Petronas fires Canadian LNG salvo

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MALAYSIAN national oil company Petronas has threatened to delay its planned Pacific NorthWest liquefied natural gas (PNW LNG) export project in Canada by up to 15 years unless a favourable regulatory and fiscal deal is in place by the end of October.

Without greater certainty on the fiscal and regulatory regime for LNG projects, Petronas said it would shelve the $11 billion investment until the the next LNG marketing window, which is expected to open sometime between 2024 and 2029.

"Project economics appear marginal," said the company's chief executive, Shamsul Azhar Abbas.

"The proposed fiscal package and regulatory pace in Canada threatens the global competitiveness of the PNW LNG project," Abbas added.

Petronas hopes to take a final investment decision on the planned 12 million tonnes per year (t/y) scheme by the middle of December.

Christy Clark, British Columbia's premier, said that while talks with Petronas are complex, she remains hopeful a deal will be done.

Petronas said both parties had agreed on clear milestones and actions to meet its mid-December target for final investment approval.

Abbas issued a similar warning in May at an industry conference hosted by the British Columbia government, but his latest threat is the first to include an ultimatum including a specific timeline for potential delays.

British Columbia is drafting its tax-policy guidance for the country's emerging LNG sector, which it has been discussing with Petronas and other developers. Final legislation is expected later this month.

The project's original plan envisaged first cargoes by 2019, which would make PNW LNG the first of the export plants planned for Canada's west coast.

Community benefits

Petronas must also strike a complex benefits deal with aboriginal communities who live near the proposed terminal, which lies just south of Prince Rupert, and with communities affected by the pipeline to the project.

Petronas has been a leading proponent of Canadian LNG after it bought local player Progress Energy. More recently, it began drilling multiple wells to increase the volume of gas reserves, and signed joint-venture deals with four other Asian nations, who will also buy the plant's output.

If the project goes ahead, it will help make Petronas the world's largest supplier of flexible LNG.

Losing the Petronas project would be a major blow to gas-rich Canada, which is trying to launch itself as a global LNG player.

Aside from Canada's low political risk and abundant supplies of gas mainly in Alberta and BC, the country's western coast is well located to supply booming North Asian LNG markets.

LNG carriers from Canada's western shores would take eight days to reach Japan, the world's biggest buyer, compared with 18 days from the Middle East and 22 days from the US through the Panama Canal. But high development costs and uncertainty surrounding British Columbia's regulatory and tax policies means there is a risk of eroding Canada's allure, and Petronas is not the only project that is threatened with delays or cancellation.

Compared with a conventional LNG project, the upstream portion of the cost structure is very high for Canadian LNG developments, many of which draw upon unconventional resources.

As 60% of the overall cost structure of an integrated LNG project is attributed to the upstream development costs, margins are relatively small.

Around 10 LNG export facilities, involving 28 companies including Shell, ExxonMobil and Chevron, have been earmarked for Canada.

Yet none of these have taken a final investment decision and stiff competition from producers in Russia, the US and East Africa, means investment in Canadian LNG is far from certain.

New players

Countries such as Mozambique and Tanzania could be the main players in a new LNG province, although production might not starting flowing until the end of the decade, while Russia's Far East offers the shortest shipping times for LNG vessels to Asian markets.

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And Canadian producers will need to offer attractive pricing, based on hybrid models that would include a gas and crude-based index, to attract Asian buyers.

For decades LNG deals have been linked to oil-indexed prices, but rising competition means emerging producers are offering innovative sales contracts and greater flexibility for buyers.

Lawyers expect price re-negotiation clauses will likely be offered too.

Shinya Miyazaki, chairman of Diamond Gas Management, which is fully owned by Mitsubishi and has a 15% stake in the LNG Canada project spearheaded by Shell, reckons deals will possibly be weighted 60-70% towards Alberta gas prices with the remaining 30-40% tied to oil prices.

Chinese buyers are likely to drive an even harder bargain than those in Japan after the huge Russia-China gas supply deal ironed out earlier this year.

Smaller Asian buyers, such as the Philippines and Bangladesh, are also eyeing British Columbia LNG contracts.

Growing doubts that Canada will become a major exporter of LNG were summed up in an investor note from Goldman Sachs issued in early October.

Lower expectations for growth in global gas demand, combined with the potential for the US to become a major exporter, means Canadian projects are among those most likely to be shelved, the bank said.

"Several projects in Canada and Australia will likely face final investment decision deferrals due to high and uncertain costs, and price-sensitive buyers," Goldman Sachs analysts said. ●