

Revisiting LNG Resale Restrictions – Implications of Recent EU Decisions

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The Qatar Petroleum Investigation

The EC investigation into Qatar Petroleum represents the most recent regulatory action around the issue since the conclusion of the JFTC's market study in July 2017. On June 21, 2018, the EC announced that it had opened a formal investigation into Qatar Petroleum, looking into whether the destination clauses in its long-term LNG SPAs with EEA gas importers are in breach of EU antitrust rules (please refer to [here](#) for a recent market update in relation to this). We expect that the investigation will conclude in 18 to 36 months' time; therefore, it remains to be seen whether the results of this investigation would be consistent with the approach taken in earlier EC investigations and recent positions adopted by regulators in Asia.

Earlier EC Investigations

Prior to the Qatar Petroleum investigation, the EC ran a series of investigations against non-EU gas producers and EU gas importers since 2000. It examined gas contracts between external gas suppliers and European gas wholesale importers, and eventually concluded that destination clauses and profit-sharing mechanisms were not compatible with EU competition law. This exercise resulted in a series of settlements with gas suppliers outside Europe. In most cases, the EC was willing to close its investigation after the relevant entity (i) had deleted the relevant offending clause(s) from existing contracts and (ii) undertook to ensure that similar clauses would not be introduced in gas supply contracts in the future.

The EC/Sonatrach/Algerian Government Negotiation and the Common Understanding

Rather notably, the EC had a seven-year-long discussion/negotiation with Sonatrach and the Algerian government resolving their differences as to whether territorial restrictions and profit-sharing mechanisms could be used in particular types of gas supply contracts. The conclusion reached in this decision is instrumental in understanding what is/is not permissible under EU competition law, which may be of considerable reference value in the context of Japan.

By way of background, Algeria supplied 11 percent of the EU's total consumption of natural gas, LNG and pipeline gas in 2006, making it the third largest gas supplier after Russia and Norway. It was a major source of energy supply in the case of, for example, Italy and Spain, where it supplied 35 percent and 34 percent of their respective total gas consumption at that time.

While the Algerian government accepted the need to delete territorial restriction clauses from gas supply contracts, it insisted on replacing them with profit-sharing mechanisms. This position was not accepted by the EC inasmuch as it would result in a substantially similar effect to including a territorial restriction clause in the supply contract. Further, the EC insisted that it would be a matter for the commercial parties to agree on the precise contractual terms under a supply contract and that it was prepared to only advise the parties as to whether a particular proposed contractual arrangement was (or was not) compatible with EU competition law.

As a consequence of the findings, the EC, the Algerian government and Sonatrach agreed that the following should be pursued in future contracts with EU counterparties:

- Sonatrach would delete territorial restrictions from all existing contracts and not insert such clauses in any future contracts.
- Sonatrach would not insert profit-sharing mechanism in new LNG contracts where its use is not permissible (i.e., contracts under FOB and/or CIF conditions).
- Sonatrach would change the then-existing LNG SPAs from other alternatives (under FOB and/or CIF conditions) to be shipped under DES terms.

- Sonatrach would remove profit-sharing mechanisms from existing pipeline contracts and undertake not to insert them in future pipeline gas contracts.
- There would not be any type of compensation or renegotiation of contracts following deletion of the relevant offending clauses.

The common understanding developed between the EC and the Algerian government is broadly similar to the JFTC conclusion.

The Gazprom/ENI Investigation and its Eventual Settlement

In a similar vein to Sonatrach's settlement, the EC issued a press release in October 2003 announcing the settlement of an investigation relating to certain gas supply contracts between Gazprom (a Russian gas producer) and ENI (an Italian oil and gas company) in relation to, among other things, destination clauses and consent clauses in gas contracts between them. The contractual commitments made by the parties, which eventually resulted in the EC deciding not to pursue further action against the parties, are as follows:

- The territorial restrictions were deleted from all existing gas supply contracts. The amended contracts provided for two delivery points for Russian gas, and ENI was free to take gas from any of those delivery points.
- ENI would have the right to resell and transport the purchased gas at its option (i.e., the resale restriction outside Italy with respect to gas purchased from Gazprom was lifted).
- Gazprom and ENI deleted the consent clauses (where Gazprom needed to obtain consent from ENI if it were to sell gas to any other customers in Italy) from all existing agreements.
- Gazprom and ENI undertook not to introduce similar provisions in any future gas supply contracts (whether pipeline gas or LNG), either between them or (in the case of Gazprom) between Gazprom and other European gas importers.

At the time of the Gazprom/ENI settlement, Gazprom was the largest gas supplier to Europe, with ENI importing approximate 20bcm (or approximately 14.6 mmtpa) of gas from Gazprom

every year.

What Does This Mean for Japanese Importers and Non-Japanese Gas Sellers?

Bearing in mind the jurisdiction-specific elements of antimonopoly rules and regulations, the EU decisions and trains of thought could be helpful in foreshadowing what the JFTC may require market players to do if the JFTC were to commence investigations against non-Japanese gas producers and/or Japanese gas importers. Drawing from the EU experience, it seems that the baseline would be to: (i) require the deletion of territorial restriction clauses from existing contracts, (ii) allow the gas buyer to resell the purchased gas at its option (other than DES contracts, where neither title nor risk has passed to the buyer), (iii) allow the gas seller to sell gas to another buyer in the same jurisdiction without having to obtain consent from its counterparty and (iv) require the parties to undertake not to insert the contested clauses in future contracts.

Even though the EU experience might be helpful, we are mindful of the fact that there are key differences between the EU and the Japan legal systems that may or may not result in similar decisions in any enforcement action in Japan. In particular, the EU Single Market Objectives could have been a main driving force behind the EU decisions that might not be relevant in the Japanese context. As a result, it might be the case that the JFTC would need to see evidence of likely negative economic effects before taking enforcement actions. The following notable differences between the EU and Japan might also be relevant:

- **Different factual scenarios:** The JFTC is taking aim at scenarios where Japanese importers are prevented from onward export of the gas to third-country operators. The EU cases discussed above, however, concern scenarios where an EU importer is prevented from reselling to another EU party (clearly impacting competition within the EU Single Market).
- **By object infringements and illegality:** Owing to the EU Single Market Objectives, and to the EU scenarios involved, the EC was able to find the relevant clauses to be by object infringements and thus illegal, not having to assess their effects. On the other hand, the clauses investigated by the JFTC are not by object infringements, and the JFTC would thus have to show anticompetitive effects (e.g., Japanese importers being prevented from onward export). Several practical difficulties arise as a result of the fragmented makeup of the Japanese LNG import market, meaning that it would be

difficult to show the effects on competition of any such contract because none of the exporters have market power (unlike the EU, where a small number of large suppliers lead the EU gas market).

Responses from Japanese Importers and Other Asian Market Players So Far

Market players in Japan have already responded to the JFTC findings. Tokyo Gas, Japan's biggest city gas supplier and second largest LNG importer, has indicated that it will not accept new long-term LNG contracts that contain clauses restricting where gas can be sold¹. Similarly, JERA, the world's biggest LNG importer and a joint venture between Tokyo Electric Power Co and Chubu Electric, is currently making progress in its talks with existing long-term LNG sellers to revise profit-splitting clauses in current contracts².

Interestingly, we also note that Petronas, the world's third-biggest LNG exporter has indicated that it "will observe" JFTC's ruling that LNG sellers should not force restrictions on reselling LNG cargoes.³ In addition, we further note that South Korea's Fair Trade Commission announced in October 2017 that it was considering whether to initiate an investigation into LNG SPA clauses that restrict buyers from reselling to other markets.⁴

In light of the above observations, we wait with interest to see (i) whether the JFTC will adopt the EC's approach in furtherance of its efforts to regulate resale and profit-sharing terms in LNG SPAs; (ii) what conclusions the EC will reach in the Qatar Petroleum investigation; (iii) what actions other Japanese importers (and non-Japanese gas sellers) will take in response to the JFTC conclusions; and (iv) whether other Asia regulators (such as South Korea's Fair Trade Commission) will initiate similar investigations and, if so, whether they will reach conclusions similar to the JFTC conclusions.

¹ See, <http://uk.reuters.com/article/uk-japan-tokyo-gas/tokyo-gas-will-not-accept-destination-clauses-in-new-lng-contracts-president-idUKKBNICA0X0?il=0>

² See, <https://www.reuters.com/article/us-commodities-summit-jera/japans-jera-in-talks-for-lng-contract-with-no-destination-limits-idUSKBN1CG0SR>

³ See, <https://www.reuters.com/article/us-lng-japan-contracts/petronas-to-observe-japan-ruling-on-lng-destination-clause-nikkei-idUSKBN1D13DJ>

⁴ See, <https://www.reuters.com/article/us-southkorea-lng/south-koreas-regulator-weighing-whether-to-start-probe-into-lng-destination-clauses-idUSKBN1CO070>

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