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Asian Buyers Still Shun Arbitration -- For Now

The arbitration case brought by Australia's North West Shelf (NWS) against Korea Gas (Kogas), the world's second-largest LNG buyer, is unlikely to encourage many copycats. But the outcome will set a precedent for Asian price-review negotiations in testing the limits of arbitration. NWS' move underscores the pressures facing LNG producers with oil-indexed contracts after prices collapsed in 2014 and buyers become more assertive. These can only mount as LNG becomes more commoditized and if oil prices rise further.

NWS is believed to have acted after failing to reach agreement with the South Korean firm during price-review talks on the 500,000 ton per year contract, which expired in 2016 ([WGI Feb.14'18](#)). The seven-year deal likely allowed a review in 2014, just as oil prices crashed and an LNG glut was forecast. Three arbitrators have been appointed to the tribunal, a Singapore-based arbitration lawyer told *World Gas Intelligence*. A hearing will take place following an exchange of written arguments and evidence from both sides over the next 12-18 months. "This may well be the first case in Asia that has gotten so far," he said. "There were a handful of cases in the past -- notices were filed but they did not go as far as setting up an arbitration tribunal." It will likely take about two years to reach a decision, but NWS and Kogas could still agree on a negotiated settlement in the interim. "The case will encourage parties to look at arbitration as a more serious option," the lawyer said. "Even if it ends up in settlement, it would represent a good example of how you can commence arbitration and negotiate at the same time."

LNG sellers have traditionally been reluctant to sue buyers whose long-term contracts are crucial to underpinning liquefaction projects, while Asian buyers are less confrontational than their European counterparts ([WGI Oct.17'12](#)). Little change is expected for now. Mehdi Chennoufi, general manager for LNG origination and business development at Shell Trading, dismisses the NWS case as "more polemic by the media." He told a recent Singapore conference that "basically, the buyers are [our] partners. From time to time, there will be arbitration and people get upset. But they will settle before the arbitrator does his job. ... If LNG gets commoditized, say by 2035, we will have more arbitration but we are not there yet." For one thing, there is much more commonality in European contracts than in Asian LNG contracts, the lawyer said. "If a buyer in Germany has made an argument under a Norwegian contract, a buyer in France can use the same argument." In Asia, "it's much harder to extrapolate from one case to another."

Price reviews tend to be held every five to seven years. The object is to agree a price competitive with that of LNG landed in Asia under long-term contracts, but lack of a regional hub price makes it hard to assess the "market price" to which the contract should be adjusted, said Merrick White, partner at law firm King & Spalding. "The rise of an Asian spot price such as Platts' JKM assists with this, but arguably these spot prices do not yet reflect the value that should be ascribed to the price for a long-term sale with its inherent security of supply."

Sellers tend to value the Japanese as "honorable buyers." But as well as paying the highest LNG prices in Asia, Japanese firms face more competition at home from deregulation of the power and city-gas sectors. With more sellers to choose from, they might be tempted to consider arbitration, and the emphasis may shift from "relationships" -- although still important -- to price competitiveness and flexibility. "Buyers in North Asia have certainly been through some realizations in the last couple of years. In some cases, long-standing relationships with sellers have not always helped them secure better terms," Ajay Singh, adviser to the president of Japan Petroleum Exploration, said, adding that some Japanese buyers paid dearly for deals signed after the March 2011 Fukushima disaster ([WGI Oct.17'12](#)). "There is a feeling that reliance on relationships is not necessarily an effective defense of their own self-interest against

some sellers who might perhaps be focused more on immediate commercial gain. ... There were no existing relationships between US sellers and Japanese buyers and the whole discussion was on the basis of the new offering." The former Shell executive does not expect the NWS-Kogas case to trigger the same level of arbitration as in Europe, but reckons the law could become a legitimate tool to resolve disputes as deals become more complex and companies upgrade legal functions.

Indian buyers have successfully renegotiated contracts outside price-review provisions by committing to take more LNG ([WGI Sep.13'17](#)). Buyers in Japan and Korea don't apparently have the same uncommitted demand, so may be more likely to consider arbitration if price review talks fail, the lawyer said, adding that arbitration is becoming more mainstream in corporate Japan. But others believe Japanese buyers will remain constrained by cultural factors, high legal costs and the possibility of losing. Some reckon the firms most likely to resort to arbitration are state-owned buyers or newer buyers without long-standing relationships with sellers ([WGI Nov.25'15](#)).

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