



Thought Leadership

THE JFTC'S DESTINATION RESTRICTION REPORT AND 'MANDATORY LAW'

WHITE & CASE

A report earlier this year by the Japan Fair Trade Commission (often called the 'JFTC') has set tongues wagging in the Asian LNG industry. However, the ramifications of the report on LNG contracting practices remain unclear. This article deals with one of the more 'legal' questions coming out of the report: What relevance does Japanese competition law have to long-term LNG SPAs which are governed by another law (likely English or New York)?

JFTC report

On 28 June 2017, the JFTC issued a report on its 'Survey on LNG Trades' based on questionnaires and interviews with Japanese and non-Japanese LNG buyers and sellers. This survey was conducted with the JFTC's compulsory investigation authority, which is rare. The use of that authority implies the seriousness of the JFTC's policy on this matter.

The report identified certain provisions commonly included in LNG SPAs as potentially violating the Japanese Antimonopoly Act.¹ On the report's analysis, most fixed-term FOB LNG SPAs have clauses which limit the destinations to which the buyer may transport and unload the LNG (so-called 'destination clauses'). However, among other things, the JFTC found that:

- Destination clauses in FOB SPAs are 'likely' to violate the Antimonopoly Act.
- The combination of destination clauses and restrictions on diversions

to other destinations is 'highly likely' to violate the Antimonopoly Act.

- Provisions in FOB LNG SPAs under which the buyer must share with the seller the profits derived from diversions are 'highly likely' to violate the Antimonopoly Act.

The report is based on the JFTC's view of Japanese law. However, most long-term LNG SPAs are governed by either New York or English law. Further, the parties commonly agree that disputes will be resolved by arbitration seated outside Japan (e.g. in Singapore, London, or New York).

The question: is how could Japanese competition law be relevant to an English or New York law-governed LNG SPA subject to international arbitration in Singapore, London or New York? One answer might be through the application of mandatory law.

Mandatory law in international arbitration

In international arbitration, sometimes arbitrators apply a certain rule of law because they consider it to be 'mandatory'. That is, they apply a rule of law even though it is not part of the law that the parties chose to govern their contract.

The starting point in international arbitration is, unsurprisingly, that the arbitrators must apply the law chosen by the parties.² This assumes that the

law chosen excludes the application of other laws. However, this rule is subject to exceptions. One important exception, although seldom applied in practice, is mandatory rules of law.

Mandatory rules are, in this context, rules that must be applied 'irrespective of the law which by application of the relevant set of conflict of law rules or the parties' choice-of-law provisions would normally be applicable.'³ Mandatory rules are a complex topic. There is no broadly established test for when arbitrators can or should apply a rule of law as mandatory. However, a consideration of the relevant material suggests broadly a three-part test.

The test's three limbs are: a close connection between the rule and the dispute; the law must indeed be mandatory; and the rule must be 'application-worthy', taking into account its nature and purpose, and the consequence of its application.⁴

The important point in this context is that competition law rules have been applied in international arbitration.⁵ The classic example of this is the US Supreme Court decision, *Mitsubishi Motors v. Soler*.⁶ In brief, that matter involved a Puerto Rican car dealer, Soler, who entered into a series of agreements under which it distributed Mitsubishi/Chrysler cars. The agreements were governed by Swiss law, and subject to Japan Commercial Arbitration Association (JCAA) arbitration. When the Puerto Rican market slowed, the dealer

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wanted to ship excess vehicles to markets in Latin America. Mitsubishi/Chrysler refused to allow this. Soler argued, among other things, that Mitsubishi/Chrysler had breached US competition law by dividing up markets. The matter of whether a JCAA tribunal hearing the matter under Swiss law could decide on US competition law matters was litigated all the way up to the US Supreme Court, which ultimately decided, by majority, that the answer is yes, it could.

Mandatory law and the JFTC report

The JFTC has opened the door to possible disputes between parties to LNG SPAs as to whether destination clauses, or profit sharing mechanisms, may be unenforceable on the basis that they contravene Japanese competition law.

If such a dispute were to be submitted to international arbitration, it could not simply be assumed as a matter of course that Japanese competition law could not be applied to an LNG SPA with a governing law provision choosing New York or English law. Rather, the tribunal would be faced with a series of questions: Are questions of Japanese competition law arbitrable in that arbitration (i.e. can the arbitrators decide those issues)? Does the Japanese competition law rule apply on a mandatory basis? Did the LNG SPA's destination clause breach a Japanese competition law rule in such a way that it was rendered invalid?

Conclusion

An open question in the Asian LNG industry is the impact that the JFTC's report

will have. When concluding new LNG SPAs with one or more Japanese parties involved, the parties will need to consider the contract terms in view of the JFTC's report. Further, the parties should consider how the JFTC report may affect their actual practices when applying destination-related provisions in existing LNG SPAs. In doing so, the parties would do well to keep in mind the possible application of Japanese competition law on a mandatory basis.

1. *Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Act No. 54 of April 14, 1947).*
2. *This assumes that the parties did choose the law. However, in negotiated, high-value agreements like long-terms LNG SPAs, that is almost always the case.*
3. *Nathalie Voser, 'Mandatory Rules of Law as a Limitation on the Law Applicable in International Commercial Arbitration' (1996) 7 The American Review of International Arbitration 319, 321 (emphasis in original).*
4. *Marc Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration' (1997) 14 Journal of International Arbitration 23, 31-32.*
5. *Eco Swiss China Ltd v Benetton Investment NV [1999] ECR I-3055.*
6. *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).*

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