LNG

Power to the buyers

LNG importers now have the upper hand when signing new supply deals – and even rejigging existing contracts

THE WORLD of liquefied natural gas has been turned upside down. A business that was for decades run according to the whims of sellers is now in the palm of buyers.

With a flood of supplies from new projects in Australia and the US (*see p24 and p26*) about to hit the market, the established LNG market is fraying. Buyers are creating new types of deals, sometimes in new importing countries, and LNG exporters are being dragged into a new era of flexible contracts.

China's biggest energy company has joined India in seeking to renegotiate long-term LNG supply deals. CNPC wants to rework the prices in its contract with Qatar, its chairman Wang Yilin said at the beginning of March.

India's Petronet stole a march in December 2015 when it renegotiated the country's only functional long-term supply contract, cutting the price of gas delivered from Qatar's RasGas by about half. As part of aggressive negotiating tactics the company also announced via press interviews that it would not perform on its 7.5m-tonne-a-year (t/y) take-or-pay contract.

A couple of years ago such antics would have seen Petronet stung with a hefty fine, a potential supply cut, and other sellers would have shunned it. Instead, RasGas meekly waived the penalty, thought to be as much as $1.5bn. In return, Petronet agreed to boost its contract volumes by 1m t/y starting in 2016 and make up the prior shortfall in cargoes over the remaining life of the deal, which runs until 2028.

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Long-term LNG contracts have never been so vulnerable. Sinking spot prices – expected to track $3-5 per million British thermal units below oil-linked term deals – are encouraging importers to seek revisions. It gives buyers in markets with the best long-term prospects for LNG expansion, such as India and China, an especially powerful negotiating position.

As well as the RasGas deal, Petronet has been critical of the price it agreed to pay ExxonMobil for 1.5m t/y from the Gorgon LNG plant in Australia, commissioned in February. Still, it would be cheaper to walk out on a US tolling agreement than other deals. India's Gail and Indian Oil Corporation, both shareholders in Petronet, have separate deals with Cameron LNG, Sabine Pass and Cove Point in the US.

A downstream market Consumers are about to get more powerful too. Jera, a joint venture formed late last year between Japanese utility firms to jointly procure fuels, is in talks with other LNG importers, including South Korea's Kogas and China's Cnooc, to build an alliance. Together these companies make up a third of global LNG trade.

With so much LNG available – uncontracted LNG will make up 25% of expected supply out to 2025 – sellers need to adapt their approach.

Much of the incremental demand will not come from the established north Asian LNG importers. Instead exporters are fiercely competing for the attention of new markets – of which there are many. Indonesia, Pakistan, Bangladesh, Philippines, Thailand, Jordan, West Africa, Uruguay and other energy-short nations all represent serious prospectives in this buyer's market.

Facing the reality of an oversupplied market, producers – perhaps following Qatar's lead – are becoming more accommodating when buyers ask for modifications. On top of India and Pakistan, Lithuania has also recently renegotiated its supply contract (with Norway's Statoil).

It seems likely that every buyer will give it a shot. More flexibility on destination clauses, indexation and price reviews are all now on the table.

And while consumers often complained of oil-indexed prices in the past, the slump in global crude has – not surprisingly – made the pricing mechanism popular once again.

Slopes (the price percentage of a barrel of oil used to set the LNG price) have even recently moved into the single digits, as sellers race to attempt to preserve their market share.

Last year, the slope pricing mechanism averaged around 12.5% compared with just less than 14% in 2014, according to energy consultancy Poten & Partners. Mixed indexations also moved into the mainstream last year – making up around 28% of contracts (gas-hub indexes and oil-price indexes each set 36% of prices).

The overall length of sales contacts is also getting shorter, down 8.5% year-on-year. On average, the terms now last just 14 years. The opportunity to renegotiate clauses has also been built into most of the contracts, while destination restrictions have been removed. It's not just lower prices that buyers want – or feel able to demand.

Indeed, contract flexibility will be key for sellers looking to find homes for their cargoes. China's national oil companies, facing weaker-than-expected gas demand growth at home have successfully negotiated to delay or divert cargoes ramping up from Australia to other markets. South Korea's Kogas and the Japanese utilities are doing the same. It's never been a better time to be an LNG buyer. **Damon Evans, Singapore**