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The Australian Competition and Consumer Commission
LNGNetbackreview@accc.gov.au

RE: ACCC LNG Netback Review: Draft Decision Paper.

Thank you for the opportunity to make a submission regarding the 2021 ACCC LNG netback review draft decision paper (Draft Decision Paper). This submission builds on ConocoPhillips Australia's 16 April 2021 submission concerning the ACCC's 18 March 2021 LNG Netback price series issues paper.

ConocoPhillips Australia supports the development of a Wallumbilla gas index which reflects the daily spot market and, in time, a liquid futures market. Until this Australian benchmark is more established, the next best alternative is the price benchmark utilised by incremental gas suppliers in the market. ConocoPhillips Australia supports the Draft Decision Paper's view that the Japan Korean Marker (JKM) represents the best alternative option as the JKM reflects a price a Queensland LNG producer would expect to receive for incremental LNG.

ConocoPhillips Australia appreciates the ACCC's hard work and analysis in conducting its review of the Netback Price Series. Ensuring that the LNG netback price series accurately reflects the commercial options available to LNG producers for their uncontracted gas is worthwhile and benefits the market.

Please see below our response to the questions posed in the Draft Decision Paper.

Length of the forward LNG Netback price series

The JKM is currently the best indicator of Asian LNG prices because it has sufficient near-term liquidity (up to two years) in spot and futures markets to demonstrate supply and demand fundamentals. ConocoPhillips Australia shares Wood Mackenzie's assessment that the JKM could increasingly replace oil-linked markers in long-term contracts as its liquidity develops.[1] The ACCC should continue to expand the forward outlook of the JKM linked LNG Netback price series beyond 2 years as JKM liquidity grows in the future.

While the LNG market was established based on oil-linked long-term contracts, LNG should increasingly be priced on a gas index as the LNG market matures. ConocoPhillips Australia understands why the ACCC and Wood Mackenzie have selected Brent futures as a guide for domestic prices. However, as Figure 1 below shows, JKM prices have not shown a correlation to oil prices (with an R^2 of 0.38) since 2018. As Wood Mackenzie also points out, there is limited transparency in pricing long term LNG based on oil benchmarks. ConocoPhillips Australia therefore suggests that use of the Brent futures index to price longer-term LNG prices be considered of very limited utility and not effective as a gas pricing index.

[1] Wood Mackenzie, 2021. ACCC – LNG Netback Price Series Review; Preliminary Report 24 June 2021: Page 7.

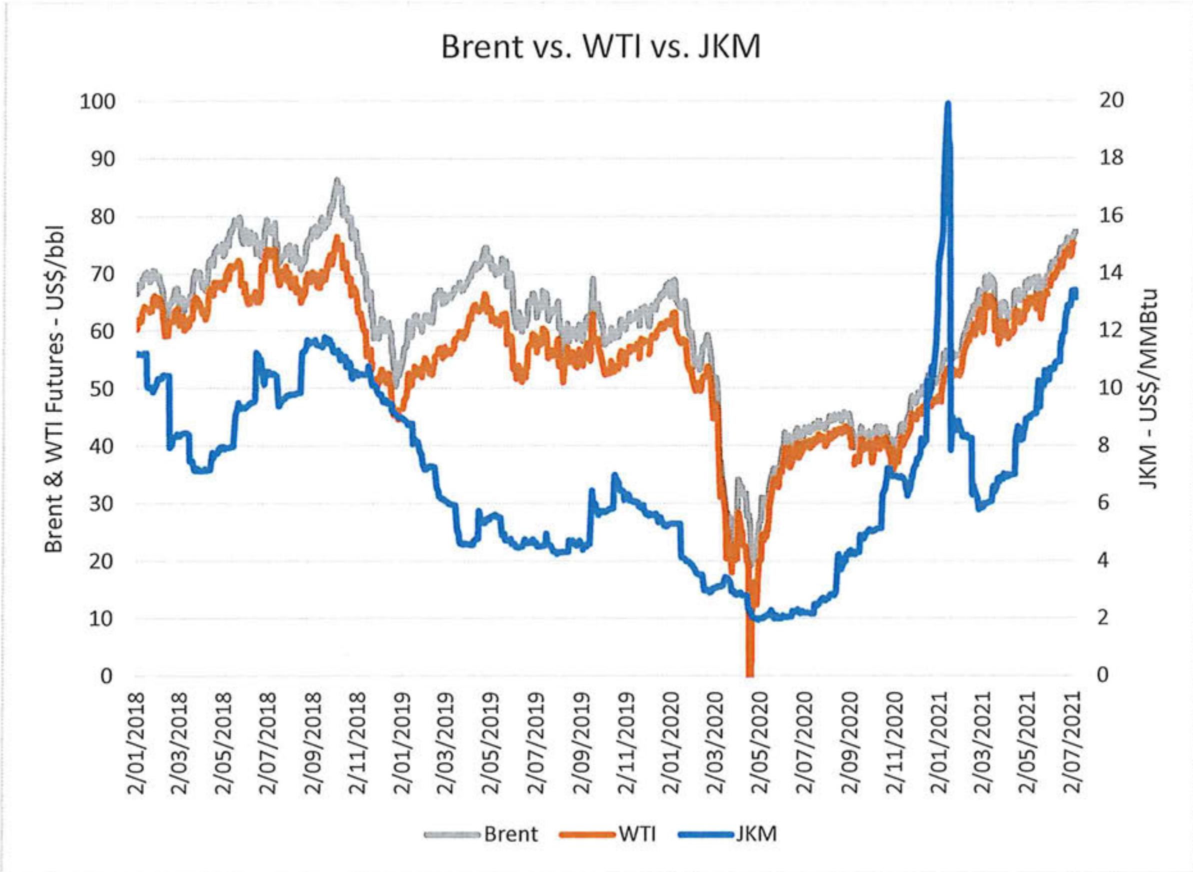

Figure 1: Daily Futures from ICE and CME.

<u>**LNG price markers to calculate the LNG Netback price series**</u>

Continue using JKM to publish historical and short-term forward LNG Netback prices.

ConocoPhillips Australia supports the Draft Decision Paper's view that the ACCC LNG Netback series should continue to base its calculations on the JKM as it remains the most relevant marker to publish historical and short-term forward prices to the Australian LNG export market.

JKM is the most used North Asia LNG price marker, having experienced considerable growth in liquidity over the last two years. The ACCC should continue to evaluate the churn rate, traded volumes, and open interest to assess the level of liquidity needed in JKM futures to extend the current forward LNG Netback price beyond 2 years. These criteria can be used to build confidence in JKM longer-term price expectations as its forward market improves in terms of volume traded and relevancy.

Publishing additional longer-term oil linked forward LNG netback prices.

Despite the historical connection of long-term LNG contracts based on an oil index, the global gas market operates on fundamentally different drivers. Thus, ConocoPhillips Australia sees limited benefit to publishing a longer-term forward LNG netback price based on an oil index as the two commodities are not correlated.

In addition, how the ACCC chooses a percentage of an oil index is not clear. It is appropriate that the ACCC source suitably qualified advice to determine the appropriate percentage of the oil price if deciding to publish longer-term forward LNG oil-linked Netback prices. It should also be recognised that the use of an oil-index in long term LNG contracts is not transparent and thus may not be a good benchmark for a domestic gas benchmark.

ConocoPhillips Australia welcomes the ACCC's acknowledgement that LNG Netback prices are not the sole factor influencing domestic gas prices. Factors other than LNG Netback prices also influence gas prices offered in the domestic market, including contract duration, end user flexibility, retailer margins, and additional transportation costs which are critical elements in long-term GSA contracts.[2] End user contracts typically provide more flexibility which are not included in LNG contracts that involve the delivery of substantial volumes of gas in a short time. Wood MacKenzie's observation that the JKM netback price is a "price floor" is accurate.

The ACCC is encouraged to reiterate the ACCC LNG Netback's role as an indicative gas price reference in its ongoing east coast gas market reporting. This would remind stakeholders that the ACCC is not providing a view on what level of gas pricing is "fair" to either sellers or buyers based on this LNG Netback series.

<u>Export costs deducted to calculate the LNG Netback price series</u>

LNG Freight costs, LNG plant costs, and pipeline costs

ConocoPhillips Australia supports the current approach to calculating forward LNG freight costs and pipeline transportation costs. Although we believe that as JKM becomes more liquid, the freight rate market will grow and extend with it. ConocoPhillips Australia supports the ACCC's decision to use consultant estimates of longer-term forward LNG freight costs.

ConocoPhillips Australia supports the current approach of deducting variable LNG plant costs is appropriate since these costs cannot be avoided in the short-run. The ACCC should consider using the term "marginal liquefaction costs" and "marginal pipeline transportation costs" to clearly identify the costs that are deducted in the Netback methodology. This is distinct from unavoidable long-run sunk costs which would have occurred whether the LNG producer exports LNG or supplies the domestic market.

As the Draft Decision Paper notes, deducting any unavoidable capital costs incurred by the LNG exporters would also contradict the ACCC Netback series' intent to provide a measure of the opportunity costs to gas suppliers of supplying gas to the domestic market, rather than export markets.

[2] ConocoPhillips Australia notes the Heads of Agreement the Australian East Coast Domestic Gas Supply Commitment acknowledges that the LNG Netback prices play a role in influencing domestic gas prices, along with cost of supply, contract terms and conditions and transportation and retailer charges.

Reviewing the LNG netback price series in 2024

A scheduled review 2024 review of the ACCC Netback series is appropriate to ensure its relevance in reflecting supply and demand factors which influence the domestic and LNG export markets.

Thank you for your consideration of our submission. Please contact James Mathews at [redacted] if you require any further information.

Yours sincerely,

[redacted]

Khoa Dao
President,
ConocoPhillips Australia