



1 June 2022

Gina Cass-Gottlieb
Chair
Australian Competition and Consumer Commission

By email: LNGnetbackreview@acc.gov.au

Dear Ms Cass-Gottlieb,

LNG PRICE ESTIMATES – METHODOLOGY PAPER

Origin Energy Limited (Origin) welcomes the opportunity to provide feedback to the ACCC on the LNG price estimates methodology paper.

The ACCC's rationale for extending the LNG netback price series is to facilitate more informed negotiations for medium-term domestic Gas Supply Agreements (GSAs), noting the current price series is limited to two years. Achieving this objective is inherently challenging, given there are many factors that influence the prices of gas offered into domestic facilitated markets or under bilateral GSAs that cannot be reflected in a single LNG netback price estimate.

GaffneyCline's primary approach is to leverage available oil-slopes from medium term oil-linked contracts. If there is insufficient data on these contracts, GaffneyCline proposes to normalise shorter and longer term contracts as a means of deriving a representative oil slope for these medium term deals. The methodology also incorporates the long run marginal cost of US LNG. These secondary indicators bear limited relevance to domestic suppliers' opportunity costs and could undermine the accuracy of the final price estimate derived.

Given the uncertainty relating to key methodology parameters such as the oil slope, and the inherently imprecise nature of the calculations, we suggest:

- A range of oil slopes are published rather than a single figure.
- Given signs of improved Japan Korea Market (JKM) liquidity (which include JKM forward price assessments from brokers and the execution of medium term JKM linked deals) the ACCC could publish netback prices based on JKM alongside those derived from oil indexation.

1. There are challenges in extending the netback series to five years

As acknowledged by GaffneyCline, LNG continues to be traded under a variety of different and complex contractual arrangements that mean direct comparison is not always possible¹. Factors including firmness, volume, location flexibility, optionality² and duration vary from contract to contract. For example, contracts commonly have specific destination clauses which restrict the regions where the LNG can be delivered, and this in turn influences the contract price.

Accounting for these factors is further complicated by the fact in many cases full contract details are not public. Any estimates are therefore likely to be dependent on assumptions applied by the consultant, and it is unlikely the value associated with different contract structures can be adequately accounted for through normalisation.

¹ GaffneyCline, 2022, *Market Advice and Estimates of Contemporary LNG Contract Prices*, p.7

² For example, max/min daily quantity, load factor and take-or-pay.

2. GaffneyCline’s methodology is complex and may not lead to an accurate netback estimate

GaffneyCline’s multi-layered methodology seeks to overcome the trade-specific challenges noted above. The methodology proposes to take the volume weighted average slopes of medium term oil-linked contracts, and adjust the average (if necessary) based on consideration of a broader set of secondary data sources that include longer term oil-linked contracts and the long run marginal cost (LRMC) of US LNG. However, the relevance of the secondary data sources to a medium-term estimate is likely to be limited, as discussed below.

- Any short term internationally tendered cargoes linked to oil: These short term tenders are largely influenced by short term supply/demand dynamics which make them less relevant to a medium term estimate. Any relevance to domestic suppliers is also diminished by the proposal to include all tenders irrespective of location/market.
- Long term oil-linked contracts: Typically, these 20-year contracts have lower oil slopes that are not offered for three to five year contracts. This is largely because long term contracts provide producers with greater certainty around future revenue streams needed to recover their large capital investments, which reduces the level of any risk premiums that may need to be factored into a supply contract.
- LRMC of US LNG: While noting the possible increased role of US LNG and its potential influence on Asian LNG contract prices we are not sure there is a clear/direct link between the LRMC of US LNG and domestic suppliers’ opportunity costs of supplying gas to the east coast market.

The rationale for weighting the secondary data sources differently depending on the level of market volatility may not be consistent with expected market dynamics. It is not clear why short term tenders are given lesser weighting and longer term deals a higher weighting at times of greater market volatility.

Given the complexity of the proposed methodology and the uncertainty associated with the inputs (noted above) we recommend the ACCC publishes a range of oil slopes rather than a single figure. The ACCC should also update the guidance associated with its LNG price estimates to highlight the uncertainty, complexity and limitations of GaffneyCline’s proposed approach, if adopted.

3. Medium term LNG netback prices based on JKM could be published alongside those derived from oil indexation.

As noted by GaffneyCline, “the fundamental supply dynamic of LNG is very different to oil, and the two commodities are increasingly de-linked”.³ As Asia is by far the most common destination for domestic suppliers’ LNG cargoes, estimates of domestic suppliers’ opportunity costs should be informed by JKM which reflects the spot market value of cargoes delivered ex-ship into Japan, South Korea, China and Taiwan.

We note market dynamics have changed since the ACCC’s final decision to use an oil-linked index for medium-term LNG netback price estimates. In its final determination for the 2021 netback review the ACCC noted that liquidity for JKM “falls after 2 years and it is not suitable to be used to calculate longer-term forward LNG netback prices”. Relatedly, the ACCC expressed a preference for a gas-on-gas marker rather than an oil index,⁴ but the lack of JKM liquidity was seen as a key obstacle to its adoption.

³ GaffneyCline, 2022, *Market Advice and Estimates of Contemporary LNG Contract Prices*, p.19

⁴ “With a well-functioning, liquid and transparent market, a gas price marker would be more suitable to extend the forward LNG netback price series in the future”. ACCC, 2021, *LNG netback review – Final decision paper*, p. 34

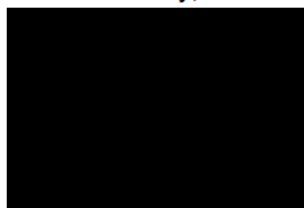
However, there are signs of potential improvement in JKM liquidity.

- Origin receives daily JKM forward price assessments over a medium term horizon (out to the end of Cal-26) from interdealer brokers.
- Origin is also aware of the execution of two medium-term JKM-linked deals:
 - In May 2021, Origin agreed a four-year supply agreement with Australia Pacific LNG for 91 petajoules of gas at a JKM-linked price.⁵
 - In September 2021, Beach Energy and BP Singapore signed a Heads of Agreement for LNG supply from Beach's Waitsia's project in Western Australia. It is a 5-year supply deal with the agreed price linked to both JKM and Brent.⁶

With improved JKM liquidity, the ACCC could publish netback prices based on JKM alongside those derived from oil indexation.

Should you have any questions or wish to discuss this submission further, please contact [REDACTED] at [REDACTED].

Yours sincerely,



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⁵ Origin, 2021, *Origin boosts gas supply to southern markets*, Accessed: https://www.originenergy.com.au/about/investors-media/origin_boosts_gas_supply_to_southern_markets/

⁶ Beach Energy, 2021, *ASX Announcement – Beach and BP sign Waitsia LNG HOA*, Accessed: https://yourir.info/resources/0c5a441cf54ff229/announcements/bpt.asx/2A1326054/BPT_Beach_and_bp_sign_Waitsia_LNG_HOA.pdf