Contract flexibility: How will LNG SPAs look in the 2020s?

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2020s: The critical decade for LNG SPAs

The emergence, and growing relevance, of short-term and spot trade.

20+ years, point-to-point delivery, 100% take-or-pay SPAs

Contract flexibility: three key dimensions

1) Pricing flexibility
2) Operational flexibility
3) Contract reopening flexibility
1) Pricing flexibility

- Price formula
- Price review
Securing long-term pricing flexibility

- New-generation price review clauses
- Recourse to formal dispute resolution
- Non-temporal triggers in Asian LNG SPAs
Change of circumstances

• Change of circumstances as a price review trigger
• The relevant market and the role of buyer’s market
• ‘In any case’ clause and financial position of the parties
2) Operational flexibility

- Commercial reasons
- Market disruptions
Responsiveness to market disruptions

• The notion of ‘genuine operational needs’
• Separate contractual regime for adjustments
• Expedited decision-making process
Cargo cancellations

- Multiple cargo cancellations in response to the pandemic
- Cancellation clauses in US LNG contracts
- Cancellation options in other contexts
3) Contract reopening flexibility

- Price terms
- Non-price terms
The ability to reopen both price and non-price terms

- No practicable basis for a comprehensive contract renegotiation
- Adjustments to non-price terms as secondary outcomes of price reviews
- Keeping the entire contract in line with changing market fundamentals
Model renegotiation clause

It is hereby agreed ... that in the event of any major physical or financial change in circumstances ... either party may serve notice on the other requiring the terms of this [contract] to be re-negotiated with effect from the date on which such notice shall be served. The parties shall immediately seek to agree amended terms reflecting such change in circumstances and if agreement is not reached within a period of six months from the date of the notice the matter shall be referred to an Arbitrator (whose decision shall be binding on both parties and who shall so far as possible be an expert in the area of dispute between the parties)...

ABP v Tata Steel [2017] EWHC 694 (Ch), emphasis added

Key considerations
- Clear basis for renegotiation
- Price and non-price terms
- Gradual contract adjustment

Modifications
- Trigger events
- Contract review process
- Limits to contract adjustment

Conclusions and outlook

1. SPAs will remain the key contractual mechanism for international LNG sales in the 2020s.
2. The primary choice will be made between flexible long-term deals and shorter contracts.
3. Contract reopening flexibility needs to be structured carefully.
4. COVID-19 has highlighted the need for adjustments to non-price terms.
5. In the 2020s, LNG contract terms will be more diverse and, potentially, more transparent.
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