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LNG projects are governed by a suite of commercial agreements, principally those between the asset (or capacity) owner and their suppliers or customers. These contracts define the levels and flows of revenues and costs and allocate the risks between the counterparties, particularly those related to price and volume of the product. Efficient management of these agreements is vital to the ultimate success of the investment.

In our previous article we looked at how LNG projects build and maintain the teams of people that run the assets once the project becomes operational. The operational integrity of the facility is critical to the business and the team needs to ensure they run reliably, in line with or exceeding the design performance. In this second article we look specifically at meeting the challenges of putting together the team responsible for managing the commercial aspects of the project, which is just as important as ensuring the performance of the facilities.

The commercial team is the primary point of contact between the asset owners and their counterparties. They are responsible for administering the routine processes of information exchange, notifications, invoices and payments defined in the contracts. They must also deal with non-routine events such as supply disruptions, unplanned plant shutdowns or a customer's inability to take the product. At all times the team aims to keep the product flowing to meet counterparties' requirements.

Today commercial teams must also manage the longer term adjustments of contracts and relations with suppliers and customers to meet the requirements of rapidly changing LNG market conditions. The asset is part of a gas chain and all parties along the chain depend on each others' performance. At the same time, the team needs to protect the interests of the asset ensuring it only bears risks in the manner defined in the contracts.

BUILDING ON EXPERIENCE

The starting point in creating the commercial operations team is the recruitment of experienced leaders. But whereas on the technical side it is possible for the senior managers to continue through from the construction and commissioning phase into operations, this is seldom achieved for commercial operations especially for liquefaction plants.

Negotiation of the key long term agreements, like the Gas Supply Agreement (GSA) or Sales and Purchase Agreement (SPA) is often a prolonged process, perhaps taking a year or more, with signature occurring before Final Investment Decision (FID). A typical liquefaction plant will take approximately 4 years after FID before it reaches start-up and full commercial operation.

The team responsible for these agreements often comprises expert negotiators who are in demand for doing other deals and because of the long interval between signature and start-up it is usually not feasible (or necessarily desirable) for those who negotiated the agreements to be the ones to administer them. Of necessity, a new commercial team will be formed that inherits the executed documents and is then tasked with operating them.

It is crucial in the establishment of the team to bring in senior commercial staff who have the depth of experience of LNG contracts to be able to review them critically and to appreciate where the challenges lie in their management. Knowledge of how the kit functions and the importance of how the commercial team must interact with other groups and its counterparties in operating the business are vital.

Bert Christoffels, the asset manager of the Sakhalin liquefaction plant and oil terminal at Prigordnoye, emphasises the importance of this depth of experience to inform "the basic understanding of what

operational assets can do and what they can't do. They know how the oil and gas chain works, from the well-head to the LNG plant and, commercially, the content of the contracts between the SEIC (Sakhalin Energy) and different customers."

Such people are obtained by a variety of means including international open recruitment. For example Sakhalin Energy placed advertisements in international journals as well as seeking Russian talent through agencies in Moscow and St Petersburg. Others come from direct contacts with former colleagues in other projects. Often the commercial manager position is filled by a nominee of one of the venture partners who can assign experienced staff. These personnel provide the core of the team to which less experienced members are added, for example, through transfers from other related areas such as finance.

The less experienced staff will learn through experience gained in the ramp up to full operations and through reviewing the contracts to develop business processes, as described below. In addition they receive formal training on the gas and oil chains and the LNG industry to understand the position of their asset and the significance of their role. Companies use a mixture of in-house and external training resources for this purpose with many now, according to Clova Bullen, manager of people development and training at Gas Strategies, opting for customised training tailored to the specific needs of their staff and the company.

UNDERSTANDING THE CONTRACTS, PROCESSES AND RISKS

As the team grows and start-up approaches it needs to commence preparation for operations. The first step is for staff to become familiarised with the agreements. If possible a formal handover with some of the negotiators leading the commercial team through the contracts and how they are structured; what was in the minds of the negotiators when clauses were written and how each clause functions both in the individual agreement and within the overall framework of the contracts governing the allocation of risks and rewards for the venture.

Going through this process sets the base for two key activities for the commercial team; building business processes and identifying risks and discrepancies.

The contracts define how the parties to the agreements will communicate on planning and running the transactions between them and how certain issues are to be decided. For the commercial team to administer them however, the processes embodied in the contracts have to be created. The steps through each process, for example creating the Annual Delivery Programme, are spread across different clauses and are subject to conditions in other parts of the agreement. All the necessary processes for running the agreement must be identified by reading the agreement thoroughly and each one mapped to provide unambiguous instructions for the team to follow.

In addition, each contract and process does not operate in isolation and it is necessary to identify where agreements and processes overlap to ensure the integrated processes conform to all agreements. The interfaces of the commercial processes with those of other groups, such as operations and finance, are identified and adjustments made to ensure all processes form a coherent whole.

For the new commercial team, participating in building the business processes is valuable in bringing deep understanding of the agreements and also in getting prepared to start administering the contracts as start-up approaches. This is a major task, however, and one in which experts with specific knowledge will – for example from finance, shipping and planning – participate often being guided by consultants with experience in business process development.

As the creation of internal processes unfolds arrangements also have to be put in place for communications with counterparties, what information will be exchanged, when, in what format and who will be the recipients. Again, processes need to be defined and adjusted if necessary to maintain coherence. Involving the commercial team in this is useful as a means of introducing staff members to their counterparts in other organisations, establishing sound relationships to continue beyond start-up.

As Leen Van den Ende, shipping and commercial manager of Sakhalin Energy, observes stepping methodically through this work not only provides staff training with detailed understanding of the contracts, it also gives individuals clarity on their roles and responsibilities. The “end result is a Commercial Business Management System. Specific tasks in these procedures are included in people’s job descriptions. Also, procedures contain clear RACI diagrams (responsible, accountable, consult, inform).”

Close examination of the suite of agreements will also identify areas where there are discrepancies that present risk for the venture. The suite of agreements is extensive and they are often negotiated at different times. It would therefore be unusual if there were no discontinuities or conflicts between them, for example in the price terms between gas acquisition and LNG sale, or in the allocation of product between different buyers in the event of capacity constraints. The team needs a full awareness of how the framework operates and where the discontinuities exist. It will be their aim where possible to revise the agreements by negotiation, but where this cannot be done the discrepancy must be accommodated in the business processes with guidance on how the associated additional risk should be mitigated.

This latter preparation is especially important today as the industry passes through major change with the opening of new markets and evolution of new trading practices, especially short term cargo diversions and arbitrage. Teams must anticipate when price reviews will be called in their contracts and how they will be prosecuted to protect value. This requires educating staff, often working with external advisers, in the detailed structures of the markets and factors that impinge on the pricing mechanism.

Understanding how the global market is developing is also required to enable commercial staff to work with counterparties to adjust operational terms (quantities, scheduling, destination) allowing both parties better to manage risks and reap additional value.

TESTING STAFF AND PROCEDURES

In technical operations there is continuity between construction, commissioning and routine operations. This provides opportunities for hands on experience for staff in understanding the performance of the asset and how it should be managed. Nevertheless the team needs to be prepared for unusual and unplanned events and the use of simulators and visits to similar facilities are valuable for familiarising technical staff.

On the commercial side too companies utilise simulations to ensure that staff are thoroughly aware of the processes and that the processes are robust. Both the routine activities and rarer, unplanned events like shipping delays and Force Majeure incidents can be tested without incurring the risk of making an error on the real event.

As Christoffels explains about Sakhalin: “During the preparation a few years ago we started very early with the annual delivery programme development, including theoretical tests; for example if there is a typhoon or a ship comes in too late, or a higher [than expected] production, summer and winter influences, etc. We have a specially designed programme provided by our Licensor Shell Global Solutions. The software was being theoretically developed and now that we are operating we are testing the programme, how close it is to reality, actually fine tuning.”

This type of trialling develops staff and increases awareness and also allows the processes to be modified in readiness for the onset of operations. As Van den Ende explains, even then there may still be teething problems to be corrected. “After implementation all commercial procedures were audited by a corporate audit team including consultants from Shell. Also, after six months of operation the procedures were reviewed and modified where necessary. These reviews included input from all stakeholders from LNG Operations, Marine, Shipping, Marketing and Finance.”

This sort of training can also be linked to the initial risk analysis of the contracts as part of staff development. Understanding the risks inherent in the contracts and the potential financial impact of events on the business raises staff appreciation of the importance of their actions. Exercises and discussions dealing with price volatility and constrained customer demand encourage them to raise their eyes above the immediate tasks to see the significance of events in the business environment that they should anticipate.

PROTECTING THE LEGACY

For an LNG project the assets and contracts will run for many years during which time the commercial team will lose the members who were part of the initial team and with them accumulated knowledge and experience. Having well designed and tested business processes provides a sound basis for continued good performance. New team members have clear statements of their responsibilities and instructions on what to do in given circumstances.

Good succession planning also underpins maintaining the quality of the team, identifying people with the right background and aptitudes and ensuring they receive appropriate internal and external training on commencing the job. This is bolstered by strong mentoring from the experienced staff helping new team members to learn on the job. Stress is placed on the latter at Nigeria LNG according to Umar Ajiya, the company's marketing manager. "In order to maintain corporate memory you must make sure that you have a robust handover and coaching and mentoring programmes put in place in addition to using your own resources instead of third-party personnel. It takes months to achieve."

It is also crucial to inform new members of the team about experience gained over the years of operating the contracts. As Christoffels puts it: "We file our learnings, what we have done in the past and use this now and in the future. It's a dynamic learning all the time." Ajiya also emphasises the importance of maintaining an efficient filing system to provide a ready means of searching for and retrieving relevant information. Being clear at the outset of how information is to be filed and retrieved will protect the legacy created by careful building of the commercial team.

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