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LNG in World Markets

SPECIAL UPDATE
Coronavirus impact

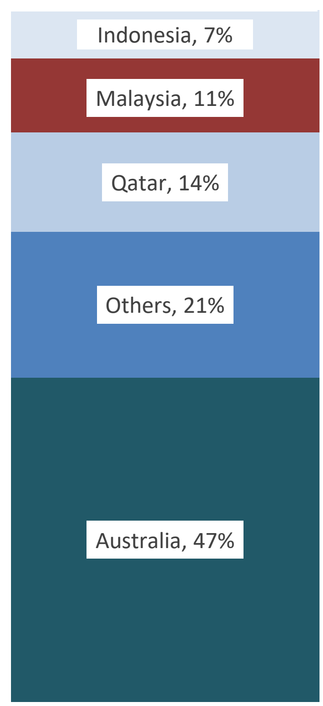
Force Majeure Threat Exacerbates LNG Bear Market

The coronavirus outbreak is having a significant effect on Chinese LNG imports, forcing LNG buyers and sellers to scramble to mitigate the impact of disruptions on demand and the market. CNOOC has declared *force majeure* on many cargoes and it and other importers are looking to delay or defer cargoes scheduled for delivery for February through April. Energy demand is taking a hit from a government decision to extend the Chinese New Year (CNY) holiday, with workers not expected to return to major cities until Feb. 10 amid domestic and international travel restrictions and supply chain disruptions. There are reports the holiday could be extended again. When economic activity resumes after the holidays, it will be at a much slower pace than in previous years.

CNOOC sent notices asking its long-term suppliers to accept *force majeure* on up to half of its cargoes set to arrive in February as a result of the unforeseen decline in demand from downstream customers. This comes on top of warm weather and slack demand growth that had been evident before the outbreak.

CNOOC's suppliers are assessing other options such as cargo deferments and diversions to other terminals while they consider whether to accept the *force majeure* declaration. Suppliers already are in discussions with CNOOC about deferring deliveries as far out as April. CNOOC is experiencing difficulties receiving cargoes at its Tianjin, Zhejiang and Guangdong terminals, several sources said. Demand at the Guangdong Dapeng and Zhuhai LNG terminals is reportedly down by as much as a third because of factory closures. CNOOC's long-term suppliers are Shell, Total, Qatargas, Tangguh LNG, Queensland Curtis LNG, Petronas and North West Shelf. CNOOC also has short-term contracts with other suppliers.

Chinese LNG imports by source



Chinese importers PetroChina and Sinopec have not declared *force majeure* and are looking to defer cargoes as their first option. However, there are indications other Chinese importers have warned suppliers that they may declare *force majeure* if there are no other options. PetroChina could also start reducing domestic gas production if gas demand remains weak over a longer period. PetroChina's term suppliers are Qatargas, ExxonMobil, Shell, Novatek and Cheniere. Sinopec's term suppliers are Australia Pacific LNG and Papua New Guinea LNG.

As many as 35 February cargoes could be subject to *force majeure* declarations with at least five already diverted as of Feb. 7. The sudden turn of events in China is pressuring already record low spot LNG prices of around \$3/MMbtu. China bought an estimated 13 MMt of spot and short-term cargoes in 2019, with 5.5-6 MMt for Sinopec, 5.5 MMt for CNOOC and 1.5 MMt for PetroChina. With significantly weaker demand, the need for cheap spot cargoes will be weighed against term supply priced at oil price slopes of as high as 14% to 16% delivered into China.

Australian cargoes are likely to be hit hardest by *force majeure* declarations as they are some of the most expensive supplies to China. Australia also accounts for just under half of Chinese imports.

On the shipping side, rates could rise if demand increases for capacity to be used as floating storage.

Epidemics can be a valid reason for *force majeure* in supply contracts. The World Health Organization (WHO) on Jan . 30 declared the viral outbreak a Public Health Emergency of International Concern. The China Council for the Promotion of International Trade is offering *force majeure* certificates to Chinese entities to give to their foreign suppliers. Acts of government can also be listed as *force majeure* triggers. Unexpected changes to economic and market conditions, and financial hardships are typically not included on lists of possible *force majeure* events contained in contracts.

Most SPAs require buyers to work to mitigate the impact of *force majeure* declarations, and discussions between Chinese buyers and suppliers on possible mitigation steps are taking place.

While CNOOC has declared *force majeure*, buyers and suppliers are trying to find ways to keep the number of cargoes subject to those declarations to a minimum. Suppliers and buyers are looking to divert cargoes to other buyers or seeking to defer deliveries. If that does not work, suppliers will either have to accept the declarations as valid, in which case they will have to absorb the impact of the disruptions - subject to the mitigation clauses in the contracts – or they will reject the declarations. In the latter case, suppliers would be compelled to send invoices to buyers for the missed cargoes. Suppliers want to avoid this as it would likely affect their relationships with buyers in the world's most important market.

Several suppliers are pushing back against the declarations of *force majeure* on the grounds that high storage levels and the wide spread between spot prices and term volumes are not valid reasons for not performing on contracts. Total publicly has rejected the *force majeure* declaration with Philippe Sauquet, head of Total's gas, renewables and power segment, on Thursday saying, "Some Chinese customers, at least one, are trying to use the coronavirus to say I have *force majeure*. If there is a real quarantine in all the loading ports and unloading ports in China, we'll have a real case for *force majeure*. For the time being, this is not the case."

There have been reports that ports are short of dock workers and other technical crews that would be needed for LNG offloading operations, but to date, no ports have been closed.

The government extended the CNY holiday by a week to Feb. 9 and travel restrictions with road closures are in place across the country. Beijing could have as many as 8 million workers who have not made it back to the capital, according to local state media People's Daily. As a result of the extended holiday and road closures, market sources say there are not enough workers and LNG trucks at the import terminals to carry out normal operations.

There is no question the outbreak will have a measurable impact on the economy. The extended factory closures, and the other measures being implemented to reduce transmission of the virus will reduce energy demand.

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