

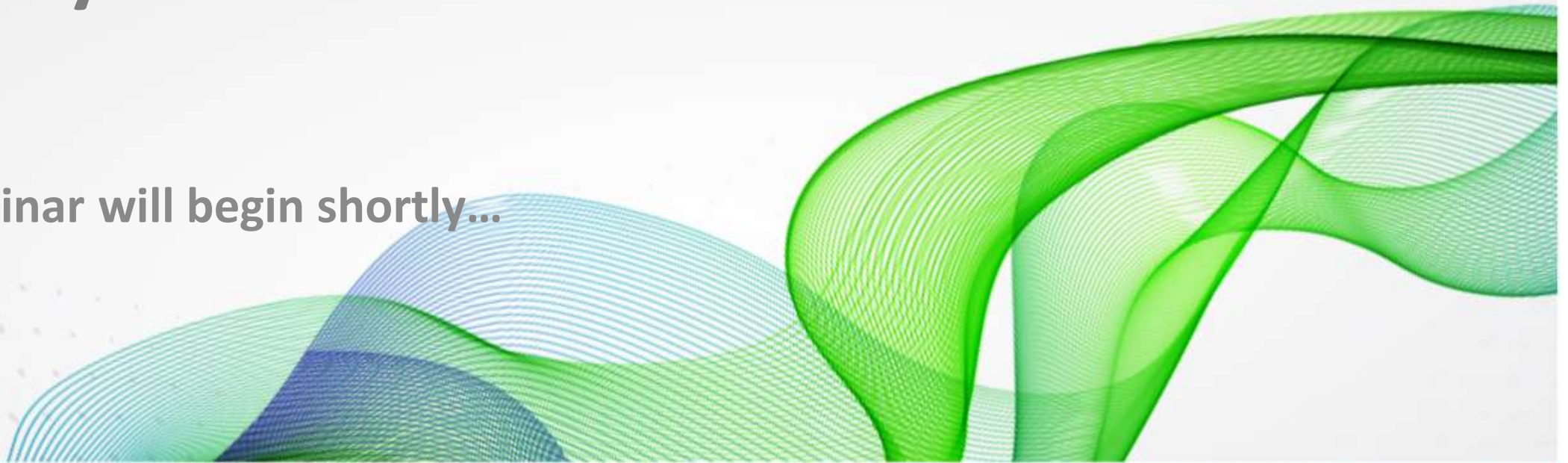


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# International gas contracts: between flexibility, security and decarbonisation

The webinar will begin shortly...





## Chair:

Dr Michal Meidan (Director, Gas Research Programme, OIES)

## Introductory remarks:

- Dr Bassam Fattouh (Director, OIES)
- Manuel Calvo Díaz (Director of Energy and Environment, Fundación Naturgy)

## Speaker:

- Agnieszka Ason (Senior Visiting Research Fellow, OIES)

## Discussants:

- David Ledesma (Distinguished Research Fellow, OIES)
- Professor Paul Griffin (CEPMLP, University of Dundee; Senior Adviser and Counsel, Oil & Gas, White & Case)



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# International gas contracts: between flexibility, security and decarbonisation

28 November 2022

Agnieszka Ason

Senior Visiting Research Fellow, OIES



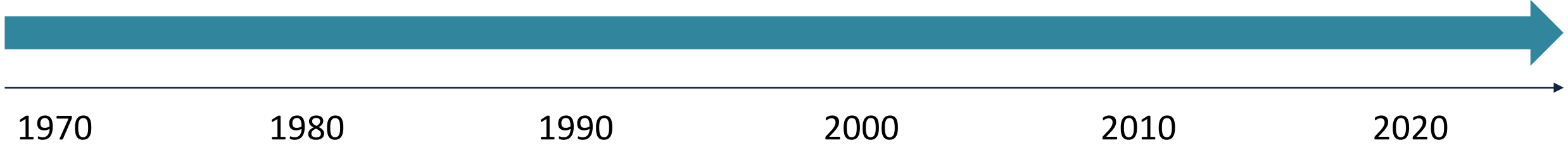
# Introduction to international gas contracts

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## *Starting point*

20+ years, inflexible, point-to-point delivery, 100% take-or-pay

**Gas Supply Contracts (GSAs) and LNG Sale and Purchase Agreements (SPAs)**



## *Recent developments*

- The emergence and growing relevance of short-term and spot trading.
- International gas contracting becomes more diverse.
- **Long-term contracts remain the key contractual mechanism for international gas and LNG sales.**



# GSAs and LNG SPAs: key contract terms and context

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- Duration
- Price
- Volume
- Transportation
- Quality specification
- Governing law
- Contract adjustment
- Dispute resolution
- Contract termination

## *International gas contracts amidst market disruptions*

The impact of the Covid-19 pandemic and the Russian invasion on Ukraine on:

- existing contracts (rouble gas payment demands, force majeure notices, price review requests),
- new contracts (priorities in contract negotiations, building blocks of new-generation contracts).



# Key challenges of international gas contracts

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**Flexibility**

**Security**

**Decarbonisation**

- **Contract price**
  - Greater diversity of pricing mechanisms in long-term contracts
  - Growth of alternatives to oil indexation in Europe and Asia
  - New-generation price review clauses in Asian LNG SPAs
- **Operational terms**
  - Delivery rescheduling
  - Volume rebalancing requests
  - Enhanced legal protection for buyers and sellers
- **Contract adjustment**
  - Focus on contract renegotiation clauses
  - Recalibration of contract terms in response to changed circumstances
  - The right balance between contract flexibility and stability

- **Traditional approaches**
  - Security of offtake
  - Security of supply
- **New imperatives**
  - **Security of supply in a global context**
    - Delivery failures and interruptions, disputes, and risk mitigation
    - Search for additional supplies of non-Russian gas and LNG
  - **Security of demand in a low-carbon future**
    - Growing focus on environmental performance of gas and LNG trade
    - Locking gas and LNG volumes in contracts going beyond 2030
- **The resurgence of longer-term international gas contracts**





## **'Carbon-neutral' LNG**

See Jonathan Stern, *Greenhouse Gas Emissions from LNG Trade: from carbon neutral to GHG-verified*, OIES Energy Insight, September 2022: 'Although 'carbon neutral' has been used as a label attached to LNG cargos where some volume of GHGs has been subject to the purchase of equivalent credits, there has been no transparency around whether and how these have been estimated and/or measured. Therefore while 'publicity stunt' could be considered a harsh judgement, these trades fall short of a required standard of environmental credibility.'

## **Precedential GHG-verified LNG SPAs**

## **Responsibly sourced / certified gas**

## **Prospects of certified gas LNG exports**

## **Focus on carbon capture and storage (CCS) and other emissions reduction technologies**

**Is there scope for international gas contracts applying GHG emissions mitigation measures (in addition to GHG emissions transparency)?**



# International gas contracts with GHG neutrality objectives

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## 1. Defining GHG emissions mitigation strategy

- Key objectives ('GHG neutrality benchmark')
- Assessment of technical and operational capabilities of the parties
- Choice of GHG emissions mitigation measures and risk allocation

## 2. Impact on the contract price

- 'Green premium'
- Cost allocation
- Price formula

## 3. New rights and obligations

- Quantification of GHG emissions
- Direct emissions reductions and carbon offsets
- Compliance with regulatory measures



# Quantification of GHG emissions

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- **Methodology subject to negotiation** in the absence of regulatory requirements
- Case-specific contractual assurances and the growing role of industry standards
- GHG emissions profile as **part of gas and LNG quality specification**
- Off-specification deliveries and delivery failures: liabilities, force majeure, contract termination
- **New category of disputes** and related choices:
  - dispute resolution framework (general or separate),
  - dispute resolution method (e.g., expert determination),
  - efficiency measures (e.g., time limits).



## Direct emissions reductions and carbon offsets

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- Fitting direct emissions reductions and/or carbon offsets into the delivery program
- Impact on contract flexibility terms – potential ‘flexibility losses’ for the parties
- Allocating risks of emissions reduction technologies across the value chain
- Mitigating the exposure to external risks of carbon markets
- Novel issues related to carbon credits (supply, transferability, retirement)
- Positioning GHG mitigation measures: within the SPA/GSA or in ancillary contracts?



# Compliance with regulatory measures

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- Decarbonisation is a regulatory risk in international gas contracts.
- The need to comply with new regulatory measures may affect earlier GHG emissions-related arrangements of the parties.
- Decarbonisation requirements will be increasingly relevant in price reviews, potentially serving as (i) a price review trigger and/or (ii) a factor to consider in a price review process.
- In long-term contracts, decarbonisation is particularly likely to have a sweeping impact on the contract terms (going well beyond the contract price).
- Robust contract adjustment mechanisms (Paul Griffin: ‘carbon reopeners’) can serve as a hedge against the uncertainty of decarbonisation requirements.



## Conclusions and contracting outlook

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1. Decarbonisation requirements have created new objectives of securing GHG emissions transparency and mitigation in international gas contracts.
2. Precedential GHG-verified LNG SPAs and certified gas sales have been announced.
3. Long-term gas and LNG supply contracts with GHG neutrality objectives (applying emissions mitigation measures in addition to emissions verification) will be the next step.
4. In the short term, the focus of market participants will be on the security of supply.
5. In the long run, the approach to GHG emissions will serve as an important differentiator for international gas contracts, shaping the dynamic of contract negotiation and execution.



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# Thank you!

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<https://www.oxfordenergy.org/gas-programme/>



# Thank you

The paper and podcast can be found at the **OIES** website:

Paper: <https://www.oxfordenergy.org/publications/international-gas-contracts/>

Podcast: <https://www.oxfordenergy.org/publications/oies-podcast-international-gas-contracts/>

And on the **Fundación Naturgy** website in English and Spanish

<https://www.fundacionnaturgy.org/en/producto/international-gas-contracts/>

