

12 April 2021

Chemistry Australia Submission: Response to the ACCC's review of the LNG netback price series

Background

1. Chemistry Australia welcomes the opportunity to provide this submission to the ACCC's Review of the LNG Netback Price Series.
2. Chemistry Australia is the peak national body representing the chemistry industry. Chemistry Australia members include chemical manufacturers, importers and distributors, logistics and supply chain partners, raw material suppliers, plastics fabricators and compounders, recyclers, service providers to the sector and the chemistry and chemical engineering schools of leading Australian universities. Chemistry Australia's affiliate members include the Australia New Zealand Industrial Gas Association (ANZIGA) and Australian Paint Manufacturers' Federation (APMF).
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), supplying inputs to 108 of Australia's 114 industry sectors.
4. As independently determined by Acil Allen Consulting in the [Chemical Sector Economic Contribution Analysis](#) report, the business of chemistry contributes \$38 billion annually to Australia's GDP and underpins the employment of hundreds of thousands of Australians due to its role as a critical enabler of almost every industry in Australia. Each of these jobs are important for the families they support and the communities they live in.
5. The Australian chemistry sector underpins more than 1,600 full time equivalent jobs for every petajoule of gas it uses. 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, and 68 times more than the gas-based electricity generation. 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.
6. Gas is used in three ways by small, medium and large chemistry sector companies – as non-substitutable raw material feedstock for larger firms and a source of process heat for steam and other energy needs. 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.

These include:

- Fertilisers and crop protection for farming
- Medical and industrial gases
- PPE, hygiene and cleaning products

- Explosives and other chemicals used in mining
 - Polymers for safe food storage, water storage, piping, irrigation and other infrastructure
 - Water treatment and sanitation chemicals
 - Various chemicals and polymers that are essential for building and construction
7. The ACCC's review of the LNG netback series can play a vital role in reforming and resetting east coast Australia's dysfunctional gas market.

A new netback series - an Australian Domestic Netback Price (ADNP) - is needed as:

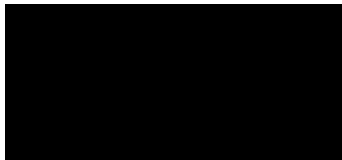
- A central element of the Commonwealth Government's gas-fired recovery plans,
 - To deliver on the commitments by the three Queensland LNG exporters to sell excess gas to the domestic market as agreed in the January 2021 Heads of Agreement with the Commonwealth,
 - A price mechanism in the gas industry Code of Conduct to provide price transparency and to level the playing field during GSA negotiations, and
 - Advance market development and Wallumbilla Gas Hub so traders and market-makers can create the derivative and hedging products to better manage international and domestic gas price risks.
8. Chemistry Australia's view is the ACCC's netback series can be improved in three ways:
- Use Henry Hub as global gas proxy.** The USA is emerging as a significant competitor to Australian LNG exports. USA LNG exports will be the price setter for gas in the Asia Pacific. The current ACCC netback series uses the Japan Korea Marker (JKM). The JKM is a relatively thinly traded 'price survey' by a proprietary service provider. Henry Hub is a fully functioning gas exchange and the world's third¹ largest futures traded commodity. Aligning the netback series would truly internationalise the ACCC netback series allowing gas market participants (LNG exporters, producers, gas consumers) to trade or hedge their domestic gas exposure.
 - Remove sunk LNG capital costs.** Domestic users should not, in fairness, be expected to help underwrite assets from which no benefit is received. This does not occur in any other export commodity market in Australia in regard to prices offered to domestic buyers. The ACCC price series should measure the marginal molecule of gas at Wallumbilla at the centre of the gas rich fields of Queensland. The current methodology includes a significant component or allowance for the capital costs of the LNG projects. Doing so has the effect of inflating the netback price series and sending the wrong price signal to the domestic market. Export capital should pay for export gas. Our recommendation is the ACCC netback series remove all LNG capital costs from its series.
 - Update production and transport assumptions.** As the ACCC has acknowledged, some transport and plant efficiency components in its methodology could be updated.

Please find attached Chemistry Australia's responses to the questions contained in the ACCC's Review of the LNG Netback Price Series Issues Paper.

¹ Source: <https://www.cmegroup.com/trading/energy/nymex-natural-gas-futures.html>

If you require further clarification of any of the points raised in our submission, please do not hesitate to contact me on [REDACTED] or by email at [REDACTED].

Yours sincerely,



Samantha Read
Chief Executive Officer

Attachment: Response to Questions

(A) The length of the forward LNG netback price series

QUESTION	RESPONSE
1. Whether there would be merit in the ACCC publishing a longer-term LNG netback price series.	<p>Yes. Aligned to the USA's Henry Hub (HH), would also allow traders to derive longer-term forward curve from the longer-dated Henry Hub forward curves.</p> <p>We suggest alignment with HH rather than with the JKM which is volatile, has relatively low depth, is not a physical hub but rather a market survey sometimes with few participants and there is no independent monitoring.</p>
2. The most appropriate period, or periods, over which to publish forward LNG netback prices, based on market trends in LNG markets and the east coast gas market.	Ideally, extending the forward series beyond its current 2 years to 3,4,5 and 10 year forward views.
3. Whether the ACCC should publish multiple forward LNG netback prices, based on different periods (to inform pricing for different GSA terms).	Yes, same answer as above.
4. How important it is that the length of the forward LNG netback price series is consistent with the duration of domestic GSAs.	Important. The solution is to align an Australian Domestic Netback Price (ADNP) to Henry Hub which has longer-dated forward curves than the JKM marker.
5. Whether there are relevant market benchmarks for a longer forward LNG netback price series, or methods/approaches to deriving such market benchmarks.	<p>The USA's Henry Hub is a deep liquid market with the sophisticated derivative product and forward curves to allow 24/7 trading and visibility from which daily, weekly, fortnightly price series and forward curves can be derived.</p> <p>As noted above, we suggest alignment with HH rather than with the JKM which is volatile, has relatively low depth, is not a physical hub but rather a market survey sometimes with few participants and there is no independent monitoring.</p>
6. Issues that should be considered in calculating a longer-term LNG netback price series.	ACCC should also consider the public policy needs of the netback series as a price discovery tool for (1) use in the Gas Industry Code of Conduct and (2) commitment by LNG exporters to offer excess gas to the domestic market.

LNG price

QUESTION	RESPONSE
7. The influence of international gas markets on pricing in the east coast gas market.	<p>International gas prices varied markedly in 2020, from deep lows during COVID to spikes during the Northern Hemisphere winter. The temporary fall in gas prices did partially flow through to the domestic market.</p> <p>However, these short-term prices do not assist Australian industry looking to secure longer-term contracts and longer-term gas supplies.</p>
8. The relevance of different international LNG and gas price markers for LNG pricing in key LNG export markets and the east coast gas market.	<p>The most relevant international gas benchmark is the USA Henry Hub, given its role as global gas price proxy.</p> <p>As noted previously, the JKM is volatile, has relatively low depth, is not a physical hub but rather a market survey sometimes with few participants and there is no independent monitoring.</p>
9. Whether the relevance of different LNG and gas price markers is different for short term versus long-term LNG netback prices.	<p>The JKM series is volatile because it is skewed to spot sales - as evidenced by price spikes in January - which skews the ACCC's series.</p> <p>A market-based exchange such as Henry Hub can better accommodate short- and long-term netback methodology given its greater market depth, which all things being equal, is less volatile, and reflects macro gas trends.</p>
10. Whether the relevance of different LNG and gas price markers, for the LNG netback price series, is likely to change over time.	<p>The USA's importance in global and Asia LNG is going to increase in the years ahead and Henry Hub pricing is likely to play a key role in Asia LNG markets.</p> <p>As the ACCC notes in its Netback Issues Paper (page 22) the USA is expected to be the largest LNG exporter by 2025 at over 38 Mtpa (~1850 PJ pa).</p> <p>As noted previously, in contrast, the JKM series is volatile, has relatively low depth, is not a physical hub but rather a market survey sometimes with few participants and there is no independent monitoring.</p>
11. Whether the ACCC should consider additional methodological approaches, such as averaging, to account for the impact of price volatility of price markers on calculated LNG netback prices.	<p>Not necessarily, because averaging can be as complex as the volatility it seeks to solve.</p> <p>Using a marker which is less volatile, such as HH, is a preferable approach. This may counteract the need to consider additional methodologies.</p>

QUESTION	RESPONSE
12. Any other issues that should be considered when determining which LNG and gas reference price should be used for the ACCC LNG netback price series.	Some published price series are aligned to proprietary information providers.

LNG freight costs

QUESTION	RESPONSE
13. Available data sources for longer-term LNG freight rates (beyond a period of two years), and whether the appropriate data source would be different if different international LNG and gas price markers were used to calculate LNG netback prices.	The ACCC could consider longer-dated freight rates sources such as the Baltic Exchange.
14. Whether northeast Asia should be considered the appropriate delivery location for the purposes of estimating LNG freight costs for LNG exported from Gladstone.	Yes
15. Any other issues that should be considered when sourcing longer-term LNG freight rates.	No

Conversion to \$AUD/GJ

QUESTION	RESPONSE
16. Whether the ACCC's current approach to converting FOB LNG prices to \$AUD/GJ is appropriate.	Yes
17. Alternative approaches that should be considered by the ACCC.	N/a
18. Any other issues that should be considered when converting FOB LNG prices to \$AUD/GJ.	N/a

LNG plant costs

QUESTION	RESPONSE
19. Whether the ACCC's current approach to deducting LNG plant and liquefaction costs is appropriate.	No. The result of current methodology is that, as Rod Sims says, 'domestic customers are paying more than overseas customers for Australian gas.' The ACCC methodology can be substantially improved, as outlined in the following responses.
20. How LNG plant and liquefaction costs should be accounted for when calculating the LNG netback price series.	Excluding all capital costs, would be more appropriate and deliver a fairer export parity price. It would ensure that Australian users are not paying for any part of the LNG liquefaction that they do not need or use.
21. Whether different approaches to LNG plant costs should be used for different reference price markers.	Regardless of marker, the series should exclude all capital costs. This will ensure export gas pays for export capital.
22. Whether different approaches to LNG plant costs should be used for short-term and longer-term LNG netback prices.	Regardless of whether the price series is 1,2,5 or 10 years, removing capital costs is the best way to improve the netback series and ensure Australians are charged a fair price.
23. Any other issues that should be considered when accounting for LNG plant and liquefaction costs.	The ACCC should update the operating and capital cost assumptions it uses for the three Queensland LNG plants

Pipeline transportation costs

QUESTION	RESPONSE
24. Whether the ACCC's current approach to deducting pipeline transportation costs is appropriate.	No, these capital cost items should be removed.
25. How pipeline transportation costs should be accounted for when calculating the LNG netback price series.	n/a
26. Whether different approaches to pipeline costs should be used for short-term versus longer-term LNG netback prices.	No
27. Any other issues that should be considered when accounting for pipeline transportation costs	As a broader policy issue, the ACCC should review if pipeline tariffs in general should be lower in a low interest environment for a monopoly or regulated assets which may have already recovered their sunk capital (or written down capital value).