



16 April 2021

Our Reference: APLNG - COR - 0014631

Australian Competition & Consumer Commission
Level 20
175 Pitt Street
Sydney
New South Wales 2000

Sent by Email: LNGnetbackreview@acc.gov.au

To Whom it May Concern

RE: ACCC review of the LNG netback price series

Thank you for the invitation to participate in the review of the LNG netback price series. This letter forms a written submission by Australia Pacific LNG Pty Limited ("APLNG") to the issues paper published by the Australian Competition & Consumer Commission ("ACCC") on 18 March 2021 ("Issues Paper").

APLNG also welcomes the opportunity to meet with the ACCC to discuss the issues raised in this submission and will be contacting the ACCC contact noted in the Issues Paper for that purpose.

APLNG is based in Queensland and is an incorporated joint venture between ConocoPhillips, Origin Energy and Sinopec. Origin Energy is the upstream operator and ConocoPhillips is the downstream operator of APLNG.

APLNG is committed to the Australian domestic gas market. APLNG is currently the largest east coast supplier, supplying around 30 per cent of the total east coast market demand via numerous long-term gas supply agreements. Some of those agreements have supply terms that extend beyond 2025, in some cases as far out as 2040. Our investment in gas production, processing and LNG production facilities have produced a global scale industry with lasting benefits for local communities and the nation.

Prior ACCC Consultation on LNG Netback Series

On 14 February 2018 APLNG provided a response ("2018 Response") to the ACCC regarding what was, at that time, the development by the ACCC of an LNG netback price series at Wallumbilla.

At the time of the 2018 Response APLNG did not support an ACCC LNG netback series on the basis that:

- Publishing an LNG netback price, even if the forecast was for up to 24 months, would not address any concerns the ACCC may have on long term supply uncertainty.
- The LNG netback series might lead to misunderstanding of the market by gas buyers.
- APLNG's then current domestic buyers were generally retail or similar businesses who manage portfolios, and those entities typically already had their own internal forecasts of LNG netback and domestic pricing.

APLNG has contracted hundreds of petajoules of gas supply to domestic manufacturer and retail customers since its 2018 Response. Based on the cumulative knowledge gained from negotiating and executing such a large volume of contracts, APLNG is of the view that the concerns that we raised in the 2018 Response have been largely substantiated.

As mentioned above, APLNG would be happy to meet with the ACCC to discuss those experiences in more detail.

In anticipation of the ACCC publishing an LNG netback series, APLNG's 2018 Response also included its views on many of the issues that are being revisited within the Issues Paper. As the fundamentals of the Asian LNG spot market and the Australian domestic market have not changed, the 2018 Response may be treated by the ACCC as valid also for its current review.

APPEA's Submission

APLNG is a member of the Australian Petroleum Production and Exploration Association (APPEA) and, as a member, notes and fully supports the separate and comprehensive APPEA submission to the Issues Paper.

APLNG's Position

APLNG offers the following responses to certain key matters raised by the Issues Paper:

- The ACCC's use of Asian spot LNG prices for the LNG netback series remains appropriate. There is no evidence of a need to change the make-up of the ACCC netback series as published for the purpose of assessing the spot price LNG exporters could reasonably expect to receive for uncontracted gas in overseas markets.
- APLNG does not specifically seek to recover costs associated with the development and construction of the LNG plant via LNG spot cargoes. If APLNG sought to recover such costs then it would not be competitive for sales of uncontracted LNG, as other LNG projects with uncontracted LNG for sale (including Australian and non-Australian projects) would undercut APLNG by only charging their short-run marginal LNG plant costs and thereby be more competitive internationally than APLNG.
- A deduction of any notional amount of LNG plant capital costs from the current make-up of the ACCC netback series would not reflect true market activity and would be equivalent to an ACCC imposed price subsidy that east coast customers would then expect to receive from East Coast LNG producers supplying domestic gas.

- APLNG's view is that publishing longer term forward netback price series based on the current approach could be misleading or create further confusion. This position is based on the following:
 - As reflected in the Gas Inquiry 2017-2020 report from October 2018 and on page 19 of the Issues Paper, JKM futures published by ICE are based on prices derived from financial markets rather than on prices for physical cargoes achieved in the commodity market (with resultant timing disconnects).
 - The JKM futures market remains relatively illiquid beyond 12 - 18 months compared to more mature derivatives markets and, as a result, futures quotes for months beyond that are a less reliable indicator of future prices.
 - (as confirmed by the Issues Paper) forward LNG freight costs between Gladstone and Tokyo are not available beyond a two year-period.
- The ACCC netback series as currently published could be enhanced through more frequent reporting (consistent with shipping and JKM reporting). In its 2018 response APLNG proposed that the data should be published weekly.
- It is important that the ACCC should continue to publish the limitations of the LNG netback series, as set out on the ACCC's website and the attached Guide to the LNG netback price series (specifically section 1.3). Many of these weaknesses were originally noted by APLNG in the 2018 Response.

APLNG observes that many of the 27 issues raised in the Issues Paper arise from how future changes within the market may possibly occur. For example:

- "The growth in supply from different regions also **has the potential to strengthen or weaken** the relationship between LNG and gas prices between different regions."
- "The US government has also approved an additional 13 LNG projects which, **if constructed**, will increase US LNG export capacity by approximately 200mpta (**although it is not certain** that all 13 projects will reach FID). This growth in LNG export capacity is **predicted** to result in the United States being the biggest exporter of LNG by 2025."
- "These developments, along with increasing US liquefaction capacity, **have the potential to** increase the importance of Henry Hub gas prices for LNG price formation in Asia. **This suggests** that the US, at times, **may** act as the marginal supplier of LNG into Asia, and particularly into the Asian spot market."
- "In practice, Qatar's ability to arbitrage between Europe and Asia, on the basis of netbacks to either region, means that Asian LNG spot prices **may be influenced** by gas and LNG prices in Europe."
- "These factors **suggest that** the importance of spot markets will continue to grow. It **also potentially will lead** to greater price volatility in LNG spot markets."
- "This growth in liquidity **may have** broader implications for future LNG spot market pricing trends **and could drive** further increases in LNG spot trade (by allowing LNG buyers and sellers to manage the risks of spot price movements).

The above statements by the ACCC are subject to a high degree of uncertainty, which the ACCC acknowledges in the language chosen. APLNG respectfully submits that the appropriate time to review the make-up of an LNG netback series (that was first published only 2.5 years ago) is at the point where the proposed Qatar and US facilities are operational and there is clear independent

evidence that a critical mass of hypothesized future change has crystallized in the market. Only at that point will there be sufficient verifiable evidence to enable alternative LNG netback price methodologies (or changes to components within the existing LNG netback series) to be directly correlated with representative pricing data for physical spot LNG sales in Asia.

Pausing to monitor for signposts of actual change would also allow time for other initiatives that form part of the Australian Government's plans for a Gas Fired Recovery to take hold. Those initiatives include the amended Heads of Agreement (HOA) that was entered into between the Australian Government and the East Coast LNG exporters as recently as January this year.

Specific Comments on Henry Hub

APLNG notes that the Issues Paper refers to the importance of flexibility of US LNG contracts, and states:

"These [US LNG] projects also have pricing for feedstock gas linked directly to the US Henry Hub, with customers typically paying a fee equal to 115% of Henry Hub pricing. In addition, market participants are able to trade futures contracts linked to Henry Hub on a number of exchanges, with physical and financial contracts available on a daily, weekly or monthly basis.... These developments, along with increasing US liquefaction capacity, have the potential to increase the importance of Henry Hub gas prices for LNG price formation in Asia. This suggests that the US, at times, may act as the marginal supplier of LNG into Asia, and particularly the Asian spot market".

APLNG notes the speculative nature of the above comment, and feels it is helpful to provide some data and observations from our experience in the market to help understand the role of Henry Hub priced gas as it relates to the north-east Asian spot LNG market:

- The US has seen a substantial increase in LNG export capacity since 2018, however only a small volume (roughly 7%) of Asian LNG imports are from the US and those imports are sold on a long-term basis.
- It is APLNG's experience that LNG buyers in Asia do not purchase spot LNG on a Henry Hub linked index.
- Henry Hub spot prices remain reflective of local supply and demand conditions, and a number of recent events and market fundamentals demonstrate that the US domestic gas market is not linked to north Asia spot LNG. For instance:
 - The significant spike in Henry Hub spot prices in February 2021, resulting from the extraordinary winter conditions experienced by the southern states of the US, did not translate into a movement in Asian spot LNG prices.
 - Conversely daily JKM prices spiked in mid-January 2021 in response to high demand in north-east Asia, shipping constraints and supply side issues. It was notable US LNG projects did not act as the marginal supplier to mitigate the volatility due to the shipping distances being too long to respond quickly enough to the tightening market.
- At present there is no physical connection between an east coast Australian domestic gas customer and Henry Hub sourced gas, due to the lack of LNG import terminals on the east

coast of Australia. As such Henry Hub prices do not have a role in influencing domestic gas prices in the east coast Australian gas market. Should LNG import terminals be built, then this would allow for the cost of imported US sourced gas to help establish an import parity pricing model reflective of competition with internationally traded volumes.

In the absence of physical connections amongst distinct markets, or evidence that the price movements reflect substitution of product, it is difficult to sustain the proposition that gas priced as a result of local supply and demand dynamics some 14,000km distant from Australia should have an influence on east-coast Australia domestic gas prices.

Specific Comments on Import Parity Pricing - Henry Hub Net Forward (Term Sale) Case Study

The Issues Paper notes that:

“...there are a number of proposed LNG import terminals for the east coast of Australia. However, we will consider the development of an import parity price separate to this review, once it becomes clearer if an import terminal will commence operation on the east coast and the arrangement that will apply to its commercial operations”.

We support the position that developing an import parity price model should wait until demonstrated change to the market fundamentals occur. APLNG does, however, note that the Issues Paper speaks to the existence of flexibility in US LNG contracts and as such considers that it is worth spending some time contemplating what a Henry Hub based import parity price marker might look like.

In considering the concept of import parity, for a US gas producer to be indifferent¹ to selling to a US domestic buyer at Henry Hub or exporting it to the east coast of Australia on a term basis then the price point would logically reflect a “net forward” of the price at which that gas supplier can sell gas at Henry Hub.

Assuming the east coast gas customer does not contract for firm capacity through US LNG export or Australian re-gasification facilities, the net forward Henry Hub price would include:

- Transportation from Henry Hub to the US LNG export facility
- Gas consumed for liquefaction, plus tolling costs at the US LNG export facility
- Shipping from the US LNG export facility to the regasification facility in Australia
- Tolling costs at the Victoria/NSW LNG import facility
- Transportation costs from the Australian regasification facility to the contract delivery point

The Issues Paper notes the existence of flexibility in US LNG contracts and correctly notes that many US LNG projects follow a ‘tolling model’ to underpin the financing requirements to construct the LNG

¹ *The ACCC’s website notes: “Individual prices paid by gas users will also reflect other factors that may be relevant to their circumstances, including the terms and conditions of their gas supply and any applicable transportation or retailer charges. When adjusted for these factors, an LNG netback price represents the price that a gas supplier would expect to receive from a domestic gas buyer **to be indifferent between selling the gas to the domestic buyer and exporting it.**”*

www.accc.gov.au/regulated-infrastructure/energy/gas-inquiry-2017-2025/lng-netback-price-series

plants, a model which differs from more traditional LNG development models, such as APLNG, which relied upon long term SPAs to underpin the economic case for the multi-billion dollar investments.

The Issues Paper further identifies that customers typically pay a fee equal to 115% of Henry Hub pricing. However, it should be noted that this component is for the variable costs of tolling the gas through their facilities. Furthermore, the Issues paper does not identify that US LNG contracts with price methodologies indexed to Henry Hub also have an additional fixed component to the tolling charge.

Considering the variable and fixed costs of liquefaction and regassification, transportation and shipping, a US supplier would consider the point at which it would be indifferent economically to selling to a domestic customer or an east coast Australian customer (were that feasible) to be in the region of Henry Hub (converted to A\$/GJ) plus A\$7.00 to A\$9.00².

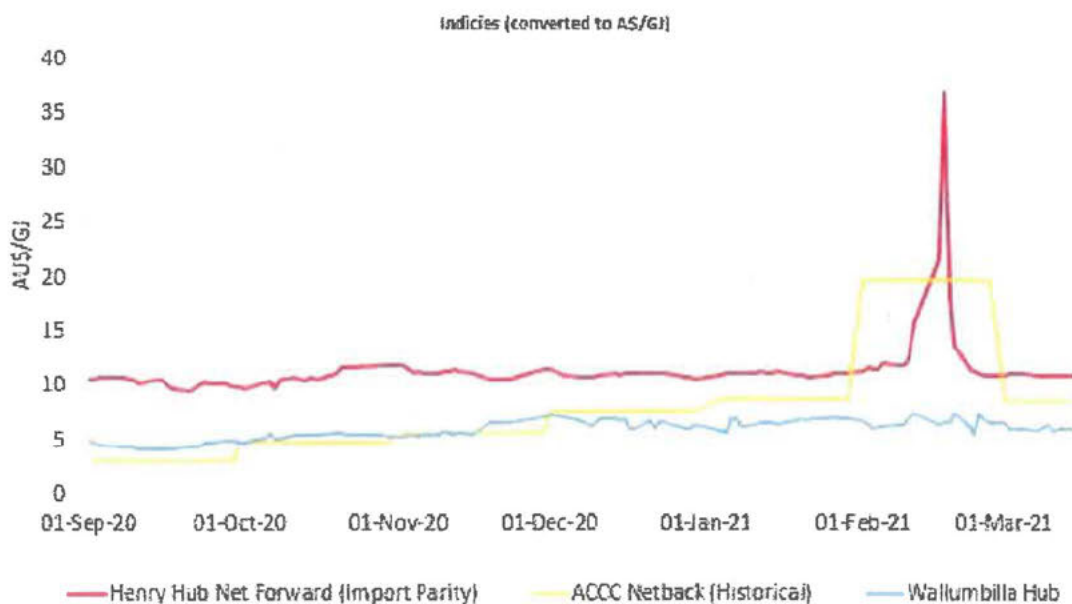


Figure: Henry Hub Net Forward (Term Sale) Case Study - Comparison

The red line in the figure above shows an illustrative Henry Hub net forward price relative to the ACCC netback series (historic) for the previous 6 months. This represents a view, for this period, of price levels at which a US gas supplier could be indifferent to selling gas to an east coast Australian gas buyer (were that feasible) as opposed to making a spot sale to a US domestic buyer at Henry Hub. The illustrative Henry Hub net forward price tracks higher than the ACCC netback price for the selected period and is subject to price volatility consistent with other traded commodities that are subject to local conditions.

² Pipeline to US LNG terminal, Shipping to Asia – Gas Intelligence Model by McKinsey Energy Insights September 2020; Variable cost and liquefaction capex recovery - IHS Connect database (69 US LNG contracts indexed to Henry Hub); Estimated regassification cost in Australia based on APLNG internal analysis/data; all US\$/mmbtu converted to A\$/GJ using 6 month average AUD:USD 0.75.

APLNG remains committed to supplying the east coast gas market, engaging with customers and working with the Federal Government to enhance the role of gas as a major contributor to the economic development of Australia and its energy future.

We trust this information is helpful, should you have any questions or would like to discuss this submission further, please contact the undersigned or Mark Hunter, Senior Commercial Negotiator at [REDACTED].

Yours faithfully,

[REDACTED]

Darren Meznarich
General Manager, Commercial
Australia Pacific LNG Pty Ltd