30 July 2021

Mr Rod Sims
Chairman
Australian Competition and Consumer Commission

By email: LNGnetbackreview@accc.gov.au

Review of the LNG netback price series – Draft Decision

Origin welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (ACCC) review of its LNG netback price series. Our views on key aspects of the Draft Decision are provided below.

The draft decision

Origin broadly supports the draft determination, and the work completed by Wood Mackenzie. The draft decision has rightly reinforced that the netback price series is an estimate of the value foregone in supplying gas to the domestic market compared to the alternative of exporting it as LNG.

The findings of the draft determination and consultant's report also align with Origin's understanding of the LNG market. Specifically, that Gladstone LNG is sold into Asian markets at JKM prices, and the relevance of any other price markers is already reflected in the JKM futures price, given it captures offers made by other international LNG producers to supply into that market.

Origin also agrees that fixed costs should not be included in the netback calculations as they cannot be avoided and are not considered when making decisions around gas sales over short-term timeframes.

However, we have reservations around the merits of extending the calculation out to 5 years as there are several issues that need to be worked through. Namely, how the forecasting uncertainty of prices 5 years out will be addressed, and how a consultant will determine applicable slope and freight costs with accuracy. The ACCC should only look to extend the netback series if it is convinced that these challenges can be overcome – which to this point remains inconclusive. Origin recommends that the ACCC only publish a final decision when it has thoroughly understood the challenges of extending the series can be overcome.

Extending the netback calculation

The LNG netback price is intended to provide an estimate of the value foregone in supplying gas to the domestic market compared to the alternative of exporting it as LNG. Origin is concerned that the extension of the existing netback calculation could create an expectation that the ACCC is forecasting future domestic prices. The netback price is not intended to represent the price of gas offered into domestic facilitated markets or under bilateral Gas Supply Agreements, given there are many factors that influence those prices.

There are several issues that drive the opacity of an oil-based netback price. Determining an appropriate slope is particularly challenging given the variable and confidential nature of oil-linked LNG strips. This could mean there may not be a singular readily available source upon which the representative slope can be derived. There is also a high degree of uncertainty for longer-term LNG freight cost forecasts as there are significant fluctuations in supply and demand factors that make predictions difficult.

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Origin notes the ACCC's intention to hire an expert market consultant to form a view on oil slopes and freight costs. This is reasonable given the difficulties noted above. However, to ensure transparency, it is crucial the ACCC run a public consultation to determine the possible approach in extending the netback series. A final decision on whether the series should be extended, could then be made following the conclusion of this process. Origin considers this to be a prudent approach as would it allow for an understanding of whether the challenges in extending the series can be overcome to a level that instils confidence in the accuracy of the netback prices.

Some of the areas that should be covered include:

- *Slopes* – It is unclear how an appropriate slope could be determined. There is no standardised approach, and it is unclear how a consultant will retrieve the necessary information, whether contracts would be used as a benchmark, and if a weighting would be applied to each contract.

- *Freight Costs* – There is no standardised approach to sourcing longer-term LNG freight cost estimates. These could be sourced from a consultant, determined through price assessment, inferred from index-listed futures, or even long-run marginal costs of new build LNG freight vessels. Each alternative ought to be fairly understood.

- *Range of prices* – Given the inherent uncertainty of the factors that could make up an oil-based price, the consultant should consider benefit of publishing a range of prices. This could account for the uncertainty and forecasting error associated with the calculation.

- *Term of prices* – Generally medium-term oil linked deals have a different term structure to short-term JKM agreements. The longer-term deals will largely reflect a price for delivery over an entire year, while spot JKM deals may reflect delivery over specific months. As such, it is appropriate to consider annual prices for an oil-linked netback, rather than an individual monthly price.

- *Terms of contracts* – Oil linked LNG contracts can often feature S-curve formulas and repricing clauses to minimise the impact of high or low oil prices. This needs to be explored to understand how it may impact netback calculations.

If you wish to discuss any aspects of this submission further, please contact Tom Strokon at [redacted] or on [redacted].

Yours Sincerely,

[redacted]

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