



12 April 2021

Mr Rod Sims
Chairman
Australian Competition and Consumer Commission

By email: LNGnetbackreview@accc.gov.au

Review of the LNG netback price series – Issues Paper

Origin welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (ACCC) review of its LNG netback price series. Our views on key aspects of the Issues Paper are provided below, and further information addressing the specific questions raised by the ACCC can be found in Attachment 1.

Purpose of the netback price series

Origin encourages the ACCC to consider the function of the netback price series while reviewing its approach. The LNG netback price is intended to provide an estimate of the value foregone in supplying gas to the domestic market compared to the alternative of exporting it as LNG. It is not intended to represent the price of gas offered into domestic facilitated markets or under bilateral Gas Supply Agreements (GSAs), given there are many factors that influence those prices. As such, any changes to the LNG netback price calculation should be based on improving the accuracy of the short-run opportunity cost estimate, rather than how the calculation is referenced against domestic pricing outcomes.

Consistent with the above, Origin considers fixed costs such as capital expenditure should not be included as they are not considered when making business decisions over short-term timeframes. As rightly identified by the Commission in its current approach, these costs cannot be avoided. Therefore, any alterations would fundamentally change the nature of the netback calculation and no-longer reflect a short-run opportunity cost.

Reference price

The Japan Korea Marker (JKM) futures price remains the most appropriate benchmark for determining LNG netback prices, as it reflects the marginal delivery price of LNG cargoes from Queensland LNG producers. This is evidenced by the fact that the bulk of Australian LNG exports are shipped to northeast Asia – in Q1 of 2021, 88 per cent of LNG cargoes from Australia were delivered to either Japan, China, or Korea¹. The relevance of any other price markers is also already reflected in the JKM futures price, given it captures offers made by other international LNG producers to supply into that market.

Noting the above, directly referencing an alternate price marker would not be reflective of actual LNG deliveries. While market dynamics in the USA do influence international LNG markets, the Henry Hub is a netback price that is influenced by the supply and demand balance of its own geographical area. It does not represent a location where Australian LNG producers deliver their cargoes, and therefore should not be considered in any opportunity cost calculation.

¹ Energy Quest. March 2021 Report. Page 100.

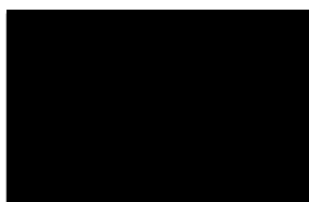
There was some consideration in the Issues Paper that short and medium term oil prices may be considered as a substitute to JKM. However, there is no standard slope calculation to determine the correlation between LNG and oil prices. It is also our understanding these deals are struck infrequently meaning they do not reflect broader market outcomes while their publication may reveal commercially sensitive information.

Length of the forward netback price series

The current netback series is published in line with the availability of liquid JKM prices, which is an important principle that should be maintained. The International Energy Agency (IEA) considers that the growing flexibility of the global LNG market has not yet resolved liquidity issues.² We are therefore not supportive of extending the forward price series beyond the current two-year window, since there is limited liquidity beyond this period which could result in LNG netback price estimates that do not accurately represent expectations of future market outcomes.

If you wish to discuss any aspects of this submission further, please contact Tom Strokon at [REDACTED] or on [REDACTED].

Yours Sincerely,



Steve Reid
Origin Energy
Group Manager Regulatory Policy

² IEA (2021), Asia's record gas prices underline the need to make its markets more resilient, IEA, Paris <https://www.iea.org/commentaries/asia-s-record-gas-prices-underline-the-need-to-make-its-markets-more-resilient>

Attachment 1. Issues paper comments

Issues	Feedback / Comments
Length of the forward LNG netback price series	
Whether there would be merit in the ACCC publishing a longer-term LNG netback price series.	<ul style="list-style-type: none"> The current period is appropriate. Liquidity of monthly JKM futures is limited beyond two years. Reliance on such information may therefore not provide an accurate reflection of actual market outcomes.
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.	
Whether the ACCC should publish multiple forward LNG netback prices, based on different periods (to inform pricing for different GSA terms).	<ul style="list-style-type: none"> As netback prices are not the sole indicator of GSA prices, there are limitations as to how much those estimates can inform domestic outcomes. For example, LNG netback pricing does not account for any plant or transport capacity constraints that may restrict an LNG producer's ability to sell gas internationally or through the terms of a GSA. The delivery periods of LNG cargoes should not be compared to the terms of domestic GSAs. LNG cargoes reflect large volumes of gas delivered instantly, while domestic GSAs reflect long term agreements with averaged daily delivery.
How important it is that the length of the forward LNG netback price series is consistent with the duration of domestic GSAs.	
Whether there are relevant market benchmarks for a longer forward LNG netback price series, or methods/approaches to deriving such market benchmarks.	<ul style="list-style-type: none"> Origin does not consider there are any appropriate methods that could be used to accurately calculate a longer-term LNG netback price.
Issues that should be considered in calculating a longer-term LNG netback price series.	
LNG price	
The influence of international gas markets on pricing in the east coast gas market.	<ul style="list-style-type: none"> As netback prices are not the sole indicator of east coast gas prices, there are limits to which the relevance of international gas markets can be discussed. East coast gas market prices are influenced by several factors including, supply costs, non-price terms and conditions, transportation, historical trends, alternative uses for gas, and timing risk.
The relevance of different international LNG and gas price markers for LNG pricing in key LNG export markets and the east coast gas market.	<ul style="list-style-type: none"> As discussed above, marginal Australian LNG cargoes are primarily sold at JKM prices making it the only relevant price marker for this calculation.
Whether the relevance of different LNG and gas price markers is different for short-term versus long-term LNG netback prices.	

Whether the relevance of different LNG and gas price markers, for the LNG netback price series, is likely to change over time.	<ul style="list-style-type: none"> At this stage it is premature to determine if other price markers will have any relevance in the future.
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.	<ul style="list-style-type: none"> LNG cargoes are sold at spot prices that reflect delivery in a specific month. An averaging approach would therefore not provide an accurate reflection of short-run opportunity costs.
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.	<ul style="list-style-type: none"> As discussed above, Henry Hub is not a relevant point of reference, and there is no standard correlation calculation to convert oil and gas prices.
LNG freight costs	
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.	<ul style="list-style-type: none"> Current freight costs are suitable for measuring the two-year forward JKM netback price. Origin does not consider a longer-term netback price to be appropriate.
Whether northeast Asia should be considered the appropriate delivery location for the purposes of estimating LNG freight costs for LNG exported from Gladstone.	<ul style="list-style-type: none"> The primary LNG export destination for Australia in 2020 was Japan, with other supplies mostly being delivered to Korea and China.³ The freight cost difference between Tokyo and other parts of Asia is not likely to be material enough to warrant a change in the calculation.
Any other issues that should be considered when sourcing longer-term LNG freight rates.	<ul style="list-style-type: none"> The current approach is appropriate.
Conversion to \$AUD/GJ	
Whether the ACCC's current approach to converting FOB LNG prices to \$AUD/GJ is appropriate.	<ul style="list-style-type: none"> The current approach is appropriate.
Alternative approaches that should be considered by the ACCC.	
Any other issues that should be considered when converting FOB LNG prices to \$AUD/GJ.	
LNG plant costs	
Whether the ACCC's current approach to deducting LNG plant and liquefaction costs is appropriate.	<ul style="list-style-type: none"> The current approach is appropriate.
How LNG plant and liquefaction costs should be accounted for when calculating the LNG netback price series.	
Whether different approaches to LNG plant costs should be used for different reference price markers.	

³ Energy Quest. March 2021 Report. Page 100

Any other issues that should be considered when accounting for LNG plant and liquefaction costs.	
Whether different approaches to LNG plant costs should be used for short-term and longer-term LNG netback prices.	<ul style="list-style-type: none"> The LNG netback price is a short-term opportunity cost calculation. Long term capital costs (such as capital expenditure) should therefore not be included, consistent with the ACCC's current approach.
Pipeline transportation costs	
Whether the ACCC's current approach to deducting pipeline transportation costs is appropriate.	<ul style="list-style-type: none"> The current approach is appropriate
How pipeline transportation costs should be accounted for when calculating the LNG netback price series.	
Any other issues that should be considered when accounting for pipeline transportation costs.	
Whether different approaches to pipeline costs should be used for short-term versus longer-term LNG netback prices.	<ul style="list-style-type: none"> As noted above, long term capital cost (such as capital expenditure) should not be included in LNG netback price calculations.