

# **Toward Increased Flexibility and Competition in East-Asian LNG Markets**

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# 1. Overview of Korean Natural Gas Sector



## 1. General description of the natural gas sector

### ➤ The world's third-largest LNG importing country

- Negligible domestic gas production
- No cross-border pipelines have been constructed so far
- Relying on imports of LNG to satisfy nearly all domestic natural gas demand

### ➤ Monopoly-based and two-tiered market structure

- KOGAS has a monopoly on the wholesale market with the exception of private direct importers for power generation or industrial consumption.
- Each privately-owned local city gas company has a monopoly on its retail markets.

### ➤ Third-party access regulation

- Regulated TPA rule applies to KOGAS-owned pipelines.
- Negotiated TPA rule applies to privately-owned pipelines, and both KOGAS- and privately-owned import terminals.

## 2. Nation-wide pipeline network

### Nationwide Pipeline Network

(As of January 2019)

#### Incheon LNG Terminal

- World's largest gas transmission capacity for a single terminal
- Storage tank: 100,000 kg x 10, 140,000 kg x 2, 200,000 kg x 8
- Berthing and loading facilities: 1 berth with 75,000-ton capacity, 1 berth with 127,000-ton capacity
- Boil off gas transmission capacity: 6,150 ton/hr

#### Pyeongtaek LNG Terminal

- World's largest gas storage capacity for a single terminal
- Storage tank: 100,000 kg x 10, 140,000 kg x 4, 200,000 kg x 9
- Berthing and loading facilities: 1 berth with 75,000-ton capacity, 1 berth with 127,000-ton capacity
- Boil off gas transmission capacity: 4,636 ton/hr

#### Samcheok LNG Terminal

- Equipped with the world's largest gas storage tank
- Storage tank: 200,000 kg x 9, 270,000 kg x 3
- Berthing and loading facilities: 1 berth with 127,000-ton capacity
- Boil off gas transmission capacity: 1,320 ton/hr

#### Tongyeong LNG Terminal

- Storage tank: 140,000 kg x 13, 200,000 kg x 4
- Berthing and loading facilities: 1 berth with 75,000-ton capacity, 1 berth with 127,000-ton capacity
- Boil off gas transmission capacity: 3,030 ton/hr

Jeju LNG Terminal (expected completion in 2019)



Source: 2019 KOGAS brochure

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## 3. Regulation of the natural gas sector

### ➤ Regulatory framework

- The City Gas Business Act
- Presidential decree
- Ministerial decree

### ➤ Regulatory authorities

- The wholesale market is regulated and supervised by the Ministry of Trade, Industry and Energy (“MOTIE”), and the retail markets are primarily regulated and supervised by their respective local governments.

### ➤ Governmental Plans impacting the natural gas sector

- The Long-term Natural Gas Supply and Demand Plan
- The National Energy Master Plan
- The Basic Plan for Electricity Supply and Demand

## 4. Present policy for LNG imports

### ➤ Increased flexibility in LNG SPAs

- Eliminating destination restrictions and take-or-pay provisions
- Increasing upward and downward quantity tolerances

### ➤ Diversification of LNG supply sources

- Improving LNG supply portfolio considering the economy and security of LNG supplies
- Diversifying pricing mechanisms to mitigate the impact of oil price fluctuations by way of avoiding JCC-linked price orientation
- Diversifying duration structure to respond to gas demand swings by way of avoiding long-term contract commitments

### ➤ Individual pricing mechanism for power generation consumers

- KOGAS's new tariff structure for power generation consumers (so-called individual pricing mechanism) will be coming up soon, purporting to enhance KOGAS's competitiveness against LNG direct imports in the increasingly competitive wholesale power market.

## 2.

# LNG Contracts and Competition Law





## 1. Regulation of the anti-competitive and unfair trade practices

### ➤ Regulatory framework

- The Monopoly Regulation and Fair Trade Act
- Presidential decree
- Guidelines issued by the relevant regulatory authority

### ➤ Regulatory authority

- Korean Fair Trade Commission (the “KFTC”)

### ➤ Regulations prohibiting anti-competitive trades

- Abuse of market dominance regulation
- Unfair trade practices regulation

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## 2. Regulation of the anti-competition and unfair trade practices

### ➤ Abuse of market dominance

- Abusive activities of market-dominant entities
- The rebuttable presumption of market-share based dominance: market dominance is presumed if the market share of one entity is 50% or more, or the combined market share of three or fewer entities is 75% or more.
- Prohibited activities include abusive pricing, control of production output, interference with other business activities, limiting market entry, exclusion of competitors

### ➤ Unfair trade practices

- Engaging in unfair trade practices in the market
- Prohibited activities: refusal to deal, discriminative transaction terms, exclusion of competitors, unfair luring of customers, coerced transactions, abuse of superior bargaining position, restrictive transaction terms, interference with other's business activities, and unfair support

## 3. Anti-competitive analysis of destination clauses

### ➤ **Anti-competitive effects of destination clauses: foreclosure effect**

- Destination clauses would prohibit buyers who need to reduce excessive LNG stocks or catch lucrative trading opportunities from reselling surplus or portfolio LNG in LNG trading markets, restraining the participation of new entrants into the markets.
- Korean buyers would have less opportunities to purchase LNG at lower prices in more competitive LNG trading markets.
- Also, Korean buyers would be forced to pay for inefficient inventory management (i.e., holding more terminal capacity required to store surplus LNG).
- Ultimately, Korean city gas customers would pay higher prices for their gas consumption as a result of the anti-competitive market practice.

### ➤ **What destination clauses could be considered not anti-competitive?**

- No reasonable ground is found with FOB term-based LNG SPAs as the title and risk of LNG is transferred to buyers at the loading terminals.
- However, where sellers are responsible for LNG shipping, destination clauses under DES term-based LNG SPAs could be considered differently to the extent that SPAs allow buyers to divert surplus LNG without imposing unreasonable conditions.

## 4. Anti-competitive analysis of diversion and profit sharing clauses

### ➤ Anti-competitive effects of diversion and profit sharing clauses

- Even in DES term-based contracts, sellers' unreasonable refusal to divert surplus LNG or profit sharing ratio that is unreasonably beneficial to sellers would have a similar foreclosure effect to destination clauses and thus could be considered anti-competitive.

## 5. Other traditional provisions

### ➤ Take-or-pay clauses

- As global LNG markets become more liquid with a substantially increased number of players, the strict off-take obligation provisions might become more questionable in terms of the facilitation of market competition.

### ➤ Excessively long-term duration

- With active trades occurring in spot and short- and mid-term markets, excessively long-term duration might become unnecessary.

### ➤ Oil-linked pricing mechanism

- With the emergence of alternative pricing solutions (such as hub price and hybrid price), the oil-linked pricing mechanism becomes less reasonable.

# --- 3. --- Conclusion



## Eliminating anti-competitive provisions from LNG supply contracts

### ➤ Destination clauses

- Destination clauses, in particular under FOB terms, would be in violation of the MRFTA, constituting (i) unfair trade practices in terms of restrictive transaction terms, discriminatory transaction terms and interference with other's business activities and (ii) abuse of market-dominance depending on LNG market conditions in which only a limited number of sellers with market dominance could supply substantial volumes to the market.

### ➤ Diversion and profit sharing clause

- Under DES terms, sellers' unreasonable refusal to divert surplus LNG or profit sharing ratio that is unreasonably beneficial to sellers would be anti-competitive as well.

### ➤ Other traditional provisions

- The legacy of traditional practices such as take-or-pay provision, oil-linked pricing mechanism and excessively long-term duration, if not extinguished, would be subject to future anti-competitive review as LNG markets become increasingly liquid, flexible and transparent.

**Thank you  
for your attention!**