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Blog Post

# Tariffs and Coronavirus Impacting U.S. LNG Trade to China

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China is the most lucrative growth market for LNG producers worldwide, overtaking Japan as the single largest importer of LNG in November 2019. China has also had the largest year-over-year growth in LNG imports since 2017. The latest figures reported by *Natural Gas Intelligence*, a trade publication, indicate that there are 22 LNG regasification facilities currently operational in China, with additional facilities under construction. Given that only 60% of China's population currently lives in urban environments (compared to 85% in many Western countries) and urbanization is expect to continue, Chinese demand for LNG appears poised for continued growth for years to come. This fact isn't lost on U.S. policymakers — as underscored by President Trump's decision to include LNG executives in a select group of U.S. business leaders accompanying him on a visit to China in 2017. So why isn't the U.S. exporting more LNG to China?

## U.S.–China Trade Dispute and LNG Tariffs

The slowdown in U.S. LNG exports to China has one primary cause: LNG import tariffs imposed by China during the escalation of the U.S.-China trade dispute. In September 2018, China imposed a 10% tariff on imports of U.S. LNG, which rose to 25% in June 2019. In a competitive global market for LNG, where offtakers are able to quickly redirect cargoes, LNG supply that offtakers from U.S. liquefaction facilities would otherwise have sent to China — the majority of which is sourced from oil & gas supermajors or trading houses rather than directly from Chinese offtakers — has been exported elsewhere. Data from the U.S. Energy Information Administration shows that there has not been a single U.S. LNG cargo sent to China since March 2019 (down from 25bcf in October 2017 — or 8% of all U.S energy exports).

In January 2020, President Trump and China's chief trade negotiator Liu He signed the

“Phase One” trade agreement. The Phase One deal committed China to increasing its purchases of U.S. oil and LNG to $50 billion above 2017 levels over the next two years. However, nothing in the Phase One deal eliminates the 25% tariff on U.S. LNG. On February 17, 2020, *Reuters* reported that, starting March 2, the Chinese government will accept applications for one-year exemptions from certain tariffs on products covered in the Phase One deal, though at this time no exemptions have yet been granted.

## Novel Coronavirus

We would expect that a reduction or elimination of China’s tariffs on LNG imports would quickly lead to a resumption of U.S. LNG cargoes bound for China. However, the novel coronavirus that emerged in early 2020 (and the response of LNG offtakers) will create some headwinds in the near term. Estimates from S&P Global Platts have suggested that the coronavirus (and related economic slowdown) could cut Chinese LNG demand by 5-7% in February alone.

Recent news reports also suggest that Chinese LNG purchasers (including Sinopec, which has an $18 billion offtake agreement with Cheniere) were considering exercising “force majeure” provisions in their LNG purchase contracts, with the potential for costly litigation if rejected by their supplier counterparties. Force majeure provisions typically provide that in certain limited circumstances outside the control of the parties — often including war, insurrection, natural disaster, disease, terrorism, acts of governments and other similar situations — performance of obligations under the applicable agreement will be excused for so long as the force majeure condition persists. While changes in commercial conditions (i.e., demand reductions) would not typically be considered force majeure, citywide quarantines or travel restrictions, as have been implemented in China, may allow Chinese offtakers to argue that their purchase obligations should be excused. The response of Chinese offtakers — and the extent to which they are willing to litigate force majeure clauses — could influence contractual terms in the negotiation of the next wave of LNG offtake agreements for U.S. liquefaction projects.

## Looking Ahead

Although the Phase One deal and reports of upcoming exemptions are a sign for optimism that U.S. LNG exports to China may resume in the near future, until tariffs are significantly reduced or removed (or major exporters otherwise exempted), we are unlikely to see a material increase in U.S.–China LNG trade. Interested parties should also observe both the economic impact of the coronavirus on the Chinese economy and the response of Chinese offtakers and counterparties to force majeure claims under offtake agreements.

Meanwhile, U.S. gas producers and liquefaction developers will be hoping for a resolution of these impediments limiting their access to the world's fastest-growing LNG market.

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