エネルギーを新しい時代へ

Commercial Developments regarding Destination Restrictions

Japan – EU workshop

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Contents

JERA：3-Step Integration Completed

	Upstream Development / Fuel Procurement	Transportation / Trading		Receiving Terminals / Storage	Power Generation
Step 1 (April 2015 -)	New Upstream Development / Procurement	Cargo Ships	Trading		New Power Generation
Step 2 (July 2016 -)	Upstream Development / Procurement (Including the existing projects)	Cargo Ships	Trading		New Power Generation / Existing Power Generation (Overseas)
Step 3 (April 2019 -)	Upstream Development / Procurement	Cargo Ships	Trading	Receiving Terminals / Storage	Power Generation (Domestic / Overseas)

Step 1 (April 2015 -)

- **Founded JERA, and integrated new business development, fuel transportation, and fuel trading businesses**

Step 2 (July 2016 -)

- **Integrated the existing fuel business (upstream, procurement) and the existing overseas power generation / energy infrastructure business (including renewable energy)**

Step 3 (April 2019 -)

- **Integrated fuel receiving / storage / gas transmission and the existing thermal power generation businesses**

- **LNG Transaction Volume: 35 MTPA**
- **Upstream Investment: 5 Projects**
- **LNG Cargo Fleet: 18 Ships**

- **Domestic Output Capacity: 67GW**
- **Overseas Output Capacity: 9GW (Developed Output)**

Prospect of Destination Free / Flex LNG

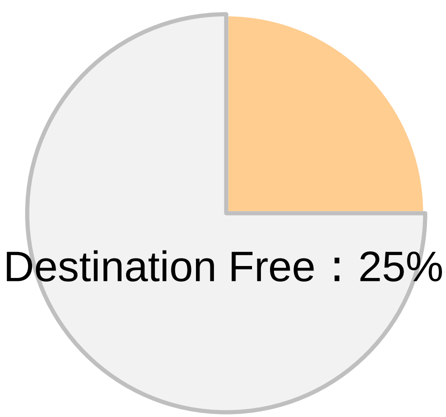
・Promoting a flexible, liquid and transparent LNG market by removal of destination restrictions
→ *Significant benefit for overall LNG Market (both Buyers and Sellers)*

・Destination Free / Flexible LNG has been increasing, owing to recent efforts of both Sellers and Buyers, with supports by Antitrust Authorities, government and related organizations

・Further increase needed ! (Requisite for new contracts)

JERA's LNG Portfolio in 2015

JERA's LNG Portfolio in 2020



Key Aspects and Challenges in removing Destination Restrictions (DES contracts)

①Compensation for Incremental Cost & Risk (vs Profit Sharing)

- Principle : Buyer compensates "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"
- Some sellers raise "Unquantifiable Risks (thus Profit Sharing is justified)"
  However, convincing examples of "unquantifiable risks" have not been recognized
  → Practice is that Buyer compensates incremental verifiable costs and risks, with quantified risks by incremental insurance fee etc.

②Re-negotiation for existing contracts (cf. Negotiation of new contracts)

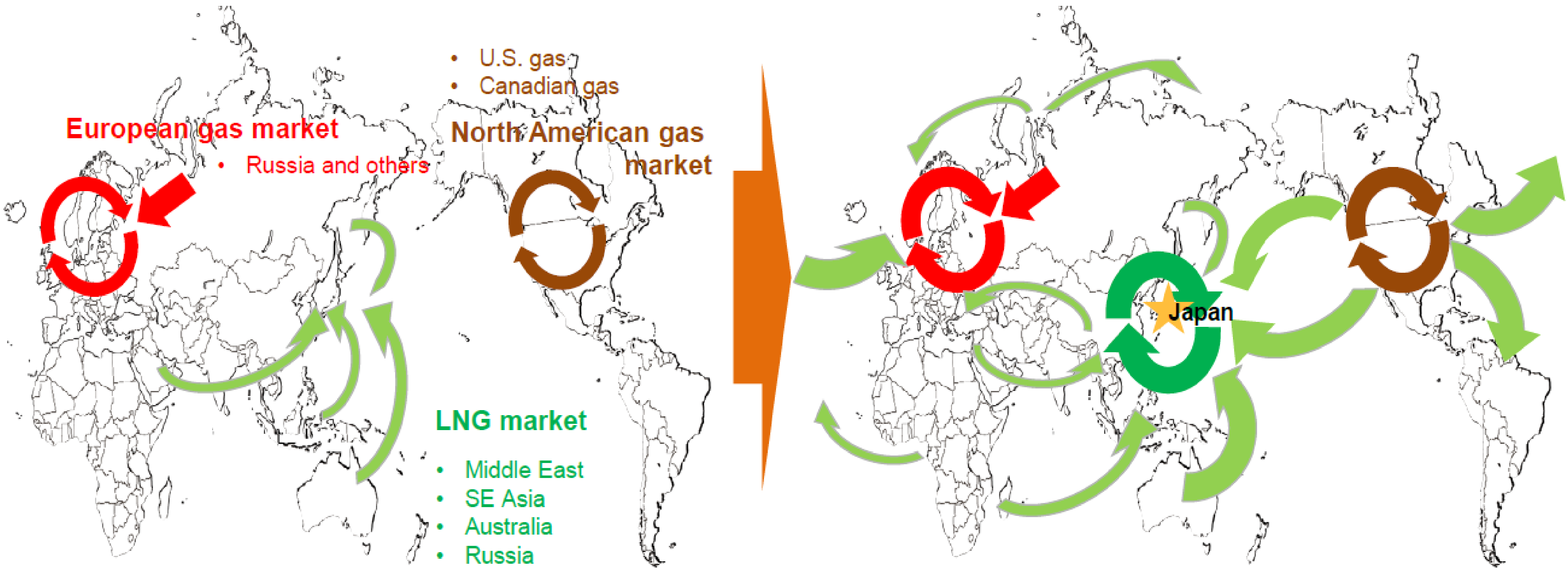
- Some sellers reluctant to amend existing contracts (even in FOB cases)
  " No rationale / motivation for actively amending contracts agreed in the past"
  → Authoritative recognition as to rule violation (and JFTC rule enforceable to outside of Japan) may be effective

③(in operation phase) Risk of "unreasonable refusal" by Sellers

- Verification of reasonableness of refusal needed
- Before refusal, due effort is needed (options include transportation provision by buyer)
- Due advance preparation may make many refusals unnecessary

Benefit of Less Destination Restrictions

・Removal of destination restrictions is beneficial for the market (both sellers and buyers)
・Actual diversion cases have been seen
→ Promotion of LNG trade
Demand Creation
Promotion of inter-regional price convergence



Source：METI

Model Diversion Clause

・Contract standardization efforts promote LNG trade（No obligation to adopt)
・Appreciate the efforts of Professor Kim Talus and the group of experts

・Preamble Notes part explains positions of antitrust laws of Japan and EU

・A few concerns in Model Diversion Clause part – may need due care in dispersing and utilizing the clauses, or try some modifications

(1) Clause 3: “In respect of each Diversion, the Parties agree on either a compensation mechanism or a profit-sharing mechanism….”

→ Concern: P/S mechanism may be misunderstood as “endorsed”?

- ✓ P/S shall not be justified unless unquantifiable costs and risks
- ✓ Excessive profit allocation to seller prohibited

→*In practice, convincing examples of unquantifiable costs and risks have not been recognized, thus P/S not justified*

(2) Approach of “Buyer’s *request* → Seller shall promptly *approve* (refusal shall be duly reasoned and justified)”

→ In practice, “*Notice* by Buyer → Diversion shall be made (*unless* refusal by Seller with justifiable reasons)”

Regional & Global Cooperation

・Cooperation and view exchanges across regions / markets / players

・Sharing the recognition of “Flexibility increase is needed for promotion of LNG market”

・Promotion of information sharing regarding specifications & data of LNG receiving terminals (S/S compatibility, fees, risks etc）

Thank you for listening

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