



THE OXFORD
INSTITUTE
FOR ENERGY
STUDIES

Decarbonisation and LNG SPAs

GIIGNL Commercial Study Group
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Introduction

- Recent industry-driven initiatives aimed at **improving ESG performance of LNG trade**
- Since June 2019: dozens of **LNG cargoes designated 'carbon-neutral'**
- 2020 and 2021: **first GHG Verified LNG SPAs** with statements of GHG emissions
- 2021: **GIIGNL releases MRV and GHG Neutral Framework**
- **'Carbon-neutral', 'green', 'clean' LNG**: a credible commercial offering?
- All levers need to be pulled to decarbonise the LNG value chain: **the growing role of decarbonisation requirements in the long-term contracting segment**



How to achieve GHG neutrality objectives in LNG SPAs?

- Two-step approach:

(1) GHG emissions transparency (quantification of GHG emissions)

(2) GHG emissions mitigation (emissions reductions and/or offsets)

- New contractual structures



- New rights and obligations of the parties



Quantification of GHG emissions

The core task in GHG Verified and GHG Abated LNG SPAs

- **Methodology subject to negotiation** in the absence of regulatory requirements
- Emerging **industry standards** provide helpful guidance to parties
- The need for verification and the expected significant role of **disputes of technical nature**
- Scope for **separate dispute resolution framework** (for example, expert determination with a decision rendered by an expert or a panel of experts within a stipulated period of time)
- The GHG emissions profile as **part of LNG quality specification**
- Scope for **bespoke liability regime for off-specification deliveries** (for example, differentiating between a breach of the specifications for CO₂ and methane intensity)



The next step in GHG Abated LNG SPAs

- Incorporating **direct emissions reductions and/or carbon offsets** into the delivery program
- Allocating **responsibility for mitigation** in a multi-jurisdictional setting along the value chain
- Assessing the **impact on contract flexibility** and potential ‘flexibility losses’ for the parties
- **Novel issues related to carbon credits** incorporated into, or linked to, long-term LNG sales
- The exposure of the parties to offset-paired transactions to **external risks of carbon markets**
- **Disputes related to the failure to reach the required level of emissions abatement**
- Scope for **bespoke liability regime for off-specification deliveries** (incl. „deliver or pay”)



Compliance with regulatory requirements

Regulatory risk in all LNG SPAs

- **Examples of regulatory measures:** certification charges, environmental taxes, and, in a more severe form, delivery bans for cargoes failing to meet the required emissions profile
- The scope and geographic focus of these measures – **largely unknown at this point**
- **EU Methane Regulation (June 2024):** the first sign of regulators taking the lead from industry on decarbonisation measures
- The recent **resurgence of substantial contract terms (10+ years)** and the need to **prepare for the impact of future regulation**
- Robust **contract adjustment mechanisms** as a **hedge against the uncertainty of decarbonisation requirements**



Decarbonisation and price reviews

- Decarbonisation will inevitably have **financial consequences for parties to LNG SPAs.**
- An emissions-related index, **tCO₂e (or similar)** could become part of a price formula.
- Changes related to decarbonisation efforts could serve as **(i) a trigger for a price review** and/or **(ii) a factor to be considered in a price review process.**
- Decarbonisation arguably falls under **the notion of 'change of circumstances'**, which can be found in many price review clauses, particularly in LNG SPAs for delivery to Europe.
- The approach to GHG emissions **could have impact on selection of 'comparable' contracts** (for the purpose of price adjustment under Asian LNG SPAs)
- New generation price review clauses will need to consider the impact of decarbonisation – **should price review clauses explicitly refer to decarbonisation requirements?**



Drafting new generation price review clauses: trigger

- **Starting point (traditional wording)**

“... if economic circumstances in the country of the Buyer, which are beyond the control of the Parties, should change significantly...”



Adding a reference to regulatory requirements

*“... if **regulatory requirements** or economic circumstances in the country of the Buyer, which are beyond the control of the Parties, should change significantly...”*

- **Alternative (incl. more specific) references**, for example, to import standards such as **“maximum methane intensity”** being **“introduced”** or **“set at the level of ____”**
- **Identifying the relevant jurisdiction**, e.g. **“the destination of the cargo”** (particularly challenging for FOB sales; issues of risk allocation and transfer)



Drafting new generation price review clauses: methodology

- **Price review clauses vary considerably in terms of price review methodology**, with formulations ranging from no guidance at all, to general guidance (e.g. *"fair and equitable"* revision of the contract price), and to very detailed guidance specifying factors or comparators that should (or should not) be taken into account in a price review.
- **Adding a reference to regulatory requirements as a factor for price adjustment**
*„The Parties shall discuss and review the Contract Price in good faith taking into consideration **regulatory requirements** applicable during the relevant price review period.”*
- **Providing guidance to the external decision-makers (arbitrators or experts)** on how to determine the relevance of incremental costs associated with decarbonisation requirements
- Particularly relevant for greenfield projects: **balancing the perceived risk of regulatory changes with the constraints on price adjustment** (e.g. +/-10% price revision tolerance)



Scope for “carbon reopeners?”

‘Meet and discuss’, change of circumstances, hardship, other clauses

Sample clause: *In the event that circumstances arise which were not foreseen at the outside of this Agreement, the Seller and the Buyer agree to meet and discuss such circumstances in good faith, with a view of taking actions appropriate to alleviate or eliminate such circumstances or the effects thereof.*

- The effects of these provisions are dependent on the wording of the contract and the applicable law
- Shared characteristic: **general and ‘toothless’**

The practice of contract adjustments

- Contract reviews triggered by commercial leverage
- Changes to non-price terms secured in price reviews
- Unsuccessful contract review attempts

Model renegotiation clause

*It is hereby agreed ... that **in the event of any major physical or financial change in circumstances** ... either party may serve notice on the other requiring **the terms of this [Agreement] to be re-negotiated** with effect from the date on which such notice shall be served. The parties shall immediately seek to agree amended terms reflecting such change in circumstances and if agreement is not reached within a period of six months from the date of the notice the matter shall be **referred to an Arbitrator** (whose decision shall be binding on both parties ... ABP v Tata Steel [2017] EWHC 694 (Ch), emphasis added*

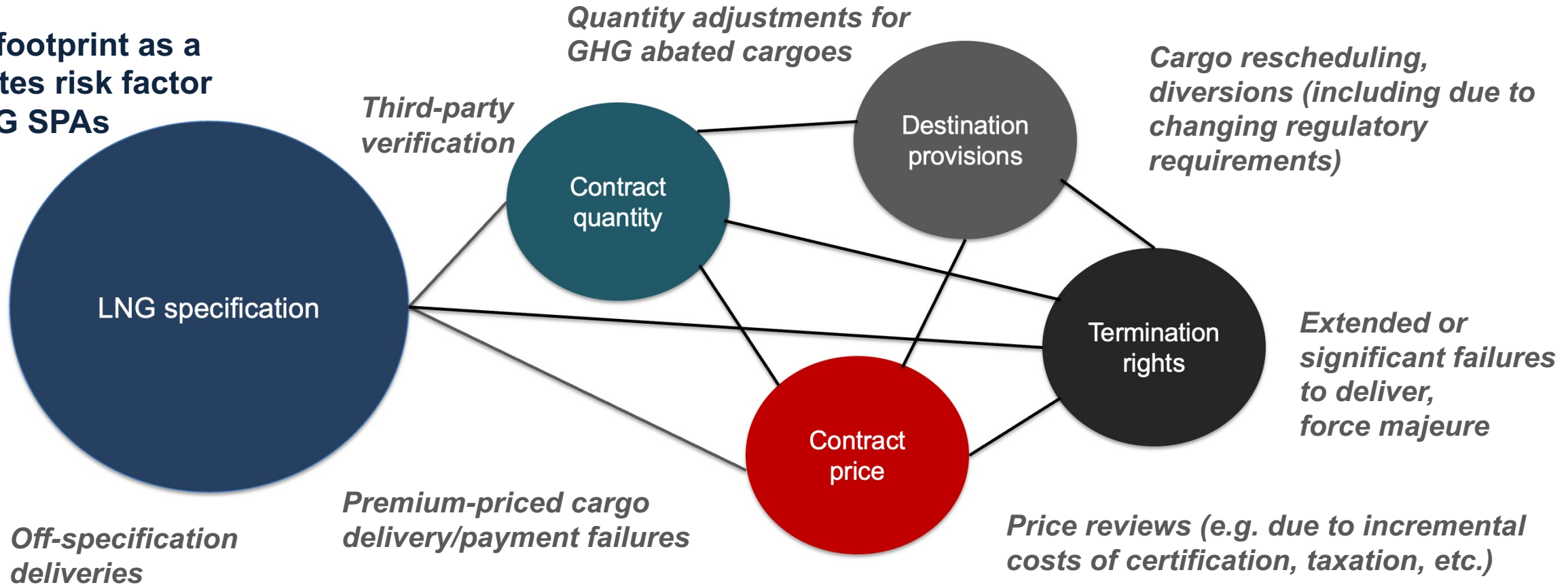
Ason, A. (2020). Scenarios for Asian long-term LNG contracts before and after COVID-19, OIES Paper NG 160.

Decarbonisation will have a sweeping impact on contract terms and require a practicable basis for adjustments going beyond the contract price.



Mitigating the risk of decarbonisation-related disputes

GHG footprint as a disputes risk factor in LNG SPAs



Decarbonisation requirements could become a major source of disputes in the LNG business.



Summary and outlook

1. **Decarbonisation** requirements have created **new objectives of securing GHG emissions transparency and mitigation in long-term LNG contracts.**
2. **The approach to GHG emissions** increasingly serves as a **differentiator for LNG contracts.**
3. **GHG Verified LNG SPAs will become standard by the end of the 2020s.**
4. **GHG Abated LNG SPAs** (applying emissions mitigation in addition to emissions quantification) **will become more common, with the ‘green premium’ gradually decreasing over the years.**
5. **The response to decarbonisation requirements** has become a top priority in the negotiation and execution of LNG contracts. The quality of that response in the context of LNG SPAs **will increasingly determine the success of a long-term business strategy for LNG trading.**



Thank you!

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OIES Gas Research Programme: <https://www.oxfordenergy.org/gas-programme/>

Ason, A (2024). *Decarbonisation and LNG SPAs* (forthcoming)

Ason, A (2022). *International Gas Contracts*

Ason, A (2022). *Rouble Gas Payment Mechanism: Implications for Gas Supply Contracts*

Ason, A (2020). *Scenarios for Asian Long-Term LNG Contracts Before and After COVID-19*

Ason, A, Meidan, M (2020). *Force Majeure Notices From Chinese LNG Buyers*

Ason, A (2019). *Price Reviews: Are Asian Contract Terms Finally Changing?*

Ason, A (2019). *Price Reviews and Arbitrations in Asian LNG Markets*

The report on International Gas Contracts is also available in Spanish at
<https://www.fundacionnaturgy.org/en/producto/international-gas-contracts/>

