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The Japan FTC's Report on LNG Trade

- Protection or Pro-competition? -

Kentaro Hirayama

Tokyo University of Science Graduate School,
Department of Master of Intellectual Property
Attorney at law, Morrison Foerster Tokyo office



The Japan FTC's Report on LNG Trade - Background

- METI's Report (Ministry of Economy and Trade)
 - Paper on Strategy for LNG Market Development (May 2016)
 - Purpose of the Paper – Creation of a flexible LNG market, with Japan serving as an LNG trading hub
 - Issues raised in the paper - destination restrictions and profit sharing mechanisms
- The JFTC's survey (July 2016 – June 2017)
 - Extensive Survey
 - Compulsory Request for Report to Japanese Buyers
 - electric power company / Gas company
 - Informal contact and request to Foreign Suppliers
 - 174-page report (June 2017)
 - The Report is theoretically non-legally binding - it does not provide definitive interpretations



The Japan FTC's Report on LNG Trade - "Problematic" Contractual Terms

- Destination restriction clause
 - Designates a destination (a list of unloading terminals) of LNG sold under an LNG supply contract.
- Diversion clause
 - Provide procedure the parties must follow if they want to divert a cargo to alternative unloading terminals
- Profit-sharing clause
 - Imposes an obligation on the buyers to share part of any resale profit (which is obtained by diverting a cargo under a diversion clause)
- Take-or-pay clause
 - Imposes an obligation on the buyer to pay for the contracted volume even if the buyer does not actually take that volume

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The Japan FTC's Report on LNG Trade - Interpretation of the Report

- "Clear warning that competition-restraining clauses should be avoided and that 'strict actions' will be taken" - ??
- No Conclusion, actually...
 - The Report carefully avoided providing any conclusion as to whether existing LNG contracts have already caused anti-competitive effects
 - although the JFTC should have sufficient information to reach a conclusion based on hundreds of contracts and interview memos of 31 companies
 - The JFTC's Secretary General reiterated that;
 - The Report does *not* state the clauses are *per se* illegal
 - Rather, the Report only states that these clauses can be illegal *if* they would cause anticompetitive effects

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The Japan FTC's Report on LNG Trade - Intention by the JFTC

- The JFTC's Intention
 - Unwillingness and reluctance to open formal investigations
 - The JFTC's Secretary General said that the JFTC strongly *hopes* that relevant parties will *voluntarily, without being compelled by government order*, change their commercial practices and relevant contracts.
 - "*Keep monitoring* the LNG market"
 - The last page of the report notes that the JFTC will monitor the market for some period of time
 - Cf. The European Commission tends to intervene contract negotiations where necessary

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The Japan FTC's Report on LNG Trade - Implication on contract negotiations

- Favorable to Japanese buyers
 - Japanese buyers will likely;
 - comply with the Report's recommendations, and
 - strongly assert that any provision suggested by the Report to potentially violate law must not be inserted in LNG supply agreements.
 - Japanese buyers' reactions
 - JERA - the world's largest importer of LNG - is in talks with foreign suppliers to remove the "problematic" provisions
 - Foreign buyers' (and authorities') reactions
 - South Korea - the second-largest LNG importer
 - Korean FTC will soon discuss this issue with the JFTC

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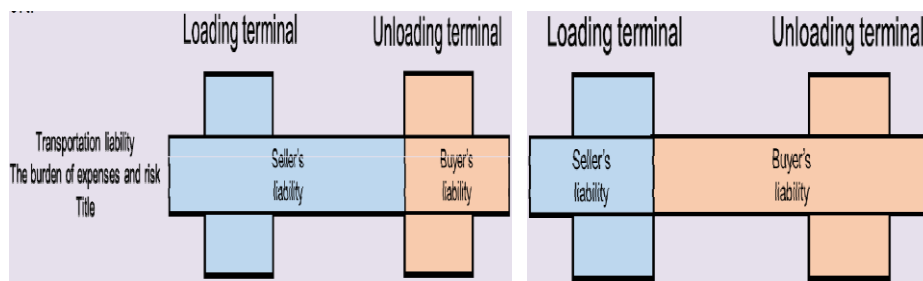
The Japan FTC's Report on LNG Trade - Analysis in the Report

- Focus is on Foreclosure Effects
 - This is in line with METI's industrial policy to create a *flexible* LNG market
 - The JFTC does not find any significant effects on price
- Market definition by types of contracts
 - Asian *fixed-term* contract market and
 - Global *spot* contract market
- Dominant position is not a requirement
 - "Unfair Trade Practice" (art. 19 of the Japanese antitrust act) can be found without any dominant position
 - The JFTC rather raised concerns about *cumulative* foreclosure effects by *multiple* suppliers
 - But who will be liable...? Causal relationship ?

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The Japan FTC's Report on LNG Trade - Analysis in the Report

- DES (Delivered Ex Ship) v. FOB (Free On Board)
 - Suppliers bear expenses and risks in DES contract



- Strict attitudes towards FOB – almost no justification
- Justifications are recognised for DES contracts, to some extent, but the JFTC still raises concerns
 - European Commission has been basically silent on DES contracts

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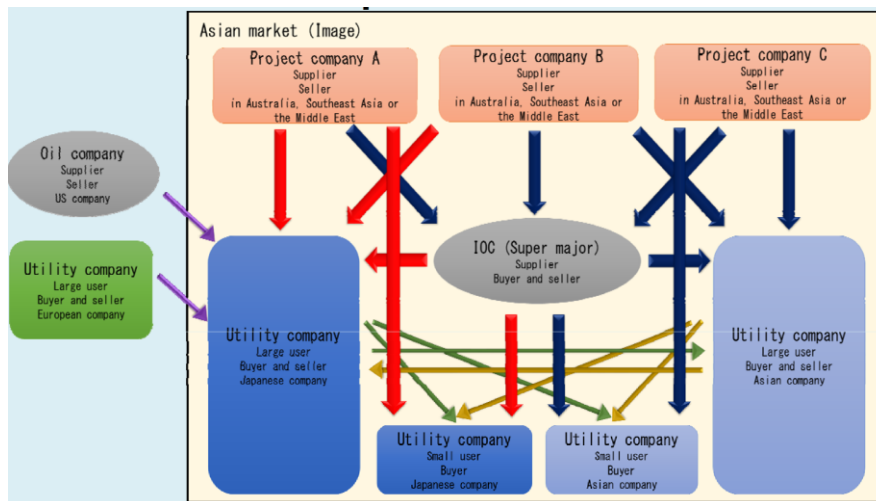
The Japan FTC's Report on LNG Trade - Analysis in the Report

- Destination restriction clause
 - Foreclosure Effects
 - it would prevent Japanese users from reselling LNG
 - FOB - No justification accepted
 - Buyer is liable for the transportation after loading
 - DES – Justification is recognised
 - However, undue refusal by Suppliers to diversion is not justified
- Profit-sharing clause
 - Foreclosure Effects
 - it would prevent Japanese users from reselling LNG
 - FOB - No justification accepted
 - DES – Justification is recognised
 - However, undue profit sharing is not justified

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The Japan FTC's Report on LNG Trade - Extraterritorial Applications?

- No definitive explanation on extra-territorial application



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The Japan FTC's Report on LNG Trade - Tool for Protectionism?

- This is a competition law report, on its surface...
- (a bit) Too strong message in the JFTC's *summary*
 - Summary – e.g. “<FOB> Providing profit share clauses is *highly likely* to be in *violation* of the Antimonopoly Act”
 - Full Report - The Report only states that these clauses *can be* illegal *if* they would cause anticompetitive *effects*
- Focus is on Foreclosure Effects
 - This supports METI's *industrial policy* to create a *flexible* LNG market
 - Strongly supports Japanese buyers
- Wrong message for foreign, younger agencies?
 - Deviation from global requirement of “dominance”
 - Unclear guidance as to extraterritorial application

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Thank you!

