Tokyo Gas, Shell sign LNG deal linked to coal pricing in rare move

TOKYO/SINGAPORE (Reuters) – Japan's Tokyo Gas said on Friday it has signed a deal with Royal Dutch Shell for the long-term supply of liquefied natural gas (LNG), partly using a coal-linked pricing formula in an unusual move for an Asian LNG buyer.

This is believed to be the first time a Japanese buyer is using a coal-based pricing index in an LNG contract, industry observers said.

The companies signed a heads of agreement for Tokyo Gas to buy 500,000 tonnes a year of LNG for 10 years from April 2020.

Japan's second-biggest LNG buyer is stepping up its efforts to diversify its supply sources and reduce costs.

“As far as Tokyo Gas and Shell know, this is the first time a pricing formula linked with a coal index has been used with LNG contracts," a Tokyo Gas spokesman said.

A pricing formula based on coal indexation will be used for part of the supply, the spokesman said, while the rest will be priced off conventional gas- and oil-linked indexes. Tokyo Gas did not give the volumes to be done under each pricing method.

"With our long-term relationship and joint consideration, we were able to achieve an innovative agreement that would enhance further diversification of price indexation pursued by Tokyo Gas," Tokyo Gas Managing Executive Officer Kentaro Kimoto said in a statement.

In Asia, most long-term LNG contracts are linked to oil prices, while supply from the United States is typically priced off the Henry Hub Index for natural gas.

Earlier this week, however, two U.S.-based firms announced alternative pricing options for contracts being signed for their new projects, ahead of an expected flood of supplies hitting global markets this year.

The deal follows a series of innovations in LNG contracts announced at the LNG2019 conference in Shanghai, said Nicholas Browne, a Wood Mackenzie analyst.

"Coal remains the largest competitor to gas in the power sector in Asia. If the index is competitive, this could be an important step for enabling LNG and utilities to better compete with coal," Browne said.

As a gas and electricity provider trying to build its share in a competitive and liberalized power market, Tokyo Gas needs to compete with cheaper baseload coal-fired power, he said.

Tokyo Gas together with Japan's Idemitsu Kosan and Kyushu Electric Power said in January they had given up their plan to build a 2 gigawatt (GW) coal-fired power station in Chiba, citing economic reasons.

“This deal may help them compete with cheaper coal based generation even though they don’t have much coal generation,” Browne said.

Shell will be supplying LNG to Tokyo Gas from its global LNG portfolio, rather than from specific LNG projects.

“Coal indexation in LNG contracts will be particularly relevant for Japanese buyers, not least because coal is an integral part of Japan’s power-generation mix,” said Abhishek Kumar, head of analytics at Interfax Energy in London.

“The move also demonstrates that some Japanese buyers are keen on spreading the price risk associated with LNG by diversifying price linkages to a variety of fuels,” he said.

(Reporting by Yuka Obayashi in TOKYO and Jessica Jaganathan in SINGAPORE; Editing by Richard Pullin and Tom Hogue)

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