NEGOTIATION GUIDE TO **LNG** **Sale and Purchase Agreement** (long term)

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Neutral Provisions to Consider

Contract Type	**Decide the general structure of your agreement** • Depletion Contract • Supply Contract volume and source specified • Portfolio Supply Contract volume specified • Life of the PSC (or other specified contract)
Selection of Parties and Party Roles	**Consider the inclusion of the following in a SPA** • Seller Group • Buyer Group • Operator • Government • National Oil Company • Ministry
	Determine roles and responsibilities prior to commercial negotiation.
CPs	**General CPs will include** • FID • Government Approval • Finance
	Determine the relevance of a longstop date for your specific deal.
Reps & Warranties	**Fundamental reps & warranties** • Incorporation • Corporate Authority • Litigation • Liens & Encumbrances
	Consider title opinions to verify fundamental reps & warranties.
	Consider exclusion of warranties implied by statute.
Term	**Use the following industry standard phasing** • Execution date • Effective date • Commissioning date • Commissioning period • Commercial start date • Termination date • Extension period (makeup, shortfall, FM)

Termination	**Options for selecting a date of termination** • Specific expiry date • Continuing default (typical range is 1-2 years) • Insolvency • Project economics insufficient to continue (excluding FM and with limitations) • Law changes • Loss of consents • Loss of permits • Supply depletion • Extended FM (typically 2 years)
	Ensure consistency with agreement upstream and downstream of SPA.
Default	**Types of default** • Failure to pay • Failure to take • Failure to ship • Prolonged shortfall
	Ensure consistency with agreements upstream and downstream of SPA.
	Understand your revenue waterfall and how each default type will impact cash distributions.
Contract Quantities	**Defining contract quantities** • Years • Volume and Years • Specific number of cargos **Benchmarking contract quantities** • Flat for the life of the contract • Forecasting **Basic components of contract quantities** • ACQ • Adjustments • Shortfall (subject to periodic cash out) • Force majeure • Make-up (subject to periodic cash out) • Carry forward (subject to periodic cash out)
	Adjustment of contract quantities every year is typical.
	Expert determination should settle disagreements regarding adjustments.
	Delivery scheme should be uniform (similar time, date) not variable. The only exception should be emergencies, unexpected events, excess, and makeups.
	After agreeing the 90-day delivery schedule the buyer and seller quantity commitments should become firm.

LNG Delivery Point

Issues important to the selection of delivery point

- Risk and title transfer
- Operational realities
- International borders
- Tax regimes
- Custody issues- license to retain custody can solve this problem
- Regulatory issues

Incoterm Issues Relevant to LNG

Selection of a delivery point will require the selection of one of the following Incoterms

- FOB (Free/Freight On Board)- seller responsibility to tender gas at a defined loading port
    - Shipping- paid by buyer
    - Insurance- paid by buyer
    - Import export formalities handled by buyer
    - Risk of Loss pass at loading port
- Ex Ship, DES,DAP- buyer is responsible for transportation from the unloading port and seller is responsible for transportation to the unloading port
    - Shipping- paid by seller
    - Insurance- paid by seller
    - Import export formalities handled by seller
    - Risk of Loss passes at unloading port

Negotiators will want to be aware of the difference in the 2000 vs. 2010 Incoterms. By way of example, DES is no longer a defined term. The DAP formulation is generally a better term for LNG deliveries, since it will more clearly define the place within the port that LNG is delivered. Agreements typically tend to omit Incoterms from the body of the agreement (instead opting to describe the delivery point mechanics) despite using the Incoterms as a structuring model.

Diversion

Requested by the buyer to divert LNG cargos to a different port.

Considerations pertaining to a diversion

- Distance of port
- Schedule delay
- Port compatibility
- Subjective test
- Increased costs borne by seller
- Shared windfall profits
- Gas source flexibility or specific source

Unless specified otherwise, FOB diversions will be fully within the control of the Buyer. Freedom surrounding DES/DAP diversions, on the other hand, will require prior specification.

Seller diversions also exist but are less common.

Ultimate Destination (Common US issue)	For US LNG exports, a Seller should be very careful to ensure that the ultimate destination of gas is not a sanctioned country. This could be a substantial risk in FOB contracts if not drafted correctly. This issue does come up in other jurisdictions, but is less common.
Heel and Boil Off	**Who will bear the risk for heel and boil off?** • FOB- the buyer will bear the risk of heel and boil off • Ex Ship, DES or DAP- the seller will bear the risk of heel and boil off Shifting risk regarding heel and boil off is not common.
Ship Transport Standards	**The following should be included in the SPA** • Minimum standards for the transporting ship • Inspection right • Liquidated damages if the ship is non-conforming • Ability to request a substitute ship
Laytime	**Laytime standards** • Specify a window of hours/days delivery is allowed • Consider inclusion of reasonable efforts period (essentially a late delivery window) to account for congestion at receiving port • Establish a mechanism for determining amount of laytime used • Liquidated damages • Demurrage • Reverse demurrage
Arrival Information	**Specify** • Arrival Time • Location
Excused Delivery Shortfalls	**The contract should include the following excused delivery shortfalls** • Buyer did not take delivery • Force majeure • Acts or omissions of the buyer • Unscheduled maintenance • Scheduled downtime • Allowed by contract • Alternative remedy available Decision should be made as to whether excess gas can be used to cover a shortfall. Impose limitations on the liability of the seller in the case of a shortfall. Lack of supply should never be considered an excuse for delivery shortfalls.

Delivery Mechanisms	**Types of delivery schemes** • Take or pay • Take and pay • Confirmation Memorandum under a long term Master Sales Agreement (quicker, best fit for aggregators, seasonal shortfalls, shortfall make ups, excess gas, portfolio players) • Full requirements (capped volume) • Delivery or pay
	Consider excluding commercial arbitrage as a reason to pay in lieu
Failure to take remedies	**The following remedies should be considered for a failure to take** • Full payment (with makeup rights) • Mitigation payment • Agreed resale price • Liquidated damages (consider upstream implications) • If government is gas recipient, use crude oil production share to cover nonpayment • Consider 3rd party payment rights as another method of covering nonpayment • Shut in gas production • Step in right
	Take and pay/take or pay contracts commonly move to exclude consequential damages. Remedies should be subject to a cap in most circumstances.
Failure to deliver remedies	**The following remedies should be considered for a failure to deliver** • Full payment • Mitigation payment • Liquidated damages (consider downstream implications)
	Take and pay/take or pay contracts commonly move to exclude consequential damages.
Off-spec (Calories)	**Key components of off spec gas** • Ensure off spec gas is notified early to mitigate timing issues downstream • Confirmed at buyers regas facility • Can be cured by infusion of liquids (treatment) and treatment pricing can be negotiated • Can amount to a failed delivery • Consider ability to interrupt loading if off spec is discovered • Unloading will be deemed an acceptance but will foreclose on shortfall remedies
	Both sides may wish to include an option for a delivery volume adjustment (in the case of LNG additional cargos). Seller will be protected from breach and buyer will be protected from a downstream breach
	Remedies should be handled as a failure to deliver unless a cure is possible.

Off-spec (Corrosives)	**Establish a maximum allowable corrosive components amount and consider the following provisions** • Ability to reject the cargo • Early notification provision • Compensation for lack of notification However, this issue is not common due to the need of LNG to be processed gas.
Attribution Hierarchy	**Consider inclusion of an attribution hierarchy for deliveries** • Satisfaction of ACQ • Shortfall gas • Make-up entitlements • Force majeure gas • Excess quantities
Measurement	**Ensure the following items are captured** • Volume • Calories • Pressure • Inerts • Meter tolerances • Adjustments (length of time to correct) • Right of buyer to install metering equipment
Price Adjustments	**Considerations regarding price adjustments** • Annual is most common • Reference specific and ascertainable tables • Set cut off dates for data
Tariffs (sometime called tolls or fees)	**Options regarding tariffs** • Include in fixed price • Exclude from fixed price • Charge at a zero tariff • Recover via a capacity charge Typically, the parties would apportion responsibility based on the location of the tariff as upstream or downstream of the delivery point. Define clearly the demarcation points of the tariffs.
Rounding	Pick an objective and verifiable standard.

Price Negotiations	**Take into account** • CAPEX • OPEX • Profit **Determine Structure of Price** • Single number • Bifurcated **Consider Specific Models** • Index • Fixed price • Fixed base • Fixed ceiling • Fixed base and fixed ceiling • Escalating base price (CPI, PPI) **Index Options** • Crude Oil • Gas Oil • Low Sulfur Fuel Oil • High Sulfur Fuel Oil • Electricity (consider heat rate of thermal plant) • Coal • Competing gas prices (Henry Hub, Balancing Point, etc.) • CPI • RPI • Basket • Alternative fuels at the sale point
	Preferable to use U.S. currency for all payments.
	Specify the banking days.
	Specify the residence of the bank where money will be deposited and who will disburse funds.
Price Redetermination	**Take Triggering mechanisms for redetermination** • Change in market conditions • Hardship • Every 3-5 years
Force Majeure	Generally, an FM provision should be limited to only those issues outside of the buyer and seller’s control. If partial performance is possible in the event of FM, buyers and sellers might consider the inclusion of an FM tolerance. The FM tolerance will allow operations to continue at a minimum delivery level. If an FM event continues for a lengthy period, buyers and sellers may contemplate building in a right of termination after a defined date. However, ensure consistency across the supply chain so termination could be sought for all agreements. Each side will want to consider continuing payment and delivery obligations for a defined period, even in the event of force majeure. If a project is financed, this will likely be a requirement.

Force Majeure Exclusions	**An FM provision typically contemplates exclusion of the following trigger events** • Events within the control of the Buyer or Seller • Third-party breach (unless caused by FM) • Sanctions • Economic reasons • Reservoir failure • Facilities failure (not caused by FM) • Untrue warranties • Alternative source available (Multiple Source Contracts only) • Change in law (only if no conflict of interest exists with the party claiming FM)
Insurance	**The following insurance types should be standard** • All risks physical damage insurance • 3rd Party Liability Insurance • Insurance required by local law
	Gross coverage limits should be established in the SPA and basic creditworthiness rating requirements of the insurance company providing the insurance should be implemented. Self-insurance is an option but likely only used between financially strong counterparties. Often lenders will require being written onto project insurance policies.
Indemnities	Pre-delivery point and post-delivery point indemnities are common.
	Tax indemnities pre and post of the delivery point are also common.
	Indemnities relating to people, property, port damage, pollution, and the environment are also possible. However, many handle the majority of indemnities in a separate Ship Shore Liability Agreement. Inclusion of a provision stating a SSLA will be signed is common. (See also "Damages to Property/Liability" below.)
Governing Law	**Governing law common in SPAs** • English law • New York law • Local law • Swiss Law • French Law • Singapore Law
ABC Provision	Agreement should incorporate provisions accounting for anti-bribery and corruption programs. Termination should be an option in the event of a violation.
Dispute Resolution	Arbitration with a neutral venue that has expertise in natural gas.

Confidentiality	**Confidentiality is almost always included and will have the following components** • General prohibition on disclosure • Consent to disclose • Separate undertaking • Exceptions Public announcements are generally prohibited and will require consent consistent with the confidentiality provision.
Entire Agreement	The entire agreement provisions are of particular relevance in the gas sales context. Since LOIs are very common, Buyers and Sellers will want to be sure the SPA supersedes all previous undertakings. If this isn't possible, define which agreement will prevail in a conflict.
Waiver of Sovereign Immunity	Before assuming a waiver provision is valid, check local law to ensure that the government is capable of waiving sovereign immunity. This is not always the case. An examination of the consequence of confiscations and the legal resource in such an event is also important.
Damages to Property/ Liability	**With regard to property damages, the SPA can include the following formulations** • Silent • Mutual hold harmless (knock for knock) • At fault • Possession based fault Reference to a future SSLA may replace this provision. Consider the inclusion of a limitation on the amounts recoverable under this provision.
Jurisdiction/ Interim, Provisional, and Conservatory Relief	Even if arbitration, expert determination or mediation are chosen to resolve a dispute, be mindful that a court of ultimate jurisdiction should be chosen. That court will ultimately be responsible for deciding measures of interim, provisional, and conservatory relief and if left unwritten might default to the location of the assets. This will commonly either match the country of governing law or the country of venue.
Material Adverse Effect outside the control of the parties	An alternative to FM, Material Adverse Effect can be used as a tool to save a struggling project. **If a Material Adverse Effect occurs, consider allowing the parties to** • Renegotiate contract terms • Submit contract terms to an expert for redetermination
Covenants	**Other covenants to consider which are used but not common include** • Upstream limitations on decision making (e.g. approval or consultation required for decisions above a certain threshold amount) • Downstream limitation on decision making (e.g. approval or consultation required for decisions above a certain threshold amount) • Periodic reserve certification

Seller Negotiation Issues

<table>
<tr><td rowspan="2">CPs</td><td>CPs for the benefit of the Seller
Regulatory & government approvals
Finance
FID
Construction (notice to proceed)
Shipping contracts
Pipeline capacity commitments
Consents</td></tr>
<tr><td>All CPs may be waived by the benefiting party.</td></tr>
<tr><td>Collateral/Credit Support</td><td>Since the selling company will be seeking to secure a revenue stream to justify a project, collateral/credit support should nearly always be pursued.
The following options are available
Parent Guarantee- subject to the creditworthiness of the buyer parent and be mindful that an exercise of the PG will nearly always be challenged
Affiliate Guarantee with intercompany loan agreement guaranteeing annual funding
LC- short term (e.g., 90 days) but a strong option. Will usually be insufficient to cover entire payment obligation. Ensure creditworthiness of financial institution
Bank Guarantee- short term but a strong option. Ensure creditworthiness of financial institution (preference towards development banks like the World Bank, IMF, ADB, etc.)
Escrow Agreement- very short term. Creditworthiness of financial institution less important
Equity Commitment Letter- weak support, very rarely acceptable
Hybrid Model combining multiple credit support options</td></tr>
<tr><td>Consents & Approval</td><td>Ask that buyer be responsible for consents and approvals downstream of the delivery point.</td></tr>
<tr><td>Term</td><td>Push for a lengthier term with sustained long-term cash flow. Match length of term with required long-term cash flow.</td></tr>
<tr><td>Termination</td><td>Push to have right to terminate when the project is no longer economic.</td></tr>
<tr><td>Maintenance</td><td>Provisions to include to account for normal scheduled maintenance
Provision to forgive the delivery of individual cargos while maintenance is ongoing</td></tr>
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Contract Quantities	**Issues to consider as the Seller** • The commitment of all dedicated area supply may reduce production risks versus a supply contract • For shortfalls on a cargo by cargo basis ensure that no penalty is possible if total cargos satisfy the ACQ • If cargos are accepted ensure that there is no penalty for over delivery • Move to include an upward or downward flexibility option to account for operational realities and well performance (not a common concept for LNG) • Round Up Right- consider inclusion of a concept which rounds the ACQ up to account for the actual capacity of the final cargo delivery. Even if this cargo arrives beyond the ACQ term • Round Down Right- consider inclusion of a concept which rounds the ACQ down to account for the actual capacity of a missing cargo. This will make carry over more efficient • If the buyer requests excess gas, use best/reasonable efforts and seek a premium on the price • If the buyer requests excess gas, that excess gas should be excluded from the ACQ • If buyer has not made up gas in [3] years than the makeup right expires • If buyer has not made up gas by the end of the contract the makeup right expires • Ensure that makeup and shortfall net to only one carry forward amount
Liquidated Damages for Shortfalls	**A seller will have several objectives when negotiating liquidated damages related to shortfalls** • Secure a high shortfall gas price (discount to headline price) • Ensure shortfall payments are accounted for on future statements, not an immediate cash-out • Ask that shortfalls be delivered ahead of makeup gas with future gas deliveries instead of cash payments • If shortfall payments are based on market replacement, the seller should seek to limit to only arm's length transactions • A shortfall cap is also an option, anything under that cap will not be charged as a shortfall payment obligation • No obligation beyond the primary or extended term of the contract
Incoterm Issues Relevant to LNG	Prefer FOB because shipping liability, custody transfer, and taxable events are released at the loading port. The seller will want to amend the basic Incoterms to indicate the point on the schematic where the gas is transferred to the LNG ship as the delivery point.
Delivery Mechanisms	**Preferences** • Take and Pay (especially for associated gas) • Take or Pay (especially for non associated gas) Selection of a delivery mechanism, however, will largely depend on price and market options.
NGLs	Expressly state that NGLs are for the benefit of the seller.

Reservations	**Seek to include the following reservations as an excuse for a shortfall** • Ship fuel use • Boil Off
Price Negotiations	The seller will typically be primarily driven by obtaining as high of a price as possible. Start in most situations by opposing a basket approach and fixing a price based on the economics of the project with an escalation factor. Generally resist efforts to bifurcate the price based on CAPEX, OPEX, and profit as that would punish the possibility of gaining efficiencies.
	The following should be avoided • Prices tied to project IRR • Complicated formulas • Integrated cost of services • A lack of understanding of the buyer's economics
Price Adjustments	Push for price adjustments to only be upward.
	Consider periods of time where price adjustment is not allowed if downward adjustment is possible.
	If the Buyer requests an MFN provision, consider requesting a reciprocal MFN provision to match better-priced contracts.
Force Majeure	**A Seller may have a unique interest in attempting to have FM applied when** • facilities issues are present • the reservoir has depleted • third party breaches impacting operations
	Also, if the Buyer is in FM, the Seller will want to negotiate the ability to sell to 3rd Parties during the FM delay.
Insurance	Ensure that any proceeds obtained by the Buyer regarding damage to facilities are actually used to repair, restore, and/or upgrade facilities before seeking seller relief.

Buyer Negotiation Issues

CPs	**CPs for the benefit of the Buyer** • Regulatory & government approvals • Reserve certification • FID • Financing • Construction (notice to proceed) • Other SPAs or GSAs • Certification of pipeline capacity • Shipping contracts • Transportation contacts • Consents

Collateral/Credit Support	The provisions of collateral/credit support will ultimately be a corporate level decision for the Buyer company. To lighten the impact of providing collateral/credit support, a trigger provision can be sought instead of compulsory support. **A trigger provision should have the following components** • Credit rating level • Corporate ratio metrics • Time at a certain credit rating or corporate ratio that make the trigger exercisable • Rarely a subjective test is used and a buyer should oppose this formulation When Seller project costs are paid off, resist the requirement of providing collateral support.
Reps & Warranties	**Request the following additional warranties** • Accuracy of data • Capability of facilities
Consents & Approval	Ask that Seller be responsible for consents and approvals upstream of the delivery point.
Term	If the regulatory environment is uncertain, consider using a shorter contract term. Match length of the term with downstream power purchase agreements and projected downstream cash flows.
Termination	**Argue against an economic termination provision** • Reject outright • Insist that during a minimum plateau period that the contract cannot be terminated • Calculation of project economics should be done on a pre-tax basis
Maintenance	**Provisions to reference that counter the need for reduced deliveries for scheduled maintenance** • Make-up cargo • Use of alternative sources (Seller assets, 3rd Party)
Contract Quantities	**Issues to consider as the Buyer** • The commitment of all dedicated area supply may reduce delivery risks • A lower ACQ could be preferable, providing more flexibility to either take excess gas or go the market • Consider asking the Seller to divide shortfalls into two categories. Missed cargos and late cargos • Consider placing a cap on excess cargos • If a downward flexibility option is requested, place a cap on shortfalls • For round up rights consider a reduction to the ACQ of excess amounts delivered in the previous year • For round down rights consider an increase in the ACQ for any shortfall from the previous year • Push to include gas takes beyond the maximum contract quantity to be included in the calculation of ACQ • Push to not pay a premium for excess gas requests • Ensure that the timing on makeup gas is long enough to match your downstream capacity to take that gas

Liquidated Damages for Shortfalls	**The buyer will have several objectives when negotiating liquidated damages related to shortfalls** • Secure a low shortfall payments price. Shortfalls will impact downstream contract obligations • Secure an alternative source of gas with compensation for the price difference from the seller • Consider an extension of primary term for shortfalls Since transportation, processing, gathering and power purchase agreements may not afford the opportunity to use future shortfall gas, gas payments, or extensions of terms, these items should also be negotiated in the context of your supply chain.
Incoterm Issues Relevant to LNG	Prefer FOB because it increases the flexibility of where the buyer can ship the gas and can lessen the impact of seller breach. The buyer will want to amend the basic terms to indicate the point on the schematic where the gas is transferred from LNG ship to the regas facility as the delivery point.
Delivery Mechanisms	Take or pay. However, for a lower price might consider take and pay.
Reservations	**Argue against the following reservations as an excuse for a shortfall** • 3rd Party Sales Ensure that reservations are not an excuse for a shortfall on the ACQ and must be made up.
Measurement	Consider only measuring based on Calories.
Price Negotiations	**Objectives for the buyer in price negotiations are** • Resist fixed price • Advocate for market-based index pricing • Ensure index closely matches local condition at the place of purchase • Exclude CAPEX from price if the project is already paid out • Request reduction in price if a liquid stream is present • Reduce price is source become cheaper • Keep in mind producer economics **Avoid** • Prices tied to project IRR • Complicated formulas • Integrated cost of services • A lack of understanding of the seller's economics
Price Adjustments	Push primarily for price adjustments which accurately reflect the local market the buyer company is selling into. Request an MFN clause to match lower priced contracts.

Force Majeure	**Similar to the Seller, a Buyer may have an interest in exercising FM when** • There are downstream facilities issues • Third party breaches impacting operations
	Similar to the Seller's desire to Sell gas while the Buyer is in FM, the Buyer will want to have the right to seek alternative sources if the Seller is in FM.
Insurance	Ensure that any proceeds obtained by the Seller regarding damage to facilities are actually used to repair, restore, and/or upgrade facilities before seeking relief.

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