

LNG Delivery Disputes

Article

October 09, 2024 | *Liquefied Natural Gas: The Law and Business of LNG* | 9 minute read

1. Introduction

Since the delivery of the first LNG cargo by the *Methane Pioneer* in 1959, the LNG market has changed dramatically, from a structured and rigid market underpinned by long-term LNG sale and purchase agreements (SPAs) to a traded market, with a large proportion of all LNG sales being made under short-term LNG master sale and purchase agreements (MSPAs) and at spot prices, or by way of swaps of LNG cargoes. The traded LNG market allows buyers and sellers of LNG to quickly trade LNG cargoes and re-optimize deliveries to benefit from arbitrage opportunities. Nonetheless, the majority of LNG sales are under long-term SPAs, which provide sellers with the long-term sales commitments necessary to take a positive final investment decision in relation to a proposed development and a 'bankable' project for the purposes of project finance lenders, while also providing buyers with security of supply.

The global LNG market reached an estimated 404 million tonnes in 2023 and individual cargo sizes have also grown, with the largest Q-Max vessels now having a capacity of 210,000 cubic metres.^[1] The LNG industry has also experienced unprecedented volatility in recent years: first, a pronounced shock and slump in prices as the effects of the COVID-19 pandemic and corresponding lockdowns slashed demand for natural gas, followed by a tightening in the market following Russia's invasion of Ukraine and a halt to the importation of a large proportion of Russian gas into Europe. Given the significant volumes of LNG that are now bought and sold globally, the greater capacity of individual vessels and ability to trade LNG cargoes in the spot market and substantial market volatility, the risk of LNG delivery disputes has increased significantly since the beginnings of the LNG industry.

Related People

Alistair Calvert

Partner

LONDON

+44.(0).207.448.4217

alistair.calvert@bracewell.com

John Gilbert

Partner

LONDON

+44.(0).207.448.4296

john.gilbert@bracewell.com

Adam Quigley

Senior Associate

LONDON

+44.(0).207.448.4214

adam.quigley@bracewell.com

Related Industries

[Energy](#)

Related Practices

[Litigation](#)

[Oil & Gas](#)

[International Arbitration](#)

This chapter discusses potential areas of dispute in relation to the delivery (and non-delivery) of LNG, including the reasons behind why a dispute may arise, together with the possible remedies available to the injured party in a delivery dispute.

Force majeure disputes and pricing disputes are discussed elsewhere in this book and are not within the scope of this chapter.

2. Failure to Deliver/Failure to Take

2.1 Failure to Deliver

(a) Economic Breach

Historically, most LNG sales were made under long-term LNG SPAs, with sellers being committed to sell specified quantities of LNG at prices that are often linked to oil price benchmarks, which may not directly correlate to the gas price at the relevant hub (eg, the Henry Hub price, relevant to free on board (FOB) deliveries in the Gulf of Mexico; the Title Transfer Facility price, relevant to deliveries in Northwest Europe; and the Platts Japan/Korea Marker price, relevant to deliveries in Japan and South Korea).

Where the market price for LNG is higher than the price under a long-term SPA, a seller of LNG may wish to reallocate cargoes that were to be delivered under the long-term SPA to the spot market in order to benefit from higher prices or otherwise reduce the quantity of LNG that it intends to deliver under a relevant cargo.

Sellers may seek to exercise express contractual rights to deliver lower quantities. For example, the seller may be able to use a downward quantity adjustment to reduce the total quantity of LNG it is required to deliver under the LNG SPA in relation to a specified period (or the remainder of the term of the LNG SPA). Alternatively, LNG SPAs typically contain an operational tolerance that permits a seller to deliver a lower quantity of LNG than the amount specified in the LNG SPA. A seller may also purport to declare that an event of *force majeure* prevents it from delivering LNG in order to deliver a cargo elsewhere in so-called 'managed breach' for economic reasons.

There is scope for dispute as to whether a seller is entitled to rely on these provisions in order to excuse itself from its obligation to deliver a quantity of LNG. LNG SPAs vary in how they address the consequences of a seller's failure to deliver a requisite quantity of LNG that would apply if the seller were unable to demonstrate that it was excused from the obligation to deliver the LNG. These provisions apply if an entire cargo is not delivered or if a lower quantity than required (and outside of the permitted operational tolerances) is delivered, in respect of the shortfall quantity of LNG.

LNG SPAs may provide for the payment of liquidated damages by the seller to the buyer if there is a shortfall quantity of LNG, with the amount of such liquidated damages being either payable upfront or offset against the buyer's payment obligations in relation to future deliveries. The level of the liability will typically be capped at a percentage of the contract price multiplied by the shortfall quantity that would have been payable by the buyer in respect of the shortfall quantity had it been delivered. Agreeing to liquidated damages for failure to deliver LNG provides the parties with certainty as to what will be payable if a shortfall arises, but may not accurately reflect the actual losses the buyer may suffer in obtaining alternative supplies. There is also the risk that in a dispute, the seller may assert that the liquidated damages represent a penalty and are therefore unenforceable (particularly under an English law-governed LNG SPA), with general damages instead being recoverable, subject to the exclusion on consequential loss and the buyer being able to demonstrate recoverable losses. Applying liquidated damages may be more appropriate in liquid gas markets where the buyer can source an alternative cargo of LNG or natural gas from other sources (eg, pipeline gas). The liquidated damages then serve to compensate the buyer for its costs in sourcing alternative supply as well as for the price differential between the contract price under the LNG SPA and the spot price. Where the buyer is not an end user of natural gas (eg, a trader), the liquidated damages may be passed straight through to the buyer under its on-sale arrangements, and there is potential for dispute if the liability provisions are not aligned under the two LNG SPAs and the trader is therefore unable to meet its obligations or liabilities under one or more of its contracts.

For deliveries into markets where there is low liquidity, the LNG SPA may establish a framework for determining the seller's liability rather than prescribing liquidated damages. For example, it may require the buyer to mitigate its losses by securing an alternative LNG cargo elsewhere and specify certain categories of loss that are recoverable or non-recoverable. The LNG SPA may establish the types of loss that the buyer is entitled to recover from the seller. Depending on the context of the LNG SPA, these could include:

- its costs in procuring an alternative LNG cargo (or pipeline gas or electricity supplies, if applicable); and
- its losses under its deliver-or-pay obligations pursuant to its on-sales agreements if it fails to procure an alternative gas supplies.

The LNG SPA may also specify whether ancillary costs – such as administrative and logistical costs associated with procuring alternative supplies of LNG or pipeline gas – are recoverable.

Where the LNG SPA does not provide for liquidated damages or establish a specific framework for determining the losses which the buyer can recover, the seller will be liable for the buyer's recoverable losses as determined under the applicable governing law of the LNG SPA.

As noted above, LNG SPAs typically include an exclusion for consequential loss. Where an LNG SPA provides liquidated damages for the seller's failure to deliver, the LNG SPA will also typically provide that such liquidated damages are the buyer's sole and exclusive remedy for the seller's failure to deliver a quantity of LNG, preventing it from bringing a claim for damages. Such exclusions and limitations on liability are often expressed to apply except in the case of fraud, gross negligence or wilful misconduct. A buyer may assert that a seller, in failing to deliver a cargo for economic reasons, has engaged in wilful misconduct so that the exclusion and limitation provisions do not apply. LNG SPAs sometimes contain a definition of 'wilful misconduct', in which case the buyer's case will depend on the interpretation of this provision and its application to the seller's actions. If the LNG SPA does not include such a definition, general rules of contractual interpretation will apply. In *De Beers UK Ltd v Atos Origin IT Services UK Ltd*,^[2] Justice Edwards-Stuart suggested *obiter* that wilful misconduct is more culpable than deliberate default and requires the party to know that its conduct will be in breach, such breach to be intentional or the party to otherwise be reckless in the sense of not caring whether it commits a breach. It may be difficult for a buyer to demonstrate that this is the case in relation to a failure to deliver by a seller in order to circumvent any contractual exclusions or limitations.

Finally, while the majority of disputes under LNG SPAs are resolved by way of a referral to arbitration, certain disputes – such as in relation to measurement issues – may be referred to an expert for determination. A referral to an expert for determination in this context may arise if there is a dispute as to the measurement of the quantity of LNG that has been delivered, with buyer and seller failing to agree on the quantity that has or has not been delivered.

(b) Delayed Start Dates

Long-term LNG SPAs are the cornerstone of LNG export facilities. Typically, the developer of an LNG export facility will sign LNG SPAs which include firm sales commitments with buyers in advance of the final investment decision and financial close in relation to an LNG project. This provides the certainty of offtake and revenues required to give the developer confidence that it will have buyers for LNG produced by its facility and ensures that the project is 'bankable' from the perspective of the project finance lenders, which require comfort that the project will generate revenues sufficient to repay the project finance debt.

The LNG SPAs with foundation buyers will therefore need to be binding, but not fully effective until the satisfaction or waiver of specified conditions precedent, such as the developer of the LNG project taking a positive financial investment decision in relation to the project and obtaining all necessary government approvals to permit the export of LNG. While the LNG SPA will become effective upon the satisfaction or waiver of these conditions precedent, the 'start date' upon which the seller becomes obliged to deliver and the buyer becomes

obliged to receive LNG typically will not occur until the LNG export plant has completed commissioning. Cargoes that are produced during the commissioning period may be sold to the buyer on an *ad hoc* basis or under the remit of the LNG SPA; or may be sold to third-party buyers if the buyer does not have the right to acquire such cargoes under the LNG SPA. LNG SPAs may provide for a windowing mechanism whereby the seller issues notices at predetermined intervals to inform its buyer when the facility is likely to achieve readiness and commence operations. Alternatively, LNG SPAs may provide for a fixed start date following which the deliver-or-pay and take-or-pay obligations become live, notwithstanding the readiness of the facility (which may be acceptable if the seller is capable of delivering LNG from an alternate facility, mitigating the risk that the facility is not ready by the start date).

When the market price for LNG is high, the seller may wish to defer the start date for as long as possible to allow it to sell cargoes to third-party buyers at the spot price, which may be higher than the prices committed under its long-term LNG SPAs. A seller may purport to be able to do so on the basis that it has not completed commissioning of its facility or by demonstrating that other conditions to the occurrence of the start date have not been satisfied, meaning that it is not yet obliged to sell cargoes to its committed buyers. One such example is in relation to the Calcasieu Pass LNG project in Louisiana, which is owned by Venture Global LNG. The developer has asserted that it is unable to supply cargoes to its buyers under long-term LNG SPAs because certain contractual criteria are yet to be met, meaning that the commitment to sell cargoes is not yet in effect. In particular, Venture Global LNG has asserted that the facility is not fully operational due to issues with power supply equipment.^[3] However, at the same time, Calcasieu Pass LNG has reportedly delivered over 200 'pre-contract cargoes' for a value of \$18 billion for over 20 months without supplying its long-term buyers.^[4] Several of these buyers have now reportedly commenced arbitration proceedings seeking to compel Venture Global LNG to comply with their interpretation of the LNG SPAs and supply LNG, as well as seeking damages.

2.2 Failure to Take

Conversely, in certain circumstances, a buyer of LNG under a long-term SPA may seek to reduce the quantity of LNG it purchases under the SPA or simply to avoid receiving a cargo altogether. In times of low LNG prices, a buyer may wish to purchase LNG at spot prices rather than under the long-term SPA (which may be oil-price linked and not reflective of the current market price available for gas). In such circumstances, a buyer may be unable to trigger a price review clause (if any) because the requirements of that clause do not apply (eg, if the price review clause requires there to be a prolonged fundamental change to the market, whereas the buyer is opportunistically seeking to benefit from a sudden but perhaps temporary change in prices). A buyer might also wish to avoid receiving cargoes in circumstances where there

is low demand from its onward customers or there are capacity restraints in its receiving infrastructure (particularly where the LNG is to be delivered to an area that is not well connected to a broader gas network).

In the first instance, if a buyer fails to receive an LNG cargo within a specified period of the delivery window – other than due to the occurrence of an event of *force majeure*, adverse weather conditions (discussed in section 5.4 below), the LNG failing to meet the requisite specifications or reasons attributable to the seller – the parties will typically be required to use their reasonable endeavours to reschedule delivery. If the buyer and the seller cannot rearrange delivery, the buyer will be liable to pay the cost of the relevant cargo to the seller. The seller will usually be required to use its reasonable endeavours to sell the undelivered cargo to a new buyer and the proceeds of this sale will be deducted from the original buyer's payment to the seller (with the seller's ancillary reasonable transportation, logistics and administrative costs in making the mitigation sale not being deducted).

Typically, LNG SPAs will provide that the right to recover the contract price (less any amounts of mitigation sale) is the seller's sole and exclusive remedy for the buyer's failure to take delivery of the LNG. This operates to prohibit the seller from bringing a claim for damages against the buyer in relation to any other costs and losses suffered as a result of the buyer's failure to receive the LNG.

This is an extract from the chapter 'LNG Delivery Disputes' in Liquefied Natural Gas: The Law and Business of LNG, Fourth Edition, published by Globe Law and Business.

[1] Shell, "LNG Outlook 2024", www.shell.com/what-we-do/oil-and-natural-gas/liquefied-natural-gas-lng/lng-outlook-2024.

[2] [2010] EWHC 3276.

[3] *Offshore Technology*, "Repsol launches arbitration case against Venture Global LNG", 21 September 2023, www.offshore-technology.com/news/repsol-venture-global-lng-arbitration/.

[4] *Reuters*, "Shell backs BP in fight over Venture Global LNG exports", 3 January 2024, <https://reuters.com/business/energy/shell-backs-bp-fight-over-venture-global-lng-exports-2024-01-03>.