

LNG Contract Penalties

Typical LNG contract penalty clauses are below. Essentially, the Buyer can source a higher priced cargo on the spot market and required the Seller to pay the difference. Historically, the spot market premium for LNG to contract LNG is around \$2/GJ when LNG is in short supply, which is when a Buyer would trigger the “Failure to Deliver” penalty.

X.3.4 Following any Deemed Failure to Deliver, Buyer shall use reasonable endeavours to procure replacement Natural Gas or LNG to the extent of the Deficiency Quantity and mitigate any losses. Seller shall pay to Buyer the sums calculated in accordance with both Clauses 6.3.4.1 and 6.3.4.2:

X.3.4.1 Where Buyer procured replacement Natural Gas or LNG, the positive difference of the following:

Total Mitigation Amount - (Deficiency Quantity x Contract Price)

The “**Total Mitigation Amount**” is comprised of (a) the purchase price of the replacement Natural Gas or LNG in a quantity up to Seller's Deficiency Quantity (always acting commercially reasonably under the circumstances) and (b) Buyer's direct costs incurred including any additional transportation and logistics costs, demurrage and reasonable legal fees incurred by Buyer arising from Seller's Failure to Deliver.

If after performing the calculation in this Clause 6.3.4.1 there is a negative difference, Buyer shall not be obliged to remit such difference but it shall be automatically applied to offset any sums that may be due by Seller to Buyer under Clause 6.3.4.2 below.

Existing GLNG contracts

Almost all of the LNG capacity currently under construction in Gladstone is contracted for 20 years or more (see Table below). The assumption used for modelling is that LNG producers must deliver this ‘already contracted’ quantity, independent of conditions in the Asia-Pacific LNG market

This implies that contracts are binding and cannot be terminated, and that contract volumes are not renegotiated, regardless of the price of LNG in the Asia-Pacific market. Existing LNG contracts for export of gas are explicitly represented in this way because contracts are likely to have penalty clauses associated with any failure to export gas from Australia. (Productivity Commission, Eastern Australia Gas Market Model).

LNG contracts (Productivity Commission)

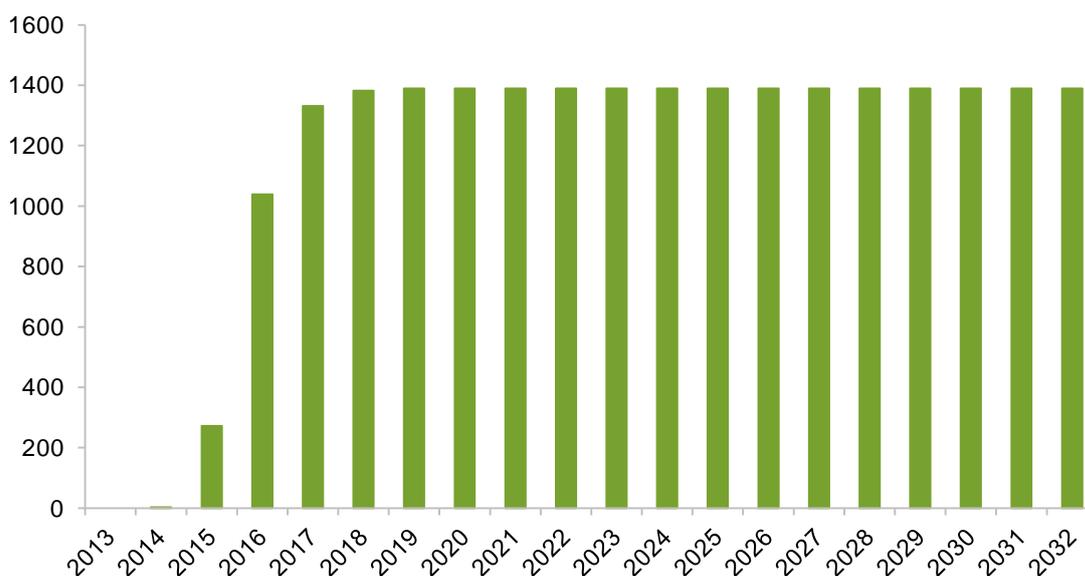
<i>Seller</i>	<i>Buyer</i>	Volume (million tonnes per annum)	Volume (PJ/yr) ^a	Time period (years)
Australia Pacific LNG	Kansai Electric	1.0	54.4	20
Australia Pacific LNG	Sinopec	7.6	413.4	20
Gladstone LNG	KOGAS	3.5	195.8	15+5 ^b
Gladstone LNG	PETRONAS	3.7	195.8	20
Queensland Curtis LNG	Chubu Electric	0.4 ^c	21.8	21
Queensland Curtis LNG	CNOOC	3.6	195.8	20
Queensland Curtis LNG ^d	CNOOC	5.0	272.0	20
Queensland Curtis LNG	Tokyo Gas	1.2	65.3	20

^a Based on a conversion rate of 1 million tonnes = 54.4 PJ (BREE 2014c). ^b Agreement is binding for 15 years with Gladstone LNG having the option to extend the agreement for a further 5 year period. ^c Agreement is for up to 122 cargoes over 21 years which is equivalent to 0.4 mtpa if a 70 000 ton capacity vessel is used. ^d To be sourced from BG Group's global portfolio of LNG plants, not exclusively from Queensland Curtis LNG.

Sources: APLNG (2012a); BG Group (2010, 2011a, 2011b, 2013); GIIGNL (2012); Santos (2010, 2013).

Gas demand for already-contracted LNG (PJ p.a.)

[NB - Santos has negotiated some of these volumes down for a limited time]



^a Includes gas used during the liquefaction process but does not include gas use and losses related to transmission, production and processing. These losses are accounted for separately.

Source: Commission estimates based on Jacobs SKM (2014b).