

2022 was one for the natural gas/LNG record books. It will be remembered as one of the most volatile and unpredictable years we have seen in the recent past. Numerous colliding and successive market events since 2020 and 2021 culminated in a wave of acute supply, operational and financial uncertainties for market players. Repeatedly throughout 2022, events brought into focus the critical question of how parties can, commercially and contractually, confront these market issues in an effort to ease and improve the effects on their business – now, and, importantly, into the future.

The events of 2022 do not, themselves, tell the full story. Since 2020, the global gas markets have had to absorb the impact of the COVID-19 outbreak, price volatility and reduced European flows. By mid-2020, many typical business activities ground to a halt and gas prices dropped to record lows. By mid-2021, economic activities were up and running again, but Russia had begun to limit the flows it sent to Europe, leading to a contraction in supply and increases in prices by late 2021. Against that backdrop, the commencement of the war in Ukraine in February 2022 dramatically expedited and exacerbated what was already unprecedented market supply and price volatility. As one of the largest producers and exporters of natural gas in the world, Russian-related natural gas activities caused a significant impact within the wider gas market, including (i) a sharp reduction of Russian gas supplies to Europe; (ii) further curtailments of Russian supplies due to planned maintenance on the Nord Stream pipeline; (iii) further reductions in Russian gas supply to Europe thereafter; and (iv) various sanctions and regulatory changes in response to the conflict causing a reduction in the overall supply of natural gas available in the global markets, leading to severe price fluctuations and gaps in the global demand profile.

Events at the Freeport LNG facility in the United States in the summer of 2022 (causing major, long-lasting LNG supply disruptions), significant, sustained summer heat waves in Japan and Europe (increasing energy demand), the impact of sanctions on Russian shipping vessels (straining supply chains), and rising spot market prices (pressuring retail energy markets) all continued to test the elasticity and durability of global markets.

Significant and sustained spot market price fluctuations prompted an evolving course of conduct by seller counterparties in the operation of short- and long-term contracts, provoking increasing incidents of contractual arbitrage, missed cargo shipments, partial loadings, and contested declarations of force majeure. This naturally impacted the reliability and certainty of supply for buyers in a market where alternative supply was not only limited, but where short-term spot purchases were consistently and considerably more expensive than the price paid under long-term contracts.

For many companies, these fast moving and escalating gas market events in 2022 were compounded by restrictive and sub-optimal contractual price and flexibility terms. This raised questions about (i) the efficacy of traditional long-term gas and LNG sale and purchase agreements (SPAs) in absorbing and/or dealing with such acute price and demand volatility; and (ii) the risk profile associated with trades and hedge transactions made in 2022 with gas prices now (in 2023) falling quickly in comparative terms to last year. This has forced market participants the world over to assess their portfolio volumes, contractual termination rights, force majeure options, contractual flexibility rights, and prices, in an effort to develop commercial and legal strategies to best confront the multiple legal, regulatory, financial and operational issues involved.

This article summarises some of the extraordinary market changes and events that occurred over the last 12 months across the global gas and LNG markets, while also introducing some predictive thoughts on what the market may witness in 2023, together with some current and emerging trends in negotiations and arbitrations being seen across the globe.

## The Russian Rouble Change

Following the start of the war in Ukraine in February 2022, President Vladimir Putin announced on 23 March 2022 that Russia would continue exporting gas under previously concluded contracts, but that exports to so-called “unfriendly countries” would change their payment currency to Russian roubles. This announcement was immediately met with public outcry and raised questions as to whether such a unilateral change could be enforced, whether affected buyers would comply, and what impact would arise if they failed to comply.

Ultimately, when Russia released Decree No. 172 (“On special procedure for the fulfilment of obligations by foreign buyers to Russian Natural Gas suppliers”) on 31 March 2022, the final payment scheme was more nuanced than first anticipated. Under Decree No. 172, Russia required that gas supplied by Russian exporters after 1 April 2022 to unspecified “unfriendly countries” must be paid for by way of a multistep mechanism through specialised Gazprombank accounts, regardless of the payment terms under the relevant long-term supply contracts.

As approximately 60% of Gazprom's gas sales exported are settled in euros and approximately 40% are settled in US dollars, the impact of Decree No. 172 would be far-reaching. Following statements from Polish importer PGNiG and Bulgarian importer Bulgargaz that they would refuse to pay for gas purchased from their long-term Russian sellers in accordance with the new payment scheme, Gazprom announced that it had taken immediate steps to shut off gas to those companies.

The EU responded immediately that the demand for payment in roubles was "unjustified and unacceptable" and "shows once again the unreliability of Russia as a gas supplier".<sup>1</sup>

The authors addressed some of the legal aspects of Decree No. 172 in an article published in the *Global Arbitration Review*<sup>2</sup> where they discussed how the particular language of a supply contract may come into play, and the options that European importers might have in connection with those new payment terms in the event gas was turned off by their Russian counterparty.

## The Impact of the Russia-Ukraine Conflict Was Felt in European and Asian Markets

In mid-2022, Gazprom Export, Russia's largest natural gas exporter, began significantly reducing gas deliveries to Europe. Issues in connection with the war in Ukraine arose on three of the main routes by which Gazprom sends gas to Europe. In May 2022, Russia banned Gazprom from sending gas to Europe through the Yamal-Europe pipeline.<sup>3</sup> Also in May 2022, Ukraine's national oil company, Naftogaz, and state-owned grid operator, GTSOU, declared force majeure in connection with gas transmissions at the Sokhranivka transit point in the Sumy Oblast region of Ukraine – a region along the border with Russia directly impacted by the war.<sup>4</sup> In June 2022, as gas deliveries from Russia dropped significantly, Gazprom Export pointed to alleged technical issues on the Nord Stream 1 pipeline and issues with respect to the return of a repaired turbine.<sup>5</sup> However, the turbine was not reinstalled once repaired because the Kremlin asserted lack of proper documentation.<sup>6</sup> Ultimately, Russia shut off flows to Europe entirely through the Nord Stream 1 pipeline.

In July 2022, Gazprom purported to declare *force majeure* retroactively to mid-June 2022. As Russian gas flows to Europe fell to record lows, the price of gas in Europe soared. In August 2022, TTF<sup>7</sup> prices exceeded €300/MWh, an increase of approximately 1000% from prior years.<sup>8</sup> Importers struggled to replace the huge volumes of gas that were no longer flowing into Europe because Russia's curtailment of supply reduced the available pool of replacement volumes.

At the same time, the resulting supply scarcity situation inflated prices and made it exponentially more expensive for importers to purchase replacement quantities for volumes they had expected to receive under their regular contracts.

While the impact on European gas markets was obvious, the impact of the war in Ukraine, and the fact that it occurred right on the heels of the COVID-19 pandemic, also caused significant upheaval in the Asian gas markets. For example:

Upstream project operators extricated themselves from certain Russian LNG export facilities.<sup>9</sup>

Certain Asian banks and financial institutions imposed restrictions on US dollar-denominated payments being made to Russia-linked banks and companies in connection with currency conversions made through US financial institutions to protect their reputational positions in the market.<sup>10</sup>

Uncertainty grew as to whether Russia's Decree No. 172 would be imposed on Asian importers purchasing gas under US dollar-denominated SPAs.<sup>11</sup>

Spot market prices became an attractive source of arbitrage for sellers with numerous (and sometimes) spurious claims of force majeure.

Market price spikes prompted countless missed cargo shipments or partial loads from sellers that were then not subsequently rescheduled, prompting affected parties to scramble for legal advice, considering issues of wilful misconduct, gross negligence and the enforceability of liquidated damages clauses.

Concerns grew over sanctions levied against Russia causing operators to avoid using Russian "delivery ex-ship" (DES)<sup>12</sup> vessels, engaged to supply LNG cargoes to local Asian buyer markets.<sup>13</sup>

The government of the Russian Federation issued two new legislative decrees in June and August 2022 – Decree No. 416 and Decree No. 1369, respectively – which asserted governmental control over the Sakhalin-II oil and gas export facility, setting out details of the process for the transfer of operatorship of the Sakhalin-II project from Sakhalin Energy Investment Company Ltd. to a newly formed Russian LLC created by the Russian government, Sakhalin Energy LLC. This meant numerous Japanese and South Korean buyers were forced to negotiate new SPAs in massively truncated timeframes for fear of losing supply in a market where replacement spot volumes were almost unaffordable.

1 "Statement by Commission President von der Leyen following the announcement by Gazprom on the disruption of gas deliveries to certain EU Member States", European Commission, 27 April 2022.

2 "Gas payment issues in Europe: what are the next steps", *Global Arbitration Review*, 11 May 2022.

3 "Russian banks gas flows to Europe through key Yamal pipeline", Bloomberg, 12 May 2022.

4 "Ukraine to halt key Russian gas transit to Europe, blames Moscow", Reuters, 11 May 2022.

5 "Russian gas to Europe falls short as heatwave drives demand", Reuters, dated 17 June 2022.

6 "Scholz blames Russia for Nord Stream gas turbine debacle", Bloomberg, 3 August 2022.

7 Meaning "Title Transfer Facility", a virtual trading point for natural gas based in the Netherlands.

8 "Infographic – A market mechanism to limit excessive gas price spikes", European Council, Council of the European Union.

9 See, e.g., "Shell intends to exit equity partnerships held with Gazprom entities", Shell website, 28 February 2022 (announcing Shell's intention to exit from its stake in the Sakhalin II LNG facility).

10 See, e.g., "Major Japanese banks to halt dollar transactions with Russia's Sberbank", Kyodo News, 26 March 2022

11 See "Asian gas buyers puzzle over Putin's demand for payment in roubles", Reuters, 24 March 2022.

12 Meaning the seller provides the shipping.

13 See "Shell idles LNG ships owned by Russia to avoid sanctions risk", Bloomberg, 7 April 2022.

Russia levelled sanctions of its own against certain of its own former affiliates involved in supplying and shipping gas in Asia, which again prompted massive supply disruptions at a time of already severe disturbance.<sup>14</sup>

As the authors of this piece previously reported in June 2022,<sup>15</sup> these developments lent themselves to testing the elasticity of the steadily evolving Asian gas market, which, over the past few years, has also witnessed cultural shifts in the approach to dispute resolution, a decline in long-term LNG prices since 2012, fast-paced market liberalisation, and the impact of the global pandemic on energy demand. As a result, we have seen a crucial behavioural change among buyers in the Asian market in grappling with the changing market horizon. In particular, Asian buyers who were often hesitant to pursue contractually entitled redress are increasingly considering what contractual tools they have at their disposal to confront these issues. This was (and will likely remain) especially true as Asian buyers have become better acquainted and well versed with the value of certain contractual provisions which has, in turn, removed any hesitation they may once have had in seeking to invoke them.

Again, as these authors noted in an earlier piece,<sup>16</sup> some market commentators previously suggested that Asian buyers traditionally harboured concerns regarding the potential damage that commencing arbitration could inflict to the counterparty relationship. This concern often (i) manifested itself in a buyer's overall strategic approach to negotiations, thereby underutilising the role of legal leverage; (ii) created an appetite to reach a prompt agreement on less favourable pricing or broader commercial terms; and (iii) provided a valuable negotiation tool to a seller counterparty, which could seek to filibuster or adopt a non-transparent approach to talks, safe in the knowledge that the buyer would not take steps to escalate matters to the available dispute resolution forum for fear of damaging the long-term relationship.

While safeguarding the commercial relationship is an important feature in the development of a price negotiation strategy rather than damaging a relationship, arbitration can actually help support and protect that long-term relationship. Now, in each of the major "JKTC" – Japan, Korea, Taiwan, and China – markets, buyers under long-term, take-or-pay contracts are now moving forward with price review negotiations and arbitrations more frequently (and more aggressively). This strategic shift has developed in an effort to secure contract prices that better reflect prevailing market prices to provide some financial security moving forward in these volatile times.

## Supply Disruptions at Freeport, USA

As if the volatility stemming from COVID-19 and then the war in Ukraine were not enough to cause turmoil in the global markets, the Freeport LNG facility encountered two major supply disruptions in the last 15 months – first as a result of Hurricane Nicholas in September 2021, and second, due to a fire that broke out at the facility in June 2022.

After missing its initial restart goal of October 2022, it was reported earlier this month that the January 2023 goal "is now out of sight", pushing supply from the facility back to at least February 2023, extending the disruptions it has had on gas markets.<sup>17</sup> Reconstruction was reported to have been completed in December 2022, but regulators from the US Federal Energy Regulatory Commission (FERC) and the Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA) have still not approved the restart. Some have speculated that additional works will be required before the FERC and PHMSA regulators will be satisfied, risking further delays. It has now been reported that the delays in bringing the Freeport facility back online have forced some of its major customers, including Japanese LNG buyers JERA and Osaka Gas, as well as BP, TotalEnergies and SK E&S to see major impacts on their businesses.

## Looking Ahead to the 2023 Market Landscape

Now, more than ever, parties to long-term gas supply contracts need to maintain a solid grasp of the contractual tools at their disposal. A strong understanding of the rights provided under the contract is a good platform for dialogue between the parties on how to address the present market circumstances. Both buyers and sellers in the market are facing these issues now and will continue to do so going forward. A firm grasp of the available options is vital in times when the sands in the global gas market are constantly shifting.

## The Year of the European Supply Dispute?

The question for European buyers now is not how to regain their Russian supplies, but where to go from here. It is generally understood that the era of Russian gas dominance in Europe has passed. Since Russia dramatically curtailed European supply, Europe has looked for other, more reliable options. Historically reliant on pipeline gas from Russia, Europe has scrambled since mid-2022 to put LNG receiving infrastructure into place so that it can diversify its supply portfolio and source gas from non-Russian sellers. Prior to the war in Ukraine, most of Europe's LNG receiving terminals were located in France, Spain, and Italy. In the wake of the conflict, countries around Europe began looking to secure floating storage and regasification units (FSRUs)<sup>18</sup> and commence construction on LNG receiving terminals. Industry analysts estimate that Europe will add approximately 50 billion cubic metres (bcm) of LNG import capacity by the end of 2023, compared with the 150 bcm of Russian gas that Europe imported in 2021.<sup>19</sup>

Russian supply curtailments have caused significant harm to European buyers, who needed to replace the volumes they did not receive from Russia with gas from elsewhere, at extraordinarily high prices. The first concern for European buyers was to secure their supply from other sources. But, having done so, they have now begun to seek compensation from Gazprom.

<sup>14</sup> See "[Russia allows gas flows to Gazprom Marketing & Trading for 90 days](#)"; The Business Times, 26 May 2022.

<sup>15</sup> "[The Asian LNG Market: Ongoing Impact of the Russia-Ukraine Conflict](#)"; June 2022.

<sup>16</sup> "[To Arbitrate, or Not To Arbitrate, That Is the Question](#)"; March 2022.

<sup>17</sup> "[Freeport LNG may extend Texas plant restart to February – sources](#)"; Reuters, 12 January 2023.

<sup>18</sup> Vessels used to store and regasify LNG back into natural gas to provide to a receiving terminal.

<sup>19</sup> "[Europe will add 50 bcm of LNG import capacity by end-2023](#)"; Energy Intelligence, 1 November 2022.

Publicly available information indicates that major European buyers have already begun to pursue legal remedies against Gazprom in arbitration. In September 2022, Ukraine's Naftogaz announced that it had initiated new arbitration proceedings against Gazprom.<sup>20</sup> In November 2022, Germany's Uniper announced that it had initiated arbitration proceedings against Gazprom.<sup>21</sup> In December 2022, Germany's RWE likewise announced that it had commenced arbitration proceedings against Gazprom over delivery shortfalls.<sup>22</sup> These look to simply be the tip of the iceberg. 2023 will undoubtedly see more such cases being commenced, with more to follow once news of the success of existing cases reaches the industry.

## The Year of the Asian Price Review?

In addressing the question of how parties can, commercially and contractually, confront these issues in an effort to ease and improve the effects now and in the future, one solution, which is becoming a key trend in the Asian market, is to commence price review negotiations.

While commencing negotiations to adjust the economics of an SPA is standard practice in the industry, the value of this exercise is often not fully realised. It can, and indeed should, be done in a way that maintains good commercial relationships while securing meaningful financial benefit for a party giving them price certainty for the next period of the term up to the next price review window. In the authors' experience, developing a robust legal and commercial strategy is critical to success. A party that builds leverage from a strong legal and factual position is more likely to preserve the long-term relationship and realise its commercial objectives through securing a reduced price or achieving other commercial currencies through improved non-price terms.

While sellers placed great emphasis on the value of security of supply in 2022, the LNG market now appears to be starting to equalise and absorb the impact of volatile 2022 gas and LNG market activity, thereby reducing sellers' ability to leverage security of supply in talks. Sellers' ability to try and leverage futures commodity prices is also anticipated to reduce this year in light of current falls in futures prices; for example, JKM is down more than 50% versus September 2022 figures.

With a number of new (and expanded) facilities planned or under construction around the world and new supply expected to come online in two to three years' time, this may create oversupply issues for many. As a result, price reviews and change-of-circumstances clauses may be used more and more frequently as portals through which to seek improvements to price but also commercial currencies such as downward quantity tolerance (DQT) and upward quantity tolerance (UQT)<sup>23</sup> rights, delivery mode changes, adding other receiving terminals and negotiating other non-price terms.

Indeed, in the face of further market pressures, it is likely that we may witness parties invoking these clauses more and more in an effort to improve their commercial currencies.

The authors of this piece are actively advising market participants in Europe and Asia on a day-to-day basis on:

- Price review strategy development, negotiations, and arbitrations
- Hardship and change of circumstance negotiations and arbitrations
- Underdelivery disputes
- *Force majeure* claims and defences
- Missed cargo disputes and wilful misconduct issues
- Portfolio review and optimisation to assess volume and destination flexibility tolerances

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<sup>20</sup> "[Naftogaz initiates new arbitration proceedings against Gazprom](#)," Naftogaz website, 9 September 2022.

<sup>21</sup> "[Uniper initiates arbitration proceedings against Gazprom and further ringfences Russian business unit](#)," Uniper website, 20 November 2022.

<sup>22</sup> "[RWE initiates arbitration proceedings against Gazprom](#)," Reuters, 5 December 2022.

<sup>23</sup> Typical provisions in long-term SPAs allowing for a reduction or increase (as the case may be) in quantity purchased within agreed limits.