LNG trade, it may also be sensible for the agreement to specify a window, before any formal dispute resolution proceedings take place in which representatives of the parties involved can attempt to resolve the matter in dispute.

Adjustment mechanisms

The sale and carriage of LNG is subject to a number of factors, which may be difficult to control, such as the weather, availability of vessels or receiving and storage terminals, and adjustment mechanisms should be put in place to allow for the likely delays or complications without the problem escalating to a dispute. Parties should be careful to note what their rights are to vary the annual delivery programme, in the event that they are unable to meet any obligations, and consider whether account should be taken of weather delays or capacity issues relating either to LNG availability or the capacity to transport or receive it, which require the purchaser to vary the volumes of LNG which they have agreed to purchase.

Typically, the seller will want to commit the buyer to “take or pay” arrangements, in which the buyer pays for all of the LNG it has agreed to purchase, even if it declines or is unable to take delivery of the full quantities. A buyer in these circumstances may want to have the right to take delivery of volumes in a subsequent contract year, if for example there is a natural disaster or other commercial circumstance which would justify this. This will of course have a significant effect on the seller’s delivery programme, which will have to be planned well in advance.

In addition to the delivery schedule, adjustment mechanisms commonly exist for the contract quantity to be varied. Both parties should be aware of any rights the buyer may have to reduce the annual quantity which it is required to take, or of any rights the seller may have to vary this for its own convenience, and whether there is any subsequent obligation to later make this up.

An LNG sale agreement is likely to also incorporate a price review clause, in which case it is necessary to be aware of the criteria for determining whether there shall be an increase. If it is simply the parties seeking to agree on a new price, will the status quo prevail if there is no agreement? Can market rates/ conditions be taken into account? Both parties should consider the application of any ‘economic hardship’ principles to the agreement by the local law.

Force majeure

LNG sale agreements almost universally include force majeure provision, which have the effect of suspending or terminating the agreement upon the occurrence of one of a range of listed events which would generally render performance of the agreement practically or commercially impossible. It should be noted however that no two force majeure clauses are the same, and careful thought should be made to which events are to be included as force majeure. Should adverse weather be included? Civil unrest? The nature of the LNG trade and the typical production locations make it hard to predict what exactly can go wrong, so it is therefore important to draft a suitably wide spectrum of listed events into the agreement’s force majeure provision.

Singapore’s LNG aspirations – ‘Phase Three’ begins for Singapore’s Jurong Island Terminal

At the end of August, it was announced that the Singapore LNG Corporation (SLNG) had awarded Samsung C&T rights to the US\$542 million engineering, procurement and construction project (EPC) to expand Singapore’s first LNG terminal, with a completion date set for 2018. Initiating ‘Phase Three’ of Singapore’s ambitious LNG storage extension programme, this new project aims to expand the terminal’s send-out capacity from



Moving forward, and further to Singapore's efforts to move away from oil to gas and reduce emissions, the Singaporean government has announced plans to supply LNG to fuel ships by 2020, beginning with a pilot programme in early 2017 which will involve funding up to six LNG-fuelled vessels at up to US\$2 million per vessel.

6Mtpa to 11Mtpa by adding a fourth LNG storage tank and additional regasification facilities to the existing terminal. With a capacity of 260,000 cubic meters, the new storage tank will be the fourth largest in the world and have the ability to fully store cargo from a Q-Max carrier, according to the SLNG.

This most recent EPC project continues the nation's already significant efforts to boost its LNG profile by investing in its infrastructure and technology. Breaking into the LNG market with the terminal's opening in May 2013, the well-established hub has since received 32 LNG vessels delivering more than 2.06 million metric tonnes of LNG to Singapore.

This latest development follows close on the heels of the June listing of energy giant Gazprom JSC (Gazprom) Global Depository Receipts on the Singapore Exchange Mainboard (SGX). With a US\$99 billion market capitalisation, Gazprom's recent listing has energised Singapore's mineral, oil and gas sector, and was heralded by

the SGX CEO, Magnus Bocker, as "an important event for SGX".

Andrew Kruglov, Deputy Chairman of the Gazprom Management Committee and head of its Department for Finance and Economics, further hailed the move as "a key milestone in Gazprom's history and further demonstrates the importance of Singapore, and the Asia-Pacific region, for Gazprom's business and future strategy."

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