

# Proposed model diversion clause for LNG SPA's

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Workshop Series on:

Key Drivers to promote Liquidity, Flexibility and Transparency of the Global LNG Market

Workshop 5: Focusing on LNG Contracts - Destination Restrictions, Profit-Sharing in Cargo Diversions, and the Model Clause

Tokyo, 9 July 2019

## **Background: Reasonably simple contractual standards are a known catalyst for trading.**

The 1<sup>st</sup> workshop in Florence concluded that standard provisions would likely help concluding transactions more readily, on generally accepted/market terms, and eliminate the risks associated with developing and negotiating such provisions anew in each contract.

In the context of this workshop series, a group of legal experts has drafted a standard clause on destination restriction and profit sharing in LNG SPAs. It has been drafted so as to comply with both the antitrust laws of the European Union and Japan.

Note: Neither the European Commission nor the JFTC formally endorses this paper nor are they bound by this paper including the proposed model clause.

## The structure of the clause consists of 4 major sections.

- 1 Basic Buyer's Right to request diversion
- 2 Limitation to 1: Seller's right to reject - for technical, operational and legal reasons
- 3 Compensation for additional costs and risks due to the diversion
- 4 Protection against arbitrary refusal

## Buyer's Right to request a diversion

1. Without prejudice to [provisions on compliance and sanctions if the language in the SPA is not inclusive] and [Buyer's obligation to take], Buyer shall have the right to request Seller to direct any Cargo scheduled for delivery in the Annual Delivery Programme or Ninety Day Schedule to an Alternate Unloading Port (“**Diversion**”).

## Seller's right to reject - for technical, operational and legal reasons

2. If Buyer elects to request a Diversion, Buyer shall provide a Notice of the Alternate Unloading Port and the other operational details concerning the Diversion included in this section 2 to Seller, and **Seller shall promptly approve such Diversion provided that:**
  - (1) Buyer has provided Seller with a copy of and Seller, acting as a Reasonable and Prudent Operator, (i) has accepted the **Terminal Rules**, and (ii) has accepted the Conditions of Use for the Alternate Unloading Port;
  - (2) Seller, acting as a Reasonable and Prudent Operator, has obtained **all required Approvals**;
  - (3) the **LNG Specification** corresponds with requirements of the Alternate Unloading Port;
  - (4) the **LNG Tanker** is or, with the Parties' reasonable endeavors and at Buyer's costs, can be made compatible with the Alternate Unloading Port;
  - (5) such Diversion will not cause Seller to be in **breach of any obligation** it has accrued prior to the provision of the Notice of Diversion;
  - (6) Seller (acting as a Reasonable and Prudent Operator) is satisfied that the Diversion can be carried out in a **safe manner**; and
  - (7) performance of the Diversion will not cause the Seller to be in breach of any applicable **laws**.

## Compensation of additional costs and risks through either a compensation mechanism ...

3. In respect of each Diversion, the Parties agree on either a compensation mechanism or a profit-sharing mechanism for the Alternate Unloading Port as contemplated below.

(1) In the case of a compensation mechanism, it will:

Compensate Seller for all the **actual documented** net costs (including costs and savings related to transportation, terminal fees, canal transit fees and third-party costs) and risks incurred by Seller to complete such Diversion to the Alternate Unloading Port.

## ... or a profit-sharing mechanism, if difficult to quantify.

(2) In the case of a Profit-sharing mechanism, it will:

Allocate all net incremental profit, if any, realized by Buyer as a result of the Diversion in a reasonable manner **premised on additional risks**, both quantifiable and unquantifiable, **and costs incurred by the Seller due to the Diversion**. Due to the difficulty of precisely quantifying all of the additional risks and costs incurred by the Seller associated with a Diversion, the parties have agreed to the **allocation of net incremental profit on the basis of [ ] percent** for Seller and [ ] percent for Buyer, which allocation the parties believe is reasonable and necessary in light of the risks associated with a Diversion. Buyer shall no later than [ ] days after Delivery notify Seller as to the net incremental profit realized with the specific Diversion. Should either Party deem it necessary to **verify the incremental profit calculation**, it shall request that Parties exchange the necessary and appropriate data. The Parties shall agree on third party expert verification of such data so as to protect the confidentiality of the data. All additional costs relating to the third-party verification shall be borne by the party requesting the verification, except where the auditor concludes that the incremental profit calculation is incorrect in which event the party providing inaccurate information shall bear the costs.

## Rules to protect Buyer against arbitrary refusal

4. Upon Seller's approval of a Diversion, the Alternate Unloading Port in such Diversion shall be considered the Unloading Port for all purposes with respect to such Cargo.
5. Seller shall not unreasonably withhold or delay its consent for a Diversion. Seller's **refusal to consent to a Diversion must be duly reasoned and justified**, with the reasoning communicated in writing to Buyer. Should the Buyer deem it necessary to verify data supporting the reasonableness of Seller's refusal to a Diversion, **a third-party expert shall be appointed to verify the reasonableness of Seller's refusal** to consent. The third-party expert shall keep all Seller's data confidential. All costs relating to the third-party verification shall be borne by the Buyer, except where the third-party expert concludes that the Seller has unreasonably withheld its consent, in which case the Seller shall bear the costs of the third-party expert.



The model clause and an explanatory note is available at: [https://www.jurists.co.jp/en/news/181022\\_2.html](https://www.jurists.co.jp/en/news/181022_2.html)