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Strategic Considerations for Price Review Success

Asia Pacific – September 2021

In recent years, many lawyers, experts and industry commentators have written about an anticipated increase in the role and number of LNG price reviews and arbitrations in the Asia Pacific LNG market. At the same time, however, there has been considerable speculation about these cases actually becoming a reality given the limited number of price review provisions within legacy contracts in the region – often none at all – together with the more traditional cultural preference to simply "meet and discuss" these issues, rather than escalate them to arbitration. That has been the historical view. As we shift our focus to the present day, the advocates of this forecasted change can be complimented for their foresight.

In the wake of a 12-month period that has presented a series of unprecedented events[1] in a highly changeable LNG market, market players have been left in a permanent reactive state, cautiously anticipating from where the next issue may emanate and how best they can mitigate it when it arises.

These uncertainties and evolving policy changes have quite rightly shone a spotlight on how parties can, commercially and contractually, combat these issues in an effort to alleviate the effects of such problems in the future. It comes as no surprise that many have turned to price review negotiations as a means through which to safeguard and shore up their interests – and this is a sensible step to take. After all, if a buyer is oversupplied, trying to reduce the price they pay for their LNG supplies to mitigate the impact of the issue is a reasonable and prudent strategy. It follows that many buyers in the Asia Pacific region have commenced, or are actively considering starting, price reviews in 2021 and 2022. The commercial reality is that price review clauses represent a fundamental aspect of long-term, take-or-pay contracts for the sale of natural gas/LNG into markets without a reliable, transparent and traded gas price based on supply and demand fundamentals.

However, given the natal stage of the price review evolution in the region, price reviews are still an unfamiliar process to many. In fact, it may be that a price review process has never been undertaken before or, if it has, it was dealt with internally and quickly, without the support of experienced expert consultants and legal counsel.

The contractual unknown can be a daunting prospect to consciously engage with, especially when, in doing so, a buyer is departing from a historical cultural negotiation stance expected by its seller counterparty. Immediately, fear and focus turn to the potential damage to the counterparty relationship. However, this should not automatically be the case. Parties need to ensure their market competitiveness and often this is achieved by securing reduced contractual volumes and prices. More importantly, though, the market is showing that many buyers are not alone in having these objectives. The hurdle comes in a lack of practical experience with the price review process. To assist in bridging this familiarity gap, this piece outlines a practical checklist for those parties considering how best to engage with, and benefit from, a price review process. These steps may provide structure and leverage for those seeking to recast (or preserve) the contractual bargains contained in their SPA portfolios.[2] Often, much can be gained by securing lower prices and greater flexibility. Starting amicable and commercial talks is likely the best way to secure this. The following non-exhaustive list of 10 points represents some key considerations for any party seeking to commence a price review process.

1 Including, for example (i) the impact on LNG demand caused by COVID-19; (ii) the winter of January 2021 provoking Asian supply issues and an aggressive spike in JKM figures to US$33/MMBtu (compared to US$2.713/MMBtu in March 2020); (iii) renewed government pressure to achieve carbon neutrality by 2050 stimulating a rise in the uptake and penetration of renewables and leaving certain parties oversupplied with LNG; and (iv) the more recent global supply delays prompted by various export facilities in Norway, Australia and Qatar experiencing production/mechanical issues at the same time.

2 This bulletin discusses generalities. The availability of any contractual right in a specific situation will depend on various factors, such as contract terms, the applicable law of the contract and the surrounding facts.

1. **Mobilise a core team comprising internal personnel and experienced external advisors at the outset**. This is a significant step. Instructing price review specialist external support early in the process allows one to take the initiative and control the commencement of the process. Experienced market experts will greatly assist the internal procurement and legal teams in data gathering, selection and the formulation of explanations and justifications for a lower price adjustment. Moreover, experienced gas sector disputes lawyers, working effectively alongside market experts/economists, can develop negotiation strategies and consider the interaction of the price review clause with other elements of the contract. On this point, a strong understanding of the contract is a good platform for dialogue between the parties on how to properly commence discussions and, thereafter, to address points of interpretation within the price review provision and wider contract.

2. **Identify and interpret the relevant trigger event(s) and key elements of the price review provision**. A key piece of initial analysis will frequently involve a detailed evaluation of the price review (and sometimes hardship) clause(s) to determine the meaning and effect of the provision(s). Among other factors, this may include a consideration of the (i) meaning of certain trigger events such as a "significant/material change" or any temporal element activating the clause; (ii) definition and scope of the relevant "market"; and (iii) applicable data sets, including the meaning of certain linguistic phrases such as "comparable" and "competitive" prices, coupled with the scope for evaluating the correct data pool.

3. **Consider whether price discussions are mandatory**. One of the most commonly expressed concerns of the Asian price review debate centred on this topic. Certain sellers in Asia claim that LNG SPAs only allow for a period of mandatory negotiation with no duty to reach agreement, nor any right to refer a breakdown of the negotiations to mandatory arbitration. An evaluation of the wording of the price review and governing law and jurisdiction provisions is critical before the commencement of any process and, in the first instance, will customarily involve an analysis of whether the price discussions are mandatory by reference to the language used. This analysis represents a key strategic consideration for the core team in the development of a negotiation plan.

4. **Develop the contractual notice and opening presentation**. Having completed the preliminary analysis of the items listed in point 2, a party may then take steps to prepare a letter/formal notice in accordance with the price review – and often notice – provision(s) in the contract to legally commence discussions within the prescribed contractual framework. Thereafter, the core team can formulate the structure and substance of an opening price reduction presentation for the first price review meeting. The first meeting is also a good opportunity to introduce the respective negotiating teams and to agree on a road map for the discussions in due course, including the frequency of meetings, location and other administrative considerations.

5. **Timing and preparedness are important factors**. While it is often prudent to commence discussions sooner rather than later, parties should not rush to convene a meeting if their negotiation strategy and analysis is premature or underdeveloped. That being said, it can sometimes be the case that parties need to commence discussions expeditiously to protect against a limitation issue in a periodic process.

6. **Consider the benefit of adopting a portfolio approach**. Most LNG buyers do not buy their LNG exclusively from one seller or singular export facility. The impact of pricing issues may be the result of high prices across various SPAs within a portfolio of contracts. As a result, there may be merit in commencing discussions with various sellers simultaneously, to try to mitigate the scale of the overall issue and to secure a price reduction as early as possible. Furthermore, the approach of sellers to various price review requests will likely differ – certain sellers may be more flexible than others. However, their conduct and response to a request will remain unknown until a buyer starts discussions, thereby reinforcing the potential benefit of simultaneous action.

7. **Protect the content of discussions and meetings**. To protect the substance of the dialogue, and to encourage a level of meaningful discussion, parties should try to ensure that any discussions with a counterparty are confidential and made on a without prejudice basis. This may help to protect positions taken in negotiations from being used in any subsequent dispute. It is also wise to reserve the right to modify a position taken in negotiations, thereby providing room to manoeuvre in response to the counterparty's position as discussions develop over time.

8. **Maintain pressure in correspondence and meetings**. A party that does not follow up consistently will likely not be taken seriously. It follows that a party should attempt to prescribe a timeline and process in accordance with the relevant contract or, if silent, by reference to reasonable commercial dealing/industry practice. This will give the negotiations structure and introduce a temporal long-stop date to focus minds in trying to reach a deal by a given deadline.

9. **Avoid detrimental concessions and compromises in the negotiations**. As an overarching point, parties should not rush to concede valuable contractual rights in an effort to secure a price decrease. Such concessions often involve detrimental trade-offs for a price reduction in return for contract extensions, volume increases or flexibility reductions. The expert/legal teams can help advise on the impact of local competition law (in relation to these terms) and the value of certain non-price terms, their role in the negotiations and how best to leverage them. It is also important not to lose sight of the length of certain long-term contracts – often over 10 years – and the changing circumstances of market conditions. A non-price term concession now may be harmful in two to five years' time in the face of a changing demand profile and increased/decreased trading opportunities depending on the state of the market and supply/demand balance.

10. **Draft detailed minutes and records of all internal and price review meetings**. Maintaining detailed and accurate accounts of all agreements and meetings may form evidence before a tribunal. As a point of good practice, therefore, it is advisable to keep records of all meetings, telephone conversations and face-to-face discussions about the price review notice, proposals and meetings. Again, on this point, the role of legal counsel in those communications may help to establish and maintain privilege, as well as ensure procedural and substantive compliance with the price review process set out in the contract.

These points notwithstanding, there is no "one approach" that applies in all cases. While similar, the profile of relevant markets, buyers, sellers, contract price formulas, negotiation styles and commercial motivations always differ. These considerations, therefore, represent a mere snapshot into what is a detailed and carefully considered commercial, analytical and legal process applied on a case-by-case basis.

If you have any questions regarding the subject matter of this bulletin, please contact the author.

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