

JFTC Views LNG Destination Restrictions as Likely to Have Antimonopoly Act Problems

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On June 28, the Japan Fair Trade Commission released a report on liquefied natural gas trade (http://www.jftc.go.jp/houdou/pressrelease/h29/jun/170628_1.html). The JFTC is an organization based on Article 3 of the National Government Organization Act, positioned as an affiliate administrative commission for the Cabinet Office to enforce the Antimonopoly Act. The research report made the following points based on written and oral interviews with business operators in Japan and other countries on LNG trade:

First, the so-called destination clause restricting an LNG buyer's resales, restrictions on the change of destination and the profit-sharing clause for sharing profit on resales between a buyer and seller for an FOB (free on board) LNG deal designating an LNG exporting country's shipment port as a point of delivery to a buyer are likely to have problems with the Antimonopoly Act.

Second, the destination clause, the restrictions on the change of destination and the profit-sharing clause for a DES (delivered ex-ship) deal designating an LNG importing country's destination port as the point of delivery to a buyer may not have direct problems with the act. If the seller refuses to give consent to the change of destination that meets necessary and reasonable conditions even for a DES deal, however, the refusal may have Antimonopoly Act problems. A change of destination clause including competition-restricting conditions or any clause conditioning competition-restricting practices on the change of destination is likely to have Antimonopoly Act problems. The profit-sharing clause, if bringing about unreasonable profit-sharing, may also have problems.

Third, the take or pay clause that requires a buyer to take delivery of a certain volume of LNG over a long term and is necessary for launching an LNG project featuring massive initial investment has no direct problem with the Antimonopoly Act. If a seller unilaterally imposes a strict take or pay clause on a buyer after recovering the initial investment without sufficient negotiations with the buyer, this could also have problems with the act.

Based on the above views, the JFTC report concludes that (1) when new LNG contracts are signed or existing contracts are renewed, competition-restricting clauses or trading practices that could restrict resales should be avoided, (2) competition-restricting practices that could restrict resales under existing contracts should be revised and (3) the JFTC will closely watch LNG

transactions and take strict actions on practices running counter to the Antimonopoly Act. The first and second conclusions urge LNG transaction parties (sellers and buyers) to take appropriate measures.

LNG plays a key role in Japan's energy mix. Particularly since the 2011 East Japan Earthquake and Fukushima Daiichi nuclear plant accident, LNG has become a very important energy source, accounting for more than 40% of power generation. One of the top priority challenges in Japan's energy policy is to procure LNG at competitive prices in a flexible manner to respond to market changes in Japan and other countries. In the meantime, a crude oil price plunge since the second half of 2014 and an oversupply in the international LNG market have led to a general LNG price decline and a buyer's market. In Japan, however, uncertainties about future gas/LNG demand are growing due to uncertainties about the restart of nuclear power plants, the expansion of renewable energy, and power and gas market deregulation. As a result, more flexible, competitive LNG procurement has become an urgent challenge, with priority given to the expansion of flexibility in LNG transactions and in the LNG market.

The Japanese government for its part has given policy priority to the improvement of flexibility in LNG transactions while taking note of the European Union's initiative since the 2000s to repeal the destination clause that it sees as impeding the single European market and violating antitrust law. The government has made a cabinet decision to repeal the destination clause. In its LNG market strategy released in May 2016, the Ministry of Economy, Trade and Industry emphasized that the destination clause should be repealed or relaxed to develop a highly liquid LNG market. In the abovementioned Japanese market environment, Japanese LNG buyers as well as the policy side have been seeking more flexible LNG procurement. The repeal or relaxation of the destination clause has become a key challenge common to government and private sectors in Japan.

The release of the abovementioned views and future responses by the JFTC as Japan's Antimonopoly Act enforcer based on detailed research and analysis will have a great impact. As the JFTC calls for revising competition-restricting trading practices in existing LNG contracts as well as for avoiding such practices for new or renewed contracts, Japanese companies will have to give due consideration to the JFTC views. The report may also have a great impact on foreign companies that are Japanese LNG buyers' counterparts. The JFTC report just encourages LNG transaction parties to take appropriate measures. In this sense, changes may come slowly. Nevertheless, the JFTC report may play a key role in revising trading practices and changing the market.

How market participants will respond to the JFTC report will attract attention. The JFTC has presented its views from the viewpoint of the Antimonopoly Act. We may have to pay attention to whether this kind of action will spread to other major Asian LNG importing countries. While Japan is the world's largest LNG importer, the LNG market is now expected to expand primarily in Asia including emerging countries. The JFTC report could become a key milestone toward the further development or reform of not only Japanese LNG transactions but also the Asian LNG market.

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