

5 August 2021

Joshua Runciman  
Director, Gas Unit  
Australian Competition & Consumer Commission  
Level 17 Casselden Place  
2 Lonsdale Street, Melbourne 3000

**Re: ACCC LNG Netback Series Draft Decision Paper Feedback Submission**

Dear Joshua,

Thank you for the opportunity to respond to the ACCC's July 2021 LNG Netback Review Draft Decision Paper. Our submission, recommendations and comments below are in addition to our 12 April 2021 submission to the ACCC.

**Chemistry Australia has reviewed the ACCC's Draft Decision Paper and recommends a range of achievable actions to improve market transparency and re-balance the inherent information asymmetry that continues to exist and which materially disadvantages consumers.**

**Improvements to the ACCC LNG Netback Price Series would provide market-based solutions that better match the information required by domestic consumers in a properly functioning market. Consumers need to achieve globally competitive inputs to meet cyclical plant capital investment needs while managing the dual complexities of the domestic market and the dynamics of an export market intrinsically linked to a maturing global gas marketplace.**

**These improvements would assist meeting the intended market reform role of the Review as part of the Prime Minister's Gas Fired Recovery Plan to better empower gas consumers. They would complement the other key reform areas of gas supply and infrastructure and help enable a functional market to re-establish itself. Combined, these would help meet the intent of the National Gas Objective of a gas market that meets the long-term interests of consumers.**

**Chemistry Australia recommends that to meet the long-term interests of consumers:**

- 1. The ACCC ensures future LNG Netback Pricing Series include a sharper focus on the market providing low capital intensive non-liquified gas to domestic consumers requiring long-term contracts to underpin plant capital re-investment cycles.**
- 2. The future LNG Netback Pricing Series include the publication of:**
  - a) Henry Hub linked Netback**
  - b) Long-run and short-run Netback**
  - c) The Australian Domestic Netback Price proposed by the Energy Users' Association of Australia.**
- 3. The ACCC align its Netback consultation with its six-monthly Gas Inquiry Reports and conduct a formal review in September 2022 before any future Heads of Agreements are signed.**

## Background

1. Chemistry Australia welcomes the opportunity to provide this feedback to the ACCC's Review of the LNG Netback Price Series Draft Decision Paper.
2. Chemistry Australia is the peak national body representing the chemistry industry.
3. The chemistry industry is the third largest manufacturing sector in Australia. Our industry directly employs more than 61,500 people (FTE) and supports approximately 212,000 FTE jobs across the economy. The industry directly contributes \$11 billion to gross domestic product (or \$38 billion including indirect contributions),
4. The sector uses approximately 3 per cent of Australia's annual gas production to create a broad range of products that are crucial to critical supply chains underpinning our economy. The chemicals sector supplies inputs to 108 of Australia's 114 industries.
5. The sector is the largest consumer of non-liquified gas for industrial purposes. Gas is used in large-scale, capital intensive plants as a non-substitutable feedstock or energy source. These plants can only consume non-liquified gas, not LNG. Gas is purchased in preferably long-term contracts to meet the typically 5-7 year re-investment cycles dictated by plant turn-around re-fits. The majority of industrial gas is purchased in this way and therefore needs to be a prime focus of the transparency improvements required by gas consumers in fully functioning market.
6. While the sector is a relatively small user of gas, ~130 Petajoules a year, in comparison to the significant volumes of gas exported, the chemicals sector adds significant value.
7. As independently determined by Acil Allen Consulting in the *Chemical Sector Economic Contribution Analysis* report, the number of jobs the chemical industry supports is much higher than other industries that use gas; 80 times higher than LNG, and 150 times more than the gas-fired electricity generation sector. The sector also adds \$286 million of value to every petajoule of gas it uses, which is 33 times more than LNG. Australians receive \$277 million more in economic benefit from a petajoule of gas that goes through the chemistry industry than they do from a petajoule of gas going to LNG exports.
8. As indicated in our April submission the LNG netback series must play its vital role in reforming and resetting east coast Australia's dysfunctional gas market. With improvements and enhancements the netback series should:
  - a. Be an underpinning element of the Commonwealth Government's gas-fired recovery plans and Job Maker Plan that delivers the transparency needed by consumers to *"ensure Australians are paying the right price for their gas by working with the ACCC to review the calculation of the LNG Netback price which provides a guide on export parity"* (Prime Minister Morrison, Tomago, 15 September 2020).
  - b. Help deliver on the commitments by the three Queensland LNG exporters to sell excess gas to the domestic market as agreed in the January 2021 Heads of Agreement with the Commonwealth,
  - c. Advance market development and the Wallumbilla Gas Hub so traders and market-makers can create the derivative and hedging products to better manage international and domestic gas price risks.

9. Chemistry Australia's feedback recommends the ACCC's netback series be strengthened to meet the needs of consumers now managing the dual complexities of domestic dynamics as well as export dynamics into an evolving global gas market. This can be achieved by providing the level of transparency required that accounts for the range of variables influencing price discovery and to overcome the entrenched information asymmetry currently disadvantaging consumers. This can be achieved by the ACCC in a number of ways:
- Broaden the series into a more transparent information set that best matches the needs of consumers, including non-liquified gas purchased to meet capital intensive plant re-investment periods, typically 5-7 years
  - Publish a Henry Hub linked netback series as a global reference
  - Publish a long-run and short-run netback series
  - Publish the EUAA's recommended Australian Domestic Netback Pricing, given 60% of the market is supplied by producers without the sunk capital of LNG exporters.

### Chemistry Australia's key recommendations to the July draft decision paper

#### ***Purpose of the netback series.***

In reviewing the LNG Netback Series, the ACCC should continue its key role of ensuring consumers have access to information that enables market-based solutions and promote transparency, competition and fairness.

We recommend that the LNG Netback Series includes a focus on:

- Providing a guide to non-liquified gas to domestic consumers requiring long-term contracts to underpin plant capital re-investment cycles, usually in the order of 5-7 years.

The ACCC's wide-ranging review of the gas industry over the past 5 years, highlights the market dysfunction and systemic problems exemplified by:

- the level of complexity and variability that exists in relation to data vital for price discovery and required for a functional market to begin to re-establish itself,
- this includes managing the dual complexities of domestic dynamics as well as export dynamics intrinsically linked to a maturing global gas market,
- the type and extent of information asymmetry that continues to exist in relation to this data that disadvantages consumers,
- the type and extent of market power in the highly concentrated and integrated LNG and gas sector, and
- the significant ownership of gas reserves held by export-focused operators.

Given the agreed dysfunction of the past 5-10 years, and the identified need to re-balance the negotiating positions of consumers with producers, the current netback series review and the changes we recommend provide a 'once in a decade' and realisable, opportunity to significantly improve gas market transparency and drive better public policy outcomes for Australian consumers. Such a fundamental re-set would enable the ongoing domestic value-adding to gas required to meet sovereign resilience and economic complexity objectives. Without this re-set, it is unclear how these national objectives will be achieved.

The current series has been a welcome starting point but does not yet overcome the inherent information asymmetry in favour of producers or provide the level of transparency consumers require. As such it can act as a de facto price signal and price floor for domestic-focused producers and LNG exporters alike.

As the ACCC acknowledges, the netback series is viewed from the perspective of the LNG exporter. In doing so it has the unintended consequence of ‘baking-in’ \$3-4 GJ of sunk capital costs into the presently calculated price series, irrespective of whether the LNG trains are operating at their full capacity.

LNG exports need to be globally competitive in order to win contracts in the global marketplace. Producers should, therefore, be in the best position to ensure their efficiently run plants and cost of production also provide the domestic gas consumers with their own requirement for globally competitive inputs.

Internationally competitive domestic gas should be our collective goal and is achievable in a country that has the reserves available to it. Australia should strive to realise the benefits of both gas exported for energy as well as domestically transformed into high-value added manufactures.

That is why we recommend Henry Hub LNG landed in Asia as a marker. Not because it is necessarily ‘cheap US gas’ but because it competes with Australian manufacturers, it is a global gas proxy, and Henry Hub LNG will compete with Australian LNG now and in the future.

The very nature of the current LNG netback short-run series means domestic consumers who can only consume non-liquefied gas, are being asked to compete and pay liquified gas prices landed in Japan, less shipping and some incremental operating costs.

It is analogous to an Australian consumer being told the export parity price for milk is the landed price of processed cheese in Japan or pig iron or stainless steel as a netback for local iron ore.

Therefore, the ACCC must ensure the netback series improves domestic gas market transparency and clearly distinguish between either (a) supplying non-liquified gas to the domestic market and (b) the cost of incurring significant liquefaction expenditure and exporting it as LNG.

To help achieve this objective, we recommend some simple, available and achievable additions able to enhance the netback series. These would be easy for the ACCC to calculate and publish in coming months.

They fit with the *raison d’être* of ACCC to improve market transparency and help to create a fully informed market. If implemented, they would complement the work being done by other government agencies in improving gas supply and infrastructure enabling a functional market.

We have three key suggestions discussed below.

### **1. Publish Henry-Hub linked netback.**

We support the ACCC’s proposal to create a longer-term 5-year price series. The ACCC recommends an oil-linked curve. However, we urge you to also create a gas-linked series using Henry Hub LNG into Asia.

As noted by the ACCC, Henry Hub is an important global gas marker and will be increasingly so in years ahead. This is consistent with the forward planning requirements of contract gas users with plant capital investment decisions.

The netback series takes an LNG producer’s perspective.

As trade-exposed, major users of gas as a feedstock to produce fertilisers for farmers, explosives for the resources sector and polymers for the agriculture, food, mining, gas, water and energy sectors, our members are reliant on long-term gas contracts to underpin investment decisions and to compete with gas-intensive imported products.

That is why achieving internationally competitive gas price is important to manufacturers and we recommend you also create a 5-year gas-linked Henry Hub based index for comparative purposes.

While we recognise the ACCC's intention to publish an oil-linked netback series with a forward view of approximately 5 years, we also recognise it would tie the netback series, and Australian domestic gas price expectations, to global oil markets. This seems at odds with a maturing global LNG market with increasing volumes more likely to rely on gas-on-gas references.

To ameliorate this inherent oil bias, we recommend the ACCC also develop a gas-on-gas marker for comparative purposes.

The April submission by Chemistry Australia and its appended analysis, highlights the changing dynamics in the world's oil and gas markets. This is also reflected in the data of the International Gas Union of the increasing trend to gas-on-gas price formation around the world.

Given the ACCC will use a consultant to help develop an oil-based netback, we believe the consultant could easily create a Henry-Hub based netback curve as well, given the breadth and depth of data on international exchanges.

The methodology of calculating a netback series is well understood. The ACCC framework, its experience and use of consultants should be able to easily create a Henry Hub based netback comparison using live traded prices.

The arguments put in favour of an oil-based netback such as broad industry familiarity with oil markets, market depth and liquidity, equally apply to Henry Hub.

To only have an oil-based marker or benchmark would reinforce the bias of the LNG series to view the netback through the eyes of a globally integrated oil and gas producer. This would allow the inherent information asymmetry to continue and consumers to be no better off, an outcome at odds with the opportunity the Review provides the market with.

Having an international gas-based series using a global recognised and deep trading market such as Henry Hub, is complementary in every way to an oil-based series and provides the ability to view 'internationally competitive gas prices' through an international gas lens.

## **2. Publish long-run and short-run netback.**

We recommend the ACCC publish its LNG netback series on both a long-run and short-run basis for the 2-year price and 5-year price series.

The LNG export facilities built in the past decade are now running at or above capacity. Market reports highlight APLNG and QCLNG regularly running above nameplate.

As the 'Developing A Robust Domestic Gas Marker' report that formed part of Chemistry Australia's April submission, "*LNG netback pricing should be based on the long-run cost that reflects a competitive gas market*" rather than short-run costs which hide the impacts of a vertically integrated market and concentrated market.

LNG exporters have a choice in how they manage their facilities, either supplying their export market contracts, selling at spot, or leaving the gas in the ground. Future investment will need to cover more than just marginal cost.

Publishing both a long-run and short-run series poses no detriment to, and would not change:

- the gas volumes required for export
- the prices locked in LNG order books, or
- the 'commercial realities' LNG exporters face.

Publishing both a long-run and short-run series will increase available transparency, enhance disclosure and public understanding of:

- The opportunities before an LNG producer to either export, supply the local market, or leave the gas in the ground
- The incentive to invest in new capacity and the likely range of costs and margins an LNG exporter may achieve
- An export parity price for capital-intensive processed liquefied gas (i.e. LNG), and
- Where a fair price fits for low capital-intensive (non-LNG gas) in the domestic market

The calculation of a short-run and long-run series should not be difficult to calculate, given the architecture is already provided in the current methodology and requires the addition of only a small amount of available data.

The sunk (and written down) capital costs of the LNG facilities are well known. Various industry studies have estimated the capex cost per petajoule or MMbtu of capacity.

For example, the addendum in Chemistry Australia's May 2021 submission to the ACCC's LNG netback review estimated gas transport and short-run costs at 98c / GJ and long-run liquefaction costs including capital costs at an additional \$2.78 / GJ.

This ~\$4 GJ of LNG-related capex – which is reflected in the netback series and which can act as a floor price - is a cost carried through the economy for a service that domestic consumers neither use, or need.

If the USA were to develop an LNG netback series it would arrive at Henry Hub gas price, if Europe were to develop an LNG netback series it would arrive at a TTF price.

Given the risk the ACCC identified that the proposed new oil-based netback series could pose as a floor price around which LNG and non-LNG gas producers will trade between themselves, or make offers to the domestic market, it is vital to distinguish between the marginal molecules of gas on offer which carry the burden of LNG capex and those that do not, and that is why we also support the calculation of an Australian Domestic Netback Price (ADNP) series .

### **3. Australian Domestic Netback Price (ADNP)**

We support the proposal shared by the Energy Users Association of Australia (EUAA) at the ACCC's Roundtable on July 20 of an Australian Domestic Netback Price (ADNP) series.

With LNG exporters providing approximately 40 per cent of the east coast market it makes sense to understand and compare the opportunity costs and price premium of the domestic producers supplying the other 60 per cent that do not have LNG sunk capital.

**The length of the forward LNG netback price series**

1. Is the ACCC's draft decision to continue publishing a 2-year forward LNG netback price series appropriate? Should the ACCC continue to publish a 2-year forward LNG netback price series	Yes. Continuing a 2-year short term forward series is appropriate. However, the series should include the full range of netback pricing recommended in this submission.
2. Is the ACCC's draft decision to publish additional longer-term forward LNG netback prices appropriate? Should the ACCC publish additional longer-term forward LNG netback prices?	Yes. It should publish a price series over a minimum 5-year forward horizon to match consumer capital re-investment cycles. The series should include the full range of netback pricing recommended in this submission.
3. Over what length of time should the ACCC publish additional longer-term forward LNG netback prices (such as 3 or 5 years)?	
4. What other issues should be considered when publishing longer-term forward LNG netback prices.	The series needs to include a focus on providing a guide to non-liquified gas to domestic consumers requiring long-term contracts to underpin plant capital re-investment cycles, usually in the order of 5-7 years.  The series should include the full range of netback pricing recommended in this submission.

## LNG price markers to calculate the LNG netback price series

5. Is the ACCC's draft decision to continue using JKM to publish historical and short-term forward LNG netback prices appropriate?	The decision only resolves part of the inherent information asymmetry that exists. To meet the needs of consumers the ACCC should publish Henry Hub and Long-run netback pricing.
6. What is the minimum level of liquidity needed in JKM futures to extend the current forward LNG netback price beyond 2 years?	No specific view.
7. Is the ACCC's draft decision to use prices in medium-term oil-linked LNG contracts to calculate additional longer-term forward LNG netback prices appropriate? Should the ACCC publish additional longer-term forward LNG netback prices based on oil-indexes?	To meet the needs of consumers the ACCC should publish Henry Hub and Long-run netback pricing.
8. Is the ACCC's draft decision to use consultant estimates of an appropriate percentage, or slope, of the oil price to calculate longer-term forward LNG netback prices appropriate?	Yes - as long as it requires quality assurance validation. This should include the ACCC using its ability to audit and otherwise scrutinise the long-term contracts LNG exporters have in place that factors the range of oil-linked slopes used to develop a weighted average 'slope'.
9. What other issues should be considered in calculating shorter and longer-term forward LNG netback prices?	The ACCC should also calculate an Australian Domestic Netback Price (ADNP). This price series should provide transparency for gas producers that do not have LNG facilities, but have the option of selling gas domestically or tolling gas through an LNG facility.



## Export costs deducted to calculate the LNG netback price series

10. Is the ACCC's draft decision to use the current approach to calculating forward LNG freight costs, for period up to 24 months, appropriate? Should the ACCC use an alternative approach?	<p>The most appropriate approach is that which delivers the greatest amount of material transparency for consumers.</p> <p>This should include ACCC audits of actual costs compared with forward estimates.</p>
11. Is the ACCC's draft decision to use consultant estimates of longer-term forward LNG freight costs appropriate? Alternatively, should the ACCC:	
12. What other issues should be considered in estimating future LNG freight costs?	
13. Is the ACCC's draft decision to use its current approach to deducting liquefaction costs to calculate additional longer-term forward LNG netback prices appropriate?	<p>No. The short-run approach which includes large allowance for sunk capital is inappropriate for consumers who only need and can only purchase non-liquified gas.</p> <p>The variables involved are many and complex, with greater transparency needed to re-balance the information asymmetry inherent in the market.</p> <p>As recommended the ACCC should publish both long-run and short run netback series to meet the needs of contract consumers.</p>
14. What other issues should be considered when estimating and deducting LNG liquefaction costs?	As above and recommended
15. Is the ACCC's draft decision to use its current approach to deducting pipeline transportation costs to calculate additional longer-term forward LNG netback prices appropriate?	No specific comments.
16. What other issues should be considered when deducting pipeline transportation costs?	No specific comments.

## Reviewing the LNG netback price series in 2024

17. Is the ACCC's draft decision to undertake another review of the LNG netback price series in 2024 appropriate?	<p>No. Given the importance of:</p> <ul style="list-style-type: none"> <li>the Federal Government's Gas-Fired Recovery initiatives,</li> <li>the commitment by the Queensland LNG exporters under a Heads of Agreement to first offer excess gas to domestic consumers,</li> <li>the role that LNG netback and domestic reference price will play in a Gas Code of Conduct</li> </ul> <p>the ACCC should align feedback on the netback with</p> <ol style="list-style-type: none"> <li>its six-monthly Gas Inquiry Reports and</li> <li>conduct a formal review in September 2022 before the next HoA is signed.</li> </ol>
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## Further Feedback

<p>Feedback is also sought on the preliminary report provided by Wood Mackenzie published on the inquiry webpage.</p>	<p>Chemistry Australia has reviewed the Wood Mackenzie report.</p> <p>Our view is that the recommendations do not match the requirements of gas consumers or provide the necessary and available level of transparent information required in a properly functioning market where globally competitive inputs need to underpin capital investment cycles.</p> <p>Chemistry Australia has provided a set of recommendations that the ACCC can add to what has been proposed and that will assist consumers with these objectives.</p>
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We would be pleased to provide or discuss any additional information you may require. Please feel free to contact me at: [REDACTED].

Yours sincerely,

[REDACTED]

**Peter Bury**

**Director – Strategy, Energy and Research  
Company Secretary**