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Australian Competition and Consumer Commission
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By email: LNGnetbackreview@accc.gov.au

ACCC LNG net back price series review
Response to the ACCC draft Decision July 2021

The Major Energy Users (MEU) is pleased to respond to the ACCC gas netback price review process and its Draft Decision dated July 2021.

About the MEU

The MEU was established by very large energy using firms to represent their interests in the energy markets. With regard to all of the energy supplies they need to continue their operations and so supply to their customers, MEU members are vitally interested in four key aspects – the cost of the energy supplies, the reliability of delivery for those supplies, the quality of the delivered supplies and the long-term security for the continuation of those supplies.

Many of the MEU members, being regionally based, are heavily dependent on local staff, suppliers of hardware and services, and have an obligation to represent the views of these local suppliers. With this in mind, the members of the MEU require their views to not only represent the views of large energy users, but also those interests of smaller power and gas users, and even at the residences used by their workforces that live in the regions where the members operate.

It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumers for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

The MEU is disappointed with the draft decision in that the ACCC continues to consider that the net back price should exclude the cost of sunk capital relating to the piping and processing plants used to liquify natural gas for export. The ACCC considers that the approach it uses to generate a price for natural gas, notionally at Wallumbilla, from the LNG spot price is equivalent to a price whereby the LNG exporters are indifferent to acquiring gas for export or selling domestically. The MEU does not agree, as the MEU considers that the netback price as constructed is effectively one where the LNG exporters are indifferent at the point of loading the LNG (ie at the export wharves on Curtis Island .

What is concerning is that the ACCC calculation assumes that the gas exporters sell into the spot market does not recover any capital costs or fixed maintenance costs for spot exports and that the exporters acquire gas from within their own resources[1]. The MEU considers that the ACCC assumptions is incorrect and need to be tested.

To develop the ACCC netback price, the exporters provide their variable costs for processing and the ACCC accepts this as the total costs the exporters incur for delivery of gas above their contracted amounts. In contrast, the MEU considers that the ACCC should be looking for independent valuations for third party processing to provide LNG, in order to identify if the exporters are providing accurate data. The MEU sees that identifying the costs for third party processing is important to assess whether the ACCC assumption that only short run marginal costs should be deducted is valid. This will then clarify the extent to which the base contract costs might cover the sunk costs and what should be deducted from the JKM price to calculate the netback price.

The MEU sees that there are a number of ways to test the ACCC assumption whether additional gas exported does incur any capital cost recovery.

The ACCC (page 8) comments that 40% of the domestic demand is provided by LNG producers[2]. Analysis of the ownership of the LNG exporters does not support this assertion as the three groups owning the six LNG trains on Curtis Island have ownerships different to the providers of gas to the LNG facilities[3]. This means that, while the gas providers for each facility will have certain contracted amounts of gas they are required to deliver to the facilities and at what price, it is the providers of gas to each LNG export facility that effectively decide whether to sell any gas they have available which is in excess gas to their contracted levels, for export or domestic use. This means that the providers of gas to the export facilities might have different contract prices for the additional gas they provide to the facilities. The MEU considers that the ACCC should identify at what prices gas providers (including those contracted to sell gas to the LNG exporters) sell gas to the LNG exporters for additional gas (ie gas above what is formally contracted). This analysis will provide two key pieces of information, viz:

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[1] The ACCC was provided with variable operating and maintenance costs by the exporters which the ACCC deducts from the JKM price adjusted for exchange rate and shipping costs. This would appear to be a simplification of reality. The exporters are incentivised to minimise their advice about these costs as this would increase the setting of the net back price.

[2] Implying that 60% of the domestic demand is from other local providers

[3] QCLNG is owned by Shell and Global Infrastructure Partners Australia with CNOOC and Tokyo Gas having interests in trains 1 and 2 respectively, GLNG is owned by Santos, Petronas, Total and KOGAS and APLNG is owned by Origin, ConoccoPhilips and Sinopec

- What the price the LNG exporters offer for processing additional gas (ie gas that would be sold on the LNG spot market), to identify what the price the LNG exporters charge for processing this additional gas for export.
- The price that the gas producers are indifferent to sell for export or sell domestically. The MEU sees that this price would reflect the price gas producers selling gas domestically receive, including those producers that are required by their agreements with governments to sell their gas to domestic customers.

With this data, the ACCC can identify what the actual cost is levied by the LNG exporters for processing gas additional to their base contracts and so test whether the assumption made by the ACCC that the netback price should deduct some capital recovery or just the variable costs for processing.

As the key driver for developing the netback price was to identify at what price there is indifference between selling gas for export or domestically, the analysis will provide a clear price (which might be different to the current calculated netback price) where producers selling gas from their production fields are actually indifferent to selling for export or domestically.

The netback price is intended to provide a price for domestic supply of gas that is related to the open market. Using third party pricing for processing would provide a price where other gas domestic gas producers[4] are indifferent as to whether they seek to export or sell domestically. The MEU considers the ACCC needs to assess what this price is, perhaps as a second price series as proposed by the EUAA in its presentation to the roundtable forum held on 20 July 2021.

The MEU is aware there are a number of firms around the world actually processing LNG for third parties and the pricing asked by these LNG processing firms is significantly higher than the prices advised by the Gladstone exporters for their variable opex and maintenance. Such parties have already provided processing facilities, so their capital is just as "sunk" as that used by the Gladstone LNG exporters. Specifically, the MEU is aware that Cheniere Energy based in Houston, provides third party processing of gas to LNG (as well as process their own gas) and Woodside offers a similar service from their existing facilities.

The MEU is also aware that the Curtis Island LNG exporters have considered third party processing of gas as well[5]. If this is the case, then the ACCC should identify what this price is, and whether the pricing offered by them for such third-party processing is just the variable operations and maintenance.

If the processing price offered by the Curtis Island exporters is higher than just the variable operating and maintenance cost, this would imply that they see a need to

[4] Including those which have tenements that are designated to produce only gas for domestic use
[5] This is because the LNG trains have a capacity greater than their contracted sales

include recovery of sunk costs in their third-party processing and so a similar recovery of sunk costs would be appropriate in the calculation of the netback pricing.

The MEU is concerned that currently gas producers use the netback price as the floor price for their domestic sales. If the netback price is inflated (as the MEU contends) then the sale price for gas sold domestically needs to be referenced to a cost base that is independent to the netback price calculated by the ACCC. The MEU suggests that the ACCC should use another price comparator such as the Core Energy forward costs for this purpose.

The ACCC proposes to provide longer term netback pricing series by use of an oil-linked approach for projecting price movements outside of the JKM tenor. While the MEU can see that such an approach is valid, the MEU recommends that the outcome should be tested against movements in other gas indices (eg Henry Hub, TTF, NBP) to ensure there is some degree of consistency in the forecast price over time.

The ACCC considers that it can confidently provide a sensible annual netback price for 2 years based on the JKM and to extend the time frame to 5 years. The MEU supports this as it would be of distinct advantage to gas buyers.

The MEU was and remains a strong supporter of this process and we would like to discuss this matter further to explain our views in more detail so we request you contact our Public Officer on [redacted] or at [redacted] to arrange a time for this to occur.

Yours sincerely

[redacted]

David Headberry
Public Officer