

India's Push to Renegotiate Long-Term LNG Contracts

Kaushik Deb and Rami Shabaneh

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India may renegotiate its long-term LNG contracts

On August 26, 2019, India's petroleum minister Dharmendra Pradhan announced that he would consider "a review of liquefied natural gas (LNG) prices under [India's] long-term contracts" (S&P Global Platts 2019). However, Mr. Pradhan did not lay out a timeline for the review and reiterated that existing contracts would be honored. This is significant given the wide divergence between prices under long-term LNG contracts and spot LNG prices in Asia since January 2019 (Figure 1). During the financial year 2018-19 (April 2018-March 2019), the average landed price for LNG in India was \$11.30 per million British thermal units (MMBtu), while the average spot price averaged \$9.24/MMBtu (IHS Markit 2019). However, spot prices have since dropped significantly. S&P Global Platts (2019) reported LNG cargo deliveries to Asia for October 2019 averaged \$4.41/MMBtu, compared with oil-indexed LNG prices to India which could range between \$7/MMBtu and \$10/MMBtu depending on the terms of the contract (S&P Global Platts 2019).

Figure 1. India's total import price versus spot prices.



Source: IHS Markit.¹

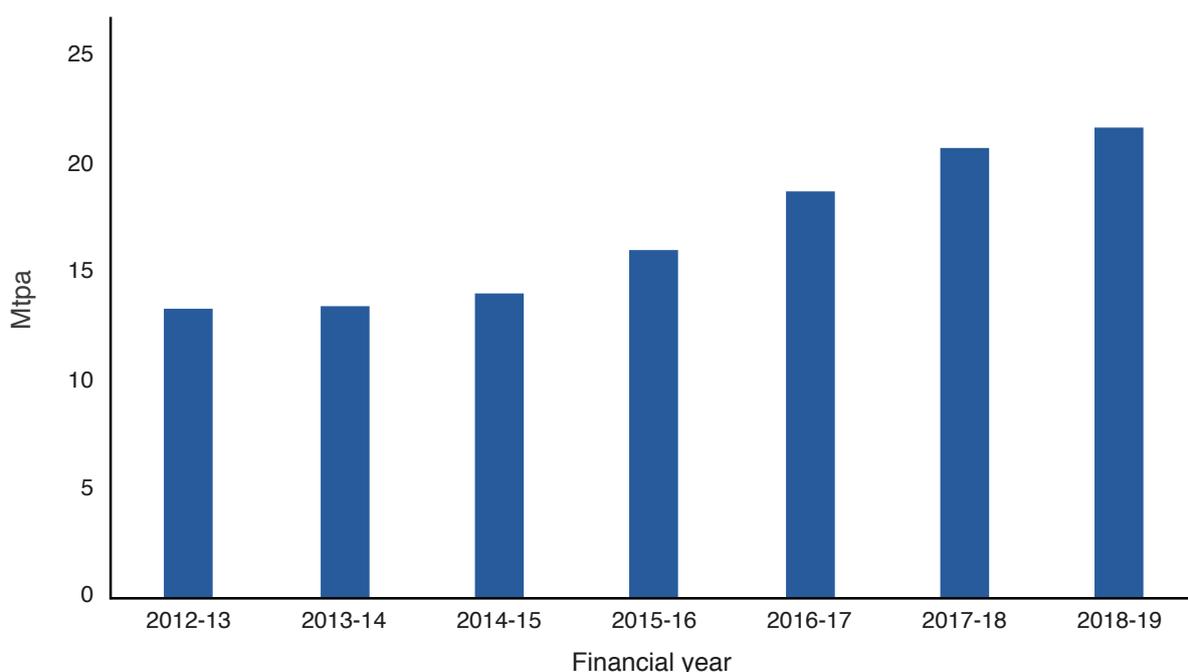
This will not be the first time India has renegotiated its long-term LNG contracts. In 2015, Petronet LNG, India's largest LNG buyer, renegotiated its contracts with Qatar's Rasgas to change the pricing formula, after LNG spot prices dropped significantly below oil-indexed prices (Petronet LNG 2016). Unconfirmed reports detailed the three elements of the renegotiation: a change in the period according to which the price was calculated; a waiver of the penalty for not honoring the take-or-pay provisions of the contracts; and an increase in the total volume of the contracts (Moneycontrol 2016).

¹ See the reference page.

In effect, Petronet agreed to take larger volumes of LNG from Rasgas at lower prices, thus ensuring Rasgas maintained its revenues from the contracts. Petronet subsequently renegotiated its long-term agreement with Gorgon LNG in Australia, resulting in Gorgon reducing the price of its LNG from 14.5% of the Japanese customs cleared price of crude oil to 13.9%. This renegotiation also made Gorgon responsible for the logistics and costs of shipping LNG from Australia to India (Livemint 2017).

The weakness in LNG prices has been critical to the growth of India's gas sector. The low spot prices since 2015 and Petronet's renegotiated prices with Rasgas allowed India to increase its LNG consumption from 14 million tonnes per annum (Mtpa) in 2014-15 to 21.7 Mtpa in 2018-19, a growth of 55% over just four years (Figure 2).

Figure 2. LNG imports into India.



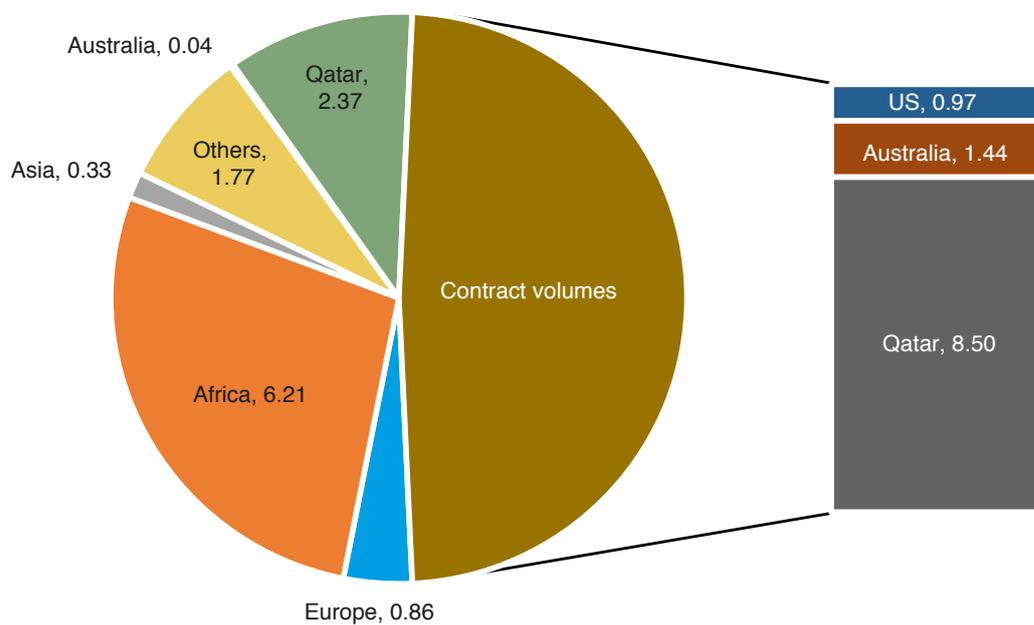
Source: PPAC (2019).

New liquefaction capacity and weaker winter demand in 2018-19 contributed to lower spot prices (Timera Energy 2019). New LNG plants with a capacity of 23 Mtpa have come online in the first eight months of 2019, mostly in the United States (U.S.). On the demand side, weaker economic conditions in Asia and the on-going trade dispute between the U.S. and China have lowered demand growth for LNG. With another 25 Mtpa of LNG capacity expected to come online by 2021, spot prices are likely to remain under pressure. If oil prices remain within the current range, the differential between spot LNG prices and LNG supplied under long-term oil indexed contracts will also continue.

India's existing import portfolio

India is currently the world's fourth-largest importer of LNG, totaling 21.7 Mtpa in 2018-19. Its current LNG import portfolio comprises LNG from Qatar (48%), Nigeria (13%), Angola (7%), Oman (5%) and the U.S. (4%) (Figure 3). Spot purchases accounted for about half of India's total imports in 2018, with imports from Africa (dominated by imports from Nigeria and Angola) accounting for nearly 60% of its total spot purchases.

Figure 3. LNG imports into India in 2018 (Mt).



Source: BP (2019).

Qatar is by far the largest of India's currently contracted LNG suppliers. The three contracts between Petronet LNG and Rasgas account for 8.5 Mtpa of India's 12.84 Mtpa of long-term contracts. Petronet also has a 20-year contract to import 1.44 Mtpa from Gorgon in Australia. Finally, GAIL, India's state-owned gas marketing and transmission company, currently has two contracts totaling 5.8 Mtpa with U.S. LNG producers. One of these contracts is with Cheniere (Sabine Pass) for 2.9 Mtpa, and the other contract is with Dominion Energy (Cove Point) for 2.3 Mtpa. However, these two contracts require GAIL only to offtake the contracted volumes and not necessarily to bring them to India. As a result, instead of shipping these cargoes from the U.S. to India, GAIL has resold some cargoes to other players, including a resale agreement with Shell for 1 Mtpa. GAIL has also established other time swap agreements with pure-play LNG traders. This resulted in less than 1 Mtpa of the total contracted volume of U.S. LNG being delivered to India in 2018. Overall, GAIL has indicated that roughly 32-35% of the 85-90 contracted U.S. LNG cargoes from Sabine Pass and Cove Point that it expects to offtake every year will go to India.

Table 1. Long-term LNG import contracts signed by Indian companies.

From node	Buyer	Seller	Export terminal	Start	Assumed duration (years)	Quantity (Mtpa)
Qatar	Petronet	Rasgas II	Rasgas II	2015	15	5
Qatar	Petronet	Rasgas III	Rasgas I	2015	15	2
Qatar	Petronet	Rasgas III	Rasgas II	2015	15	1.55
Australia West	Petronet	Exxon Mobil	Gorgon	2017	20	1.44
U.S.	GAIL	Cheniere	Sabine Pass T3	2017	20	2.9
U.S.	GAIL	Dominion	Cove Point	2018	21	2.3
U.S.	IOC	Mitsubishi Trading	Cameron	2019	20	0.7
Mozambique	BPCL	Anadarko JV	Mozambique LNG	2025	15	1
Unspecified	H-Energy	Petronas		2019	3	0.36
Unspecified	GAIL	Gazprom M&T		2021	20	2.60
Unspecified	Shell	Total		2019	5	0.53

Source: Nexant WGM (2018).

Note: BPCL = Bharat Petroleum Corporation; IOC = Indian Oil Corporation.

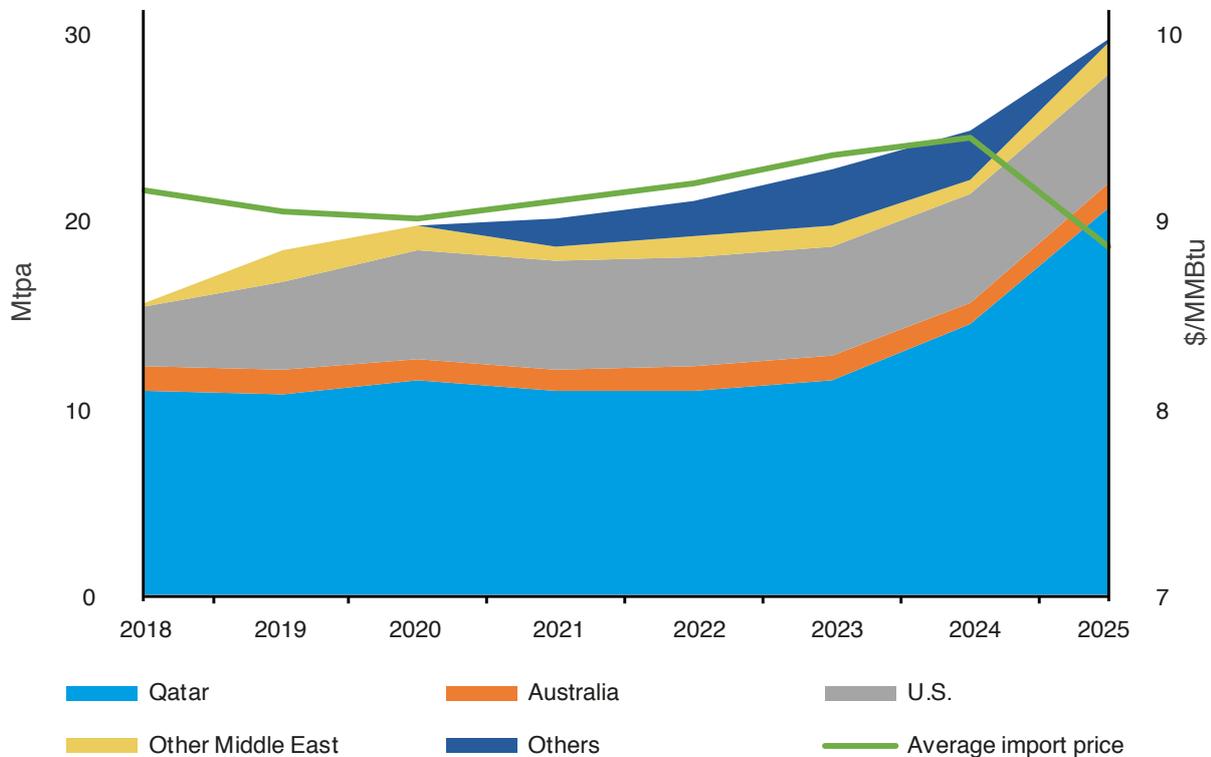
More long-term contracts are due to come into force over the next few years. They include contracts between the Indian Oil Corporation Limited and Bharat Petroleum Corporation Limited, and between Sempra Energy-promoted Cameron LNG and Anadarko-promoted Mozambique LNG. Finally, three other contracts between LNG trading subsidiaries of Indian oil and gas companies to buy LNG are not origin specific.

The role of long-term contracts in India’s LNG portfolio

Given the dominance of higher-priced LNG supplies from long-term contracts in India’s import portfolio, there is pressure on the government to renegotiate these contracts so that these higher prices are brought in line with the, now lower, spot prices. Since the price differential between LNG prices based on these oil indexed long-term contracts and spot LNG prices has persisted since January 2019, and is likely to continue and perhaps increase over the next few months, the push to renegotiate the pricing conditions under these contracts should also continue. This insight uses the World Gas Model (WGM) to assess the importance of long-term contracts in India’s LNG import regime. The WGM is a multi-period complementarity model for the global natural gas market (Egging, Holz and Gabriel 2010). It optimizes over producers, traders, pipeline and storage operators, liquifiers and regasifiers as well as marketers.

If the current set of long-term contracts were to continue under a business as usual (BAU) scenario, India’s optimal LNG portfolio in 2020 would comprise imports from Qatar (58%), the U.S. (29%), Australia (6%) and other Middle Eastern countries (6%) (Figure 4). By 2025, the share of Qatar in such an optimal portfolio would increase to 70%, with the share of the U.S. falling to 19% and that of Australia declining to 4%, even though contractual volumes would be maintained.

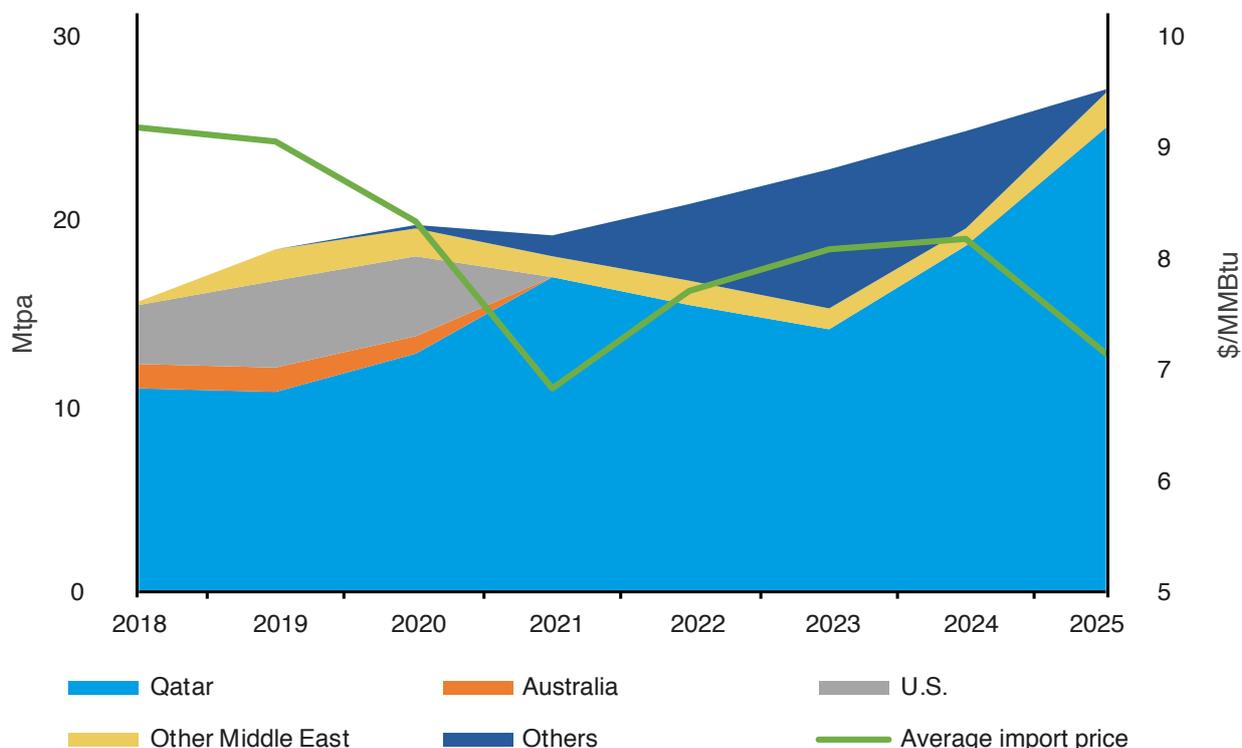
Figure 4. India’s optimal LNG import mix with existing long-term contracts.



Source: WGM run by KAPSARC.

If India did not have any operational long-term LNG supply agreements going forward, then all future gas imports would be contracted through the spot market. LNG importers would then be free to optimize their imports, choosing only the cheapest suppliers. These suppliers would likely be geographically closer to India, thus also reducing shipping costs. Assuming away the long-term supply agreements with Qatar, Australia, and the U.S., the import portfolio becomes regional and is met by suppliers from the Middle East, overwhelmingly dominated by Qatar (Figure 5). More significantly, in this scenario, the average import price of LNG between 2020 and 2025 falls by \$1.7/MMBtu, resulting in cumulative savings of nearly \$15 billion between 2020-25.

Figure 5. India’s optimal import portfolio without long-term contracts from 2020.

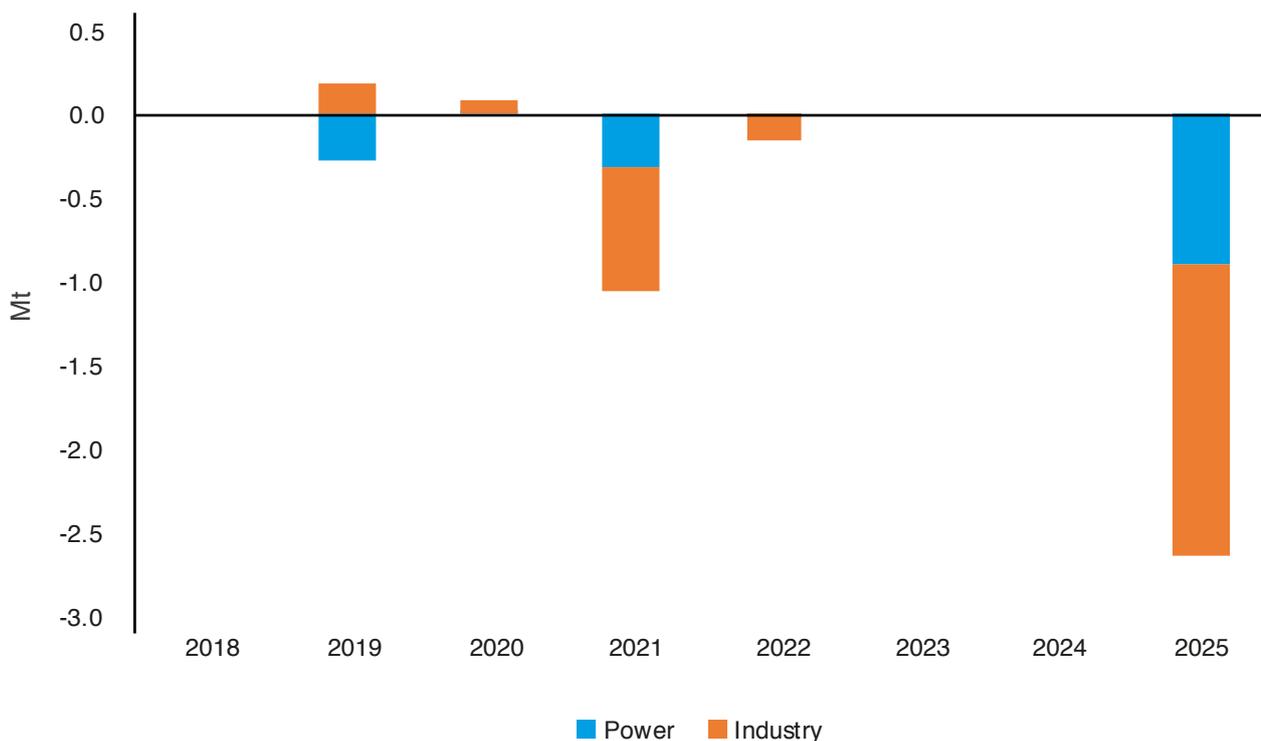


Source: WGM run by KAPSARC.

However, without these long-term agreements, suppliers would be under no obligation to make LNG available to India and would likely reallocate sales to the highest bidders in the spot market. In particular, once the current spurt in LNG supply peters out, and the market tightens again by the mid-2020s, India would be crowded out of global LNG markets. This would limit its ability to import LNG and would result in lower domestic consumption. The impact of this squeeze in supply would be most strongly felt in the two largest and most price sensitive consuming sectors of natural gas in India, industry and power (Figure 6).

India's total gas consumption would fall by an average of 0.7 Mtpa during 2020-25 due to lower supplies from LNG imports.

Figure 6. Change in India's natural gas consumption due to lower supply.



Source: WGM run by KAPSARC.

Conclusion

It is clear that a large part of India's LNG import portfolio relies on long-term contracts. India continues to highlight the need for a weaker price regime in these contracts (Ministry of Petroleum & Natural Gas 2019). While a move away from such contracts would result in India being able to source LNG supplies more cheaply, potentially saving US\$15 billion between 2020-25, it would also result in a fall in gas supplies to India, as LNG suppliers would not be bound by long-term contracts. The decline in LNG supplies would hit the largest natural gas consuming sectors in India the most, namely industry and power. Thus, the loss in committed gas supplies must be weighed against the overall fall in import costs for gas.

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