

Japanese Companies Stepping up Efforts to Secure U.S. LNG Exports

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Japanese companies have accelerated efforts to secure U.S. LNG exports originating from shale gas. On April 17, Mitsui & Co. and Mitsubishi Corp. stated that they have broadly agreed to secure 4 million tonnes in LNG exports each, including those possibly to Japan, from Sempra Energy Inc. which is planning to export LNG from the Cameron LNG receiving terminal in Louisiana. On April 27, Tokyo Gas Co. and Sumitomo Corp. stated that they have reached broad agreement with Dominion Cove Point LNG L.P. to liquefy natural gas into LNG at an annual volume of 2.3 million tonnes at the Cove Point LNG Terminal in Maryland and launched negotiations on their final agreement.

The Cameron LNG project calls for starting construction in the second half of 2013 to convert an LNG import terminal into an export terminal and for launching LNG production and export in late 2016. The project envisages three 4-million-tonne gas liquefaction trains with a total annual capacity of 12 million tonnes in LNG. The three trains include two with a total capacity of 8 million tonnes for exports including those possibly to Japan. Gas for liquefaction there will be procured from the market. The parties reportedly plan to consider using gas from the Marcellus and Eagle Ford shale gas fields where Mitsui has participated in production and acquired interests.

The Cove Point project also calls for converting the present LNG import terminal into an export terminal to export 5 million tonnes per year from 2017. The project participants are considering procuring gas from such sources as the Marcellus shale gas field where Sumitomo has also acquired an interest. LNG from U.S. shale gas may thus be imported into Japan.

On both projects, various negotiations and construction will be required before final agreements are reached. In order to enable U.S. LNG to be exported to Japan, project participants will also have to negotiate with the U.S. government to acquire licenses for LNG exports to countries that have no free trade agreements with the United States. However, the recent progress in deals for LNG exports to Japan represents a great step forward for Japan's stable LNG procurement and supply.

Before these actions by Japanese companies, South Korea's KOGAS and India's Gail took the initiative in securing U.S. LNG exports by taking part in the Sabine Pass LNG project. In Japan, there had been concern that Japanese firms would lag behind in exploring U.S. LNG exports. But the

recent moves indicate that Japanese companies are catching up with the forerunners.

These moves are important because there are growing expectations on LNG in Japan as well as challenges regarding stable LNG supply, including how to address the Asian premium on LNG prices. The current LNG price in Japan is more than eight times as high as the current U.S. gas price which has slipped below \$2 per million British thermal unit. Energy experts in Japan have widely recognized that the wide price gap, though attributable partly to market structure differences, has become a serious problem that cannot be ignored.

What are the implications of the recent series of actions by Japanese firms in this sense? First, these deals could directly impact LNG procurement prices. A KOGAS agreement for the Sabine Pass LNG project indicates that U.S. LNG imports into Japan would be highly competitive, even with transportation costs taken into account, under the presumption of present gas price levels including around \$2/MBtu in the United States and more than \$16/MBtu in Japan (Asia). But we must pay attention with regard to this presumption. There is no guarantee that LNG imports from the United States will remain price competitive if and when U.S. prices rise with Japanese prices falling on crude oil price drops.

The second important implication is that Japan could start LNG imports based on a pricing approach that would be different from the existing Asian approach linked to crude oil import prices. At present, however, pricing approaches for the two deals involving Japanese firms are still uncertain, depending on future negotiations. If the participants in these deals adopt the Sabine Pass LNG pricing approach, which differs from the existing Japanese traditional approach, they may plan on making a breakthrough in discussions on LNG pricing approaches. It is also significant that the diversification of pricing approaches is expected to help risk diversification in terms of price.

The third implication is that LNG imports from the United States under a new pricing approach could contribute to enhancing Japan's bargaining power in negotiations with other LNG suppliers. The other LNG suppliers include not only the existing gas exporters to Japan but also future exporters subject to new LNG import projects. Since the existing LNG import contracts for Japan as the largest LNG importer in the world are so significant in Japan's total LNG import volume, Japan's bargaining power at negotiations on these existing contracts may greatly impact its overall LNG procurement prices and conditions. Future LNG suppliers for Japan include Australia that plans to expand LNG production capacity and Russia that is conscious of enhancing efforts in the Asia-Pacific market. LNG imports from the United States under a new pricing approach may be significant for Japan in considering future relations with these countries.

While Japanese companies have begun to step up efforts to import LNG from the United States, future developments over a long time before actual imports begin are uncertain. In this respect, we may have to closely watch changes in both the Japanese and U.S. energy situations. Nevertheless, the recent developments surely represent a significant step.

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