

Copyright © 2017 [Energy Intelligence Group](#). All rights reserved. Unauthorized access or electronic forwarding, even for internal use, is prohibited.

WED, MAR 22, 2017

## Japan Reviews LNG 'Destination Clauses'

An ongoing review by a Japanese government agency on whether 'destination clauses' in long-term LNG contracts violate the competition law and hurt the Japanese market, the world's largest LNG buyer, could have major implications for LNG suppliers if antitrust authorities formally object to such arrangements, according to law firm Baker Botts.

"If the JFTC [Japan Fair Trade Commission] formally objects to these arrangements, then this may result in the forced renegotiation of LNG sales and purchase agreements, a complicated renewals process and/or trigger price review procedures," the US-based law firm said.

The JFTC initiated the review last year at a time when the international LNG market was undergoing structural changes that saw trade shifting away from point-to-point sales to greater liquidity as new supplies came on line and new markets emerged ([WGI Jul.20'16](#)).

Destination restrictions prevent buyers from reselling cargoes that would compete with other cargoes from the same seller. Easing or abolishing them is a critical issue for Japanese power utilities since deregulation and competition from coal and nuclear may leave them with excess contracted supply.

Japan has been lobbying members of the G7 group to encourage more liquidity and transparency in the LNG market by relaxing or abolishing destination clauses ([IOD Apr.18'16](#)).

JFTC's investigation followed a decision by the EU in 2001 to ban destination restrictions on all LNG contracts for antitrust reasons while the US will export LNG on an f.o.b. basis. The JFTC is expected to comment on its review next month.

So the key question is whether the JFTC will follow the EU's lead or apply its decision exclusively new contracts, given the massive number of contracts Japan has in its portfolio. Japan imported 83 million tons of LNG last year, of which 70% to 80% were long-term supplies.

"A JFTC finding that destination clauses are in violation of the law would in principle also apply to existing agreements," Paul Lugard, a competition lawyer with Baker Botts told *International Oil Daily*. "As a consequence, suppliers would then no longer be able to force buyers to comply with those provisions."

Lugard said the perceived competition problem, the alleged lack of arbitrage and competition in the Japanese market, may not be solved if JFTC limits its actions to future agreements only. Nonetheless, he noted the JFTC could theoretically "either limit an infringement decision to specific agreements, negotiate a settlement agreement with current suppliers, or issue a policy statement that would only apply to future agreements."

LNG observers reckon that the JFTC is most likely to take a soft policy-based approach that target new contracts. Suppliers argue, however, that new contracts are already more flexible and that buyers should pay more for destination flexibility. Suppliers also suggest that the Japanese government should not interfere in bilateral, commercially agreed deals while questioning the JFTC's jurisdiction over foreign suppliers.

---

Qatargas, the world's largest supplier, will likely suffer as a JFTC ruling would create more competition among its cargoes and undermine its position as a swing supplier to Asian and Atlantic markets.

"Generally, competition agencies will assert jurisdiction over business practices that have a direct and reasonable foreseeable effect on trade and competition in their jurisdiction, regardless [of] whether the agreements are entered into by foreign suppliers," said Lugard. "The issue for the JFTC is whether such clauses have that effect. To make that finding would be precedent setting."

Another key question is whether the JFTC would apply its decision to f.o.b contracts so that buyers take title to cargoes at loading terminals -- or are delivered in such a way that the cargo belongs to the supplier until it is unloaded at an import terminal.

Many contracts signed with Asian buyers have incorporated destination clauses, even for f.o.b deals.

"Destination restrictions constitute an integral part of the overall commercial bargain between the parties to the agreement. In the vast majority of cases, and with the exception of Europe, these type of provisions are legitimate and do not raise any antitrust concerns," Jay Alexander, a senior trial partner who leads Baker Botts' arbitration and dispute resolution, told IOD.

Baker Botts also raised the possibility that antitrust authorities in other Asian countries may follow JFTC's lead.

"Much will depend on JFTC's next steps and whether other markets experience similar issues like Japan and how the JFTC actions may be alleged to 'distort' competition between buyers in various jurisdictions in the region," Lugard said, adding that South Korea, Taiwan -- and perhaps China -- may follow suit.

**Clara Tan, Singapore**