



公正取引委員会
Japan Fair Trade Commission

Survey on LNG Trades (Summary)

June 28, 2017



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1 Objectives and Methods

Objectives

In recent years, the following significant changes in the demand and supply of liquefied natural gas (hereinafter, “LNG”) are pointed out:

1. Tendency to ease supply-demand balance along with restart of nuclear power plants and along with future diversification of energy mix
2. More uncertain prospects Japanese users have in forecasting domestic demand and supply because of full liberalization of electricity and gas retail markets
3. Worldwide increase in demand, including Asia
4. Worldwide increase in supply along with development of unconventional natural gas etc.

Because of the above, **Japanese users predict excess supply of LNG currently. However, they are concerned that destination restrictions will prevent them from reselling excess LNG inside or outside Japan in future. The Japanese government has decided to promote abolishment of destination restrictions at the Cabinet meeting.**

Given these changes, the Japan Fair Trade Commission (hereinafter, “JFTC”) has initiated a survey in order to clarify the problems in perspective of competition policy and the Antimonopoly Act.

Methods

- Subject: LNG sales to domestic users etc.
- Survey Period: July 2016 to May 2017
- Methods: Questionnaires and interviews
- ◆ Questionnaires
 - **14 domestic users (Total share, approximately 96%)**
Ordered to produce a report based on the Article 40 of the Antimonopoly Act (Response rate 100%)
 - **32 domestic and foreign suppliers (Total share, approximately 95%)**
Requested to produce a report (Response rate, 75%)
 - 6 Foreign users
Requested to produce a report (Response rate, approximately 67%)
- ◆ Interviews
 - 17 users (14 domestic and 3 foreign users)
 - 10 suppliers (3 domestic and 7 foreign suppliers)
 - 4 others

Suppliers and users in Japanese LNG trade

It is difficult to transport and store natural gas in the gaseous state under normal temperature and pressure. → Japanese users import LNG by shipping. Since July 2016, JERA Co., Inc. has succeeded the Fuel Procurement Departments of Tokyo Electric Power Co., Inc. and Chubu Electric Power Co., Ltd.

Suppliers	Contract Quantity	Share	Users	Procurement Quantity	Share
Malaysia LNG Sdn. Bhd.	16.92 million tons	21.0%	Tokyo Electric Power Co., Inc. (Currently: JERA Co., Inc.)	22.89 million tons	27.4%
Qatargas	11.69 million tons	14.5%	Tokyo Gas Co., Ltd.	13.27 million tons	15.9%
Australia North West Shelf LNG Partnership	9.64 million tons	12.0%	Chubu Electric Power Co., Ltd.(Currently: JERA Co., Inc.)	12.51 million tons	15.0%
Sakhalin Energy Investment Company Ltd	5.47 million tons	6.8%	Kansai Electric Power Co., Inc.	8.74 million tons	10.5%
Abu Dhabi Gas Liquefaction Company	4.30 million tons	5.3%	Osaka Gas Co., Ltd.	7.80 million tons	9.3%
Others	32.67 million tons	40.5%	Others	18.36 million tons	22.0%
Total	80.69 million tons	100%	Total	83.57 million tons	100%

Note: The JFTC based on the amount of the fixed-term contracts for LNG supply to Japan existing in April 1, 2016

Source: The JFTC based on the reports from users etc.

Note: The JFTC based on the LNG quantity procured by Japanese users in fiscal 2015

Source: The JFTC based on the Ministry of Finance “Trade statistics” etc.

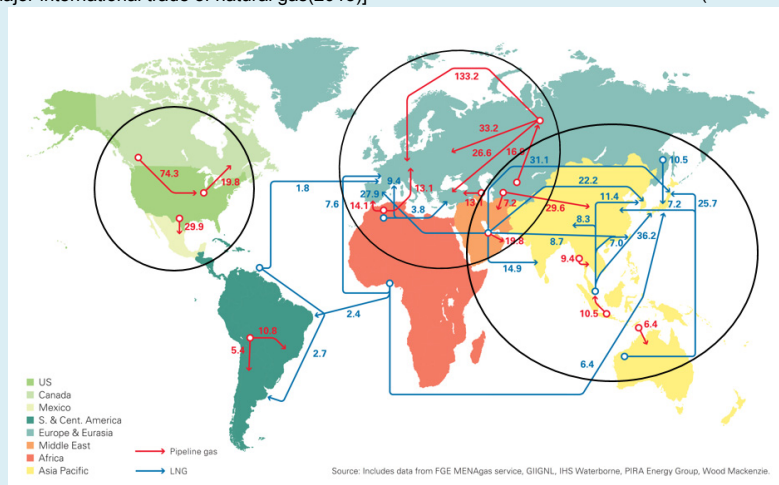
2 Global Circumstances and Regional Circumstances

Global Circumstances

International long-term trades of natural gas can be classified into ones in North America, ones to Europe, and ones to Asia, mainly due to the transportation distance. However, LNG spot trades may be conducted between any suppliers and users in the world, if the selling price matches the supplier's cost.

[Global major international trade of natural gas(2015)]

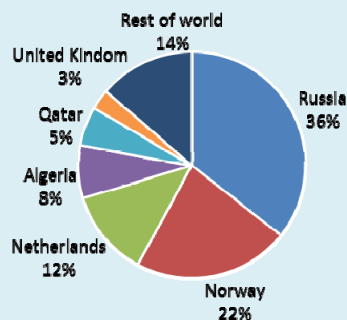
(Unit: 1 billion m³)



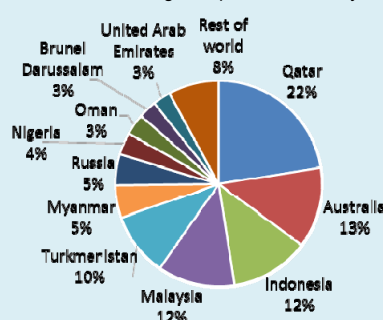
Source : BP "Statistical Review of World Energy 2016" Black circles were added by the JFTC

[Volume share of natural gas imported to Europe by supply country]

[Volume share of natural gas imported to Asia by supply country]



Source : The JFTC based on IEA "Natural Gas Information 2016"



Source : The JFTC based on IEA "Natural Gas Information 2016"

The share of international LNG trade in all international natural gas trade was about 19% in 2000, about 30 % in 2010, and about 31% in 2015. The share has been increasing in recent years.

Because Asian countries are generally distant from the supply countries, some are island countries and so on, pipeline is not economical in many Asian countries. Therefore, international natural gas trade by many Asian countries is usually LNG transaction.

Regional Circumstances

[North America]

The United States production of natural gas has significantly increased because of Shale Revolution after the late 2000s.

According to the IEA report, North American production of natural gas is forecast to significantly increase further.

[Europe]

European countries import natural gas from Russia, Norway etc..

According to the IEA report, European production of natural gas is forecast to decrease in the future, however, European consumption of natural gas is forecast to remain at the current level.

[East Asia]

East Asian countries import natural gas mainly from Southeast Asia, Australia, the Middle East etc.. The volume share of the LNG import in East Asia (Japan, South Korea, China and Taiwan) is about 60% of all world LNG import.

According to the IEA report, Japanese consumption of natural gas is forecast to decrease in future, however, Chinese natural gas consumption is forecast to significantly increase.

3 Characteristics of LNG Projects

LNG Project

An LNG Project means both business plan of an oil company regarding LNG production and sales, and the business activities based on the plan. In general, such a project comes into effect after a final investment decision (“FID”) on production and loading facilities which are necessary to establish an LNG supply chain.

LNG project has the following characteristics:

The Establishment of LNG supply chain

LNG trade needs a chain of processes as follows: 1) natural gas production in gas fields, 2) liquefaction at a loading terminal, 3) transportation by LNG ship, 4) regasification at an unloading terminal and 5) transportation to final consumption area.

Such a chain of processes is necessary for completion of LNG trade, which is generally called “LNG supply chain”.

[Image of LNG supply chain]



Source: The JFTC based on website of INPEX, K-Line and Tokyo Gas Co., Ltd.

* Since the number of route-unspecified or uncontracted LNG ships has increased in recent years, the spot charter market of LNG ships has also been expanding. As, the spot charter of LNG ships has been oversupplied, the price is decreasing in recent years.

Large initial investment

To establish LNG supply chain,

(i) **Oil companies need to invest in production facilities of gas field and loading terminals** (In many cases, they need to invest in LNG ships as well).

(ii) **Electricity and gas companies need to invest in unloading terminals** (In some cases, they invest in LNG ships as well).

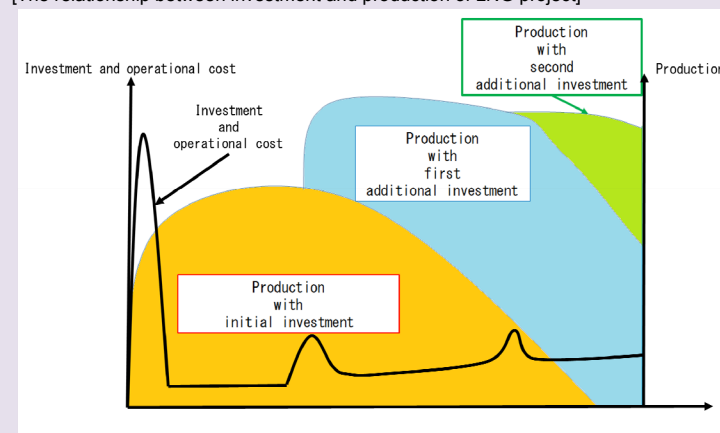
* The (i) above, which is the object of an LNG project, needs a large initial investment.

➤ Several ten billions to several hundred billions Japanese yen in each investment is needed for the construction in gas field.

➤ **Several hundred billions to several trillions Japanese yen in each investment is needed for the construction of loading terminal. Especially, the development of LNG needs a large investment.**

Additional investment to the plan of exploration and production may be needed for gas fields to improve the LNG production in some existing LNG projects, because of declining recoverable reserves of natural gas. However, the amount of such investment is smaller than that of the initial investment.

[The relationship between investment and production of LNG project]



Source: The JFTC based on public information etc.

4 Necessity of Long-term Contracts

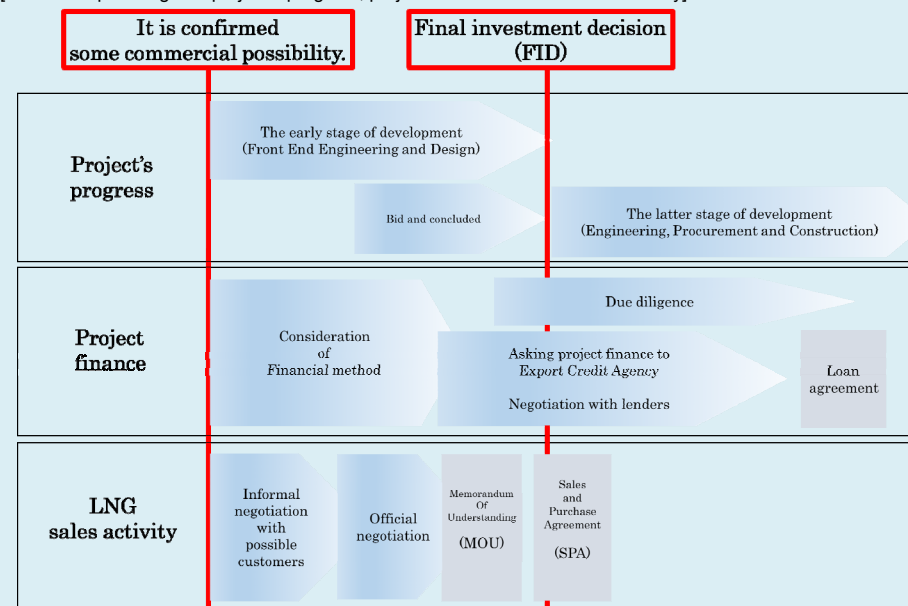
Project Finance

Most oil companies depend on project finance, whose repayment is the revenues only from a specific project, and whose security is the assets of only a specific project. This is because most oil companies need to avoid financial deterioration and large risk due to project failure and large debt.

In deciding whether to accept project finance, lenders **confirm profitability in detail (due diligence)**.

- ✓ Whether the natural gas proved reserves are sufficient.
- ✓ Whether the LNG project construction and operation will be conducted without interruption, and whether the damage of disaster and accidents will be covered by sufficient insurance.
- ✓ Whether the supply chain has already been established, and the supplier can get sufficient income.
- ✓ Whether a supplier concludes LNG offtake contracts, total values of which fulfills all repayment of the project finance.

[Relationship among the project's progress, project finance and LNG sales activity]



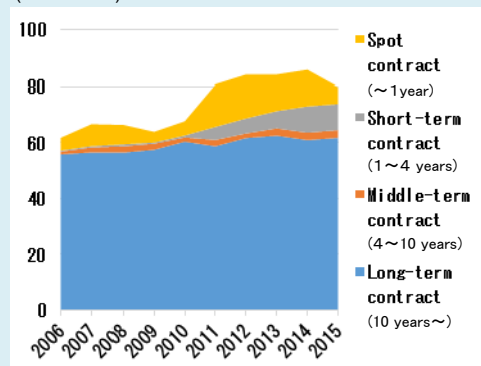
Source: The JFTC based on public information etc.

Long-term Contracts and Take or Pay Clauses

Guarantee of sustainable and full payment of contract by users is an important element for a final investment decision because an LNG project needs a large initial investment and loans. Before an FID, therefore, oil companies usually conclude some memorandum of agreements and obtain commitments that buyers receive a certain volume of LNG steadily for a long term.

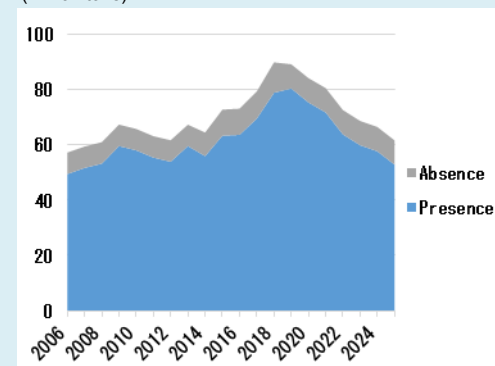
- ✓ **Long-term contracts** have buyers commit to receive a certain volume of LNG steadily for a long term.
- ✓ **Take or Pay clauses** impose an obligation to pay for all the contracted volume, including the volume buyers do not actually receive.

[Transition of the sum of procurement quantity by the length of contract-term]
(million tons)



Source: The JFTC based on reports from users

[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of Take or Pay clauses]
(million tons)



Source: The JFTC based on reports from users

Some contracts provide Deliver or Pay clauses that impose an obligation of a certain level of compensation on sellers when the actual supply quantity from sellers is insufficient to sellers' obligation, however, the number of such contracts is limited.

5 Terms of Delivery and Destination

Terms of Delivery

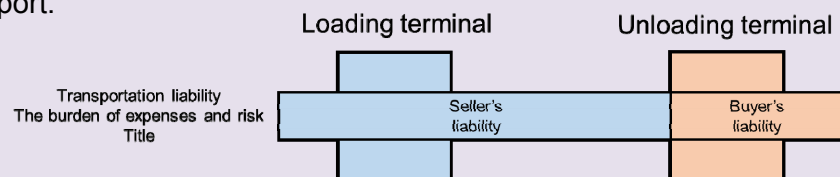
In almost all of the international LNG sales and purchase contracts, either DES (Delivered Ex Ship) term or FOB (Free On Board) term is used.

In general, property in each cargo is transferred from the sellers to the buyers at the delivery point.

DES Term

DES term means the term of delivery that designates a destination port in an importing country as the delivery point. **Sellers must transport the goods to the destination port. Also, sellers must bear all expenses and risks of the transportation to the destination port.**

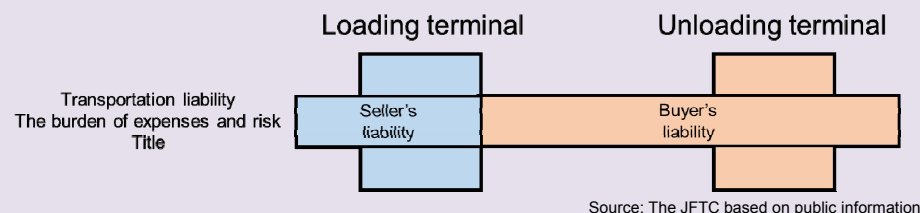
Under an international LNG sales and purchase contract, an unloading terminal in an importing country is usually the destination port.



FOB Term

FOB term means the term of delivery that designates a shipment port in an exporting country as the delivery point. **Buyers must transport the goods from the shipment port. Also, buyers must bear all expenses and risks of the transportation from the shipment port.**

Under an international LNG sales and purchase contract, a loading terminal in an exporting country is usually the shipment port.



In the early days of LNG transaction, most of the long-term contracts were concluded with DES terms due to the necessity for sellers to deliver. In recent years, the number of FOB contracts has been increasing in the new long-term contracts.

Destination

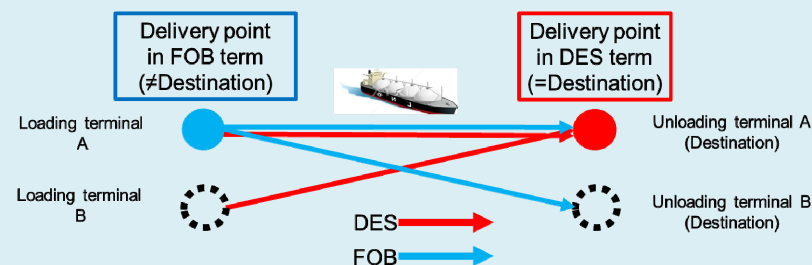
Destination means a port where an LNG ship is heading.

Under the DES term, the delivery point is the destination port (= Destination)

Under the FOB term, the delivery point is the shipment port (≠ Destination)

Under a DES contract, a provision that specifies the destination is necessary, as the delivery point is an unloading terminal and the seller is responsible for transportation to the unloading terminal.

Under an FOB contract, a provision that specifies the destination is not necessary, as the delivery point is a loading terminal and the buyer is responsible for transportation from the loading terminal.



6 Destination Clauses and Destination Restrictions

Destination Clauses

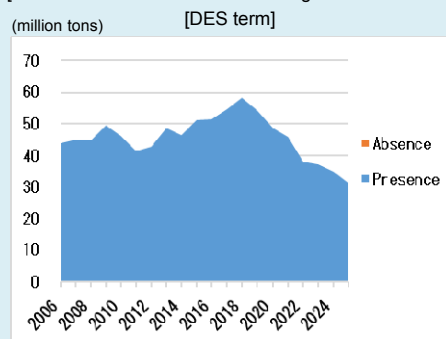
Destination clauses mean the clauses that designate a list of unloading terminals as destination ports of LNG ships.

Provision of destination clauses

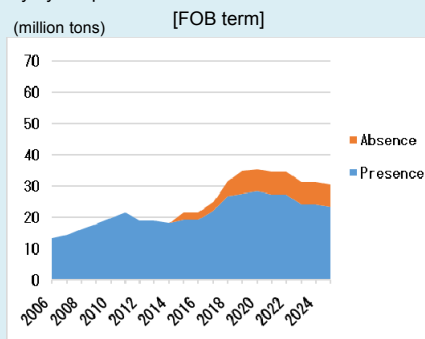
All long-term DES contracts provide destination clauses.
Most long-term FOB contracts also provide destination clauses.

- * The majority of the long-term FOB contracts that do not provide destination clauses are purchase contracts concluded with the subsidiaries of users to receive 1) LNG corresponding to the rights and the interests acquired through the participation in a project (Equity lifting) or 2) LNG liquefied from natural gas purchased in production countries on commission (Liquefaction Tolling Agreement).

[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of destination clauses]



Source: The JFTC based on reports from users



Source: The JFTC based on reports from users

Scope of destination

There are two methods to designate a list of unloading terminals: 1) a listing method and 2) a comprehensive designation method.

However, **there are few contracts** (only 15.9% of all FOB contracts) **whose list of unloading terminals includes foreign unloading terminals**. As for the **contracts whose list of unloading terminals include unloading terminals other than those of buyers**, 60.6% of FOB contracts include such unloading terminals, while, **the volume of such DES contracts is still small** (27.3%).

[The scope of destination]

Source: The JFTC based on reports from users

Method of defining	Scope of Destination	Percentage (DES)	Percentage (FOB)
Listing method		93.8%	49.7%
	List only names of buyers' unloading terminals	68.9%	33.9%
	List names of other unloading terminals than those of buyers	24.9%	15.8%
	<div>Including co-buyers' terminals</div> <div>Including other domestic terminals than buyers</div> <div>Including foreign terminals</div>	18.4%	3.8%
Comprehensive designation method		6.2%	50.3%
	Comprehensive designation only of unloading terminals of buyers	3.7%	5.5%
	Comprehensive designation including other unloading terminals than those of buyers	2.4%	44.8%
	<div>Including co-buyers' terminals</div> <div>Including other domestic terminals than buyers</div> <div>Including foreign terminals</div>	1.7%	32.6%
		0.7%	38.0%
		0%	15.9%

Destination Restrictions / Destination Flexibility

In this report, a certain extent of restrictions on buyers' free designation and diversion of destinations are called **"destination restrictions"**. Also, the extent to which users can designate destination ports or divert to alternative destinations is called **"destination flexibility"**.

- * In general, "abolishment or relaxation of destination clauses" may have the following two meanings: 1) abolishment of destination clauses and 2) relaxation of the requirements provided by diversion clauses.
 - (i) Considering abolishment of destination clauses, we must note that destination clauses are not necessary under a FOB contract, while destination clauses are necessary under a DES contract.
 - (ii) Considering the relaxation of requirements provided by diversion clauses, we must note that while the destination restrictions are considered severe under contracts that provide many restrictive requirements, users consider that the destination restrictions are the severest under contracts without diversion clauses, because sellers do not assume the possibility of diversion. Also, we must note that the level of destination restrictions depends not only on the requirements provided by destination clauses and diversion clauses but on the sellers' interpretation and operation.

6 Destination Clauses and Destination Restrictions (cont'd)

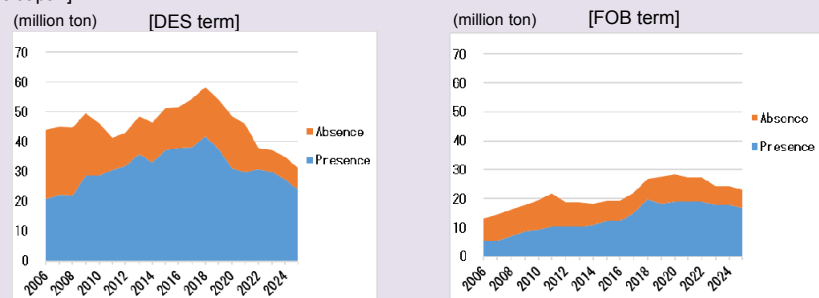
Diversion Clauses

Operational redirect to an alternative unloading terminal not in the list designated by the destination clauses is called “diversion”, and the clauses providing the requirements and the procedure of such diversions are called “diversion clauses”.

Diversion Clauses inside Japan

Among long-term contracts that provide destination clauses, **most contracts provide diversion clauses inside Japan.**

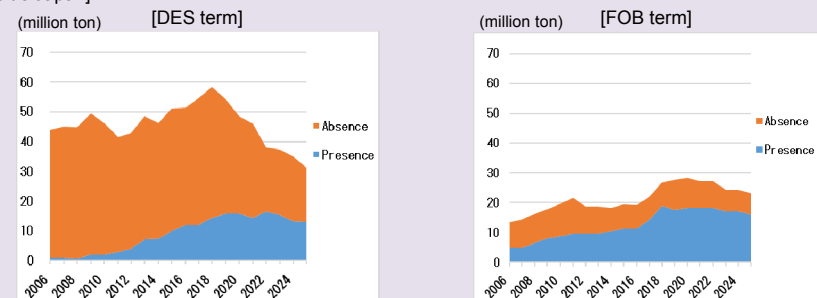
[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of diversion clauses inside Japan]



Diversion Clauses outside Japan

Among long-term contracts that provide destination clauses, **most FOB contracts and some DES contracts provide diversion clauses outside Japan.**

[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of diversion clauses outside Japan]



Requirements of Diversion with DES term

Most contracts provide fairly reasonable requirements (ii, iii or iv in the table below), and most contracts with diversion clauses inside Japan and some contracts with diversion clauses outside Japan provide competition-restraining requirements on diversion (v, vi or vii).

[Percentage of the DES contracts with requirement on diversion inside or outside Japan (Volume ratio)]

	Diversion clauses inside Japan		Diversion clauses outside Japan	
(i) Seller's consent	70.9%	[96.1%]	23.4%	[100%]
(ii) Compatibility and safety	48.4%	[65.6%]	17.4%	[74.1%]
(iii) Buyer's payment of additional cost	48.2%	[65.4%]	20.2%	[86.2%]
(iv) Limitation of assignment of ships	36.0%	[48.8%]	17.4%	[74.1%]
(v) Only buyer's operational reasons	28.2%	[38.3%]	5.2%	[22.4%]
(vi) Prohibition of reselling by commercial reasons	20.0%	[27.1%]	1.8%	[7.8%]
(vii) Prohibition of reselling to seller's consumers	1.0%	[1.3%]	1.0%	[4.1%]
(viii) Prohibition of direct reselling	0%	[0%]	0%	[0%]
Contracts falling under any of (ii)~(iv) above	55.1%	[74.7%]	21.1%	[90.3%]
Contracts falling under any of (v)~(viii) above	41.1%	[55.7%]	6.1%	[26.1%]

Note: Figures in the left are percentages in all long-term contracts. Figures in the right (in bracket) are percentages in all long-term contracts providing diversion clauses.

Source: The JFTC based on reports from users

Requirements of Diversion with FOB term

Some contracts provide fairly reasonable requirements (ii or iv in the table below), and some provide competition-restraining requirements on diversion (Inside Japan: v, vi, Outside Japan: v, vi, vii or viii).

[Percentage of the FOB contracts with requirements on diversion inside or outside Japan (Volume ratio)]

	Diversion clauses inside Japan		Diversion clauses outside Japan	
(i) Seller's consent	28.7%	[51.0%]	48.2%	[90.9%]
(ii) Compatibility and safety	7.6%	[13.6%]	4.6%	[8.7%]
(iii) Buyer's payment of additional cost	0%	[0%]	0%	[0%]
(iv) Limitation of assignment of ships	7.4%	[13.1%]	4.6%	[8.7%]
(v) Only buyer's operational reasons	7.4%	[13.1%]	8.3%	[15.6%]
(vi) Prohibition of reselling by commercial reasons	5.8%	[10.3%]	4.6%	[8.7%]
(vii) Prohibition of reselling to seller's consumers	0%	[0%]	7.4%	[13.9%]
(viii) Prohibition of direct reselling	0%	[0%]	8.9%	[16.8%]
Contracts falling under any of (ii)~(iv) above	7.6%	[13.6%]	8.9%	[16.8%]
Contracts falling under any of (v)~(viii) above	12.9%	[22.9%]	21.8%	[41.2%]

Note: Figures in the left are percentages in all of the long-term contracts. Figures in the right (in bracket) are percentages in long-term contracts providing diversion clauses.

Source: The JFTC based on reports from users

* Some users pointed out there were some cases where they hesitated to make a diversion request by considering the burden of negotiation to acquire seller's consent. Other users pointed out there were many cases where diversions could not be done due to lack of seller's consent, and, in some cases, sellers refused to divert without any explanation, and only indicated that requesting a diversion was in violation of the contract.

7 Profit Share Clauses and Resale

Profit Share Clauses

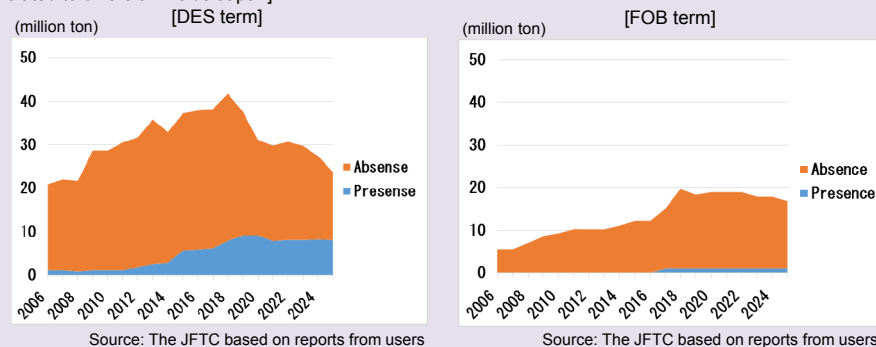
Profit share clauses are those that impose an obligation on buyers to share a part of resale profit with sellers when a buyer resells LNG to third parties by means of diversion.

- * In general, under a long-term contract without diversion clauses, the possibility of diversion is not assumed, therefore, profit share clauses are not provided in such a contract, either.
- * Users pointed out that in recent years, more contracts provide profit share clauses than before because sellers require them as a compensation for the relaxation of destination restrictions.

Profit share clauses related to diversion inside Japan

Among long-term contracts providing diversion clauses inside Japan, many contracts do not provide the profit share clauses related to diversion inside Japan.

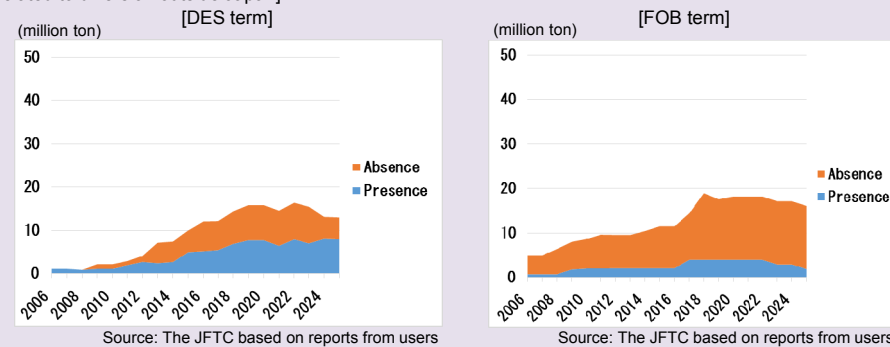
[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of profit share clauses related to diversion inside Japan]



Profit share clauses related to diversion outside Japan

Among long-term contracts providing diversion clauses outside Japan, about half of the DES contracts and some FOB contracts provide profit share clauses related to diversion outside Japan.

[Transition of the sum of Annual long-term Contract Quantity by the presence/absence of profit share clauses related to diversion outside Japan]

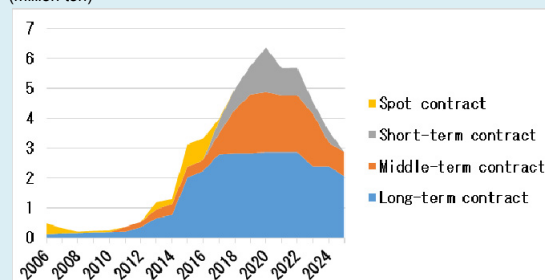


Resale

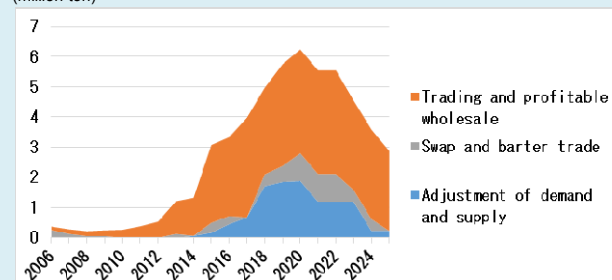
Resale means that users resell LNG purchased from sellers to other buyers.

- * The percentage of annual quantity of all resale contracts by Japanese users in the annual quantity of all long-term purchase contracts by Japanese users is forecast to reach about 7% in 2020.

[Transition of sum of Annual resale Contract Quantity classified under the length of contract-term]



[Transition of sum of Annual resale Contract Quantity classified under purpose of resale]



8 Price Trends

Price Formula

In general, natural gas contract price is decided by a certain formula.

A typical formula is “ $Y = aX + b$ ” (Y: Contract Price, X: Price Index, a: Coefficient, b: constant)

- For a price index “X”, an oil price or a natural gas market price is adopted. **A price formula that uses an oil price as a price index is called “oil indexation”. A price formula that uses a natural gas market price as a price index is called “market indexation”.**
- Coefficient “a” and Constant “b” are decided through individual negotiation.

Pricing formation mechanism in each destination

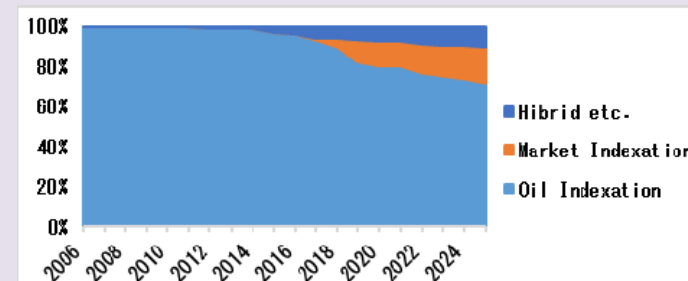
In LNG trades to Asia, the oil indexation that uses the JCC price (note 1) as an index is basically adopted. However, in recent years, the market indexation that uses the HH price (Note 2) as the price index has sometimes been adopted.

In natural gas transaction in North America, market indexation that uses the HH price as the price index is often adopted. In natural gas transaction to Europe, although the oil indexation had been adopted before, in recent years more contracts have adopted the market indexation than before.

(Note 1) JCC (Japan Crude Cocktail) price is an average price of crude oil imported into Japan. This price is monthly published by the Ministry of Finance in trade statistics.

(Note 2) Henry hub price: Henry hub is a typical formation point of natural gas price in North America.

[Transition of pricing formation ratio in Japan (Volume ratio)]



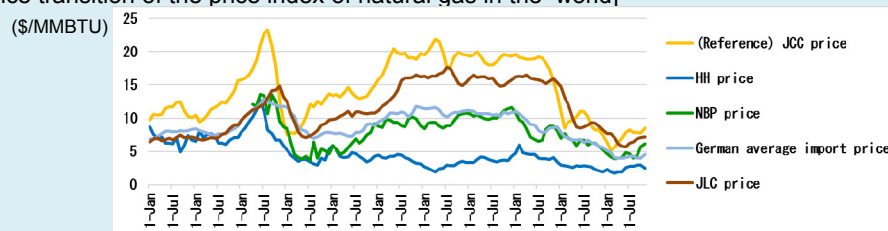
Source: The JFTC based on reports from users

Price Trends

LNG price for Asia is basically decided by the oil indexation. Due to lack of pipeline and arbitrage trade, **the LNG price for Asia is more influenced by the crude oil price than one for other areas.**

The natural gas price for North America and Europe (Note 3) is influenced by the balance between demand and supply and arbitrage trade because each area has pipeline network. **Especially, HH price is not influenced by crude oil price, and is only influenced by the balance between natural gas demand and supply in North America.**

[Price transition of the price index of natural gas in the world]



(Note 3) NBP price is a spot market price in UK.

Source: The JFTC based on public information

Influence of contract conditions on price

Some suppliers pointed out that a buyer will need to pay more for LNG contracts if destination restrictions are relaxed. Therefore, an econometric analysis (multiple regression analysis etc.) was made regarding the influence on contract prices of various contract conditions including the destination flexibility under fixed-term contracts exert.

As a result, **a significant correlation was not found between various contract conditions including the destination flexibility condition and trade price**, with only some exceptions (Note 4).

(Note 4) Significant correlation was found between the terms of delivery and the trade price; trade prices under DES terms are higher than those under FOB terms. This seems to be due to the transportation cost. A significant correlation was also found between upward quantity tolerance (UQT) and trade price. The bigger the allowable quantity of increase is, the higher the trade price is.

9 Market Environment of LNG Trade

Product Range

- ✓ Relevant products can be classified into two categories; products under fixed-term contracts (hereinafter, “fixed-term contract market”) and products under spot contracts (hereinafter, “spot contract market”).

Geographic Range

[LNG suppliers]
(Fixed-term contracts)
➢ Asia
In the Middle East, Southeast Asia, Australia,
etc.
➢ Europe
In Europe, Africa, the Middle East etc.
(Spot contracts)
All over the world

[Price formula and Price Level]
(Fixed-term contracts)
➢ There is a large difference between Europe and Asia.
➢ In Asia, price formula is oil indexation, and there is no significant difference between Japan and South Korea in price levels, for instance.
(Spot contracts)
➢ An LNG price under a spot contract is defined through arm’s length negotiation across the world.
➢ The price level has been same across the world since 2015.

- ✓ Fixed-term contract market

LNG sales market in which suppliers are in the Middle East, Southeast Asia, or Australia etc. and users are in Asia including Japan (hereinafter, “Asian market”).

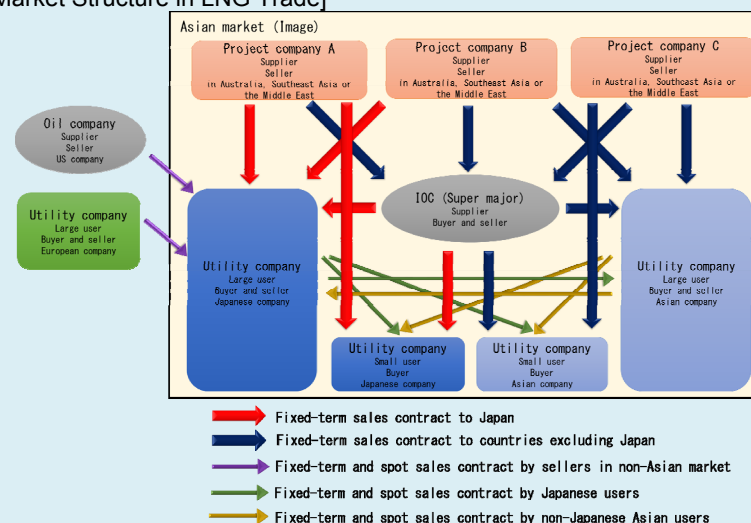
- ✓ Spot contract market

LNG sales market in which suppliers and users are from all over the world (hereinafter, “World market”).

Summary

- ✓ In this report, we discuss the influence of destination restrictions provided by fixed-term contracts to Japan in the fixed-term contract market on competition in the fixed-term contract market (Asian market) and in the spot contract market (World market).
- ✓ When we discuss the influence on competition, it is necessary to take into account that the quantity of LNG newly procurable for buyers is limited in the fixed-term contract market and/or in the spot contract market.

[Market Structure in LNG Trade]



Destination Restrictions

[Basic Understanding]

- Destination restrictions prevent Japanese users from reselling LNG to the ones such as other users in fixed-term contracts or in spot contracts practically.
- When a supplier (a seller under a fixed-term contract) prevents a user (a buyer) from reselling LNG by means of imposing destination restrictions which tend to cause a situation where new entrants are excluded in the fixed-term contract market (Asian market) or in the spot contract market (World market) and/or their trading opportunities are lessened in these markets, such conduct is deemed to have “foreclosure effects”, and is, in principle, in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).
- Resale by reloading method cannot fully be an alternative method to resale by diversion.

[Necessity and Reasonableness]

<FOB term>

- **Destination clauses are not necessary**, because the delivery point is the loading terminal (the shipping port) and the buyer is liable for the transportation after loading LNG in the shipping port.
- Although properties and risks in each cargo are transferred from sellers to buyers at the delivery point (the shipping port), destination restrictions prevent buyers from reselling freely and properly. Therefore, **such restrictions are not generally considered as reasonable**.

<FOB term>

Providing destination clauses is likely to be in violation of the Antimonopoly Act (Unfair Trade practices: Trading on Restrictive Terms).

The restrictions on diversion as well as providing destination clauses are highly likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).

<DES term>

- **Destination clauses are necessary**, because the delivery point is the unloading terminal (the destination port) and the seller is liable for the transportation before unloading LNG in the destination port.
- **“Seller’s consent” to diversion will be regarded as a natural procedure**.
- There are some contracts providing requirements of fairly necessity and reasonableness on diversion. **In some cases, however, there are differences in the interpretation of the requirements between sellers and buyers. There are also some contracts providing competition-restraining requirements on diversion.**

<DES term>

Providing destination clauses, the provision to require “seller’s consent” to diversion or the provision of the necessary and reasonable requirements to diversion are **not in itself problematic under the Antimonopoly Act**.

However, **even if a buyer’s request meets any requirements of necessity and reasonableness from a seller, when the seller refuses its consent to diversion, such refusals are likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).**

When a seller, on an operational or contractual basis, requests competition-restraining requirements for diversion, such requirements are highly likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).



Profit Share Clauses

[Basic Understanding]

- Profit share clauses prevent Japanese users from reselling LNG to other users practically and indirectly.
- Profit share clauses have some effects of decreasing the resale profit for the buyer and of depriving users of opportunities of the buyer's resale, depending on calculation methods and distribution ratios of resale profit. In addition, when the calculation methods and distribution ratios of resale profit are not clear or when a buyer is required to submit confidential information to a seller, the effect of depriving buyers of the opportunities to resale becomes more significant.
- When a seller prevents a user from reselling LNG by means of imposing profit share clauses which generate foreclosure effects, such clauses are, in principle, in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).

[Necessity and Reasonableness]

<FOB term>

- Although properties and risks in each cargo are transferred from the sellers to the buyers at the delivery point (the shipping port), profit share clauses indirectly prevent the buyers from reselling freely and properly. Therefore, in general, **such clauses are not considered as reasonable.**

<FOB term>

Providing profit share clauses is highly likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).

<DES term>

- Because properties and risks in each cargo are transferred from the sellers to the buyers at the delivery point (the destination port), sharing resale profit with a seller is regarded as a kind of compensation for changing contractual requirements after seller's consent to resale. Therefore, **such clauses have some reasonableness, even though they indirectly prevent the buyer from reselling LNG.**
- Such clauses have some reasonableness because of providing an immediate and smooth solution as to the difficulty in determining the sellers' non-quantifiable risk.

<DES term>

Providing profit share clauses is **not in itself problematic under the Antimonopoly Act.**

However, **(i) when such clauses contribute to unreasonable profit sharing with a seller, or (ii) when such clauses have some effects to prevent a buyer from reselling due to a seller's request for the disclosure of the profit or cost structure, these are likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Trading on Restrictive Terms).**

Take or Pay Clauses

[Necessity and Reasonableness]

- **Guarantee of sustainable and full payment of contract by users is an important element for a final investment decision because an LNG project needs a large initial investment and loans.**

Providing Take or Pay clauses is **not in itself problematic under the Antimonopoly Act.** However, **when a seller's bargaining position is superior to that of a buyer and the seller unilaterally imposes Take or Pay clauses and strict minimum purchase obligation without sufficient negotiation with the buyer even after the seller has already got sufficient return for initial investment, strict minimum purchase obligation as well as providing Take or Pay clauses are likely to be in violation of the Antimonopoly Act (Unfair Trade Practices: Abuse of Superior Bargaining Position).**

Based on this report, when LNG sellers conclude a new contract or revise a contract after the expiration, LNG sellers should not provide competition-restraining clauses nor take business practices which lead to the restrictions of resale and so on. Also, as for the existing contracts before the expiration, LNG sellers, at least, should review competition-restraining business practices which lead to restrictions of resale and so on.

When active competition in the fixed-term contract market and the spot contract market leads to reduction of the LNG procurement cost, LNG buyers are expected to properly reflect such reduction on electricity rates or city gas rates and to contribute to the benefit of Japanese consumers.

The JFTC will keep monitoring the LNG market and take strict actions against any violations of the Antimonopoly Act.