

Client Alert

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AN ASIAN LNG SPOT PRICE – HAVE WE REACHED THE TIPPING POINT?

For several years, many government agencies, LNG industry players and commodity trading organisations have been pushing for the development of an Asian LNG market price that is independent of oil prices and reflective of the LNG value in Asia and the Asian supply and demand balance. Initiatives, each backed by the relevant government, are underway in Singapore, Japan and Shanghai to establish LNG price indexes that reflect these regional markets, with each initiative seeking the establishment of a reliable and liquid price index that reflects the relevant Asian market (an Asian LNG equivalent of Brent or Henry Hub).

To date, these initiatives have yet to result in an Asian LNG pricing index that the LNG sellers and buyers can rely on for their mid to long term pricing basis. However, recent trading data for the Platts JKM™ (Japan Korea Marker) indicates that, perhaps, the LNG industry has finally settled on a first benchmark for spot and short term LNG sales in Asia.

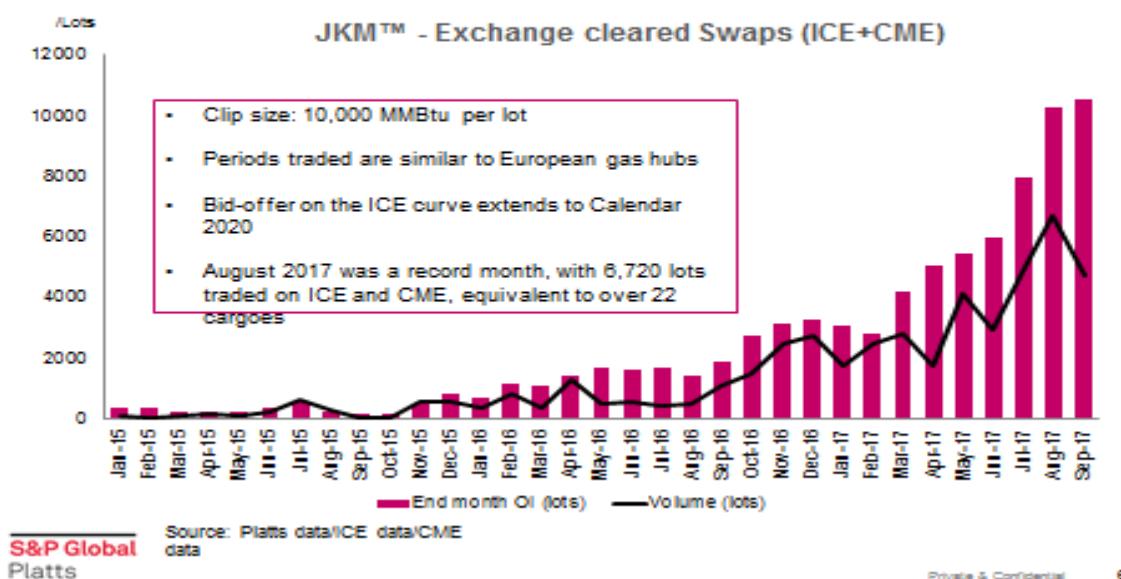
Platts JKM™

The Platts JKM™ is the benchmark price for spot physical LNG cargoes delivered ex-ship into Japan and South Korea. Platts launched JKM™ in 2009, followed by JKM™ Swaps, a cash-settled derivative contract based on Platts JKM™ assessments, in 2012.

During the first three quarters of 2017, the volume of, ICE and CME cleared JKM™ Swaps was almost triple the volume of that in 2016, and significantly the JKM™ Swaps end-month Open Interest levels are rising faster still (see figure 1 below).

Figure 1

Q1-Q3 2017 Cleared JKM™ Swaps nearly triple whole of 2016



Why have the cleared JKM™ Swaps taken off? As with all traded products, each participant in the market is driven by different reasons; however, what has been underpinning this growth is the vastly increased use of the Platts JKM™ in physical contracts. In 2017, market analysts reported that there has been a substantial growth in physical LNG trades between Japanese LNG traders, APAC LNG producers, Japanese power utilities, Asian end users and major portfolio traders, all of whom are using Platts JKM™ as the benchmark price. These contracts are increasingly covering multiple cargoes which extend over several years, indicating that market participants are progressively more comfortable basing their short and mid-term trades on the Platts JKM™. Extrapolating the industry's comfort with the use of the Platts JKM™, surely it will not be long before long term LNG contracts for the region are also priced off the Platts JKM™ benchmark?

Why is it that Platts JKM™ is being used?

In their assessment of which price index to use, industry participants are looking for an index that is published, trustworthy, reflective of the relevant market prices and most importantly, sufficiently liquid so as to prevent market players from manipulating the physical market. Ideally, this index can then be used for trading on an exchange in both physical and paper markets.

Platts JKM™ is a published index and the energy industry has a long established experience of basing transactions on Platts data. As an example, all pipeline gas sales from Indonesia to Singapore have been priced off Platts' HSFO

assessment and Singapore's LNG imports are priced off Platts' Brent assessment. This evidences the trust of the energy industry in Platts' assessments and that its methodology accurately reflects the relevant market price.

In the past, the obstacle for the establishment of an Asian LNG price index has always been liquidity: insufficient LNG was sold on a spot basis to enable a clear market price to be established on a daily basis. However, as global short term and spot sales reached 28% of total LNG trade (in 2016, 72.3 MT of LNG was sold on a short term or spot basis)ⁱ, with a significant proportion of such spot sales being for delivery into Japan and South Korea, it does appear that there is now sufficient liquidity for a reliable price assessment.

Further, another attraction of Platts JKMTM is that it can be traded in the derivatives market in the form of the ICE and CME cleared JKMTM Swaps. Therefore, in addition to the availability of a reliable price marker, industry participants are also able to manage their price risks through a sophisticated and well regulated exchange.

Does Platts JKMTM Success Preclude the Development of Other Indexes?

It seems unlikely that the success of Platts JKMTM will hinder the establishment of other Asian LNG price indexes. In reality, the opposite is more likely to be the case, with the successful development of one Asian LNG price index being a powerful impetus for the development of others. If there is a reliable and transparent price reporting for one market, this encourages other markets to be priced off that index, which in turn leads to a growth in the LNG trade in such other markets that in turn leads to them becoming independently quoted market prices.

Referring to Europe as an example, there are quoted gas spot prices for British NBP, Dutch TTF, German NCG and GASPOOL, Belgian Zeebrugge and ZTP, French PEG Nord and TRS, Italian PSV, Austrian VTP, Czech VTP, Spanish PVB, Slovak VTP and Turkey: 14 quoted spot prices for a market of approximately 750 million people. It seems very likely that there will be more than one LNG spot price to cover the vast Asian market of more than 4.4 billion people.

Looking closer at the situation in Asia, Singapore currently imports 3 MTPA of LNG and the new gas aggregators, Shell and Pavilion (an LNG and gas company backed by the Singapore government), will each have exclusivity to market up to a further 1 MTPA or for three years, whichever is earlier.ⁱⁱ The Singapore LNG terminal has an LNG storage capacity of 540,000 m³,ⁱⁱⁱ and is currently constructing an additional 260,000 m³ of storage capacity which will be available in 2018^{iv} and has the ability to store and re-load cargoes and break bulk for regional distribution. Pavilion and PLN have recently signed a Memorandum of Understanding to explore the development of the potentially large LNG break bulk market in Indonesia. Pavilion is also growing an LNG bunkering service to fuel the increasing number of LNG powered vessels that visit Singapore. Further, when the supply of pipeline gas from Sumatra to Singapore ends at the end of 2022, this is most likely to be replaced by LNG, the equivalent of which is approximately 3.5 MTPA (and probably requires the development of an additional LNG import terminal). These events will fuel the expansion of Singapore's LNG market, and by the mid 2020s, Singapore could easily be a 10+ MTPA market with an active physical traded market. In addition, Singapore already has the SGX LNG "Sling" Singapore price assessments and related exchange traded contracts and the GLX on-line physical LNG trading platform (see www.glx-lng.com for further details), all of which supports the development of a reliable LNG market price.

As LNG industry participants become increasingly familiar transacting on a Platts JKM™ basis, it seems very likely that this will encourage further activity in the Singapore market, thereby assisting the development of a Singapore market price.

Conclusions

The rapid rise in the cleared Platts JKM™ Swaps market is a clear indicator that significant quantities of physical LNG are being traded on a Platts JKM™ basis. Typically, in a relatively young derivative market such as the cleared Platts JKM™ Swaps market, activity is directly caused by activity in the underlying physical market: the derivative market is being used to manage price risk in physical positions rather than purely as a speculative venture (which only tends to happen in large highly liquid derivative markets such as Brent).

Looking back at the development of other commodity indexes, the factor that ultimately determines which indexes get recognised is the amount of trading conducted based on that index. Accordingly, it is the market participants that determine the success of an index. If the volumes of cleared Platts JKM™ Swaps continue to rise in 2018 (as they have in 2017), then the LNG industry is likely to look back at 2017/2018 as the tipping point – the period in which confidence in the Platts JKM™ grew to such a level that a truly liquid, transparent and reliable Asian LNG spot price emerged.

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ⁱ IGU 2017 World LNG Report: https://www.igu.org/sites/default/files/103419-World_IGU_Report_no%20crops.pdf

ⁱⁱ Singapore Energy Market Authority, 24 October 2016: "Pavilion Gas and Shell to Import Next Tranche of Liquefied Natural Gas for Singapore", https://www.ema.gov.sg/media_release.aspx?news_sid=20161024v3FMJbVQe2bK

ⁱⁱⁱ Singapore LNG terminal has three 188,00m³ storage tanks (540,000 m³ total LNG working capacity) and a regasification capacity of around 6 million tonnes per year.

<https://www.slng.com.sg/website/content.aspx?wpi=Terminal+Facts+%26+Figures&mmi=85&smi=116>

^{iv} Reuters, 24 August 2017: "Pavilion Gas clinches two-year LNG storage capacity deal in Singapore", <https://uk.reuters.com/article/asia-lng-singapore/pavilion-gas-clinches-two-year-lng-storage-capacity-deal-in-singapore-idUKL4N1L93I3>