Ripe for change

The challenges are significant, but growing liquidity and efforts to simplify supply agreements are building the path toward more standardized, efficient and cost-competitive trading practices.

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The standardization of LNG trade is challenging, but structural industry changes are yielding results. The expansion of spot and short-term trades, a growing diversity of market participants, and the phasing out of destination clauses have increased market transparency and competition.

This has accelerated a market trend toward standardizing the contractual norms by which LNG cargoes are changing hands, which could have significant implications for trading efficiencies and the overall cost structure of the LNG industry.

Ripe for change

There are two key factors holding back standardization and trading liquidity: the deeply entrenched use of Master Sales and Purchase Agreements (MSPAs), and the variegated nature of LNG trading arrangements.

Currently, LNG counterparties need to negotiate a set of bilateral commercial terms through an MSPA before embarking on a trading relationship. Cargoes are then traded under another commercial agreement, the Confirmation Notice (CN), based largely on the MSPA terms.

This means that companies need to sign dozens of bilateral MSPAs, each of which are bespoke and slightly different, before starting active trading. This restricts market access for new entrants.

Furthermore, a single cargo that has been traded multiple times will be subject to a variety of MSPAs, and this is likely to reduce efficiency over time as cargo churn increases with the development of spot trade. Traders are also exposed to legal risks if the same terms are not used in back-to-back trades.

There are alternatives. Instead of signing separate MSPAs with each counterparty, LNG stakeholders could agree on and adopt a set of general terms and conditions (GTCs) for all LNG trading transactions.

GTCs are widely used in the oil and pipeline gas markets. Shell's Suko 90 for trading Brent crude oil cargoes and the NBP 97 for UK gas trading are two such examples.

In April 2019, BP unveiled an LNG MSPA template for delivered ex-ship contracts (DES LNG MSA).

This followed a reference set of GTCs created by French law firm De Gaulle Fleurance in 2018 and a standard MSPA template from Switzerland-based trader Trafigura in 2017.

Industry groups such as the International Group of Liquefied Natural Gas Importers and the Association of International Petroleum Negotiators have also published their own templates in recent years.

Standard MSPAs and GTCs govern the bulk of terms, while the key trading variables of a spot or short-term transaction — such as price, quantity and calorific value — are typically agreed in the CN.

These CN trading variables differ from deal to deal, but increasing transparency and cargo churn have engendered greater consistency and visibility of a trading standard for DES Northeast Asia LNG.

For example, for deliveries to Japan, South Korea, China and Taiwan, nomination deadlines for alternate LNG vessel, discharge port and loading port have been almost halved to 30 days over the past few years, and that is gaining acceptance as market standard.

Rewards too big to ignore

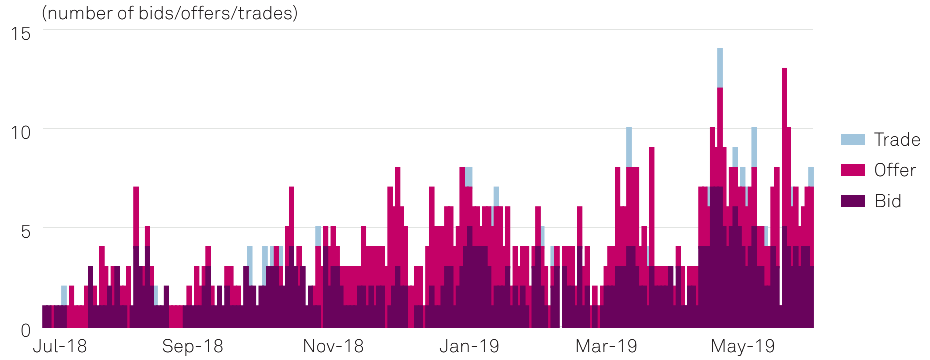
This shift toward greater flexibility will become more prominent in the next decade, as LNG of differing qualities shipped on varying voyage lengths from the US, Mozambique, Canada and Russia enters global buy portfolios, paving the way for trading standardization.

While adoption is not guaranteed, a standard GTC could be the trigger for greater market development.

Lowering the barriers to new entrants would build liquidity, while cutting the overall time and resources needed to conclude LNG transactions would improve both trading transparency and the industry's overall cost structure.

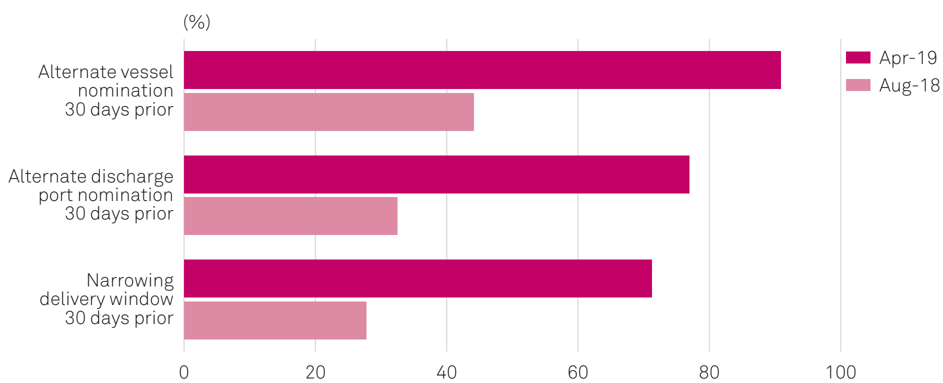
While there has been significant industry inertia in terms of adopting an industry standard for LNG trading, with companies still opting to use their own bespoke terms, the potential rewards of standardization as liquidity continues to build into the 2020s will be too big to ignore.

PLATTS ASIA LNG MOC ACTIVITY STEADILY RISING, WITH OVER 700 BIDS, OFFERS AND TRADES TO DATE



Source: S&P Global Platts

PERCENTAGE OF MOC ORDERS ADHERING TO STANDARD TERMS INCREASES



Source: S&P Global Platts

PRAs, platforms and exchanges

Price reporting agencies, trading platforms and exchanges will also play a key role in this transformation.

Platts continues to refine and standardize the trading terms for its JKM Market on Close (MOC) assessment process, while setting the normalization terms for bids, offers and trades that are considered non-standard or restrictive around elements such as quality, quantity and delivery location.

In April 2019, a total of 76.9% of all MOC bids and offers stipulated nominations of alternate discharge port 30 days before delivery. This compares with just 32.5% in August 2018.

The JKM MOC standard guidelines are a first step to giving the industry more clarity on the definition of a standard spot cargo trade into Northeast Asia, which could boost trading liquidity and increase market transparency over price formation. At the same time, visibility of a set of benchmark specifications may also further encourage standardization.

