

GGP: Will US LNG Remain Priced Out of Europe?

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When in 2012 Cheniere Energy Inc. broke ground with its first LNG liquefaction plant, it was hailed as the beginning of the end of Russia's pipeline-enforced dominance of the European Union natural gas market. Many expected US LNG and Russian gas to battle it out for the price-setting role in Northwest Europe's liquid gas trade. And many still do.

However, the latest US Department of Energy (DOE) export data available for Cheniere's Sabine Pass export terminal – currently the only operating US LNG export facility – show that in the Louisiana terminal's first 15 months of operation only 7.3% of exports went to the EU, and that not a molecule of US gas was delivered to Northwest European destinations. All the exports within the EU were to Spain, Portugal, Italy and Malta, with 85% of the volumes delivered to the Iberian Peninsula.

In fact, the principal destinations for Cheniere's gas have been South America and the Caribbean, accounting for 42.9% of all exports, and Asia, which took 30%. Mexico was the single largest market for Cheniere's gas, importing nearly three times the total volumes delivered to the EU.

Before exports began, expectations were high that Cheniere's gas would find a home in Europe. Cheniere Marketing International LLP signed two agreements with EDF in 2015 to deliver up to 50 cargoes of LNG to Europe between 2016 and 2018 at prices linked to the TTF. In the same year Cheniere signed an agreement with Engie SA to deliver up to 60 cargoes from 2018 through to 2023.

The market still believes that once US LNG exports start flowing to Europe they will provide a price ceiling for European LNG and a cap on EU pipeline gas prices. Since DOE figures suggest no sales under any of these agreements have been exercised by the end of April, this ceiling may be long time in the building.

Cargoes of Sabine Pass LNG were reportedly delivered to the Netherlands and Poland in June, and a further cargo is expected to be delivered to Lithuania this month, but these all appear to have been spot rather than term deliveries.

The failure of US LNG exports to date to break into Northwest Europe seems entirely due to cost. The weighted average price of US LNG exports under long-term contracts, including liquefaction fees as reported by the DOE for the first four months of this year was \$6.77/mmBTU fob, compared with a spot price of \$6.00/mmBTU on the TTF. Even cargos sold into relatively high-priced Spain in early 2017 were sold at around \$7.00 dlrs/b FOB compared with a domestic MIBGAS market price which averaged \$ 7.30 /mmBTU. Adding freight costs to the FOB costs of these cargos suggests that buyers at very best broke even.

This means that US FOB prices for LNG are broadly higher than inland EU gas prices, particularly in the key North European market. The expected transatlantic arbitrage opportunity is thus all but eliminated, particularly in the face of competitors that can match inland EU prices. The stubborn prevalence of oil-related LNG pricing in a weak oil market, which is long both in oil and LNG, may spread beyond Europe and make US LNG exports equally unattractive in Asia. The average January-April oil-indexed Japanese LNG delivered cost was \$7.65/mmBTU.

It appears that the key hurdle to making US gas competitive is the level of liquefaction fees, which in US contracts are added to the commodity price to give the FOB cost of LNG. While early lifters of LNG from Sabine Pass, including Shell and Spain's Gas Natural, are paying fees of \$2.25-2.50/mmBTU, other contract holders are paying \$3.00/mmBTU, according to Cheniere SEC 10K filings. Buyers of LNG from other US terminals under construction are said to have agreed to pay liquefaction fees of up to \$3.50/mmBTU.

What will it take to change this situation? The existing US LNG formulae will be more attractive than oil-related delivered pricing when three factors combine: low Henry-Hub gas prices; a tight world LNG market; and high crude prices which lift the price of oil-indexed LNG. Absent significant geopolitical upheavals, only the first looks likely over the next few years. In this context, the sponsors of some US LNG projects under development are said to even be considering oil-index pricing alternatives.

The fundamental question is how long contracted buyers of US LNG will be willing to pay a premium to lift US LNG in an oversupplied market rather than buying LNG from more traditionally structured, oil-price-related suppliers such as Qatar or Australia. Major portfolio buyers in Japan and South Korea may be happy with the diversification of supply that US LNG provides, but already Sabine Pass LNG buyers such as India's GAIL are moving to limit their direct exposure to US LNG. Reuters reported in March that GAIL has swapped a significant proportion of its US LNG availability with trader Guvnor in exchange for LNG delivered to India. In June, Reuters reported that GAIL is trying to renegotiate the terms of its contracts with US LNG producers to obtain lower prices.

After all, why pay nearly \$7 for a commodity which is far away when someone will deliver it to your door for a dollar less?

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