



ENERGY INSIGHTS – LNG

APRIL 2022

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THE ROLE OF LNG IN EUROPE'S QUEST FOR ENERGY DIVERSIFICATION:

Challenges, Chances, and Concerns – and the Contractual Fundamentals of Contracting LNG Supplies

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ABSTRACT

The war in Ukraine has prompted EU leaders to step up their efforts in diversifying European gas supplies away from Russia. A steep increase in supplies of LNG to Europe is seen as one important part of the answer. In the short term, the question may be whether Europe has sufficient LNG uptake capacity and, if so, whether it can attract sufficient supplies on a tight global market. On the longer term, rebounding supplies will likely be secured in long(er) term LNG supply contracts to be concluded by European buyers.

The present paper outlines the current market and political environment in Europe and gives some insights into the nuts and bolts of contracting for LNG supplies. In particular, the authors discuss pricing issues, the term of the contract, offtake obligations and volume flexibility. They also shed light on price revision clauses, "hardship" and force majeure, as well as the delivery terms. The paper is wrapped up by an assessment of the dispute resolution and choice of law clauses to be included in LNG supply contracts.

In our analysis, the focus lies on challenges resulting from the present market and political environment. The main perspective taken is that of potential European LNG buyers. The paper addresses selected contractual issues only; while it provides some general guidance and food for thought, it cannot replace individual legal advice.

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1. INTRODUCTION: EUROPE'S NEED TO DIVERSIFY FROM RUSSIAN GAS

On 24th February 2022, Russia started its invasion of Ukraine. Ever since, the world has not been the same anymore, particularly in Europe. The war has caused immeasurable human tragedy and is likely to cause severe economic fallout. Amongst others, the war in Ukraine has made EU member states, once again, painfully aware of one major flaw in the European energy system: the **EU's traditional overdependence on Russian natural gas**. Some 45 % of the EU's total gas imports come from Russia, but levels of dependence vary considerably across EU member states, reaching as high as 55 % in Germany or even 80% in Austria.¹ Also, the invasion came at a time when gas storage levels across Europe were already at record lows and falling steeply ever since.² Whilst the EU³ and certain member states have spun into regulatory action to prescribe minimum storage filling levels to avert a full-blown gas crisis,⁴ the challenge will of course be to "find" enough gas to fill storages.⁵ More recently, prompted by Russia's announcement to accept payment under gas supply contracts in their local currency, Ruble, only, some member states (notably Austria and Germany) have proclaimed the early warning stage of their respective gas supply emergency plans.⁶ At the next stages, industrial users may well face reduced gas quotas, with production reduction or even shut-downs as a potential consequence.

The situation is hence serious. On 8 March 2022, the EU commission has, against this background, announced plans to eliminate dependence on Russian gas by 2030: In its **"REPowerEU" Communication**, the EU announced plans to diversify gas supplies and fill storage levels across

¹ European Union, European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions REPowerEU: Joint European Action for more affordable, secure and sustainable energy, COM(2022), 108 final, p 2; BMWI, FAQ-Liste LNG-Terminal in Deutschland, available at: https://www.bmw.de/Redaktion/DE/Download/S/faq-liste-lng-terminal-in-deutschland.pdf?__blob=publicationFile&v=8; K. Abnett, No EU countries have signalled gas supply emergencies, European Commission says, Reuters 31.03.2022, available at: <https://www.reuters.com/business/energy/no-eu-countries-have-signalled-gas-supply-emergencies-european-commission-says-2022-03-31/> (03.04.2022).

² European Gas Hub, *European gas storage: fill up the tank please*, available at: <https://www.europeangashub.com/european-gas-storage-fill-up-the-tank-please.html> (29.03.2022); N. Buli, *European gas storage levels survive winter but summer refilling looms*, Reuters 18.02.2022, available at: <https://www.reuters.com/business/energy/european-gas-storage-levels-survive-winter-summer-refilling-looms-2022-02-18/> (29.03.2022); latest storage information can be found on: <https://agsi.gie.eu/#/>.

³ Regulation (EU) 2017/1938.

⁴ Energielenkungsgesetz § 26 ff.

⁵ Another question further down the line may be how to incentivize or else compel storage customers to inject sufficient volumes where gas prices will likely remain high over the summer (cf M. Fulwood et al, *The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications*, OIES Energy Insights: 110, p 28, available at: <https://a9w7k6q9.stackpathcdn.com/wpcms/wp-content/uploads/2022/03/Insight-110-The-EU-plan-to-reduce-Russian-gas-imports-by-two-thirds-by-the-end-of-2022.pdf>).

⁶ BMWI, Bundesministerium für Wirtschaft und Klimaschutz ruft Frühwarnstufe des Notfallplans Gas aus – Versorgungssicherheit weiterhin gewährleistet, Pressemitteilung 30.03.2022, <https://www.bmw.de/Redaktion/DE/Pressemitteilungen/2022/03/20220330-bmwk-ruft-fruehwarnstufe-des-notfallplan-gas-versorgungssicherheit-gewaehrlistet.html> (30.03.2022, 18:05); Bundeskanzleramt, Ukraine-Gasversorgung: Krisenkabinett der Bundesregierung und Behörde E-Control rufen Frühwarnstufe aus, Media Information 30.03.2022, available at: <https://www.bundeskanzleramt.gv.at/medien/medienangebote/medieninformation.html>.

the EU to at least 90 % by 1 October 2022.⁷ Additional “non Russian” gas is wanted – and LNG imports from alternative suppliers are one focus of how EU leaders propose gas inflows to Europe can be increased. The EU proposes an estimated 50 billion cubic meters⁸ equivalents of LNG annually to replace Russian gas starting by the end of the current year 2022 (and a mere 10 bcm in pipeline import diversification). Equally in March 2022, the **International Energy Agency** released a **“10-Point Plan to Reduce the European Union’s Reliance on Russian Natural Gas”**, which also recommends turning to different pipe gas sources as well as to LNG in order to achieve diversification and securing supply in Europe.⁹

Europe’s overdependence issue is two-fold: On the one hand, the acute problem is Europe’s need to replenish its almost depleted gas storages before the next heating season to avoid industry lockdowns or, even worse, a full-blown gas supply crisis. This calls for short-term solutions. On the other hand, Europe needs to achieve diversification of its natural gas supplies in the medium and long term. In this regard, one question may also be, what role LNG is to take in the energy mix and as a substitute to Russian gas, specifically in the long run. Notably, in line with Europe’s *Fit for 55* goals,¹⁰ the Union has vowed to make a strong push for renewables, including renewable and low-carbon gases such as biomethane and hydrogen¹¹, on the supply side, as well as for energy efficiency, on the demand side.¹² Commentators across the political spectrum will agree that there is some controversy on what role natural gas, and particularly LNG, should have in the energy transition.

So, how will LNG be part of the answer? In fact, EU politicians¹³ have already declared LNG a short-term solution and long-term supplies are already being negotiated as we write. The coming weeks and months will probably shed more light on the challenges, chances and concerns associated with stepping up LNG supplies to Europe. Whilst things are very much in flux, the authors share their current thoughts and observations by first, briefly, addressing the **current and potential role of LNG in the European gas and energy market**, also with a view to energy transition (**Section 2**), before turning to the **fundamentals of LNG supply contracts (Section 3)**, giving guidance and insights on some aspects of typical contractual provisions. When discussing contractual clauses, we will give particular focus to considerations that may be relevant in the eyes of those actors now tasked with implementing the lofty European diversification goals – the

⁷ COM (2022), 108 final, p 4-5.

⁸ Billion cubic meters is subsequently abbreviated as “bcm”.

⁹ IEA (2022), *A 10-Point Plan to Reduce the European Union’s Reliance on Russian Natural Gas*, IEA, available at: <https://www.iea.org/reports/a-10-point-plan-to-reduce-the-european-unions-reliance-on-russian-natural-gas>.

¹⁰ COM (2022), 108 final p 8.; IEA (2022), *A 10-Point Plan to Reduce the European Union’s Reliance on Russian Natural Gas*, point 4.

¹¹ COM (2022), 108 final, p 9.

¹² IEA (2022), *A 10-Point Plan to Reduce the European Union’s Reliance on Russian Natural Gas*, point 8.

¹³ Reuters (25.03.2022), *U.S. LNG will help reduce EU’s Russian gas dependency, von der Leyen says*, available at: <https://www.reuters.com/business/energy/us-lng-will-help-reduce-eus-russian-gas-dependency-von-der-leven-says-2022-03-25/> (29.03.2022).

potential European buyers of LNG on the global market.

2. LNG AND THE EUROPEAN (LIQUIFIED) GAS MARKET IN EARLY 2022

2.1. CURRENT ROLE OF LNG IN THE EUROPEAN GAS MARKET

To recap the basics: Liquefied Natural Gas (LNG) is natural gas which, after having been purged from certain components, is brought to its liquid form by cooling down the gas to -162°C. Through this process of liquification, the volume shrinks by a factor of about 600. Therefore, as compared to its gaseous form, the quantity that can be transported or stored is increased by the factor 600 whilst taking the same space. The LNG produced in the liquefaction facility is then loaded onto LNG carriers – specialized vessels – to be transported to markets overseas. At its destination, the LNG is generally re-gasified before further transmission via pipeline.¹⁴

The re-gasified LNG can be used in the same way as natural gas to produce electricity or heat. Moreover, LNG in its liquid form is also increasingly used as a fuel for heavy-duty trucks or ships; power plants use LNG as backup fuel in case of a peak in demand.¹⁵ When produced from renewable sources (i.e. bio gas derived from organic matter such as waste), LNG will turn into LBG – liquified bio gas, *aka* biomethane.

Natural gas accounts for some 21,5 % of the EU's primary energy consumption. As the world's biggest gas importer, the **EU imports 80 % of its gas demand from third countries**.¹⁶ In 2021, 20 % of gas imports were made in the form of LNG cargoes, whereas the main European importers were Spain, France and Italy.¹⁷

In 2021, **Russia** was not only Europe's dominant source of pipe gas, but also ranked within the three main suppliers of LNG to Europe (2021: 20 %).¹⁸ The ambitious goal of massively reducing and ultimately replacing Russian gas imports in their entirety will hence leave a massive gap, which other suppliers must fill quickly. Indeed, the main LNG supplier to Europe in 2021 – the **United States** – already announced that they would make available substantial additional LNG

¹⁴ IGU, *Natural Gas Advantage Facts&Figures*, available at: <https://www.igu.org/facts-figures/> (29.03.2022).

¹⁵ B. Palmer, *Liquefied Natural Gas 101*, NRDC 04.01.2022, available at: <https://www.nrdc.org/stories/liquefied-natural-gas-101> (29.03.2022).

¹⁶ ACER, *Gas Factsheet*, available at: <https://www.acer.europa.eu/gas-factsheet> (29.03.2022).

¹⁷ IGU, *2021 World LNG Report*, p 9, available at: <https://www.igu.org/resources/world-lng-report-2021/>.

¹⁸ V. Zaretskaya & W. Wilczewski, *Europe relies primarily on imports to meet its natural gas needs*, U.S. Energy Information Administration 11.02.2022, available at: <https://www.eia.gov/todayinenergy/detail.php?id=51258> (29.03.2022).

supplies.¹⁹ Accordingly, US LNG developers see their chance of securing European supply contracts to underpin financing for the expansion of LNG facilities.²⁰ Notwithstanding, further supplier countries will be required to satisfy all of Europe's need for gas. Negotiations with other potential supplier countries such as **Qatar** (currently providing 24 % of LNG imports to Europe)²¹, East Africa or maybe even Australia (the world's biggest exporter of LNG)²² may be expected and are, partly, already on their way.²³

2.2. LNG AND ENERGY TRANSITION

According to EU leaders, natural gas has a role in the EU policy framework for energy transition, often referred to as a **"bridge fuel"** required to back up renewables in power generation during the transitory period.²⁴ In particular, the use of natural gas (and LNG), which has lower combustion emissions relative to other fossil fuels - particularly coal²⁵ - may be considered as a "greener" alternative to rebounding coal fired power plants, gas-to-oil switching, or ramping up nuclear power generation. However, increased LNG imports to the EU – the largest gas importing region with highly climate-sensitive policies – may also meet challenges and concerns:

To start with, LNG, when taking into account the entire LNG supply chain, produces significantly **more lifecycle greenhouse gas-emissions than commonly associated with pipe gas**²⁶ - LNG is hence seen as a less "green" alternative.²⁷ One particular issue with LNG is that of **methane emissions** (methane being a much more potent greenhouse gas than carbon dioxide) which may

¹⁹ Of 15 bcm of LNG per year; K. Taylor, *EU, US strike LNG deal as Europe seeks to ditch Russian gas*, EURACTIV 25.03.2022, available at: <https://www.euractiv.com/section/energy/news/eu-us-strike-lng-deal-as-europe-seeks-to-ditch-russian-gas/> (29.03.2022)

²⁰ S. Kennedy, *Opinion: Europe's wartime dash for LNG complicates US-China trade*, Energy Monitor, 6.04.2022, available at: <https://www.energymonitor.ai/policy/international-treaties/opinion-europes-wartime-dash-for-lng-complicates-us-china-trade> (20.4.2022).

²¹ V. Zaretskaya & W. Wilczewski, *Europe relies primarily on imports to meet its natural gas needs*, U.S. Energy Information Administration 11.02.2022, available at: <https://www.eia.gov/todayinenergy/detail.php?id=51258> (29.03.2022).

²² IGU (2022), 2021 World LNG Report, p 9.

²³ B. Anderson, *Qatar will stand 'in solidarity' with European countries during energy crisis*, CNN Business 25.03.2022, available at: <https://edition.cnn.com/2022/03/24/energy/qatar-gas-europe/index.html> (04.04.2022, 09:42); J. Holleis & M. Schwikowski, *Europe looks to Africa to fill natural gas gap*, DW 04.03.2022, available at: <https://www.dw.com/en/europe-looks-to-africa-to-fill-natural-gas-gap/a-61017873> (04.04.2022)

²⁴ Recently, e.g. in the framework of the EU Taxonomy (cf. European Commission (01.01.2022), *EU Taxonomy: Commission begins expert consultations on Complementary Delegated Act covering certain nuclear and gas activities*, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_2 (04.04.2022)).

²⁵ Although natural gas is not a low-carbon gas – like hydrogen or biogas – it still at least halves the CO2 emissions (U.S. Energy Information Administration, *How much carbon dioxide is produced when different fuels are burned?*, available at: <https://www.eia.gov/tools/faqs/faq.php?id=73&t=11> (29.03.2022)).

²⁶ Cf. e.g. the American Petroleum Institute's December 2020 report, C. Swanson et al, *Sailing to Nowhere: Liquefied Natural Gas Is Not an Effective Climate Strategy*, NRDC 08.12.2020, available at: <https://www.nrdc.org/resources/sailing-nowhere-liquefied-natural-gas-not-effective-climate-strategy> (04.04.2022).

²⁷ J. Wachsmuth et al (2019), *Wie klimafreundlich ist LNG?*, Umwelt Bundesamt, p 27, available at: <https://www.umweltbundesamt.de/publikationen/wie-klimafreundlich-ist-lng> (04.04.2022).

cast doubts on the advantages of gas, particularly LNG, as a transition fuel.²⁸ One acute challenge for LNG suppliers is hence to work towards more climate friendly and safe transport or “carbon neutral” LNG, and European buyers may so demand (see Section 3.4.4.).²⁹

Another aspect for European buyers who are working against the backdrop of the EU Green Deal may be a preference of LNG produced from conventional gas, rather than from shale gas (i.e. from hydraulic fracking-sources), given that fracking technologies are effectively banned throughout parts of Europe and have caused political controversy (see below Section 3.2.2.).³⁰

Also, as the denominator “bridging fuel” suggests, LNG’s longer-term role in Europe’s energy mix may be questionable: In the longer run, as more renewables and greater energy-efficiency measures under the EU Green Deal take effect and decrease gas demand, LNG may not be politically welcome anymore. The lack of clarity on which role natural gas (and hence LNG) should take in the future may be aggravated by the rise of new, cleaner fuels as e.g. (green) hydrogen. For LNG buyers today, this, of course, may raise concerns when it comes to longer contract durations for their LNG supplies (see below Section 3.3.2.).

Relatedly, considering LNG’s heavy reliance on dedicated infrastructure, the industry faces criticism that increasing LNG imports might **perpetuate dependence on fossil fuels** for many years to come. A new wave of long-term contracts for LNG in Europe boosting the development and construction of new LNG infrastructure around the world will not only garner praise for securing supplies, but may also raise public concerns as to what extent continued investment in fossil fuel infrastructure is still required (see below Section 3.3.2.).

2.3. POTENTIAL ROLE IN THE FUTURE MARKET: LIMITATIONS TO LNG UPTAKE IN EUROPE AND TIGHT GLOBAL SUPPLIES

Natural gas in its liquified form **“plays different roles in different markets”**.³¹ For Europe, as indicated, the latest consensus is that flexible LNG should step in to replace the gas quantities which will be missing after withdrawal of European buyers from Russian-sourced gas – or after a cutting of the tabs by the Russian supplier, whoever moves first.

²⁸ See the recent comprehensive study published by the Oxford Institute of Energy Studies in January 2022 (J. Stern, Measurement, Reporting, and Verification of Methane Emissions from Natural Gas and LNG Trade: creating transparent and credible frameworks, OIES papers: NG165, p 4, available at: <https://www.oxfordenergy.org/publications/measurement-reporting-and-verification-of-methane-emissions-from-natural-gas-and-lng-trade-creating-transparent-and-credible-frameworks/> (04.04.2022)).

²⁹ E. Blanton & S. Mosis (2021), *The Carbon-Neutral LNG Market: Creating a Framework for Real Emissions Reduction*, ENERGOPOLICY.COLUMBIA.EDU | JULY 2021, p 3, available at: <https://www.energypolicy.columbia.edu/sites/default/files/file-uploads/Carbon-neutral%20LNG%20commentary.%20design%20reflow.%2007.02.21%20.pdf> (04.04.2022)

³⁰ European Commission, *Shale gas and other unconventional hydrocarbons*, available at: https://energy.ec.europa.eu/topics/oil-gas-and-coal/shale-gas-and-other-unconventional-hydrocarbons_en (04.04.2022).

³¹ S. Finizio, *Destination Restrictions and Diversion Provisions in LNG Sale and Purchase Agreements* in THE GUIDETO ENERGY ARBITRATIONS (J. Rowley 3rd ed. (2018), Global Arbitration Review), p 218.

Efforts to step up LNG supplies to Europe had been ongoing even before the Russian war on Ukraine started; accordingly, LNG supplies were already at a record high in January 2022, at 10 bcm.³² There may be limits, however, as to how much LNG Europe can take on the one hand, and as to how much LNG Europe can attract in supplies on the global market, on the other hand. LNG may therefore rather be a mid- and long-term solution for diversification, its usage as a short-term remedy is facing challenges:

As already described above, the supply of LNG relies on the availability of dedicated infrastructure, including sufficient capacity to re-gasify any delivered LNG cargoes. Put simply, the issue here is that whilst Europe (N.B. the EU jointly with the UK) may possess sufficient **LNG terminals** overall to ramp up imports,³³ the European gas networks are not sufficiently well connected to use all terminals to their full capacity: Whilst terminals in Northwestern Europe have higher utilization rates, terminals in other parts of Europe, notably in Spain with a poor connection to the rest of Europe, are not currently suited to effectively distribute LNG inflows to other parts of Europe.³⁴ Therefore, the EU has to increase its distribution effectivity, storage volume and utilization capacity in the short term. Although, achieving these goals seems feasible, it goes hand in hand with serious costs.³⁵

In the mid to long-term, the construction of additional LNG terminals was said to be necessary to enable a sustainable increase in LNG imports to Europe (some may look to floating LNG terminals as a more short-term part of the solution). Currently, ten new LNG terminals have either been proposed or are already under construction within the EU which could provide some 67.9 bcm per year of additional LNG import capacity³⁶ – amongst those e.g. the planned German LNG terminal in Brunsbüttel with an annual capacity of 8 bcm. New European LNG terminals are already being designed with a view to ensuring their subsequent conversion and use for hydrogen or other alternative energy sources.³⁷

Increasing Europe's LNG take-up may face a second bottleneck, particularly in the short- and mid-term: **Global LNG supplies are currently tight**. There is only so much LNG in the world and

³² M. Fulwood et al, The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications, p 3.

³³ ACER (17.02.2022), *Wholesale Gas Markets Monitoring 2021 – Key developments*, p 10, available at: <https://www.acer.europa.eu/events-and-engagement/news/wholesale-gas-markets-2021-rebound-demand-lower-lng-imports-and-high> (04.04.2022).

³⁴ Global LNG Hub, *Could LNG replace Russian pipeline gas?*, available at: <https://globalnghub.com/could-lng-replace-russian-pipeline-gas.html> (29.03.2022); European Commission, *Liquefied Natural Gas*, available at: https://energy.ec.europa.eu/topics/oil-gas-and-coal/liquefied-natural-gas_en#:~:text=In%202021%2C%2013%20EU%20countries,EU%20gas%20imports%20in%202021 (29.03.2022).

³⁵ M. Fulwood et al, The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications, p 27-28; Rystad Energy, *Rystad Energy Impact Report: Russia's Invasion of Ukraine*, 21.03.2022.

³⁶ Statista, *Largest liquefied natural gas import terminal projects proposed or under construction in the European Union (EU) as of 2021, by capacity*, available at: <https://www.statista.com/statistics/1251671/leading-lng-import-terminals-projects-in-the-eu-by-capacity/> (30.03.2022).

³⁷ Cf. the example of the German-Brunsbüttel terminal (German LNG Terminal, *German LNG Terminal and Shell sign Memorandum of Understanding on the import of LNG through the planned terminal in Brunsbüttel*, Press release 23.03.2022, available at: https://germanlng.com/wp-content/uploads/2022/03/EN_2022-03-22-PM-MoU-Shell.pdf).

existing volumes are, to a large extent, bound in long-term contracts; additional volumes cannot be brought onto the market on short notice, given the considerable lead time and investment volumes to expand liquefaction and shipping capacities. Also, LNG supply globally is forecast to remain tight in the coming years, with the next substantial supply additions projected for 2025-2027.³⁸ In the medium and long run, overall supplies are forecast to rebound and existing volumes may be freed up following the expiry of long-term delivery obligations.³⁹

For the coming years, however, LNG suppliers have already warned that the limited worldwide LNG supply may not be able to satisfy all European demand.⁴⁰ A short-term solution may lie – and, to some extent, has already been practiced – in attracting individual LNG cargoes to the European market, including both spot cargoes as well as cargoes that can be diverted under existing term contracts with destination flexibility (see below Section 3.4.4.). This **cargo diversion** from other markets, notably from Asia, however, also presupposes that a sufficient spread between the prices paid by European buyers and those prices achievable on the initially designated (mostly: Asian) markets persists.⁴¹ The short-term solution will hence not be cheap. Cargoes could e.g. be shipped to UK terminals, re-gasified there and the gas would then be flowing into Continental Europe via the Interconnector.⁴²

3. CONTRACTING FOR LNG

3.1. INTRODUCTION

3.1.1. In LNG Supply Contracts, there is No One-size-Fits-all

When we get to the nuts and bolts of contracting for LNG supplies, the first realization must be that – apart from the LNG-commodity trades which often rely on Master Sales Agreements – there

³⁸ M. Fulwood et al, The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications, p 28.

³⁹ M. Fulwood et al, The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications, p 27.

⁴⁰ K. Witsch, *Öl- und Gaskonzern Shell warnt: Auch LNG könnte knapp werden*, Handelsblatt 21.02.2022, available at: <https://www.handelsblatt.com/unternehmen/energie/verfluechtigtes-erdgas-oel-und-gaskonzern-shell-warnt-auch-lng-koennte-knapp-werden/28089360.html> (30.03.2022, 16:38); IGU (2022), 2021 World LNG Report, p 43-45.

⁴¹ And that this spread does not only provide a delta in the commodity price but also cover any costs of such diversion, including sums payable to the initial contract partner to “unwind” a spot cargo sale (cf A. Patten & P. Thomson, *LNG Trading in LIQUIFIED NATURAL GAS: THE LAW AND BUSINESS OF LNG*, (Griffin 3rd ed. (2017)), p 281).

⁴² M. Fulwood et al, The EU plan to reduce Russian gas imports by two-thirds by the end of 2022: Practical realities and implications, p 4; Reuters (24.03.2022), U.S., UK to send more LNG to Europe -British ambassador, available at: <https://www.reuters.com/business/energy/us-uk-send-more-lng-europe-british-ambassador-2022-03-24/> (04.04.2022).

is no such thing as a standard LNG supply contract (yet).⁴³ Rather, there is a **variety of different contract designs** for LNG supplies.⁴⁴ Those vary substantially, e.g. in terms of duration (short term vs long term⁴⁵), delivery terms (e.g. delivered FOB at the loading board versus delivered ex ship at the unloading board⁴⁶), pricing formulas (e.g. oil indexation vs hub indexation or hybrid formulas⁴⁷), point-to-point contracts versus portfolio contracts,⁴⁸ destination-specific supplies versus destination-free supplies, etc.

This diversity of contractual terms and conditions is due, amongst others, to a heterogenous and not (yet) globalized LNG market: Different buyers and sellers – ranging from gas producers to portfolio sellers, and from utilities to trading companies – are active on different gas markets into which LNG is supplied. Rapidly shifting market forces impact the eventual contract design and the negotiated outcome.⁴⁹ As indicated, there is **no truly global LNG market** (as yet) and, even within regions, LNG pricing and terms differ.⁵⁰

3.1.2.A Seller's Market

The specific allocation of risks in individual contracts (price, quantity and other risks) will typically reflect the **market forces** at play at the time and in the region of contracting. Indeed, LNG supply agreements are and probably will remain, in the near future, "**heavily negotiated and tailored contracts between diverse sellers and buyers**".⁵¹ The European LNG-supplies will likely be no exception, even though these are probably challenging times to go shopping for LNG:

Already in the past, LNG markets have been highly dynamic, repeatedly shifting between a seller's and a buyer's market: As outlined above, the current market fundamentals – tight supplies and increased, urgent European demand, soaring hub prices for natural gas⁵² – make for a perfect **seller's market**. Needless to say, this may not be the best time for European buyers who come

⁴³ When it comes to LNG trading in the course of short-term transactions – as opposed to long or longer-term supply contracts – there are Master Sales Agreements ("MSAs") regulating certain contractual aspects (P. Griffin & M. Jarvis, *Obligations and failures to deliver or take under long-term LNG sale and purchase agreements* in LIQUIFIED NATURAL GAS: THE LAW AND BUSINESS OF LNG, (Griffin 3rd ed. (2017)), p 216; S. Barra, *LNG master sale and purchase agreements* in LIQUIFIED NATURAL GAS THE LAW AND BUSINESS OF LNG, (Griffin 3rd ed. (2017)), p 287), those MSAs are closely related to the kind of framework agreements typically found in commodity trading (P. Griffin & M. Jarvis, *supra*, p 220).

⁴⁴ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 1 and 7.

⁴⁵ See below Section 3.3.1. and 3.3.2.

⁴⁶ See below Section 3.4.4.

⁴⁷ See below Section 3.2.

⁴⁸ S. Finizio, *Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 18.

⁴⁹ H. Sullivan, *LNG sale and purchase agreements* in LIQUIFIED NATURAL GAS: THE LAW AND BUSINESS OF LNG, (Griffin 3rd ed. (2017)), p 185.

⁵⁰ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*; Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 4.

⁵¹ H. Sullivan, *supra*, p 212.

⁵² European Commission (17.01.2022), *Quarterly market reports confirm influence of global gas prices in EU in the third quarter of 2021*, available at: https://ec.europa.eu/info/news/quarterly-market-reports-confirm-influence-global-gas-prices-eu-third-quarter-2021-2022-jan-17_en (04.04.2022)

to the negotiation tables with a long wish-list driven by security supply concerns and energy transition requirements, to dictate contract terms. Commercial and political leverage may be increased where the EU actors proceed united.⁵³ Either way, it will be of particular importance to enter any such contract negotiations with a good understanding of the workings of LNG supply contracts, in general, and aware of the specific contractual questions which may arise in the present market and political context, in particular.

It is a truism that **good and far-sighted contract drafting** will prevent the hassle and cost of disputes arising further down the road. In the following, we will discuss the key contract parameters, i.e. price (Section 2), term and volumes (Section 3), before turning to other potentially relevant clauses (Section 4). We will do so with a particular focus on the potential perspective of European buyers.

Of course, this paper can only highlight a small selection of contractual issues. It cannot replace individual legal advice.

3.2. CONTRACT PRICE

3.2.1. Decoupling of LNG from Oil-prices in the European Market

Discussing pricing in gas supply contracts, including LNG supply contracts, cannot do without a quick look back in time: **Historically**, prices for LNG were **tied to the price of oil**, just as were prices for pipe gas.⁵⁴ For lack of a market price for the commodity natural gas, the oil price was the next best proxy. Most LNG supply contracts **globally** are still indexed, at least in part, to the oil price (particularly Brent) today.⁵⁵ Whilst prices are somewhat starting to converge, pricing regimes have not even harmonized regionally; even less is there a global market price for LNG.⁵⁶

Looking at the European natural gas markets, gas prices **decoupled** from the oil price when **liquid trading hubs** for natural gas emerged in the wake of liberalisation of European gas markets in the 2000s. It is these European gas hubs on which gas volumes are traded and which now send transparent price signals – in some contrast to the Asian gas market, where a liquid trading hub has so far failed to develop.⁵⁷ With a focus on Continental Europe these hubs include, first and foremost, the TTF (Title Transfer Facility), the Dutch virtual trading point; the German gas hub THE (“Trading Hub Europe”, born from a merger of the NCG and Gaspool market areas as of 1 October

⁵³ European Commission, *Commission outlines options to mitigate high energy prices with common gas purchases and minimum gas storage obligations*, Press release 23.03.2022, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1936.

⁵⁴ E.g. L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 2.

⁵⁵ IGU (2022), *2021 World LNG Report*, p 35.

⁵⁶ H. Sullivan, *supra*, p 198.

⁵⁷ Therefore, Asian market participants turn to the JKM, the Japanese Korean Market index, researched and published by Platts as a market price benchmark.

2021); the CEGH in Baumgarten, Austria (“Central European Gas Hub”), which is as much a virtual trading point as a physical gas hub. Potentially less relevant for the Central and Eastern European gas markets is the UK’s National Balancing Point (NBP); for sales from US exporters, the US gas hub “Henry Hub” may be suggested as a price benchmark.⁵⁸

The decoupling of the market price for gas from that for oil started off in pipe gas supply agreements; currently, the residual level of oil-indexation in European supply contracts is low, varying between the individual European countries. **Hub indexation** also increasingly finds its way into the pricing clauses of long-term LNG supply agreements.⁵⁹ Increasingly, therefore, LNG supplied to Europe is priced in relation to liquid⁶⁰ natural gas market indices, i.e. based on gas-to-gas competition.

3.2.2. Pricing Arrangements: Escalation Clauses

As LNG supply contracts are diverse, so are pricing arrangements: The contract price agreed in an LNG SPA, very much like that in a conventional gas SPA, will typically comprise of (i) a **base price** and (ii) a **price escalation element**, which allows the price to be escalated on a periodic basis.⁶¹ As such, the price per unit of LNG/gas (e.g. per metric ton or per billion cubic meter, or per British thermal unit) under the contract will effectively be determined by application of the contractual **price formula**, i.e. the so called price escalation clause.

The “escalator” agreed on by the parties as relevant for their contract will often be, as already indicated, the price of gas as traded on a certain hub or the oil price; however, indexation may also be set to other energy sources (such as – traditionally – coal), to LNG spot prices (e.g. as published by Platts), or to electricity prices (e.g. where the gas is used, in part, for power generation).⁶²

Depending on the parties’ negotiations, the contract price may be tied to a mix of different components. In such **hybrid pricing formulas**, the parties will link their contract price not only to one but to a specified basket of different benchmarks. Typically, a certain weighting of the individual selected components is applied. A hybrid formula for European imports may e.g. link to European hub prices and LNG spot prices. Where (and to the extent) indexation refers to the hub in the buyer’s market, it remains with the seller; where (and to the extent) it is based on the hub in the seller’s market, the price risk is shifted to the buyer.⁶³ Traditionally, in pipe gas

⁵⁸ J. Sutcliffe & J. Blaney, *Arbitration of LNG Price Review Disputes* in N. Ziadé (ed), *BCDR International Arbitration Review*, (© Kluwer Law International; Kluwer Law International 2020, Volume 7 Issue 1), Fn 1.

⁵⁹ H. Sullivan, *supra*, p 198-199; S. Finizio, *Destination Restrictions and Diversion Provisions in LNG Sale and Purchase Agreements* in *THE GUIDE TO ENERGY ARBITRATIONS* (J. Rowley 3rd ed. (2018), *Global Arbitration Review*), p 220.

⁶⁰ Liquid in this context refers to the liquidity of a trading hub rather than the physical state of the natural gas.

⁶¹ H. Sullivan, *supra*, p 200.

⁶² L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, *Oil, Gas & Energy Law Intelligence*, Vol. 18 - issue 3 (2020), p 3.

⁶³ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, *Oil, Gas & Energy Law Intelligence*, Vol. 18 - issue 3 (2020), p 7-8.

contracts, the typical risk allocation makes the buyer take the volume risk, whereas the seller takes the price risk.⁶⁴ It should be noted that the buyer's and seller's market in this context denote the market in which the seller buys the commodity and the buyer re-sells it; this is not necessarily identical to the market the LNG is delivered to, especially in cases where the unloading port will not connect to the buyer's "home" transmission network (see below Section 3.2.3.). Parties could also consider including several regional hubs into their basket, which they consider equally relevant to their contract, e.g. from both the seller's and the buyer's market, in an effort to spread the price risk between the parties. To illustrate, this may e.g. include the TTF as a relevant benchmark for price setting in LNG supply agreements in (NW) Europe, and the Henry Hub which may be relevant for certain US-exported quantities.

As said, even where relevant gas hub prices are available – as is the case in the European market(s) – the parties may also refer (as part of the relevant basket) to other benchmarks, such as published prices for LNG. One prominent example are the **price benchmarks published by Platts**, including the Platts Northwest Europe (NWE) assessment, or the Platts assessed prices for delivered LNG in the Mediterranean (MED), which give insights into the price level of LNG in that market as opposed to hub gas. At times where pipe gas is preferred over LNG (or vice versa), these Platts assessments are at a discount (or, respectively at a premium) as compared to the relevant hub price (i.e. the TTF).⁶⁵

The effect of a price escalation formula will be that, as the relevant price benchmark(s) moves up and down, the contract price will directly react these developments. In an effort to protect the parties against too high or too low prices caused by the fluctuation of the price benchmark, parties at times include upper and lower price caps, which result into **S-curves** of their contract price.⁶⁶

The **base price** will often be determined starting from the absolute level of the relevant price benchmark as of the time of contracting, or as of the time of commencement of deliveries. Depending on the market environment, this base price "P0" may be set at a discount or at a premium to this benchmark. It is typically set in absolute figures (e.g. in Euro cents or US cents per unit of gas). As for Europe, the relevant hub prices, including the TTF, currently are trading at all-time highs,⁶⁷ so that one challenge for buyers may be not to lock in overly high base prices.

Also, quality has its price, if you will: For instance, a **particular – increased – level of flexibility** in contractual supplies will likely come at some cost, potentially including an elevated base price (unless otherwise reflected in the contract pricing structure; see Section 3.3.3.). Further, where

⁶⁴ E.g. H. Sullivan, *supra*, p 202.

⁶⁵ IGU (2022), *2021 World LNG Report*, p 33.

⁶⁶ H. Sullivan, *supra*, p 201.

⁶⁷ S. Twidale, *European gas prices touch new highs as Russia supply fears grow*, Reuters 02.03.2022, available at: <https://www.reuters.com/business/energy/european-gas-prices-touch-new-highs-russia-supply-fears-grow-2022-03-02/> (04.04.2022).

European buyers succeed in contractually implementing **standards for methane- or, respectively, greenhouse gas-monitoring** for delivered LNG cargoes (as discussed below Section 3.4.4.), this will likely also come at an additional cost (as recently summarized by the Oxford Institute for Energy Studies, “*Natural gas and LNG exports, if based on these standards or those set out in the EU Methane Strategy, may be able to command premium prices from buyers eager to demonstrate their own GHG reduction credentials to governments, customers and civil society.*”).⁶⁸ Similarly, some buyers may want to contractually ensure that the LNG they will receive under their supply contract is not produced from **shale gas**, i.e. derived from hydraulic fracturing. To the extent they, hence, contractually specify the origin of contractual supplies to come **from specific none-shale natural gas reserves or wellheads** – this may again come at a premium (and it may rule out part of US-sourced LNG).

More generally, where an LNG SPA serves to underpin the financing of new liquefaction infrastructure, the price may include two components: Besides a commodity component which will often be hub-indexed as above, the contract may foresee a fixed charge.

Price escalation formulas as described above reach their **limits**, when it comes to changes in the commercial, regulatory, financial, political, technical or other circumstances which are not or not duly reflected in the fluctuation of the selected price benchmark. To accommodate the interests of the parties under a long-term contract to adjust their contract price to changed circumstances, notably where this would be required in order to maintain their commercial bargain (i.e. the contractual equilibrium), or where this would otherwise be required to accommodate the parties’ protected interests, the **price revision clause** enters the scene.

We will discuss price revision clauses in more detail below at Section 3.4.1.

3.2.3. Additional Cost Components for LNG Deliveries

In addition to the above considerations, the European LNG buyer – particularly buyers who need to transport the LNG for use in their landlocked markets – may be faced with **additional cost components** which will add to the contractually determined “commodity price”. Depending on the structure of the LNG supply arrangement, these may particularly include re-gasification and transport costs.

Upfront, once the LNG is delivered at the designated terminal, it must – where it is not transported on and/or consumed in its liquid form – enter the grid of the transmission network to which the unloading port connects. To this purpose, it needs to be re-gasified. **Re-gasification fees** and **grid entry fees** will then be added to the landed LNG import price.

In addition, a buyer of LNG who wishes to bring the purchased quantities to its domestic market

⁶⁸ J. Stern, *Methane Emissions from Natural Gas and LNG Imports: an increasingly urgent issue for the future of gas in Europe*, OIES paper: NG 165, p iv, available at: <https://www.oxfordenergy.org/publications/methane-emissions-from-natural-gas-and-lng-imports-an-increasingly-urgent-issue-for-the-future-of-gas-in-europe/> (04.04.2022).

may incur additional transport costs: The delivery point for gas supplies determines who bears the transport costs until that point – this is true for LNG supplies just as much as for pipe gas deliveries. Where the buyer, after take-over of the gas at the delivery point, needs to ship the gas on to another market, it is the buyer who needs to book respective shipping capacity and pay additional **entry and exit fees**, crossing the intermediate market areas, until the volumes are finally entered into the grid of the “home market” (it is well understood, of course, that these “volumes” will be made up of gas molecules which are most likely not those initially re-gasified).

This may lead to a **cascading of (first re-gasification and then) transport tariffs**, effectively rendering the commodity price per unit of gas considerably more expensive as compared to alternative pipeline supply delivered in or closer to the buyer’s home market. From the buyer’s perspective, this may call for a discount on the relevant hub price when determining the base price in the LNG supply contract. To what extent such demand can effectively be realized will hinge on the buyer’s commercial leverage, notably the availability of alternative – “politically correct” – pipe gas supplies.

3.3. CONTRACT TERM (DURATION) AND QUANTITY

3.3.1. General: Long term still prevailing

Traditionally, most LNG supply contracts have had all the well-known features of gas supply contracts required to secure a stable revenue stream in view of the massive upfront capital investments⁶⁹ into the upstream and midstream gas infrastructure⁷⁰: First, a **long contract term**, coupled with, second, a **high offtake commitment**. In turn, to accommodate the buyer’s interests, changing circumstances are typically reflected in price revision clauses (see below Section 3.4.1.).

Still today, a **majority of LNG supplies** on the global market are contracted **long-term**, whereas spot trading and short-term contracts⁷¹ have been on the rise for some time now.⁷² And whilst

⁶⁹ K. Talus, *Price review arbitration in the Asian LNG markets – “The times they are a-changin”*, Journal of World Energy Law and Business, Vol. 14 Issue 2 (2021), p 101.

⁷⁰ I.e. in the case of LNG: the liquefaction ports, the re-gasification terminals, the charter of the highly specialized LNG vessels etc.

⁷¹ Spot sales would concern the delivery of single cargoes within several months; short-term agreements would be entered into for a duration of several months up to several years (cf S. Finizio, *Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 16).

⁷² L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 1; H. Sullivan, *supra*, p 193. There is no clear-cut answer to when a short(er) term contract turns into a long(er) term one and no clear definition of when a contract will be long-term; whilst long-term contracts will definitely include those entered into for a term of 10 years and more (traditionally even 20 to 30 years plus), contract with a somewhat lower delivery period (e.g. seven or even five years) may equally display the characteristics of a long-term supply contract. definitions of what is a short-term and what is a long-term transaction vary; some commentators count contracts up to a term of four years as short-term transactions (cf A. Patten & P. Thomson, *supra*, p 278).

the average length of LNG contracts had fallen to a record low in the buyer's market of 2017,⁷³ conditions have since reversed. The signs now, again, point to longer terms.

3.3.2. Parties' Interests re Contract Duration – Aligned and Diverging?

In general, the term of a contract is also a function of the market forces at play at the time of signing and the respective interests of the counterparties to that contract. When it comes to the actual term of an LNG-supply contract (to be) concluded today, the following aspects may be relevant:

As indicated above, LNG **suppliers** may demand a long(er) term of their downstream contracts, particularly where they need to secure revenue streams over many years in order to amortize (finance) any initial capital investments in LNG infrastructure projects. Only long-term large offtake commitments can serve to underpin the development of new LNG infrastructure.⁷⁴ Whether suppliers source the LNG from an existing, maybe even amortized LNG train, or rather from a yet to be built facility awaiting the final investment decision, will therefore starkly impact how strongly they will (and need to) push for longer contractual terms.⁷⁵ In the current market environment, particularly where long-term contracts are needed to ensure the development of sufficient export and import infrastructure in time to avoid supply bottlenecks, longer term contract terms may be on the rise. In such contracts, the effectiveness of the agreement may be made dependent on the supplier making the final investment decision with regard to the construction and operation of the LNG liquefaction plant; these agreements, subsequently, also need to provide for the case that the plant will not be commercially operable as and when planned (e.g. by giving the purchaser a right to terminate in such case).

More generally, suppliers will prefer to **align** the contract term⁷⁶ **with their pre-existing upstream and midstream contracts**; put simply, where a particular seller is bound long-term to purchase from a certain liquefaction plant or under its vessel charter, it will likely require a comparable long-term supply agreement with its buyers.⁷⁷

From the **buyer's** perspective, the key word in today's European market is of course "**security of supply**": A longer contract term coupled with the seller's obligation to deliver certain minimum contract quantities during this term will be required to secure supplies for the buyer's own as well as its customers' consumption needs.⁷⁸ In a market which is short of "politically correct" gas, for

⁷³ Global Gas Hub, *Collapse in LNG Contract Lengths Raise Future Supply Concerns*, available at: <https://globalnghub.com/collapse-in-lng-contract-lengths-raise-future-supply-concerns.html> (04.04.2022).

⁷⁴ A. Patten & P. Thomson, *supra*, p 275.

⁷⁵ H. Sullivan, *supra*, p 187-188.

⁷⁶ As would be the case for other provisions, e.g. force majeure clauses; see below Section 3.4.2.

⁷⁷ J. Kay & P. Roberts, *Structuring LNG projects: Evolution or revolution in the LNG supply value chain?* in LIQUIFIED NATURAL GAS THE LAW AND BUSINESS OF LNG, (Griffin 3rd ed. (2017), p 168.

⁷⁸ S. Finizio, *Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 16, Fn 156.

some buyers a longer term may be the price they are willing to pay in order to ensure this security of supply.

Also, a security of supply-conscious buyer may want to put into place contractual **safeguards against under-deliveries**: Notably due to organizational and logistical issues in the LNG supply chain, it may at times be challenging for the seller to provide cargoes in time or at all. An effective compensation mechanism may disincentivize the seller from prioritizing other customers when experiencing logistical problems or from selling LNG off into higher priced markets, while paying the “cheap” contractual penalties to our buyer.⁷⁹ In a similar vein, it may be advisable to diligently regulate the scope of the seller’s liability for late or missing cargoes, including e.g. by circumscribing the type of loss which should be compensable as a consequence of such breach of contract.⁸⁰

More generally, where security of supply is a concern for the buyer, the latter may also consider whether to **assure that the seller has sufficient volumes** at its disposal in order to keep up supplies during the entire contract life; issues may arise in this regard e.g. where a certain gas reservoir from which the seller sources its supplies risks to be over-sold, or nears completion.⁸¹

Apart from their security of supply-considerations, buyers may also wish to **hedge against price volatility** on the gas spot market and thus increase predictability of pricing over the term of their contract; it will depend on the specifics of the contractual price revision clause to what extent and for what periods higher or lower prices are indeed stabilized over the term of the contract (see below Section 3.4.1.).⁸²

On the other hand, in some respects a long contractual term may also be a thorn in the side of potential European buyers: Those buyers – particularly where subject to **EU climate transition policies**, and even more so when state-backed – may be concerned that contracting for LNG supplies long-term might mean **committing to using fossil fuels for many years** in the future, locking them up for too long and undermining the aims of energy transition.

To what extent European buyers succeed in translating these concerns about environmental policy goals into specific contractual provisions will, again, be a question of commercial and, potentially, political leverage. One consequence may be that buyers may try to stay clear of (genuinely) long contractual terms. Apart from shorter contract terms, this might include volume adjustment (i.e. reduction) rights of the buyer, premature termination rights or similar. Buyers may also push for more flexibility in offtake volumes, to ensure they do not commit to taking more LNG than necessary (see below Section 3.3.3.), or advocate for the inclusion of a tailored

⁷⁹ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 11.

⁸⁰ H. Sullivan, *supra*, p 196-197.

⁸¹ H. Sullivan, *supra*, p 209.

⁸² L. Woellwarth, *Global Data summarises 2021’s long-term LNG contracts*, LNG Industry 27.12.2021, available at: [https://www.lngindustry.com/liquid-natural-gas/27.12.2021/globaldata-summarises-2021s-long-term-lng-contracts/\(04.04.2022\)](https://www.lngindustry.com/liquid-natural-gas/27.12.2021/globaldata-summarises-2021s-long-term-lng-contracts/(04.04.2022)).

change-in-circumstances clause (see below 3.4.3.). Relatedly, buyers may strive to source their LNG from amortized wells to the extent such quantities are not already locked up in long-term contracts.

Last, one very general word of caution against the background of the application of **European competition law to LNG contracts under which the fuel is imported into the European market**: Generally, if the parties' market shares are large enough, long contract durations coupled with high volumes and high Take or Pay-obligations are potentially prone to locking up a certain part of demand on the respective market and hence to foreclosing it to other potential sellers – an effective non-compete clause. Similarly, the signing of what is perceived as excessive contractual take-off obligations may also, assuming dominance of the seller, qualify as an imposition of unfair contractual conditions. Either may call European competition law into action (Articles 101 and 102 TFEU), with its notorious nullity sanction for anticompetitive clauses. Indeed, whilst it is common wisdom that long-term supply contracts render market transformation more difficult, this may particularly apply at a point when policy makers want to go full speed ahead with reaching energy transition goals. Positive effects of long-term LNG-supplies such as security of supply considerations, the investment in required infrastructure etc may have to be weighed against any potential anti-competitive effects. Prospective contract partners may hence want to confirm the functioning and validity of their envisaged contract design against European competition law, ahead of contract conclusion.

3.3.3. Off-take obligations: Take-or-Pay versus flexibility

As explored above, the buyers' desire to ensure secured supplies against the backdrop of a pronounced seller's market may well indicate that contract durations of newly concluded LNG supply agreements will again be rather long(er) term. The long(er) term of the LNG supply contract typically comes with the obligation of the buyer to take the supplied LNG or else still pay for it (other than for excused non-take⁸³). This so-called **take-or-pay ("ToP") obligation**, also well-known from traditional pipe gas SPAs, places the quantity risk (aka volume risk when it comes to pipe gas) on the buyer.

The contractual mechanism of "take-or-pay" operates as the long-term assurance of a certain minimum level of sales under the contract, as – from the seller's perspective – a minimum payment guarantee. Only coupled with such ToP obligation can a longer contract term accommodate the seller's interests in a predictable revenue stream over a longer period of time. The buyer's offtake obligation will be expressed as a certain **percentage of the annual contract quantity (ACQ)**, i.e. of the total quantity of LNG that the seller may be required to sell and deliver, and the buyer may be required to take and receive, over the course of each contract year. To illustrate, the parties could foresee a minimum contract quantity and hence ToP-obligation with

⁸³ This may include e.g. constellations of non-delivery or non-acceptance following a force majeure event, or off-spec deliveries.

regard to 80 % of the ACQ. The precise level of this ToP-obligation, however, will be intensively negotiated. Depending on bargaining power and the commercial drivers underlying the ToP-structure, the minimum contract quantity (and, accordingly ToP obligation) may range considerably **between 70 – 95 % of the ACQ**, or even beyond.⁸⁴ Any ToP-payments due are calculated on an annual basis, after the end of the respective contract year.

It is easy to see that, from the buyer's perspective, a lower minimum annual quantity is preferable. In particular to the extent the supply contract does not serve to underpin new LNG-infrastructure, the commercial leverage for lower ToP-quantities may increase. Also, the buyer will often be interested in being able to **shape its offtake profile according to its needs** (including the needs of the customers it supplies – be it heating for homes, for gas-fired power plants for electricity generation, or for industry usage). In the buyer's market, gas consumption will often not be flat throughout the year, but follow a certain pattern, creating a desire to structure the contract quantities flexibly (often: seasonally).

Where the annual ToP-obligation is not further negotiable, one way of building such **flexibility**⁸⁵ into the supply contract may be by stipulating lower minimum monthly quantities, with the possibility of an annual rebalancing to "catch-up" missing quantities in individual months, so as to reach the annual ToP-level. Similarly, in order to structure cargo deliveries seasonally, contracts may stipulate a lower minimum monthly quantity during the summer season (i.e. the storage injection season, Q2 and Q3), and a higher monthly quantity during the winter season (i.e. the storage withdrawal season, Q4 and Q 1).

Another frequent approach to granting flexibility would also be to allow for so called **make-up quantities**: The buyer would then be entitled to make up for any quantities it paid but did not take, by off-taking equivalent quantities at a later stage during the contract term (or even beyond). The time period during which such quantity deficiencies have to be taken (from the buyer's perspective: for as many subsequent contract years as possible, likely even after expiry of the regular contract term), or the pricing of such make-up quantities (e.g. as a blend of the prices applicable in the initial delivery period and, respectively, in the make-up-period), will be the subject of negotiations. On the buyer's wish list in terms of downward flexibility may also be the right to carry forward overtakes in certain contract periods to subsequent contract periods.⁸⁶

The flipside to the buyer's right to take corresponding quantities of LNG previously not taken will be the seller's obligation – often: to make (reasonable, best) **endeavors – to make available such quantities**, typically on top of the (minimum) annual quantities applicable to the make-up year.

Granting the desired flexibility may be **somewhat more challenging for a seller of LNG** than it

⁸⁴ H. Sullivan, *supra*, p 190-191 S. Finizio, *Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 19, Fn 179.

⁸⁵ Flexibility in this context refers to a modulation of supplied quantities (volume flexibility), rather than the ability to transport the cargoes to varying destinations (destination flexibility).

⁸⁶ H. Sullivan, *supra*, p 190-191.

typically is for a seller of pipe gas: The logistics behind the “flow” of LNG are comparatively more complex than “turning on and off of the gas tap” on pipe gas transmission infrastructure.⁸⁷ When it comes to an LNG supply contract, offering flexibility will typically include that the seller will have to schedule and deliver (and the buyer accept) any additional cargoes on top of those scheduled under the annual delivery program (see below Section 3.4.4.).⁸⁸ Deferrals of LNG cargoes will require adjustments to the schedule of chartered LNG vessels and will presuppose the (continued) availability of unloading and re-gasification capacity at the receiving terminals. Whilst the agility of LNG cargoes diverted to just where they are needed or, respectively, to the respective premium markets, is often praised, LNG may in some respects behave less flexibly in this regard. This is why, traditionally, LNG contracts **offered less flexibility** in quantities delivered over time **when compared to pipeline gas supplies**, with buyers typically committing to take a certain number of cargoes per year.⁸⁹

To the extent a contract does accommodate a certain level of flexibility, this will hold value for the buyer and hence, likely, come at an **additional price**: One approach would be to increase the base price. Another approach would be to split the contract price into a fixed and a variable fee component, with the fixed fee being a capacity fee (as traditionally prevalent in transport or storage contracts for pipe gas, which is payable per unit of time irrespective of the quantities off-taken under the contract), i.e. a fee payable per cargo, irrespective of whether this cargo was shipped or not; and a variable price for the quantities of LNG effectively taken under the contract.⁹⁰ Also, contracts may provide for individual cargoes to be cancelled by advance notice and against payment of a cancellation fee, essentially covering the supplier’s fixed costs.

As regards contract volumes, long-term supply contracts often foresee, for varying reasons, a certain **build-up period**, during which the ACQ is ramped up until it reaches the contractual plateau. This may also be relevant for European LNG buyers in the present circumstances when they strive to phase out other sources of gas, from which buyers cannot diversify instantly, whilst phasing in LNG supplies. Conversely, parties may also consider providing for a phase-out period towards the end of the SPA’s life during which the ACQ is gradually decreased. In any case, such arrangements will not only affect the ACQ but, as a consequence, the buyer’s respective ToP-obligation.

3.4. OTHER CONTRACTUAL PROVISIONS

Beyond the fundamental parameters of an LNG supply contract as discussed above, other

⁸⁷ S. Finizio, *Destination Restrictions and Diversion Provisions in LNG Sale and Purchase Agreements* in THE GUIDETO ENERGY ARBITRATIONS (J. Rowley 3rd ed. (2018), Global Arbitration Review), p 222.

⁸⁸ P. Griffin & M. Jarvis, *supra*, p 229.

⁸⁹ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews* Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 5.

⁹⁰ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 7 and 11.

contractual aspects may also merit a closer look – and some thought before signing off, especially in the current market environment. This includes, inter alia, the following selected provisions:

3.4.1. Price Revision Clause

Parties to long-term agreements generally share the interest of avoiding a (sustained) misalignment between the contract price and the market price for the contracted good. Price-review clauses (aka price re-openers, price-review, price adjustment clauses) address this issue and, in long-term gas supply contracts, typically work to counterbalance the burden of high offtake obligations agreed for the entire contract life span. They are hence a well-known feature of European pipe gas supply agreements – and one which has given rise to a large body of arbitral awards at that; **traditionally, price review clauses can also be found in European long-term LNG supply contracts.**⁹¹

LNG supply chains are considerably exposed to market and technological changes, which as such would be enough to militate for the inclusion of a price review clause. In addition, today's buyers of LNG for Europe will also be mindful that the pending energy transition may well potentially impact the economics (or even the *raison d'être*, see below Section 3.4.4.) of their LNG supply agreements during the course of their terms. More generally, when seeking to lock in long(er) term LNG supply agreements in the present market environment, buyers may want to make sure that they are not being stuck with an uneconomical purchase obligation, but that their contract prices will come down again when and if the energy markets calm down. To that end they will have to include an effective price review mechanism.

A price review clause will often be the result of individual negotiations; notwithstanding, several common features – in particular, structural features – exist.

Adjustment trigger: First, the parties need to define when and under what circumstances a price review may be sought. Typically, in the interest of some level of price stability, the parties will limit the exercise of that right to a certain number of **cyclical price reviews** over the contractual term (i.e. every three years), likely with an additional “joker” (or “wildcard”) review available to each party. Also, the right to request a price review will be premised on the fulfilment of the contractually agreed “**trigger criteria**”. Often, this will include reference to a certain qualified (e.g. significant, substantial) change of circumstances on the relevant market; the parties may also e.g. refer to a certain change in the value of gas on the relevant market, or to a misalignment between the contract price and the relevant market price (level), etc. In general, parties should try to avoid disputes as to whether the trigger criteria are fulfilled and, as appropriate, include several alternative trigger events. Also, it is advisable to specify **which relevant market** should be the

⁹¹ H. Sullivan, *supra*, p 201-202. Depending on the allocation of price and volume risk, not all long-term LNG supplies will include price review mechanisms; e.g. in FOB-contracts indexed to the hub of the seller's market (e.g. Henry Hub for US LNG exports), no price review mechanism may apply (L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 7-8).

pertinent benchmark, both in terms of geography and product market. In this regard, it might also make sense to refer not only to changes **in but also affecting the relevant market**. This can clear all doubt as to whether developments elsewhere in the global LNG supply chain, which however do impact the market relevant under the price review clause, shall be covered.

Relevant changes may include **regulatory reforms** in the seller's or buyer's market; changes in the regulation, economics or technology of LNG infrastructure, including liquefaction, re-gasification, shipping of LNG or other relevant transport. Where the buyer bears re-gasification and transport costs and, further, where such costs have been considered as part of the parties' initial bargain when setting the base price, an argument may be made that **(substantial) changes to such costs could also be relevant for triggering a review** of the contract price.

Often, the parties will stipulate that the change must be **beyond the parties' control and not foreseeable or anticipated** at the time of contracting (and hence not reflected in the current contractual pricing regime). If certain developments may be foreseeable but should still be covered, it is recommendable to formulate the clause accordingly (e.g. when it comes to changes in the energy markets following the process of energy transition).

When stipulating which changes should be relevant, it is also recommendable to define the **reference point or review period** (typically this will be tied to the time of contracting, or else the effective date of a prior price review). Also, the parties might consider indicating that the significant change must have a certain **lasting effect**, so as not to lock what may be considered mere market fluctuations into the adjusted price formula (until the next revision).

Adjustment criteria: Often the trigger criteria will already, in broad strokes, indicate the general direction which the parties want the price adjustment to take. E.g. a significant change in the relevant market may, under a clause, call for an "according" adjustment of the contract price, or an adjustment "reflecting" the changed circumstances. Beyond such abstract indications, however, parties should make sure to include sufficiently specific adjustment criteria, which they jointly consider should be relevant for the revised price. This will increase chances of the clause to be regarded as sufficiently determined and hence as "actionable" – i.e. capable of being applied by an arbitral tribunal, should the parties' negotiations on an adjusted price fail (see right below). For lack of **sufficient determination** (Section 863 ACCP) price revision clauses will not be enforceable.

Notwithstanding, whilst parties may want to include or even list specific criteria to be taken into account when revising the contract price, they will inherently only be able to formulate such criteria in general terms. Relevant criteria may e.g. include the **prices in a designated market**, often the buyer's market (i.e. the downstream market where the LNG quantities need to be competitively marketed), or else the prices in the market of origin, i.e. the sellers' market. In order to ascertain these prices or this relevant price level, the negotiators may want to consider making reference to a **transparent and publicly available index or other benchmark**. Conversely, when including reference to the level of prices in comparable (long-term LNG) contracts this may

come with the drawback that such price level – as ascertained on the basis of confidential contracts – may ultimately be difficult to demonstrate in a dispute without extensive expert evidence.

Where they refer to the “**value of the LNG** sold under the contract” as a criteria for adjustment, the parties should consider further specifying how to determine such value, including on which market, based on an objective or subjective assessment etc.

As the case may be, the clause may also require the parties (or, absent party agreement, the tribunal) to duly consider the parties’ **underlying costs structure** relevant to the fulfilment of the supply agreement, e.g. taking into consideration the buyer’s changing costs for re-gasification and transport or the seller’s changing costs for liquefaction and (typically) shipping.

Interpretation of the clause in the individual circumstances of the case will confirm if and to what extent the clause should operate to preserve the **initial commercial bargain struck**. Ideally, this purpose, too, is expressed in the clause itself. Also, for the avoidance of all doubt, **the parties should consider clarifying to what extent the contract price is indeed subject to the price review**, i.e. expressing e.g. that the revision extends to the contractual price provisions as a whole (and ideally adding a specific reference to the respective paragraph number in the contract).

Adjustment process: The price review process will generally be initiated by one party giving notice of its request for a price review (commonly referred to as the trigger letter); any formal (and substantive) requirements for such **trigger letter** should be described in the clause. Often, the review clause will expressly foresee that any negotiated or imposed (by the AT) price revision will take effect retroactively as from the date of the trigger letter. Also, the clause will typically specify a certain **negotiation period**; the expiry of this period should be clearly inferable from the contract in order to avoid all uncertainties concerning whether or not the formal requirements for triggering the price review and for the tribunal’s jurisdiction are fulfilled; it needs no explanation that the parties are free to extend such negotiation period in mutual agreement at any time (but should do so in writing).

Importantly, should negotiations not lead to a revision of the price, the parties had better used clear language to express their intent to **confer upon the competent arbitral tribunal the power to adjust their contract price** in an arbitral award. Since in some legal systems it may be doubtful whether a price review clause can indeed be enforced in arbitration, the choice of the applicable law may be key in ensuring the operability of such clause. In many (civil) legal systems, including Austria, prevailing case law confirms that the tribunal’s adjudicative power also includes the power to adjust the contract price – in a constitutive award - based on the parties’ price adjustment clause; this will typically also be the case for a standard ICC clause, as has recently been clarified under Austrian law.⁹²

⁹² OGH, docket no. 18 OCg 10/19y, of 2 Feb 2021. On the position of English law on price renegotiation clauses, recently *Associated British Ports v. Tata Steel UK Limited* [2017] EWHC 694 (Ch).

Last, the **relation between the price review clause and a more general contract adaptation clause**, if any, should be given some thought. The parties should be clear and make clear in their contract to which extent changes in the commercial and other circumstances can not only lead to a price review – and are hence “consumed” by any such agreed or enforced price adjustment –, but could, beyond that, also lead to an adjustment of other contract parameters (See below Section 3.4.3. on general contract adjustment clauses).

3.4.2. Force Majeure Clause

Force majeure clauses are a common feature of LNG supply contracts. They may excuse one or both parties from contractual performance in case of occurrence of a – contractually defined – force majeure event.⁹³ A force majeure clause typically covers constellations which **prevent** – in whole or in part – a party **from fulfilling its contractual obligation**, at all or on time. This is particularly relevant for LNG supply agreements, which are susceptible to disruptions at many stages of the LNG supply chain, so that parties may not be able to deliver or accept cargoes as contractually agreed. Whilst force majeure clauses are diverse and their scope and effect will vastly depend on the specific language chosen by the parties in their contract, most clauses share a common structure:

First, a force majeure clause mostly lists the events which qualify as **force majeure events** under the specific contract (e.g. war, embargoes, pandemic/epidemic, natural events). A force majeure event is inherently one which is beyond control of the parties and cannot be overcome by them.⁹⁴ The exact delineation of the relevant events is often subject to intense negotiation. Often, the parties will discuss and define which specific issues along the LNG supply chain should constitute force majeure, and which should not. Also, they may want to agree on how to address governmental acts, including changes in regulation, such as European legislation which may affect the role of gas in the future energy mix.

If a party considers that a force majeure event occurred, the clause will stipulate an obligation to notify the other party. Such **force majeure notice** often must include the particularities of the purported force majeure event, any mitigating actions taken by the notifying party and an estimated time period of the force majeure event.⁹⁵

The clause will also govern the **consequences** of the force majeure event. Often, the affected party will be entitled to suspend performance of its obligations or “cancel” certain deliveries, with the underlying long-term contract remaining in effect. However, if the force majeure event lasts for a longer or unforeseeable period of time, parties may also be entitled to terminate the entire

⁹³ J. Baily & R. Lidgate, *LNG – a minefield for disputes?* in LIQUIFIED NATURAL GAS: THE LAW AND BUSINESS OF LNG, (Griffin 3rd ed. (2017) p 318.

⁹⁴ H. Sullivan, *supra*, p 194.

⁹⁵ S. Barra, *supra*, p 298.

contract.⁹⁶ Certain contractual obligations – as notably the obligation to pay monies, will likely not be relieved by force majeure.

Force majeure clauses must be read and understood against the **background of the applicable law** (on this, see below Section 3.4.6.). Most civil law jurisdictions will make provisions for force majeure events. The question will then be to what extent the contractual clause modifies – expands or restricts – the statutory remedies. English law, in contrast, (or, for that matter, NY law) does not recognize force majeure or related concepts and provides no statutory remedies.⁹⁷ Therefore, if parties are contracting under English or NY law, they have to apply particular diligence when detailing the types of events which should entitle them to relief from their obligations. Also, parties may want to ensure that the scope of force majeure relief in their various contractual relations downstream and upstream is regulated “back-to-back”.⁹⁸

3.4.3. Adaptation Clauses / “Hardship” Clause

Over the - long - term of an LNG supply contract, **circumstances may fundamentally change**. Whilst contractual **performance may still be possible**, so that reliance on *force majeure* will not be promising, the **contract may still be severely affected** by such change in circumstances, e.g. where it overthrows the contractual equilibrium, renders performance considerably more onerous, or the contractual purpose frustrated.

The parties are free to stipulate in their contract that, in the event of certain qualified changes, they are to renegotiate and, as the case may be, adjust their contract. In practice, such **adaptation clauses** – for lack of a better umbrella term – can take all different shapes and forms; they go by various different names, including “hardship”, “loyalty”, “material adverse change”, “changes in circumstance” and others. Irrespective of the heading assigned, a thorough construction of the individual clause – often in conjunction with the rest of the contractual framework – is required to determine the scope and effect of the individual adaptation clause.⁹⁹ As observed earlier, where LNG supply contracts span a long contract duration they are inherently and particularly vulnerable to changes in commercial, technical and regulatory (or other) circumstances. The parties may hence want to consider whether inclusion of a – tailored – adaptation clause will serve their interests.

Similar to price review clauses, adaptation clauses will **vary greatly in detail**; nonetheless, they often follow a **typical structure**: First, the clause will circumscribe the **trigger** criteria, i.e. the

⁹⁶ S. Barra, *supra*, p 298-299.

⁹⁷ P. Griffin & M. Jarvis, *supra*, p 239.

⁹⁸ E. Kaufman & S. Svinkovskaya, *Chapter 5: Gas and Liquefied Natural Gas Disputes* in LATIN AMERICA ENERGY AND NATURAL RESOURCES DISPUTES: ISSUES OF FORCE MAJEURE, HARDSHIP, AND PRICE REOPENERS, (G. Alvarez et al. (eds), Kluwer Law International) p 132-133.

⁹⁹ Cf., on this and the legal questions raised by general adaptation clauses in general, in detail, see L. Beisteiner, *The (Perceived) Power of the Tribunal to Revise Contracts – The Austrian Perspective* in AUSTRIAN YEARBOOK ON INTERNATIONAL ARBITRATION 2014 (Klausegger et al (eds.) 2014), p 77 seqq.

nature and specifics of the change in circumstances and its required impact on the contract. As indicated, often, the agreed hurdle will be along the lines that such changed circumstances severely impact one of the parties' performances, e.g. by resulting in an excessive burden on one party, without rendering performance outright impossible; or that these changes fundamentally alter the contractual equilibrium or bargain.

Frequently, adaptation clauses will exclude changes which could have been foreseen or anticipated at the time of contract conclusion or renegotiation from triggering its application (see above, already, in the context of price review). The parties should carefully assess and stipulate, however, whether this criterion should be of general application in their contract. This is particularly so where, according to the parties' interests, specific circumstances which are not strictly speaking **unforeseeable and unanticipated** should allow for a contract adjustment. It is highly recommendable to make this sufficiently clear in the clause, as otherwise a requirement of lack of foreseeability may be read into it as an implied term (similar considerations may apply to the frequently included requirement that changes have to be beyond the control or come from outside the sphere of the affected party).

Such clarity in drafting might be of particular relevance when contracting today: Whilst we do not currently know how geopolitics, gas pipe supply to Europe, the energy transition or the pandemic will evolve, those are currently all "**known unknowns**": The parties would therefore, generally and with certain limitations, be in a position to include provisions into their contract in anticipation of certain developments, as e.g. a regime change in Moscow leading to a revival of gas supplies from Russia, a technological breakthrough in the renewables sector, greatly accelerating the potential switch from gas to renewables, a further deterioration of the treatment of democratic values in the seller's state, etc. Where the parties do not regulate such eventualities, contract interpretation might eventually hold them to have, by leaving this open, allocated the risk of such events unfolding to lie where it falls. Relief otherwise available under the applicable law in case of fundamental changes will then likely not apply. As one example, where the buyer, some years into the contract's term, faces regulatory or commercial pressure to phase out of natural gas entirely and without delay, contract interpretation may show that this is indeed – put bluntly – the buyer's problem, who will be caught in another 10 years of ToP obligations (always depending on the individual circumstances of the case, of course).

Whether the buyer can convince its counterparty to write any particular remedy into the contract in the event that changes comparable to those afore mentioned materialize, will of course depend on its commercial leverage. Contractual remedies might include e.g. rights of premature termination of the contract for due cause (e.g. to enable switching from gas to renewables), or of reduction of the contract in size (i.e. reduction or phase-out of ToP-volumes), or others. As opposed to general adaptation clauses, in these examples the clauses would address **specific contractual parameters** only – as e.g. the term or the contractual quantities. Not the entire bargain, but only specific contractual parameters would conceivably be subject to adjustment.

Depending on the parties' drafting, such clauses may well turn out sufficiently specific and create enforceable adjustment rights of one party (always subject, of course, to a detailed analysis of the individual clause under the applicable law).

This may be different for **general adaptation clauses**, however, which are inherently more general, abstract and comprehensive, calling e.g. for a "fair and equitable", "according" or "respective" adjustment of the (entire) contract "in the spirit of the parties' bargain". The question of the **legal effect** of such clauses will invariably be complex. Often, the clause will foresee that, where one party notifies the other of a fundamental change-event covered by the clause, the parties shall convene within a certain period of time and discuss an adjustment of their contract. And, indeed, such clause may open useful avenues to **formally trigger negotiations** with the potential of jointly agreeing on whether and how to rebalance their contractual bargain in light of the changed circumstances. The merit of renegotiation clauses must not be underestimated, notably where parties on both sides must justify any decision to walk away from negotiations vis-à-vis their supervisory boards, supported by extensive legal analysis.

Where such discussions do not result in an amicable adjustment, the questions will arise, if and how such clause can be "**enforced**" – i.e. whether an adjustment can be imposed upon the other party against its will, or at least whether, failing an agreed adjustment, the willing party is entitled to exit the contract prematurely: N.B., this question only arises where it can be established that the parties **intended to create an obligation to agree** on an adjustment, rather than merely an obligation to negotiate in good faith. Again, clear drafting is key. Where, as often, the ultimate language of the contract is a compromise, it is particularly important to document the negotiating process leading up to the ultimate wording.

Provided the parties' intent is indeed for such "enforceable" clause, the thorny question is whether, under the applicable law, such general adaptation clause may be howsoever "enforceable" at all. Even when choosing a legal order which holds less reservations to adjusting the contractual parameters where the contractual bargain is severely derailed, problems will arise regarding the **sufficient determination** of such clauses: Inherently general as this clauses invariably are so as to encompass a multitude of different developments and a multitude of "fair" reactions to such developments, there will not be the one and only way to adapt the contract in a given situation. Rather, it would then be upon the arbitral tribunal to choose between multiple different – all, arguably, reasonable – approaches, as e.g. altering the term, the delivery points, the offtake obligations etc or any combination thereof. It can easily be seen that it would be upon the arbitral tribunal to re-write the parties' bargain where they themselves could not commercially agree. Under most applicable laws, such clause will not be operative on the substantive law-level already, since it lacks sufficient determination (or determinability). In addition, at the level of procedural law, the question arises whether an arbitral tribunal may be given the power to generally adjust contracts in the first place, i.e. whether this could still qualify as exercising an adjudicative function.

However, **even if the adjustment of the contract is not directly enforceable under the clause**, contract adaptation clauses can shed light on the availability and (restrictive or extensive) interpretation of statutory instruments otherwise available under the applicable law: As the case may be, the chosen applicable (civil) law may regulate the so called *clausula rebus sic stantibus*; remedies provided under Austrian, Swiss or German law would e.g. include pre-mature contract termination for due cause, or contract adjustment based on the concept of fundamental change of contractual foundation (*Wegfall oder Änderung der Geschäftsgrundlage*). The applicable law will define the interplay between this *clausula*-principle – which serves to, exceptionally and as an *ultima ratio* calling, adjust the contract where circumstances change fundamentally – and the *pacta sunt servanda* principle – which calls, on its part, for upholding the parties' bargain as it stands, despite changed circumstances. Notably, through an adaptation clause the parties may be held to have derogated from individual requirements, or to have added others for a *clausula*-relief to be granted; interpretation may also conclude that such *clausula*-relief should be excluded. Also, an adaptation clause may shed light on whether, according to the parties' intent, any and all future changes should be exhaustively tackled by an adjustment of the contract price (i.e. by operation of the price review clause), or whether there is still scope **to adjust other contractual parameters**. Also, in specific constellations an argument may be made that, if no agreement is reached on an adjustment, the willing party would be entitled to prematurely terminate the contract.

On balance, the contract's fate will depend on the exact terms of the contractual adaptation clause, within the framework of the entire contract, against the background of the negotiation setting and the applicable law – and, not infrequently, the **approaches taken by the arbitrators** ultimately deciding thereupon.

3.4.4. Delivery Terms

As one commentator put it, “[t]he functions of LNG sales and LNG shipping are so inextricably linked that they should properly be considered as a single component”¹⁰⁰ – which clearly speaks to the importance of the delivery-terms for the commercials of an LNG supply contract.

As is well known, shipping of the commodity LNG is done by seaborne vessels. The supply contract hence also needs to have regard to the specifics of such delivery by sea, including the allocation of risks during transport, the destination port, the employed vessel, insurance coverage etc.

Most commonly, supply contracts foresee that LNG be delivered under one of the following terms:¹⁰¹

- **Free on Board (FOB)**: The seller must make the LNG available at a certain loading port for the buyer to collect it by vessel of the buyer; the buyer provides the required

¹⁰⁰ J. Kay & P. Roberts, *supra*, p 156.

¹⁰¹ P. Griffin & M. Jarvis, *supra*, p 213-214.

shipping capacity;

- **Ex-Ship deliveries** (previously “DES”; under the 2010 Incoterms replaced by DAT, “delivered at terminal” or DAP, “delivered at place”): The seller must make the LNG available at a certain delivery port of the buyer by vessel of the seller; the DAP-term specifies that delivery takes place when the goods are at the buyer’s disposal at the designated place – i.e. the port -, ready to be unloaded by the buyer, whereas under a DAT shipment the unloading will be the seller’s responsibility.

Dependent on the agreed delivery terms, charter of the LNG vessel is hence contracted and paid for by either the buyer or the seller (unless one party owns the carrier). The supply contract will typically stipulate **notification and cooperation** duties to regulate and facilitate the physical activity required in order to load the LNG onto and off the vessel – this process of loading or discharge will mostly take several hours. To cater for the event that the destination port suffers an outage or lacks capacity, the parties may add alternative discharge ports to their primary unloading port. If delays occur in loading or discharging the LNG, hence keeping the vessel in port beyond the agreed time, this may give rise to compensatory payments, so called demurrage claims.¹⁰²

The **transfer of title** concerning the LNG quantity usually hinges on the delivery point: In FOB agreements, the buyer already takes title to the LNG when it is loaded. In ex ship-agreements, the title passes to the buyer upon unloading only – at the flange coupling of the unloading line with the LNG carrier; the seller still bears all risk of seaborne transport.¹⁰³ The parties may also agree on different “title transfer points” which shall apply for title and, as the case may be, risk transfer.

In case of FOB deliveries, often, buyers will contractually secure flexibility as to the destination of the LNG cargoes (European buyers would do so with the support of EU competition law, which seeks to ban anti-competitive destination clauses). Conversely, at least globally, ex ship-LNG supplies do often include destination clauses and it may be difficult to argue and negotiate for destination flexibility.¹⁰⁴

To further specify the contractual delivery provision, the parties under term LNG supplies invariably draft an **annual delivery program** for each contract year, specifying inter alia the anticipated quantities of LNG to be shipped over time, the aggregate number of cargoes, the specific LNG vessels used, the scheduled arrival periods, and the receiving terminals.¹⁰⁵ The annual delivery program also indicates any scheduled maintenance. Round-up or round-down quantities may be agreed in order to achieve delivery of the contractual quantities in full cargoes.

When it comes to specifying the LNG carriers employed, European buyers may seek to

¹⁰² P. Griffin & M. Jarvis, *supra*, p 214.

¹⁰³ L. Agosti & B. Moselle, *LNG Disputes beyond Price Reviews*, Oil, Gas & Energy Law Intelligence, Vol. 18 - issue 3 (2020), p 7.

¹⁰⁴ H. Sullivan, *supra*, p 211.

¹⁰⁵ Also cf. H. Sullivan, *supra*, p 205-206.

contractually ensure that certain minimum **safety and environmental requirements** are implemented in the contract, e.g. as regards security, vessel fuelling etc. This is because the ecological footprint of LNG shipping, notably the methane and, more generally, GEG emissions associated with it, will vary considerably depending on the characteristics of the vessel employed. The parties may agree on the deployment of carriers complying with certain technological and ecological standards, or may even create an obligation to abide by the respective strictest industry standard as applicable from time to time. This may, evidently, result in a balancing act between increasing costs of the imported gas, and pushing for a reduction of the climate footprint of such imports.

In fact, when it comes to the issue of methane leakage (see already above Section 3.2.2.), importers into the EU may now play a particular role in the wake of the Global Methane Pledge signed at the COP-26 and in anticipation of the binding regulation included in the **proposed EU Regulation on Methane Emissions Reduction**:¹⁰⁶ Under this policy framework, it will be them who will be paying charges for import-associated emissions. To avoid such penalties, importers will therefore be incentivized to incorporate into their LNG import contracts standard procedures (i) for the measurement, reporting and verification of methane emissions for the specific LNG supply chain underlying their contract, as well as (ii) for the offset of any remaining methane emissions, as measured and verified. Ideally, each delivered LNG cargo would then bear an individual emission tag, which allows for transparent and equivalent offset for the supply-chain emissions of that specific cargo, from production to delivery at the designated unloading port. This might prove more complex for some origins of LNG than for others (e.g. US LNG will derive from numerous different wells, resulting in varying emission footprints for different LNG terminals, whilst e.g. Qatari natural gas is essentially produced from one offshore field).¹⁰⁷

The incorporation and the working of such procedures into newly concluded contracts – including their credibility to show accurately measured and objectively verified emissions covering the entire LNG (export) supply chain (or at least to the receiving port) – may be key in ensuring that gas and notably LNG can continue to play a role in the low-carbon energy transition. Indeed, the market is already moving fast into this direction¹⁰⁸ and increased LNG supplies to Europe may be an opportunity to continue this push.

¹⁰⁶ J. Stern, Measurement, Reporting, and Verification of Methane Emissions from Natural Gas and LNG Trade: creating transparent and credible frameworks, OIES papers: NG 165, p 10-11.

¹⁰⁷ Ibid. p 23-26, 30.

¹⁰⁸ E.g. K. Adler, *Questions grow on LNG's carbon footprint, despite demand increase*, IHS Markit 13.01.2021, available at: <https://cleanenergynews.ihsmarkit.com/research-analysis/questions-rise-on-lngs-carbon-footprint-despite-demand-increase.html> (04.04.2022); J. Stern, *Methane Emissions from Natural Gas and LNG Imports: an increasingly urgent issue for the future of gas in Europe*, Introduction: "We have already seen deliveries of 'carbon neutral' LNG cargoes to Asia, as well as a long-term LNG contract in which the greenhouse gas content of cargoes will be measured, reported and verified (MRV) according to an agreed methodology." (available at: <https://www.oxfordenergy.org/publications/methane-emissions-from-natural-gas-and-lng-imports-an-increasingly-urgent-issue-for-the-future-of-gas-in-europe/> (04.04.2022)).

3.4.5. Dispute Resolution Clause

International commercial arbitration is – and has traditionally been – the most commonly used dispute resolution method in LNG contracts.¹⁰⁹ Recent surveys confirm this preference of arbitration: Although only few are specific enough to focus on LNG contracts or at least the energy sector in general, these surveys clearly indicate that arbitration (particularly in combination with other ADR methods) remains to be the preferred option for dispute resolution in international contracts across sectors,¹¹⁰ including in the energy sector.¹¹¹

Indeed, there are various **benefits of arbitration** over other methods of resolution of international commercial disputes. The respondents of said surveys most often referred to the expertise of the decision maker(s), neutrality, confidentiality and enforceability as the decisive factors for choosing arbitration.¹¹² Whilst all of these pull-factors have validity when it comes to opting into arbitration for LNG supply contracts, the expertise – including the practical experience, industry knowledge and technical expertise – of the arbitrators chosen by the parties probably stands out. Practically speaking, in anticipation of complex technical or economical issues, parties can tailor-make their tribunal, e.g. by choosing industry experts as wing arbitrators, with an energy lawyer presiding over the proceedings as chairperson. Whilst parties may also want to prescribe in their arbitration clause that the entire panel of arbitrators must have “knowledge” on long-term international LNG SPAs (or similar), it will rarely be recommendable to include too specific qualification requirements of the to-be-nominated arbitrators already in the arbitration clause: This may often unduly complicate the process of constituting the arbitral tribunal. As another factor, the high level of procedural flexibility which arbitration offers, notably when handling expert evidence on complex questions of fact and law – including e.g. joint expert reports or expert conferencing – will make arbitration a highly attractive choice. Similarly, parties to international LNG contracts will want their dispute resolution mechanism to be unbiased towards either of the parties, particularly where those might be state-actors, which, again, will cause them to opt for arbitration.

As discussed above, LNG supply contracts are frequently defined by their long-term nature and

¹⁰⁹ J. Sutcliffe & J. Blaney, *Arbitration of LNG Price Review Disputes* in N. Ziadé (ed), *BCDR International Arbitration Review*, (© Kluwer Law International; Kluwer Law International 2020, Volume 7 Issue 1) p 140.

¹¹⁰ 90 % of respondents prefers arbitration or arbitration in combination with ADR according to the 2021 Queen Mary University Survey (*2021 International Arbitration Survey: Adapting arbitration to a changing world*, p 5, available at https://arbitration.qmul.ac.uk/media/arbitration/docs/LON0320037-QMUL-International-Arbitration-Survey-2021_19_WEB.pdf).

¹¹¹ 84 % of the respondents in energy sector chose arbitration as the most or the second most preferred dispute resolution mechanism in the 2013 Queen Mary University Survey (*Corporate choices in International Arbitration Industry perspectives*), p 7; 56 % of respondents from energy sector chose a form of arbitration as the most preferred method of dispute resolution (with another 26 % choosing mediation) according to the ICEA Dispute Resolution in the Energy Sector Initial Report, p 9 (available at: <http://scottisharbitrationcentre.org.stackstaging.com/wp-content/uploads/2015/05/ICEA-Dispute-Resolution-in-the-Energy-Sector-Initial-Report-Square-Booklet-Web-version.pdf>).

¹¹¹ International Chamber of Commerce (ICC), *Dispute Resolution 2020 Statistics*, p 30 (available at <https://iccwbo.org/publication/icc-dispute-resolution-statistics-2020/>).

¹¹² 2013 Queen Mary University Survey, p 8; ICEA Report, p 8.

the complex logistics of the LNG supply chain may create a **specific need for mutual cooperation** over the (long) term of the contract.¹¹³ Against this background, the dispute resolution clauses seen most often in these contracts are **multi-tiered** and require one or more attempts to resolve a dispute amicably before it can be brought before an arbitral tribunal.¹¹⁴ Such steps will mostly be negotiations, but may also include e.g. expert determination of certain technical aspects of the dispute (e.g. measurement disputes; determining of replacement indices), or other forms of ADR.

When drafting an arbitration clause, the parties must make several important choices, which include selection of the seat of arbitration and the applicable arbitration rules. The primary effect of the **choice of seat** is determining the legal “home” for their proceedings, with the procedural law of the seat applicable as *lex loci arbitri* and the courts of the seat having jurisdiction to supervise and assist the arbitral process, notably in proceedings for setting aside of the award.

The choice of a particular set of **arbitration rules** will determine whether the proceedings will be administered by a certain arbitral institution, or rather conducted on a so called *ad hoc basis*. In choosing the applicable arbitration rules, the parties will seek a good balance between flexibility and clarity on the arbitration procedure. In respect of arbitration institutions, the parties look for professional and effective administration of their case. Recently, in the wake of the COVID-19 pandemic, an institution’s ability to assist in conducting virtual hearings has emerged as one key requirement.¹¹⁵

Which **arbitral institution** the parties will hence settle on in their arbitration clause because they consider it neutral and competent will depend on various factors, including the respective origins and backgrounds of the parties (and, not infrequently, of their legal advisors). European-seated arbitration is heavily dominated by the ICC (Paris) and the LCIA (London), with the SIAC (Singapore) and the HKIAC (Hongkong) coming third and fourth.¹¹⁶ Depending on the parameters of the individual contract, other candidates within Europe will include the SCC (Stockholm) and the VIAC (Vienna). Both are traditionally well-versed in resolving disputes between Russian sellers and European buyers of pipe gas, and may hence be equipped for managing LNG supply disputes.¹¹⁷

As opposed to choosing a particular arbitral institution, parties on commodity markets seem to have an above average preference for **ad hoc arbitration**, usually applying the UNICTRAL Arbitration Rules.¹¹⁸ The reason for this trend is the additional flexibility provided by the absence

¹¹³ See above Section 3.3.1.

¹¹⁴ E.g. E. Chan, *Forecasting Energy Disputes in Asia*, L. Boo and G. Born (eds) Asian International Arbitration Journal, (© Kluwer Law International; Kluwer Law International 2020, Volume 16 Issue 1) p 42 – 45; T. Williams & A. Durrani, *Oil and Gas Arbitration: A Perspective from Qatar*, in N. Ziadé (ed), BCDR International Arbitration Review, (© Kluwer Law International; Kluwer Law International 2020, Volume 7 Issue 1) p 147.

¹¹⁵ 2021 QMU Survey, pp. 11-12.

¹¹⁶ *Ibid.*, pp. 10-11.

¹¹⁷ *Ibid.*, p. 10.

¹¹⁸ *Ibid.*, p 9.

of an administering institution.¹¹⁹ Also, for lack of a chosen institution, the process is free from all hints of partiality and entirely confidential. Some of the newly to-be-concluded European supply contracts concerning imports from overseas may likely to follow this trend, choosing UNCITRAL Arbitration Rules as a compromise where regional customs in selecting institutions cannot be reconciled.

As indicated above, the choice of the seat generally entails the choice of a jurisdiction, and the parties will pick a legal system perceived to be arbitration friendly. This involves, among others, being party to the New York Convention to ensure cross-border enforcement of awards, an up-to-date and well-tested arbitration act and a state judiciary which approaches arbitration with a positive and supportive attitude as well as the necessary expertise.¹²⁰ Speed of setting aside proceedings may also a factor to be considered, which further favours jurisdictions with single-instance proceedings such as Switzerland and Austria. The available statistics confirm that the seats in Europe chosen most often remain to be London, Geneva and Paris.¹²¹ Looking beyond Europe, whilst European parties will likely want to avoid seats in the Middle East, New York may be another candidate; also, Asian arbitration hubs – such as Singapore – may be viewed as neutral choices.

Apart from these general considerations, negotiators of LNG supplies may also want to be mindful of the **public policies** (*ordre public*) of their intended seat jurisdiction. Most jurisdictions consider violation of public policy as one of the grounds for setting aside of an award. Therefore, by choosing the seat of arbitration, the parties are subjecting their contractual relationship to the public policy of a specific state (in addition to the public policies of those jurisdictions where the parties' assets are located, and where hence the enforcement of a potential award would take place). In the context of LNG, such public policies may be particularly relevant e.g. when it comes to sanction regimes or environmental policies.

3.4.6. Choice of Law Clause

Just as the arbitration clause, the selection of the governing substantive law (i.e. the “choice of law clause”) is another of the so-called midnight clauses, which often receive less attention than they would deserve. As long as the parties perform in line with the contractual provisions, the governing law may be of little relevance. Nevertheless, in a dispute scenario, the governing law may play a key role. This particularly holds true for LNG supply contracts, e.g. in respect of matters such as change in circumstances, hardship or *force majeure*. But the applicable law may also be decisive when it comes to the enforceability of price revision clauses or other adaptation clauses,

¹¹⁹ Ibid., p 9.

¹²⁰ ICEA Report, p. 11; 2021 ICC Survey, p. 8.

¹²¹ International Chamber of Commerce (ICC) - *Dispute Resolution 2020 Statistics*, p 30 (available at <https://iccwbo.org/publication/icc-dispute-resolution-statistics-2020/>); 2021 QMU Survey, p 7.

as outlined above.¹²² Since statutory regimes tend to vary considerably on these questions, the chosen law may ultimately determine the outcome of a dispute.

Traditionally, many LNG contracts are governed by **English law**, which, as it is probably fair to say, dominates the industry.¹²³ New York law is another usual suspect, frequently encountered in LNG supplies.¹²⁴ Beyond these two common law jurisdictions, other options – including civil jurisdictions, such as e.g. Swedish law – have their place but seem to have been less prevalent in the past.

One of the consequences of applying English law – for better or for worse – is that English law will show the greatest restraint when it comes to adjusting the parties' bargain and relieving parties from obligations which they freely undertook. Put simply, the parties will be held to the letter of the contract they signed, and their commercial deal will not be re-balanced by the court (or tribunal). No general concept of change in circumstances will operate, just as no general good faith principle.¹²⁵ This will ensure some degree of predictability and stability.

Parties from **civil law** jurisdictions, however, may not always want to cut off the otherwise available recourse to the courts (or tribunal) for seeking *ultima ratio*-support where shifts in the market or in other circumstances fundamentally affect their bargain. Such support will take the form of a judicial re-balancing of contracts, within very narrow confines.¹²⁶ Often, such parties will, in their previous energy supply contracts (notably gas supply agreements with Russian suppliers now to be replaced), have been used to a broader application of civil law concepts, such as change in circumstances and good faith. For these European buyers, the effects of the standard choice-of-law may then come as an unpleasant surprise and English law may not always be the “natural choice”. In particular, with the UK having left the EU, parties to LNG contracts for imports into the EU may also want to ensure to align their contract with European (regulatory) law. All of this could indicate that the choice of law in may shift in favour of alternative, Continental European legal orders, including e.g. Swiss or Austrian law.

Another important aspect to consider will be the potential application of the United Nations Convention on Contracts for the International Sale of Goods (the “**CISG**”), which is designed to be used in international commerce. The CISG will apply, even absent an express choice by the parties in their contract (and absent an express opt-out), where the states of both parties are

¹²² See Section 3.4.1. and 3.4.3.

¹²³ J. Sutcliffe & J. Blaney, *Arbitration of LNG Price Review Disputes* in N. Ziadé (ed), BCDR International Arbitration Review, (© Kluwer Law International; Kluwer Law International 2020, Volume 7 Issue 1) p 133.

¹²⁴ S. Barra, *supra*, p 301.

¹²⁵ J. Sutcliffe & J. Blaney, *Arbitration of LNG Price Review Disputes* in N. Ziadé (ed), BCDR International Arbitration Review, (© Kluwer Law International; Kluwer Law International 2020, Volume 7 Issue 1) p 139.

¹²⁶ *Ibid.*, 139-140.

signatories.¹²⁷ The CISG takes a specific approach to addressing change in circumstances and inability to perform, in its Art 79 CISG. The so called “exemption” concept enshrined in leg.cit. is markedly narrow. Whilst it may, as such, be more acceptable for parties accustomed to English law,¹²⁸ from the perspective of parties with a civil law background, the question arises whether the application of Art 79 CISG will operate to cut-off recourse to the otherwise available statutory instruments of contract adjustment or termination for cause. Indeed, Continental European buyers may want to carefully consider whether to exclude application of the CISG (or, more specifically, of its Art 79). More generally, the CISG will often be excluded also when opting for NY law.

¹²⁷ Signatory states include most of the European countries with the notable exception being the United Kingdom. Also, whilst the USA and Australia have signed the CISG, e.g. Qatar has not. For an up-to-date list of signatories see: https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg/status.

¹²⁸ Schwenger, I. H., & Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Oxford: Oxford University Press (2016), p 1128-1154.

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We are looking forward to your questions or comments.

Do reach out to the ZfZ Energy Team. We are at your disposal to discuss your case and to assist with your contract or dispute. Of course, this publication cannot replace individual advice.

OUR ENERGY INDUSTRY FOCUS

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