

Chapter 4

Policy Recommendations

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Chapter 4

Policy Recommendations

4-1. Market Creation

4-1-1. Acceleration of Destination Restriction Removal

After the Japan Fair Trade Commission (JFTC) study was published, destination restrictions are being removed from new long-term contracts. The destination clause in the existing contract, however, seems to have remained, although the JFTC study urges the Japanese LNG buyers to renegotiate the clause in the existing contract. This is because the destination restriction is still regarded as a bargaining chip for LNG sellers and the removal of the destination restriction accompanies the revision of the other contractual conditions including price. Some buyers prefer to maintain a favorable relationship with sellers and are not very willing to discuss this issue with sellers. An additional driver is needed to enforce the JFTC's suggestion on the renegotiation of the destination restriction.

In Japan, it is desired that JFTC will conduct a follow-up survey with legal authority to ensure the destination restriction is removed from existing long-term contracts as well. Anti-monopoly authorities in other countries, including the US Fair Trade Commission, are also recommended to study this practice and provide a view on this issue.

4-1-2. Development of Reliable LNG Price Benchmark

An LNG price benchmark is a missing link of beneficial active spot trades and market liquidity and transparency in Asia. Buyers and sellers require full transparency in the fundamentals of supply and demand, without which the LNG market cannot fully expand. Existing pricing methods that are linked to the crude oil price are not rational since most of the LNG demand growth in the future will be observed in the power sector, where LNG usually competes with coal and renewable energy. The volume of trading at the existing price benchmark is growing, but it is not reliable enough to gain confidence from all market participants.

An increase of flexible LNG supply through removal of the destination restrictions in long-term contracts, as well as investment in new liquefaction capacity to supply destination-free LNG cargoes, will help to solve this problem. In addition, an initiative by a large market player to pick up a specific benchmark for their term contract price formula may be required to create a

representative price benchmark, just as Centrica picked up the UK National Balancing Point as a price benchmark for their term contract. Also, market participants are encouraged to participate in spot-trading platforms and disclose the price level for which they transact a particular spot cargo. An established benchmark will enhance both market liquidity and supply security.

4-2. Demand Side

4-2-1. Assistance to Private Investment in LNG Value Chain (Downstream)

The development of LNG import facilities (re-gasification, gas distribution pipelines, power plants) requires billions of dollars in capital outlay; this can be tied up for as much as a decade before any revenue is realised. LNG projects also face important risks across the entire value chain; feedstock costs can rise, interruptions are possible in feedstock delivery systems, regulatory programmes can impose new requirements on both exporters and importers, government policy can change, and financial performance of an LNG project can be disrupted by price changes and demand shifts.

Addressing these risks can enhance predictability and bring more LNG projects to FID. Assistance from export credit agencies, insurance for political and non-performance risks can address important obstacles to bring projects to FID. Continuing capacity building for regulatory authorities and development agencies remains essential. Steady efforts to assist private investment should be undertaken by revising the conditions for financial assistance provided by ECAs in Japan and in the US. Congressional review is ongoing to consolidate the US ECAs so they can more effectively assist private investments in new Indo-Pacific energy infrastructure projects.

4-2-2. Engagement with Emerging Buyers

As the presence of emerging LNG buyers increases, a closer communication and cooperation with them has become more important. Because the demand in these countries tends to be more unstable, sharing market status information or demand patterns will benefit all players in the LNG market. Emerging buyers will also find it useful to exchange views on how to develop LNG markets with preceding importers.

Such a collaboration will also improve the natural gas supply security of LNG importers. Unlike the international oil market, there is no equivalent organisation or system like the International Energy Agency's emergency response framework. Communicating and discussing the latest demand and supply balance of the international LNG market, the outlook of demand and

infrastructure development, and supply security measures such as inventory holding or developing storage facilities will enhance emergency preparedness.

Building a new cooperative framework from scratch will require huge resources. Using an existing framework such as ASEAN+3, APEC, or the East Asia Summit group will be an effective solution, since their members cover most of the major LNG buyers in Asia. To augment such a framework, the annual LNG Producer–Consumer Conference held in Japan will also deepen gas supply security, since it is the platform where policy makers and government officials regularly convene and can discuss cooperative actions. Adding a new role and objective as the platform of Asian LNG supply security discussions to the Producer–Consumer Conference will bring a valuable opportunity for every stakeholder in the global LNG market to discuss supply security and ensure sound development of the Asian market.

4-2-3. Development of a Fast-Tracking Tool for Project Development

Providing a model project structure and required documents will facilitate infrastructure development, since many Asian emerging countries have limited or no experience of LNG imports or gas-to-power projects. This is particularly the case in an LNG-based gas-to-power project as it contains various value chains from LNG procurements to construction and installment of a receiving terminal and gas-fired power plant. It usually requires a long-term, thorough negotiation to determine the structure of the project, especially who undertakes what responsibility and what kind of risks are endemic. If there were a model project structure that the host country and project developer could refer to, it would be more efficient to discuss and determine the structure.

In many Asian emerging LNG importing countries, laws and regulations for import and utilisation have not been well developed. Such model documents will be a useful reference point for each stakeholder.

Ideally, the project structure would be fully tailor-made to reflect the local conditions and requirements. However, it is also true that such a tailor-made approach requires a far longer time for the project to be realised. There is an acute and urgent need for energy and power supply in emerging Asian countries, and using the model project will be an efficient solution to fast-track gas-to-power projects. Multilateral development banks such as the World Bank or the Asian Development Bank will lead the formulation process based on their vast experience and deep expertise.

4-2-4. Preparation for the Emergence of LNG Bunkering Demand

As LNG bunkering advances globally, there is the potential that bunker fuel markets will become fragmented. Where maritime operators had limited fuel type choices but ubiquitous supply availability, there now is the possibility of the inverse: many different fuel choices with gaps in coverage across the globe. For LNG bunkering to succeed, coordination is necessary.

Operators and other maritime participants, especially those with long investment horizons, need to be vigilant: the IMO 2020 sulfur directive is not the last rulemaking that it will undertake. Already, there are discussions regarding GHG emissions, and this will impact fuel choices. This will critically advantage LNG, but primarily in the longer term.

For LNG bunkering to develop in Asia, the EU, through its TEN-T initiative, offers a model template. Each of TEN-T's efforts are coordinated on many fronts, with clear requirements and timetables comprehensively covering operating and financial parameters.

4-3. Supply Side

4-3-1. Assistance to Private Investment in LNG Value Chains (Upstream)

As in downstream, a policy measure to assist private investments in upstream and liquefaction is also critical. As with the case of investments in downstream sectors, assistance from export credit agencies in Japan and the US will continue to play a vital role.

For US exporters, a timely and predictable process for evaluating and issuing permits for both building natural gas pipelines to move feedstock to export facilities, as well as permits for liquefaction facilities, is essential. Regulatory risks can be a major impediment to reaching FID. In this respect, US regulatory agencies are making progress. DOE has developed a timely, predictable, and informed process for issuing LNG export permits. The permit process for pipelines and LNG export facilities as administered by FERC has suffered from a growing workload, but recent reforms offer considerable promise. Continued attention to improving the FERC process is warranted.

New investment structures can also enhance predictability. Tellurian's Driftwood LNG project has built an integrated investment programme that includes upstream assets, pipelines, and a liquefaction facility on the US Gulf Coast. In this financial structure, an LNG investor can now lock in the cost of the entire value chain at an equivalent of US\$3/Mcf. Other investment structures may also emerge to address other risks from LNG development.

4-3-2. Innovative Investment Plan for Upstream Investments

Ensuring sustained investments in the upstream sector is a vital condition of natural gas supply security. Demand in emerging LNG importers is growing at an unexpected speed, and lack of timely investments will cause a supply crunch and intolerable price hikes, both of which will eventually harm the interests of buyers and sellers alike.

The widening mismatch of interests between buyers and sellers has been often cited as a reason for stalled FID in the last few years. Market players have not been able to adapt to a new model of risk allocation under the new LNG market reality, with a larger number of emerging LNG buyers and growing demand for shorter and flexible supply. There is a dire need for innovative ideas to break the current FID deadlock. A packaged investment for wellhead natural gas production, pipeline, and liquefaction plant construction such as Tellurian's equity model may be one such idea. Both buyers and sellers are required to consider something different to proceed with the further expansion of the Asian LNG market.

4-3-3. Collaboration to Avoid the Panama Canal Bottleneck

ACP recognises the potential capacity problems of the Panama Canal for LNG tanker passage in the future and has already taken several steps to avoid such bottlenecks. However, it is still uncertain if its actions are enough to accommodate the rapid expansion of US LNG exports given the large seasonal demand fluctuations. The US, Japan, and other LNG importing countries will minimise this risk by active information sharing and policy discussions.

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