**Navigating the LNG crisis**

**[Amna Umar Khan](https://nation.com.pk/Columnist/amna-umar-khan)**

November 04, 2021

Imagine you sign a contract to sell your iPhone. The worth of the iPhone in the market at the time is, hypothetically, $1000, so you charge that as the price to the customer you are selling the phone to. The customer, who direly needs this phone, for whom, let’s imagine, that the iPhone is an utter necessity, provides some protection for himself, stating that if you default on the agreement, you, the seller, are bound to pay a penalty of $2000. It sounds fair; the contract is signed.

Now let’s assume that in a week, international markets go haywire, and the market price of an iPhone soars to $12000. Somehow it has become the need of the hour, and everyone wants one, and are willing to pay exorbitant prices for it. What do you, as a businessman, do? Do you go ahead and honour your commitment? In a business sense, the smart move would be to default on your contract, pay the penalty of $2000, and sell your device to richer people willing to pay six times the original price, and still make a profit. Your original customer however is left in disarray, without the necessity he thought he had secured.

[Entire group of female US senators call on Biden to protect Afghan women's rights](https://nation.com.pk/05-Nov-2021/entire-group-of-female-us-senators-call-on-biden-to-protect-afghan-women-s-rights)

This hypothetical around iPhones, a luxury, becomes much more serious when one considers that this is what is happening in the global market with Liquefied Natural Gas (LNG), and the poor customer, who is left without their necessary product, which in this case are LNG cargoes, is us, Pakistan. It seems certain that we will face gas shortages this winter, as two LNG suppliers in contract with us to supply LNG shipments are now defaulting on their commitments, seeing more promise catering to the record rise in the market price of LNG. Considering the massive difference of nearly $70m per cargo between the long-term contracted price and the current spot market, they are not wrong. The two LNG suppliers, Eni SpA and Gunvor Group Ltd., find it more profitable to default on their agreements with the State-owned Pakistan LNG Ltd., and pay the penalty, rather than selling the LNG shipments below the current price.

If these contracts fall through, and both the LNG suppliers refuse to honour their commitments of supplying LNG cargoes, Pakistan will be left with 9 LNG cargoes instead of 11, which will definitely lead to shortages. Pakistan will also inevitably have to find other on-the-spot exorbitantly expensive replacements, that will weigh heavily on the already burdened exchequer and hike up our import bills, and consequently, the current account.

[Pakistan likely to face Aussies in World T20 Cup semi-finals](https://nation.com.pk/05-Nov-2021/pakistan-likely-to-face-aussies-in-world-t20-cup-semi-finals)

There is no way to mitigate the blow—this is definitely a gut punch. Analysts have stated that this frenzy was not the government’s fault, as there was no way it could have predicted this unprecedented rise in global prices. In fact, LNG was adopted as a more affordable option to oil in 2015, and as a way to develop diplomatic and strategic relations.

However, in the years since Pakistan started investing in LNG, the multiple disruptions and instability should indicate that there is something wrong, either in our negotiation phase during the tender offers, or in the drafting of the Master-Sale Agreements (MSA). These MSAs were long-term agreements, signed with Gunvor for five years, and Eni SpA for fifteen years, in 2017.

This is not the first time that the price mechanism in those MSAs have proved counterproductive for Pakistan. Under the MSAs, the contract price was agreed at around 11-12 percent of “Brent”, which for a given month, was calculated as the arithmetic mean of three values of all settlement prices as published in the International Exchange for three months immediately preceding the month of the unloading of the LNG cargo. This has proved highly disadvantageous for Pakistan. Just in 2020, Pakistan considered terminating its agreements with Eni SpA and Gunvor. Due to a global crash in oil and LNG prices in the wake of the coronavirus pandemic, the on-spot cargo prices had dropped more than 50 percent in the past year and reached a record low of $2.71 per million British thermal units (Btu), while Pakistan was paying more than $7.42 per million Btu. However, the penalty clause for termination, which would have cost Pakistan $300 million in penalties, dissuaded the government from exercising this option.

[Pakistan Cricket Team living the spirit of 'Khelein' by Qamar Saleem](https://nation.com.pk/05-Nov-2021/pakistan-cricket-team-living-the-spirit-of-khelein-by-qamar-saleem)

It seems inherently unfair that suppliers who enjoyed selling at premium prices during a market crash, get to default now, on below market-level penalties, when current prices are soaring. Some of this is partly due to the smart business sense of Gunvor and Eni SpA, which were able to identify the right time for default at a reduced penalty. This is something Pakistan failed to do in 2020, albeit not entirely our fault considering the pandemic was so unanticipated. However, a large part is also due to the clauses of the MSAs. If the MSAs have been drafted in such a way that a developing country pays more than double the value for a commodity when its market is crashing, but is defaulted on and left to grapple with the circumstances when the market soars, then there is clearly something very wrong.

Is all doomed? There is still some room to prevent the suppliers from defaulting. Under Clause 2.1.1 of the MSAs, Pakistan can, through negotiations, update the quantity supplied and prices applicable to something more suitable to the suppliers. That is what the government seems to be engaged in doing, while also exploring other options, including seeking bids for two replacement cargoes.

[Bezos' Blue Origin lose appeal in fight against NASA lunar lander contract](https://nation.com.pk/04-Nov-2021/bezos-s-blue-origin-lose-appeal-in-fight-against-nasa-lunar-lander-contract)

However, there is no guarantee that the replacement bids will also not result in default, as LNG suppliers expect a greater rise in prices. Pakistan could go to the London Court of International Arbitration and seek to prevent default by the LNG suppliers, but this is a lengthy and costly process, bound to result in failure due to the lack of protections in the MSAs.

What lessons can we learn from this moving forward? All of our brushes with any international investment or business opportunities indicate that Pakistan needs better legal language that can protect the country’s interests. The world market and the investment circles are rife with deals that end up ultimately exploitative for developing countries. The new bids issued by the government repeat nearly the same language, with no update on the default clause, leaving Pakistan vulnerable again. Indemnity clauses also need to be strengthened to protect the country from losses incurred because of any ungainly actions by LNG suppliers.

[10 killed after consuming toxic liquor in India's Bihar](https://nation.com.pk/04-Nov-2021/10-killed-after-consuming-toxic-liquor-in-india-s-bihar)

Secondly, it is useful to remember that the rest of the remaining 9 LNG cargoes are being provided by Qatar due to a long-term agreement signed earlier this year. The deal was criticised at the time of signing, but it was seen as a reinforcement of friendly relations with Qatar. It is precisely the diplomatic relationship between Qatar and Pakistan that gives some reassurance that Qatar will not default from its agreement at this crucial time. Gunvor, a commodity trader, and Eni SpA, an Italian entity, have relatively little stake in the diplomatic consequences this default could have. This political aspect should be a factor in how Pakistan accepts bids from competing LNG suppliers in the future.