

Offshore Energy Law

Destination clauses: destined for the chop?

Destination clauses in certain types of LNG contracts have come under fire recently from the Japan Fair Trade Commission (JFTC), which is concerned that such clauses can impinge on principles of fair competition in the marketplace. The development comes at a time when Asian LNG buyers are being seen to display a preference for shorter-term, more flexible contracts. As such, it is likely to be welcomed by LNG buyers in Asia.

Destination clauses, which are often included in long-term LNG SPAs, designate specific LNG receiving terminals for LNG cargoes sold under the SPA and prevent the buyer from ultimately discharging the cargo outside of its home destination.

Under EU competition rules, such clauses are not permitted in long-term FOB (free on board) delivery contracts where the receiving terminal is in the EU. The delivery point under an FOB contract is the loading terminal, with the buyer being liable for the transportation of the LNG cargo from the loading terminal to the discharge port. Therefore, imposing a destination restriction prevents buyers from freely reselling LNG (including exploiting price arbitrage opportunities), even though they will already have taken title and risk for the LNG before this point.

In contrast, in long-term DES (delivery ex-ship) contracts, such clauses are generally permitted, as the delivery point here is the buyer's unloading terminal and the seller usually has title in the LNG and is liable for the LNG up to this point.

The JFTC opened an investigation into the use of these clauses in LNG agreements in 2016. In July 2017 it published findings stating that, although destination clauses were not in themselves problematic in DES contracts, they were generally "neither necessary nor reasonable" in FOB contracts and were therefore highly

likely to violate Japanese antitrust law in these circumstances. This echoes the view taken by the EU Commission.

The development is significant, given that Japan is the largest LNG importing country in the world.

However, the JFTC's survey was stated to be forward-looking and did not call for the revision of such provisions in existing LNG SPAs. Instead, it warned against their inclusion in SPAs which are yet to be signed. In this respect, it differs from the approach taken by the European Commission, whose review of destination clauses at the turn of the century prompted the re-opening and re-negotiating of a number of long-term LNG SPAs.

Nevertheless, LNG suppliers should beware: it is still open to the JFTC to commence proceedings in relation to existing LNG contracts, particularly in FOB contracts. Parties should be alive to this issue when negotiating MSAs which may include destination clauses.

"LNG suppliers should beware: it is still open to the JFTC to commence proceedings in relation to existing LNG contracts, particularly in FOB contracts"



Rhiannon Davies
Partner, London

T: +44 20 7809 2033
E: rhiannon.davies@shlegal.com