

7 February 2023

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By email: [GasMarketConsultation@treasury.gov.au](mailto:GasMarketConsultation@treasury.gov.au)

**RE: Subject: “Options to ensure the domestic wholesale gas market delivers for Australians” consultation submission**

Dear Sir/Madam,

Please find attached Senex Energy Pty Ltd’s (**Senex**) submission in response to the consultation paper entitled “Options to ensure the domestic wholesale gas market delivers for Australians” released on 9 December 2022 (**Consultation Paper**) and the *Energy Price Relief Plan 2022* passed on 15 December 2022.

This submission has been prepared on the basis of the legislation as passed through Federal Parliament and regulatory actions as described subsequently by the Federal Government and the Australian Competition and Consumer Commission (**ACCC**). Senex understands that the final design of the measures will be informed by responses to the consultation, including the design of the proposed mandatory Code of Conduct (**Mandatory Code**) and its application. As the proposed Mandatory Code has not been made available, adequate consideration of its design is not possible in this submission.

## General comments

It is Senex’s position that the Federal Government’s interventions, as currently presented, will fail to deliver on the criteria they are designed to meet as outlined in the Consultation Paper.<sup>1</sup>

They do not adequately target the underlying causes of high prices; they do not ensure that any lower gas pricing will flow through to intended beneficiaries; and critically, they fail to provide the safeguards required to ensure investment in new gas supply will continue.

To the contrary, they erode investment confidence, undermine efforts for additional gas supply, reduce Australia’s energy security, and risk Australia’s reputation as a reliable energy supplier to its trading partners. The interventions have resulted in energy market uncertainty, severely reduced gas market transactions, caused investment in new gas supply to be suspended, and made the Australian energy market less resilient ahead of cold winters and hot summers, especially in the southern States.

Continued investment in gas supply as an essential part of Australia’s energy security, and in the transition of eastern Australian energy markets, is at risk.

Through this consultation period, it is possible to ensure the above risks, and the Consultation Paper objectives, are adequately addressed and successfully delivered. Senex hopes this is the intention of the Federal Government and is willing to engage in good faith on this basis.

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<sup>1</sup> Consultation Paper, p. 5

## About Senex

Senex entered the Australian gas industry in 2015, supplying gas from the Surat Basin to the domestic market. Senex is not an LNG producer. It has a track record of investing in reliable and affordable gas supply for Australian households and businesses, while supporting jobs, Australian manufacturing and regional economies.

Senex is majority owned by POSCO INTERNATIONAL Corporation, a subsidiary of Korea's POSCO Group, one of Australia's largest natural resource customers and investors. POSCO invested in Senex because it saw value in the Australian energy market and understood Australia to be one of the lowest risk places to invest in energy. These interventions materially challenge this understanding.

## Senex investment plans

In mid-2022 Senex announced plans for a more than \$1 billion investment to bring new gas to the domestic market from the Surat Basin.<sup>2</sup> This planned investment would see Senex producing 60 petajoules (PJ) per year, equivalent to more than 10 percent of annual eastern Australian gas demand. In September 2022, the board also approved plans to further double gas production to 120 PJ per year by the end of 2027 and to extend significant investment across the natural gas value chain.

Following the passing of the gas market intervention legislation in December 2022, Senex was directed by its shareholders to pause investment and associated recruitment pending the finalisation of this consultation.

Further, the intervention derailed Senex's Expression of Interest (**EOI**) process for the sale of 229 petajoules of additional gas to the domestic market from late 2024, which was conducted in good faith and in accordance with the Voluntary Code of Conduct (**Voluntary Code**).<sup>3</sup>

The EOI was heavily oversubscribed, with offers for over 700 petajoules of gas on contract durations of up to 15 years, demonstrating the willingness of seller and buyer to agree satisfactory terms for gas supply.

Senex's EOI process demonstrates there is **no market failure** for gas supply from 2025 and therefore no case for heavy-handed and enduring market intervention.

Unfortunately however, the Federal Government's actions have reinforced unreasonable and unsustainable expectations that intervention will deliver superior terms and conditions (including price) for buyers, resulting in the withdrawal by many buyers from active negotiations and revision of offers. Heavy-handed and enduring market intervention has only served to impede the efficient operation of the market.

If the Federal Government is minded to intervene in energy market regulatory settings, any changes must be **considered, measured, targeted and time-bound**, involving genuine industry consultation and Parliamentary oversight. None of these conditions are evident in the current intervention package as presented by the Albanese Government.<sup>4</sup>

Senex and its shareholders stand ready to invest billions of dollars in new energy supply for Australia, and have the balance sheet strength, capability and capacity to do so. But for this to happen Senex must be confident that the necessary regulatory settings are stable and sufficiently balanced to incentivise the necessary risk-taking of material investment in new gas supply.

Capital is mobile and seeks secure investment environments, and this fact must be respected when decisions to intervene in markets are being contemplated.

In this submission, Senex has set out the requirements to give it the necessary confidence to make these significant investments.

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<sup>2</sup> Senex media release: [Senex to invest more than A\\$1 billion to boost domestic natural gas supply](#)

<sup>3</sup> Voluntary Code of Conduct, 9 August 2022

<sup>4</sup> [Media release from the Prime Minister, Treasurer and Minister for Climate Change and Energy, 9 December 2022](#)

## **Treasury Laws Amendment (Energy Price Relief Plan) Act 2022 (the Act)**

Senex respectfully warned last year that the Act and announced regulatory actions would prove a failed policy solution, effectively curtailing gas supply in the medium and long term.

The only sustainable response to high prices in a demand-inelastic domestic gas commodity market is additional domestic gas supply. The Act instead threatens to suffocate industry investment confidence, likely requiring further interventions in the future – including the breaking of LNG export contracts to divert supplies to the domestic market and damaging relationships with our important trading partners.

### **Natural gas is essential for a transitioning energy market**

Eastern Australia's energy market is complex and finely balanced. Natural gas is required to play an increasingly critical role in providing reliable energy to support Australia's energy security as the nation pursues a very ambitious renewable energy and emissions reduction plan. Further, natural gas is required as a direct input for Australian manufacturing and energy intensive businesses – which face technical barriers to electrification.<sup>5</sup> Natural gas is also critical to Australia's \$100 billion manufacturing industry which directly employs 890,000 people.<sup>6</sup>

Australia's renewable energy commitments will require investment and project execution on an unprecedented scale.<sup>7</sup> Expecting that the required renewables investment will be delivered successfully is a high-risk strategy, with Federal Minister for Climate Change and Energy Chris Bowen himself stating there is a need to ensure there is enough gas supply to play its important role as a flexible fuel in peaking and firming through the transition.<sup>8</sup>

Further, the Australian Energy Market Operator (**AEMO**) has reaffirmed the critical importance of gas in the transition, describing gas in its 2022 Integrated System Plan as having a crucial role for decades as a reliable and flexible stabiliser for the electricity grid.<sup>9</sup>

The consequence of reduced investment in new supply is the diminution of the critical safety net gas provides if the large-scale renewable energy build-out does not go according to plan.

### **Massive continued investment needed**

The eastern Australian gas market requires continued multibillion-dollar investments to keep supply up and prices down. When investment slows, or is not allowed to progress, such as in Victoria or New South Wales, gas supplies decrease and prices increase. Senex's proposed Atlas expansion is an ideal example of the domestically-focused investments required to deliver new supply and put downward pressure on prices.

In December 2022, Prime Minister Anthony Albanese said, *"there is no impact on new investments of any proposition that went through the Parliament"*,<sup>10</sup> while Resources Minister Madeleine King's spokesperson said *"the [gas price] cap did not apply to new projects such as Atlas"*.<sup>11</sup>

Whilst the interventions as passed by Parliament do not reflect these statements, we trust that there is a genuine intention and willingness from the Federal Government that new investment in gas supply such as Atlas (and its expansion) will be supported, consistent with statements made last year by the Resources Minister calling for more gas fields to be unlocked, stating more supply as the "best solution" in the face of a "very concerning" gas shortage.<sup>12</sup>

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<sup>5</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, p. 22

<sup>6</sup> [Policy issues - Manufacturing with gas | APPEA](#)

<sup>7</sup> [Minister for Climate Change and Energy Chris Bowen speech at the AFR Energy & Climate Summit, 10 October 2022](#)

<sup>8</sup> [Chris Bowen interview with Renew Economy's Energy Insiders Podcast, 20 December 2022](#)

<sup>9</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, p. 33

<sup>10</sup> Prime Minister Anthony Albanese [Transcript](#) 23 December 2022

<sup>11</sup> ABC News *Senex Energy Says its Gas Expansion has been put on hold after [energy cap announcement](#)* of 22 December 2022

<sup>12</sup> [Minister King speech, 11 August 2022](#)

## **Proposed regulatory steps must be more focused**

Senex does not agree that the current eastern Australian domestic gas price situation warrants heavy-handed and ongoing regulatory intervention (especially noting Senex's EOI process outcomes outlined above). Nonetheless, if the Federal Government is set on this course, it is important that regulation is **considered, measured, targeted and time-bound** and does not disincentivise gas supply into the domestic market.

As such, Senex urges the Federal Government to focus on utilising the regulatory and contractual tools already at its disposal, amended and strengthened as required, including the Heads of Agreement process and the Australian Domestic Gas Security Mechanism.

Importantly, focus on improvement of these existing instruments avoids collateral damage to domestically-focused producers such as Senex, which are a critical part of the required solution to domestic gas prices.

Further, small commercial and industrial customers remain overwhelmingly reliant on gas retailers to supply their energy needs. These customers are located in distribution networks generally dominated by an incumbent gas retailer and cannot easily access wholesale gas supply, with upstream gas suppliers generally unable to sell gas directly to these users.

Given the Federal Government's stated aim to provide lower energy prices for consumers, any suite of regulation must include proper accountability for retailers, re-sellers and other intermediaries to ensure reduced wholesale gas commodity prices are passed through to end-users.

## **Conclusion**

Senex does not agree that the current eastern Australian domestic gas price situation warrants heavy-handed and ongoing regulatory intervention, and has substantial concerns with the approach adopted by the Federal Government.

In this submission, Senex has set out a series of recommendations in order to give it the necessary confidence to make significant investments in new gas supply in eastern Australia. We welcome the opportunity to work collaboratively with the Federal Government to ensure key objectives and intervention criteria are met for the benefit of all Australians, whilst avoiding unintended and damaging consequences in eastern Australia's complex energy system.

Thank you for the opportunity to provide this submission. Please do not hesitate to contact me on [GasMarketConsultation@senexenergy.com.au](mailto:GasMarketConsultation@senexenergy.com.au) for further consultation or discussion.

Yours sincerely,

**Ian Davies**  
**Chief Executive Officer**  
**Senex Energy Pty Ltd**

## Consultation Submission

# Options to ensure the domestic wholesale gas market delivers for Australians



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# 1. Executive Summary

Senex firmly believes that the Federal Government's unprecedented intervention in the wholesale gas market, as currently presented, is misguided and will result in less gas, a less reliable electricity system, fewer jobs, a reduction in manufacturing capacity, and a weaker Australian economy.<sup>13</sup>

The ACCC states this intervention has been informed by six years of work and study.<sup>14</sup> However, the supporting material provided to date contains no evidence that price control measures applicable to all producers are an appropriate response to the issues identified.

Senex fully supports measures to provide relief to Australian households and businesses from rising energy prices, as well as efforts to ensure adequate supply of gas to support Australia's energy system transformation. However, the intervention as currently presented works against these objectives. There are other, more targeted and effective solutions available.

The only sustainable response to high prices in a demand-inelastic domestic gas commodity market is additional domestic gas supply. The intervention has created a climate of sovereign and commercial risk that now jeopardises new investment in existing and undeveloped natural gas fields, including Senex's proposed more than \$1 billion expansion. Beyond these immediate investment plans, Senex had planned to invest significant additional capital across the natural gas value chain.

Australia needs clear, targeted and effective energy policy that enables the confidence to invest across the energy value chain, and ensures Australians can access secure, reliable and affordable energy for manufacturing, businesses and homes, as Australia's electricity sector transitions to renewables.

Senex presents the following issues and recommendations for consideration.

## 1.1. Continued investment in eastern Australian gas supply is critical. This intervention threatens to suffocate industry investment confidence.

- Eastern Australia's gas and electricity energy markets are inextricably linked.<sup>15</sup> At present, the electricity system is usually firmed with coal and hydro driven supply, with natural gas playing a supporting role and firming when coal and hydro are not available.<sup>16</sup> Aside from this important role in electricity generation, natural gas is a direct input for a range of manufacturing and commercial uses and provides a source of heating for residential dwellings.<sup>17</sup>
- The nation is set on an ambitious decarbonisation plan over the coming decade, which will see closures of coal fired power stations, electrification of residences and businesses, and a truly heroic build-out of renewable power generation and associated transmission and distribution infrastructure.<sup>18</sup> The unprecedented scale and speed of this change demands a reliable contingency plan if things do not go according to plan, substantially increasing the importance of natural gas in firming the electricity system.
- Further, natural gas is required as a direct input for Australian manufacturing and energy intensive businesses – which face technical barriers to electrification.<sup>19</sup> Natural gas is also critical to Australia's \$100 billion manufacturing industry which directly employs 890,000 people.<sup>20</sup>

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<sup>13</sup> Consultation Paper, p. 4, states "Current low levels of competition between producers, high prices and risks of supply shortages warrant the inclusion of a reasonable pricing provision within the code." The logic in this statement cannot be supported. Price controls reduce investment, reduce competition by intentionally harming domestically-focused gas producers, reduce supply, increase demand and therefore do nothing to reduce high prices, however do exacerbate "risks of supply shortages".

<sup>14</sup> [Gas super profits can 'fund exploration', says Gina Cass-Gottlieb | The Australian](#)

<sup>15</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, pp. 31 - 33

<sup>16</sup> AER, State of the Energy Market 2022, p. 37, 38, 40

<sup>17</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, p. 6

<sup>18</sup> See Step Change Scenario from AEMO, 2022 Integrated System Plan, June 2022; NSW Department of Planning, Industry and Environment, NSW Electricity Infrastructure Roadmap, November 2020; QLD Department of Energy and Public Works, Queensland Energy and Jobs Plan, September 2022

<sup>19</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, p. 22

<sup>20</sup> [Policy issues - Manufacturing with gas | APPEA](#)



- Long-forecast declines in historic southern gas production basins, and moratoria on Victorian and New South Wales onshore gas development are leading inevitably to an increased reliance on Queensland gas production.<sup>21</sup> It should be noted that material continued annual investment in Queensland's Surat Basin is also required to simply maintain production levels due to natural reservoir decline.
- Accordingly, jeopardising investment in new gas supply for eastern Australia will have extremely serious implications for Australia's energy security, threatening jobs and industry, as well as community acceptance of a rapid transition to renewables.

## 1.2. **The intervention fails to focus on the linkage between domestic and international markets as the key driver of domestic gas prices, and its broad application intentionally harms domestically-focused gas producers seeking to support Australia's energy security. Further, the intervention does not ensure reduced wholesale gas commodity price savings are passed through to end-users.**

- Unregulated international gas markets and contracting has exposed domestic customers to competition from international buyers. The Federal Government cites international price pressures caused by Russia's war in Ukraine as the primary reason for rising electricity and gas prices in Australia, triggering the need for market intervention.<sup>22</sup>
- As such, if heavy-handed regulation is considered necessary, Senex urges the Federal Government to focus on utilising the regulatory and contractual tools already at its disposal, amended and strengthened as required, including the Australian Domestic Gas Security Mechanism<sup>23</sup> and the Heads of Agreement,<sup>24</sup> which will better support achievement of the Federal Government's objectives in the gas market.
- Importantly, a focus on improving these existing instruments avoids collateral damage to domestically-focused producers such as Senex, which are part of the required solution to domestic prices. Domestically-focused producers make new investments in the Australian market to provide net supply into the domestic market.<sup>25</sup>
- Without more measured and targeted regulatory steps, domestically-focused gas producers who are genuinely ready and willing to invest in new domestic supply will be harmed, facing materially disproportionate regulatory and financial risks, including risks to investment funding.
- Without more measured and targeted regulatory steps, the competitive market power of incumbent LNG exporters will only increase.
- In addition, domestic wholesale gas price outcomes may not be passed through to key consumer segments (such as small commercial and industrial customers) unless accountability to do so is placed on all retailers, re-sellers and other intermediaries in the gas supply chain.<sup>26</sup> Without adequate accountability across the whole of the supply chain, returns merely shift from gas producers to other market participants who share none of the risk or cost associated with exploring for, developing, and producing the gas commodity. Senex notes that simple extension of the proposed Mandatory Code to retailers and re-sellers may not be an appropriate tool for such

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<sup>21</sup> ACCC, Gas Inquiry 2017 – 2025, Interim Report July 2022 (July 22 Interim Report), p. 28

<sup>22</sup> Consultation Paper, p 4

<sup>23</sup> Customs (Prohibited Exports) Regulations 1958, Div 6

<sup>24</sup> Heads of Agreement: The Australian east coast domestic gas supply commitment (Sept 2022)

<sup>25</sup> See ACCC, Gas Inquiry 2017-2030, Interim Report January 2023 (January 23 Interim Report), p. 11

<sup>26</sup> ACCC, January 23 Interim Report, p. 35 cites average prices offered by producers between Mar-Aug 2022 for 2023 supply at \$19.77/GJ, with average prices offered by retailers for C&I users for the same period (gas component only – excluding retail costs) at \$20.01/GJ. Given the supply of gas to retailers by producers for 2023 on-supply to retail customers will have been contracted by retailers prior to this offer period, the prices paid by retailers in the wholesale market would have been significantly lower (the same ACCC source cites Jan 2021 to Feb 2022 producer offers for 2023 supply averaging \$8.56-\$10.51). Conclusion: wholesale price outcomes secured by retailers are not passed through to their customers, rather the prices charged by retailers (for the gas commodity component only) closely mirror "market" prices, reflecting rational commercial behaviour.



accountability due to the structure and operation of businesses in that part of the gas supply chain compared to the wholesale market.<sup>27</sup>

**1.3. Whatever form the proposed Mandatory Code takes, Part IVBB of the *Competition and Consumer Act 2010 Cth* (CCA), inserted by the *Treasury Laws Amendment (Energy Price Relief Plan) Act 2022* (the Act) represents an ongoing threat to investment because it is so wide ranging.**

- Presently, the scope and remit of the proposed Mandatory Code is unknown. Regardless, Part IVBB of the CCA (**Part IVBB**) contains the potential for ongoing and wide-ranging interference in the wholesale gas market if the proposed Mandatory Code is drafted so as to permit a power for the issue of further legislative instruments by any Minister, the regulator or staff members of the ACCC or Australian Public Service.<sup>28</sup> The potential for further “rules” to be made in addition to a Mandatory Code, or future amendments to the Mandatory Code, undermines any regulatory stability and predictability that the Mandatory Code may offer, even with the parliamentary registration and disallowance process providing a degree of oversight.
- Part IVBB does not require the Mandatory Code to preserve the terms of gas supply agreements once they have been entered into and there is nothing in Part IVBB that ensures the Mandatory Code will not have retrospective powers. While the Consultation Paper provides that once a contract is agreed, any disputes will be governed by the relevant contract, it is unclear this provision will be implemented and maintained in the Mandatory Code.<sup>29</sup> This undermines foundational elements of an efficient, functional economy and the rule of contract – the ability for parties to set out the rules of their relationship in a binding contract.
- In passing the Act, the Federal Government has signalled a willingness for substantial intervention in functioning markets, without genuine consultation. The advice on which the intervention is based fails to provide compelling or logical justification for the extent or nature of the intervention.<sup>30</sup>
- Investment risk of this magnitude will result in reduced investment as mobile capital finds alternative opportunities in more secure environments, with reduced investment leading to reduced supply.
- Part IVBB threatens to suffocate industry investment confidence, likely requiring further interventions in the future – including the breaking of LNG export contracts to divert supplies to the domestic market and damaging relationships with our important trading partners.

**1.4. Price regulation of a competitive market is an inappropriate and disproportionate regulatory measure that will result in a distortion of the market price signals needed to bring on new supply, while providing limited prospects that policy objectives will be met.**

- An uncertain price setting regime will act as an inaccurate price cap, exposing producers to pricing at, or below, the regulated price, but not at prices exceeding it. This will expose the producer to only downside risk, but without the compensatory upside risk associated with inherently high-risk exploration and resource production sector investment. This will mean, on average, the regulated price will not reflect the producer’s long run marginal cost. The reason the regulated price is a cap

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<sup>27</sup> Consultation Paper, p10, references retailers’ “different cost structures”. Senex notes this is an inadequate rationale to not implement significant accountability and surveillance measures to ensure savings are passed on, and should be the subject of further consultation.

<sup>28</sup> See Sections 53P and 53ZI of Part IVBB of the CCA.

<sup>29</sup> For example, there is nothing in Part IVBB that prevents the Mandatory Code from enabling a buyer who has entered into a gas supply agreement (whether before or after the introduction of the Mandatory Code) to utilise a mandatory dispute resolution mechanism to seek a lower gas price at any time, for any reason, including by termination of the entire agreement and then acquisition of gas from an alternative source. This is notwithstanding the original terms of the agreement upon which the gas producer made its investment decision in reliance on the projected revenue stream from that agreement.

<sup>30</sup> See Sections 4.3.1 of this submission

is illustrated by assuming rational buyer behaviour to seek the lowest possible price in two simple scenarios:

- When, but for the regulated price, the "market price"<sup>31</sup> would have exceeded the "regulated price", gas buyers will obtain the regulated price, which may be guaranteed through arbitration.
- When the buyer expects the "market price" to be less than the "regulated price", they will either negotiate for the market price or seek market price through the spot markets instead of engaging with gas producers.
- The price regulation and arbitration regime (as currently described) appears to provide no way for the contract price to reflect the specific circumstances or risk positions of the respective parties, or other value add components of contracts. This underscores that the price regulation applying in other non-competitive market segments for homogenous services is ill-suited to a competitive market which offers a range of products and services and on a range of terms, many of which are desired by customers willing to pay for them.
- The application of price control to all gas producers, being a competitive market segment, is contrary to economic and regulatory practice and theory.<sup>32</sup> Attempts to apply price regulation, which is normally reserved to monopoly infrastructure, to such a market ignores the diverse nature of services and products provided under gas contracts.<sup>33</sup> Such misapplication of price regulation will stifle contractual negotiations and remove the efficiencies provided by a competitive market – efficient allocation of a scarce resource and signals for new investment.
- Neither the Federal Government nor the ACCC has provided evidence that the eastern Australian wholesale gas market displays the type of monopoly characteristics that should be subject to the sort of price regulation proposed in the Mandatory Code. In addition, no evidence has been provided of the principles (economic or otherwise) upon which the decision to impose price regulation on all gas producers is based.
- Decisions to adopt price regulation for a particular market segment or assets within that segment have historically been made following a thorough review,<sup>34</sup> and/or based on principles contained in legislation, with recommendations on regulation made by independent entities.
- There is no modern example of price regulation in an analogous competitive market that the Federal Government can point to in support of its actions. Price regulation has (largely) been confined to monopolistic markets in Australia. Attempts to liken the gas price regulation to the eastern Australian retail electricity market or the European Union and United Kingdom gas market rules are unconvincing, and are incomparable for a range of reasons.<sup>35</sup>
- During times when, but for the regulated price, the "market price" would have been higher than an estimated regulated price, arbitration, or even the mere threat of arbitration, will become the primary means by which wholesale gas prices are set, rather than being a fallback mechanism.<sup>36</sup> This will drive a range of behaviours and outcomes contrary to the stated aims of the intervention including concentration of sales to a smaller group of customers.<sup>37</sup>
- In addition, the proposed price setting mechanism will be excessively difficult to apply in practice and will not in any case arrive at the theoretically pure pricing that the ACCC believes it should.<sup>38</sup>

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<sup>31</sup> In this context, "market price" means that price that may exist in the absence of the regulated price as a result of domestic gas supply and demand balance, one indicator of which could be the spot market price

<sup>32</sup> Refer section 6.3.3 of this submission, and footnotes 94-98 inclusive

<sup>33</sup> Refer section 6.3.2 of this submission

<sup>34</sup> For example, in respect of Australian energy markets, see Industry Commission, Report No.11 (Energy Generation and Distribution), May 1991

<sup>35</sup> Refer section 6.3.4 of this submission and footnotes 105 to 106

<sup>36</sup> Page 9 of the Consultation Paper proposes a Code without setting limits on when a buyer can unilaterally initiate arbitration, and on what terms and conditions can be the subject of such arbitration

<sup>37</sup> In circumstances where a producer faces the prospect of multiple expensive and time consuming arbitration proceedings, and there is no differentiation between customers (other than credit quality) because there can be no price differentiation under the Mandatory Code, a producer would rationally limit the number of Gas Sales Agreements it makes.

<sup>38</sup> Refer sections 6.3.5 and 6.3.6 of this submission

- Senex does not believe price control measures are appropriate in these circumstances, and instead supports promotion of additional supply and competition between suppliers through the various means identified by the ACCC in its July 2022 gas inquiry report.<sup>39</sup>
- Further, Senex urges the Federal Government to focus on utilising the regulatory and contractual tools already at its disposal, amended and strengthened as required, including the Heads of Agreement process and the Australian Domestic Gas Security Mechanism. Importantly, focus on improvement of these existing instruments avoids collateral damage to domestically-focused producers such as Senex, which are a critical part of the required solution to domestic gas prices.

### 1.5. Process failures

- The lack of consultation in respect of the Act undermines the regulation process. Despite months of commentary, no genuine consultation was undertaken in advance of the suite of interventions proposed on 9 December 2022. Subsequently labelling two business days as a “consultation period” for the Act<sup>40</sup> displays a lack of genuine intent to consult with those most affected by the intervention.
- Senex understands that the final design of the measures will be informed by responses to the consultation, including the design of the proposed Mandatory Code and its proposed application. As the Mandatory Code has not been made available to date, adequate consideration of its design at this stage is not possible.<sup>41</sup> Nonetheless, Senex has responded based on its understanding of the Mandatory Code’s objectives and high-level principles.
- Senex expects that the proposed Mandatory Code, when released, will be open for consultation for an adequate and reasonable period and that genuine consideration will be given to comments made by industry. We believe a thorough and comprehensive consultation process is essential to ensure additional foreseeable issues are raised and addressed.
- Senex trusts that the Federal Government will receive the recommendations set out below as being a genuine attempt to assist in ensuring the primary objectives of the intervention are met<sup>42</sup> – lower energy prices for consumers, and more investment and gas supply for the domestic market. Senex supports the Federal Government in creating the regulatory environment necessary to facilitate investment.

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<sup>39</sup> ACCC, July 2022 Interim Report, p. 14 - 15

<sup>40</sup> Refer [Options to ensure the domestic wholesale gas market delivers for Australians | Treasury.gov.au](https://www.treasury.gov.au/consultation-papers/consultation-paper-ensure-domestic-wholesale-gas-market-delivers-for-australians)

<sup>41</sup> Refer [Options to ensure the domestic wholesale gas market delivers for Australians | Treasury.gov.au](https://www.treasury.gov.au/consultation-papers/consultation-paper-ensure-domestic-wholesale-gas-market-delivers-for-australians)

<sup>42</sup> See page 5 of the Consultation Paper for the criteria the intervention is intended to meet

## 1.6. Recommendations

Senex and its shareholders stand ready to invest billions of dollars in new energy supply for Australia, and have the balance sheet strength, capability and capacity to do so. But for this to happen Senex must be confident that the necessary regulatory settings are stable and sufficiently balanced to incentivise the necessary risk-taking of material investment in new gas supply.

In this submission, Senex has set out the requirements to give it the necessary confidence to make these significant investments.

### **Recommendation 1** (*repeal or amend Part IVBB of the CCA*):

- a) *Repeal*: repeal Part IVBB of the CCA, and utilise existing regulatory and contractual instruments referred to in Recommendation 2; or
- b) *Amend*: undertake a genuine consultation process on draft amendments to Part IVBB sufficient to instil certainty for gas market participants as to the future operation of Part IVBB, including as to matters that may be the subject of future legislative instruments.

In the absence of (a) or (b), investors may require a bi-lateral agreement with Federal and/or State Governments before proceeding with material new investments.

### **Recommendation 2** (*utilise existing regulatory and contractual instruments*):

If the Federal Government is set on its course to impose heavy-handed regulatory intervention, utilise existing regulatory and contractual instruments, amended and strengthened as required, including the Heads of Agreement process and the Australian Domestic Gas Security Mechanism, without extending regulatory, economic and competition burden to domestically-focused producers. Regulatory intervention must be considered, measured, targeted and time-bound.<sup>43</sup>

### **Recommendation 3** (*competition reform, not price controls*):

Should a Mandatory Code be introduced to all producers and consumers, eliminate price controls from the Mandatory Code and promote gas supply investment and competition, including through the measures identified by the ACCC in its July 2022 Interim Report<sup>44</sup>.

### **Recommendation 4** (*ensure contract sanctity*):

Should a Mandatory Code be introduced, in order to preserve the basis on which investment decisions are made, the Mandatory Code should apply to both producers and consumers, and cease to apply to a contract once that contract has been entered into. That is, the Mandatory Code should only apply to pre-contractual conduct, with the contract terms to govern the relationship between the parties. This should be enshrined in Part IVBB.

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<sup>43</sup> Noting Senex's EOI process demonstrates there is no market failure for gas supply from 2025.

<sup>44</sup> ACCC, July 2022 Interim Report, p. 14 - 15

**Recommendation 5** (*limit arbitration*):

Should a Mandatory Code be introduced, limit the instance and extent of arbitration. Basic and reasonable measures should be included to limit the instance and extent of arbitration outcomes on these matters by ensuring:

- a) Arbitration is only available pre-contract (which is consistent with the Consultation Paper) and after a specific offer is made by a producer to an individual customer that includes volume, level of take or pay, load factor and price;
- b) the scope of arbitration is limited to those matters where the producer's offer to an individual customer deviates from the previously indicated non-binding terms provided by a customer; and
- c) the scope of arbitration does not extend to determination of the terms and conditions of an agreement.

**Recommendation 6** (*ensure savings are passed through to end-consumers*):

Address governance and accountability of the whole energy supply chain, including retailers, re-sellers and other intermediaries, to ensure domestic wholesale gas market commodity price savings are fairly passed through to end-consumers.

## 1.7. Consultation questions

Senex does not agree that the current eastern Australian domestic gas price situation warrants heavy-handed and ongoing regulatory intervention, and has substantial concerns with the approach adopted by the Federal Government. Accordingly, Senex has not provided specific responses to the questions outlined in the Consultation Paper, noting that the responses to these questions' intent are adequately covered by the content of this submission.

Senex expects that the proposed Mandatory Code, once released, will be open for consultation for an adequate and reasonable period and that genuine consideration will be given to comments made by industry. We welcome the opportunity to work collaboratively with the Federal Government to ensure key objectives and intervention criteria are met.

## 2. Assessment against criteria for intervention

The Consultation Paper contains a list of criteria for intervention.<sup>45</sup> Senex provides its assessment and response to the intervention criteria below.

Criteria for Intervention	Senex assessment / response
<b><i>Be effective at limiting increases in domestic wholesale gas prices.</i></b>	<p><b>Achieved in the <u>short-term only</u>. Not achieved in the medium to long-term.</b></p> <ul style="list-style-type: none"> <li>In the short-term, the benefit of price control (in particular the Price Order) will flow to other supply chain participants such as retailers. Large customers may benefit from price control in the short-term, but there is no certainty that key customer segments such as small commercial and industrial customers will benefit from lower prices in the wholesale market.</li> <li>In the medium to long-term, <u>all gas consumers</u> (including electricity markets) will be worse off as new investment is deterred and supply is reduced.</li> <li>Pricing in eastern Australia's domestic gas market is a function of supply. Part IVBB of the CCA, the Gas Market Emergency Price Order (the <b>Order</b>) and a reasonable pricing provision (<b>RPP</b>) disincentivises investment and thus supply. This will result in less supply and continued increases to domestic wholesale gas prices.</li> </ul>
<b><i>Be targeted and fit-for purpose, to minimise any distortionary impacts in energy markets and related markets.</i></b>	<p><b>Not achieved.</b></p> <ul style="list-style-type: none"> <li>The intervention more broadly, and the Mandatory Code specifically, is neither correctly targeted nor fit-for purpose despite the ACCC identifying specific conduct of concern.</li> <li>The Mandatory Code and RPP is proposed to apply to <b>all</b> projects of <b>all</b> producers (i.e. is not targeted) and customers in the wholesale market. It is not clear whether the Mandatory Code will apply to other participants in the wholesale market (retailers, re-sellers and other intermediaries), risking opportunities for arbitrage.</li> <li>Price regulation of the upstream gas market will place an inaccurate cap on the prices at which buyers and seller will transact. This will distort price signals for investment, further jeopardising the delivery of new supply.</li> </ul>
<b><i>Allow producers to make a reasonable return on investments, to ensure sufficient domestic supply and diversity of suppliers.</i></b>	<p><b>Not achieved.</b></p> <p><i>Reasonable return on investments, and ensuring sufficient domestic supply</i></p> <ul style="list-style-type: none"> <li>Price regulation based on a uniform hypothetical new entrant will not identify the return investors require across different projects as participants do not have the same capital structures and systemic risks, and project characteristics differ substantially.</li> </ul>

<sup>45</sup> Consultation Paper, p. 5

	<ul style="list-style-type: none"> <li>• The regulated price will expose producers to downside risk, but not the upside risk associated with a project.</li> <li>• Producers will be unable to price the uncertainty of the regulatory regime in the contract price.</li> <li>• These issues present disincentives to invest, leading to reduced investment and reduced domestic supply.</li> </ul> <p><i>Diversity of suppliers</i></p> <ul style="list-style-type: none"> <li>• The intervention will disincentivise current and new suppliers from bringing new gas to the domestic market, resulting in less supply and less diversity.</li> <li>• Senex built a gas supply position organically and from nothing, and can assure the Federal Government that a new entrant that has most, if not all, of its assets subject to the uncertainty introduced by Part IVBB, has its prospective customer contracts subject to being reopened and repriced, and has its financing dependent on the security of its customer contracts, will not invest or obtain finance in this investment environment.</li> </ul>
<b><i>Retain incentives for future investments to develop and bring gas to market.</i></b>	<p><b>Not achieved.</b></p> <ul style="list-style-type: none"> <li>• Senex is unable to see any interpretation of Part IVBB and associated instruments that could be interpreted as preserving investment incentives.</li> <li>• The potential for ongoing and wide-ranging interference in the wholesale gas market, the prospect of customer contracts being reopened and repriced at any time, exposure to only downside risk, an inability to understand and model proposed returns on investments and the prospect of lengthy and ill-considered arbitration make for clear disincentives to invest.</li> </ul>
<b><i>Be capable of being implemented in a clear, workable way which does not create excessive uncertainty or undermine the functioning of the gas market</i></b>	<p><b>Not achieved.</b></p> <ul style="list-style-type: none"> <li>• The passing of the Act in its current form represents the very embodiment of uncertainty from a gas market perspective.</li> <li>• The effects of the uncertainty are already presenting in the market with both buyers and sellers paralysed and awaiting further guidance on the form, detail and application of the Mandatory Code.</li> <li>• Senex has not currently seen evidence that the contemplated arbitration processes can be implemented without imposing significant administrative and commercial burden on participants.</li> <li>• A regulated price ignores the complexity of contractual negotiations and terms that underpin commodity sales in many circumstances. Regulated prices will reduce productive market activity and efficiency.</li> <li>• The above points amount to an excessive level of uncertainty which is undermining the proper functioning of the gas market.</li> <li>• Senex believes other, less distortionary actions can be taken.</li> </ul>



<p><b><i>Allow producers to continue to meet their existing contractual obligations, including long-term foundational contracts with international partners.</i></b></p>	<p><b>Not achieved.</b></p> <ul style="list-style-type: none"> <li>Part IVBB does not prevent a Mandatory Code from applying to existing contractual arrangements, thereby creating uncertainty as to the standing of existing contracts (e.g., the ability to reopen and re-negotiate terms including price). We understand (and expect) this is not the intention. Contract sanctity is currently expressly <i>not</i> assured in Part IVBB.</li> </ul>
<p><b><i>Support Australia's emissions reduction target and the transition of our domestic energy markets</i></b></p>	<p><b>Not achieved.</b></p> <ul style="list-style-type: none"> <li>Part IVBB, the proposed Mandatory Code and RPP substantially increases investment risk that will directly lead to reduced new gas supply.</li> <li>AEMO has described gas in its 2022 Integrated System Plan as having a <u>crucial role</u> for decades as a reliable and flexible stabiliser for the electricity grid.<sup>46</sup></li> <li>Reduced investment in new gas supply will result in the diminution of the critical safety net gas provides if the Federal Government's ambitious renewable energy build-out does not, for whatever reason, go to plan, and increased emissions from other forms of energy that are inevitably required and sourced in Australia and overseas.</li> <li>It should be of the highest priority for the Federal Government to secure sufficient gas supply to safeguard eastern Australia's electricity for households and businesses. Part IVBB and associated instruments make the transition of eastern Australia's energy system substantially riskier.</li> <li>Reduced gas supply risks a retrograde step in the energy transition akin to what is being observed in Germany where there is a return to coal for energy security due to a lack of gas supply and associated generation to reliably firm renewables.<sup>47</sup></li> </ul>

<sup>46</sup> AEMO, 2022 Gas Statement of Opportunities, March 2022, p. 33

<sup>47</sup> Bloomberg, 'Germany Revives Coal as Energy Security Trumps Climate Goals', December 2022

### 3. Analysis and explanation of key issues

The following sections provide further analysis and supporting external data in respect of each of the issues identified by Senex in the Executive Summary.

#### 4. **The intervention fails to focus on the linkage between domestic and international markets as the key driver of domestic gas prices, and its broad application intentionally harms domestically-focused gas producers seeking to support Australia's energy security. Further, the intervention does not ensure reduced wholesale gas commodity price savings are passed through to end-users.**

##### 4.1. Summary of the issue

- Unregulated international gas markets and contracting has exposed domestic customers to competition from international buyers. The Federal Government cites international price pressures as the primary cause for rising electricity and gas prices in Australia, triggering the need for market intervention.
- The Mandatory Code is proposed to apply to all gas producers. Such application ignores that:
  - The commercially rational behaviour of those producers with access to both the domestic and international gas markets creates a linkage between domestic and international markets, driving the current pricing concerns.
  - Some downstream gas chain participants (eg, re-sellers of gas, retailers and power generators) are exempt from price controls and there is no guarantee that consumers or small commercial and industrial (C&I) end users will benefit from the full effect of price controls when they are applied to producers only.
  - Domestically-focused producers – critical for investment in new eastern Australian 'net supply'<sup>48</sup> – will bear the bulk of the regulatory and financial burden imposed by the intervention, as they do not have direct access to unregulated international export markets.
- The regulatory intervention does not include measures to ensure that critical downstream market participants (eg, retailers and re-sellers) pass through lower wholesale pricing. This means there is limited likelihood that the regulatory intervention will sustainably address the policy issue of higher domestic prices as the intervention will merely shift returns from gas producers to other supply chain participants.
- This inappropriate targeting of regulation that includes domestically-focused gas producers will result in less investment and less competition, leading to less supply, higher prices and the inevitable need for further intervention.

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<sup>48</sup> See ACCC, January 23 Interim Report, p.11

## 4.2. Description of the issue

**Interventions are intended to target high prices borne out of structural market conditions and perceived competition issues.**

Both the Consultation Paper, and the Summary of ACCC Advice to Government<sup>49</sup> (**ACCC Advice**) identify that the Mandatory Code is intended to deal with two policy issues:

- Increases in gas and electricity prices...which are expected to continue, arising from international gas and LNG markets;<sup>50</sup> and
- Low levels of competition between producers.<sup>51</sup>

### **The Mandatory Code to apply to all gas producers.**

Given the broad drafting of Part IVBB (Subdivision B) and the lack of limitation to the Mandatory Code's potential application (section 53P), there is almost no certainty as to what matters may be included in the Mandatory Code, nor the extent to which they may be applied.

The Consultation Paper states that:

- the Mandatory Code will apply to **all domestic gas producers** in their negotiation of wholesale gas supply contracts;
- the Mandatory Code will include a reasonable pricing provision (**RPP**) that will apply to the first sale of gas by producers in the eastern Australian region, so would not apply to gas sold at the wholesale level by other market participants like retailers, which have different cost structures, therefore excluding pertinent participants in the gas supply chain;<sup>52</sup>
- the Mandatory Code will build on the existing Voluntary Code and will place obligations on both **producers and buyers** of gas in the domestic wholesale market. These obligations include those related to the way parties conduct themselves in negotiations, information disclosure, and some minimum terms and conditions; and
- broader application of the Mandatory Code to wholesale gas contracts sold by other market participants will be considered and informed by the ACCC's advice and responses to the Consultation Paper.<sup>53</sup>

In addition, the Mandatory Code is proposed to also contain an arbitration process for the resolution of pre-contractual disputes that is generally available on all terms of gas supply contract negotiations, including price.<sup>54</sup>

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<sup>49</sup> Summary of the Australian Competition and Consumer Commission Advice to Government, undated and issued with the Consultation Paper on 9 December 2022.

<sup>50</sup> Consultation Paper, p. 4; ACCC Advice, pp. 1, 2

<sup>51</sup> Consultation Paper, p. 4; ACCC Advice, p. 4

<sup>52</sup> Consultation Paper, pp. 9, 10

<sup>53</sup> Ibid, p. 9

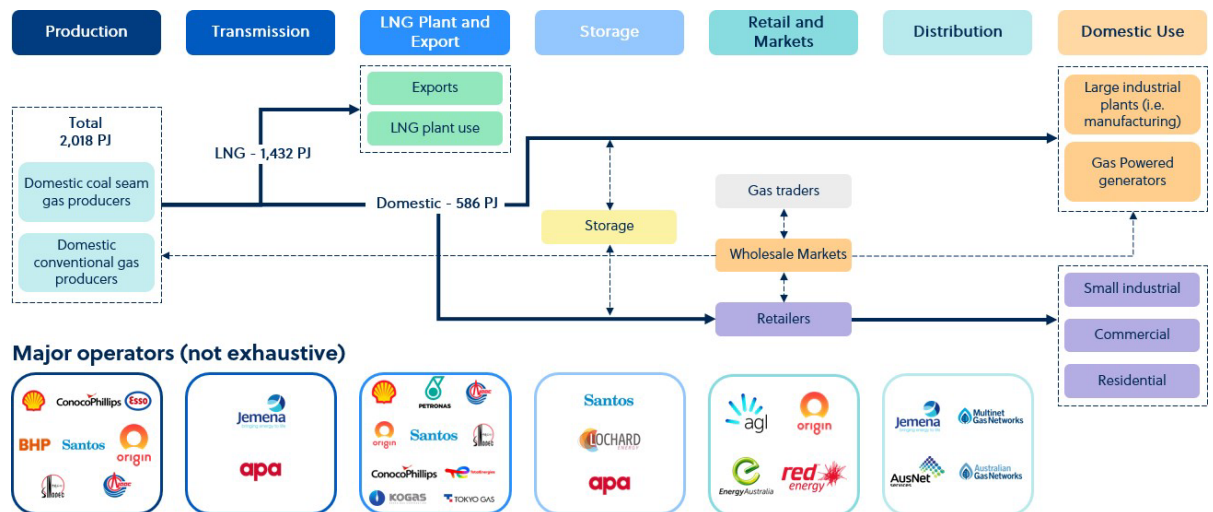
<sup>54</sup> Ibid, pp. 9, 13

### 4.3. Impacts and consequences

#### 4.3.1. Untargeted regulatory intervention on all producers merely shifts returns to other supply chain participants.

The eastern Australian gas supply chain involves a range of participants who each play a necessary role in getting the gas to its end user and contribute to gas prices for that user (see Figure 1).

Figure 1: Eastern Australian gas supply



Source: adapted and based on information from AER, State of the Energy Market 2018.<sup>55</sup>

However, the ACCC Advice is entirely concerned with the returns of gas producers, noting that, “gas producers stand to make windfall gains from the all-time highs in international gas and LNG prices stemming from a decline in Russian gas supply leading up to and following the conflict in Ukraine.”<sup>56</sup>

In turn, the analysis contained in the ACCC Advice is materially deficient in attending to how pricing, and hence returns, are flowing in the gas supply chain:

- The ACCC Advice presents data reflecting offers for supply in 2023<sup>57</sup> (see Figure 2 below). This data indicates there have been numerous offers for 2023 supply below the price ordered cap of \$12/GJ even shortly after Russia’s invasion of Ukraine.

<sup>55</sup> Production and demand figures sourced from AER, State of the Energy Market Report 2022. Major producers and LNG exporters sourced from ACCC, July 2022 interim report, pp. 99 – 100. The three gas exporters in Australia are APLNG (a Joint Venture between ConocoPhillips (47.5%), Origin (27.5%) and Sinopec (25.0%)), QCLNG (a Joint Venture between Shell (73.8%), CNOOC (25.0%) and TokyoGas (1.3%)) and GLNG (Santos (30.0%), Petronas (27.5%), Total (27.5%) and Kogas (15.0%)). Major producers have been identified as those with an actual or implied market share of at least 5%. Implied market shares were calculated for businesses operating under a joint venture. Major storage providers were identified by AEMO, Gas storage facilities Eastern and South Eastern Australia, 2015 and AFR, QIC lodges \$967m claim against EnergyAustralia over Iona gas plant sale, 2017. Major retailers identified by AER, Retail energy market performance update, Dec 2022 and ESC, Victorian Energy Market Report 2019-20, 2020. BHP share of eastern Australia production now held by Woodside.

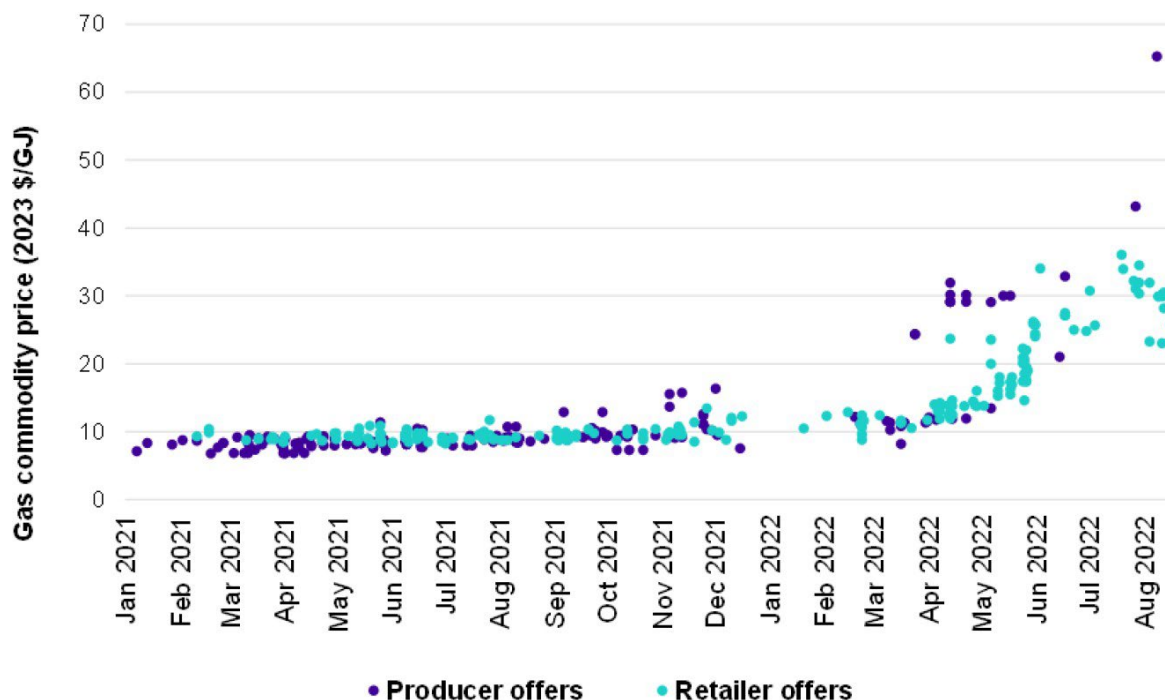
<sup>56</sup> ACCC Advice, p. 2

<sup>57</sup> ACCC Advice, p. 1

- In fact, in the ACCC Gas Inquiry 2017 – 2025, Interim Report July 2022 (**July 2022 Interim Report**) the following statement was made regarding recent supply agreements for 2023 supply:

*"The average price payable for 2023 supply in recent Gas Supply Agreements (GSAs) in the southern states is expected to be \$9.25/GJ for supply by producers, and \$10.01/GJ for supply by retailers. The average price under GSAs with producers in Queensland is expected to be \$7.37/GJ."*<sup>58</sup>

**Figure 2: Copy of Chart 1 of the ACCC Advice: Gas commodity prices (2023\$/GJ) offered in the east coast gas market for 2023 supply<sup>59</sup>**



- The ACCC Advice fails to consider why demand for 2023 delivered gas would be left uncontracted despite nearly 18 months of sub \$12/GJ offers to customers by sellers. The advice certainly does not reference, in any way, the ACCC's own findings with respect to actual supply contracts for 2023 made in its July 2022 Interim Report.
- Furthermore, the ACCC Advice offers no explanation for why, if supply for 2023 has been largely contracted at less than \$10/GJ, retail usage tariffs for all retail customers are approaching \$40/GJ in 2023.

The ACCC's analysis overlooks the role that retailers and re-sellers are playing in the high prices being currently experienced by gas customers. Properly targeted regulatory intervention should look through the supply chain and at retail and re-seller conduct to ensure wholesale gas market price savings are flowing through to end consumers.

If accountability to pass through wholesale gas market pricing to customers is not placed on retailers and resellers, there is limited likelihood that the returns removed from domestic producers via price regulation will flow through to intended end-customers. As such, the intervention will not meet the policy objectives of lowering prices for end-customers of electricity, gas, and goods.

<sup>58</sup> ACCC, July 22 Interim Report, p. 12

<sup>59</sup> ACCC Advice, p. 1

Although Senex does not believe the intervention will drive lower wholesale domestic gas prices (any lower prices will be despite the intervention, not because of the intervention), if there is any price relief it is not guaranteed to extend to certain customers such as small commercial and industrial businesses. Increased accountability for retailers and re-sellers to pass through lower wholesale gas prices will be required.

#### **4.3.2. Domestically-focused gas producers who are critical for investment in new domestic 'net-supply' will disproportionately suffer the impacts of regulatory intervention**

Domestically-focused producers like Senex are contributors to 'net supply' in eastern Australia.<sup>60</sup> Domestically-focused producers do not have access to the export market – and therefore must 'meet the market' domestically in order to sell gas.

In contrast, large gas producers with direct access to export markets give rise to the internationally linked equilibrium domestic gas price:

- LNG exporters, acting in the capacity of domestic gas producer, will make an economically rational decision to preference the export market unless the domestic gas price represents a competitive alternative; and
- LNG exporters, acting as a domestic gas buyer, make an economically rational decision to compete for incremental cheaper supply from the domestic market to sell into a higher priced export market (subject only to their obligations under the Heads of Agreement (HoA) and Australian Domestic Gas Security Mechanism (ADGSM), if triggered).

There is nothing in the Consultation Paper or intervention package<sup>61</sup> that indicates that these large, internationally linked, producers will be forced to supply sufficient volumes of gas into the domestic market. The significant differences between producers operating in the upstream gas market in terms of access to multiple markets will mean that the regulatory intervention will have a disproportionate regulatory and financial impact on domestically-focused producers.

Without more measured and targeted regulatory steps, domestically-focused gas producers who are genuinely ready and willing to invest in new domestic supply, and which are part of the required solution to domestic prices, will become collateral damage.

#### **4.3.3. Increased concentration of gas suppliers, reducing competition.**

The ACCC identified in its Gas Inquiry 2017 – 2030, Interim Report January 2023 (January 23 Interim Report) that LNG exporters, and their associates have influence over 90% of 2P reserves in the east coast market.<sup>62</sup> This is in addition to having a 78% share (2020-21) of actual production.<sup>63</sup>

Placing a disproportionately heavier regulatory burden on domestically-focused producers will exacerbate the concentration of participants in favour of larger incumbents who are better able to tolerate the regulatory risk environment (and who are less impacted by the regulatory intervention). This will allow these producers to continue their participation in the market while smaller, domestically-focused producers are forced to exit the industry or are unable to develop new supply, resulting in less competition. This is contrary to the stated objective of the intervention to 'allow producers to make a reasonable return on investments, to ensure sufficient domestic supply and diversity of suppliers.'

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<sup>60</sup> ACCC, January 2023 Interim Report, p. 11

<sup>61</sup> Key documents contained on Treasury [website](#): Options to ensure the domestic wholesale gas market delivers for Australians

<sup>62</sup> ACCC, January 2023 Interim Report, p. 7

<sup>63</sup> ACCC, July 22 Interim Report, p. 98

5. **Whatever form the proposed Mandatory Code takes, Part IVBB of the CCA, inserted by the Act, represents an ongoing threat to investment because it is so wide ranging.**

5.1. **Summary of the issue**

- Part IVBB contains the potential for future wide-ranging interference in the wholesale gas market. It allows for the Mandatory Code to be drafted in such a way that it gives powers to any Federal Minister, the Regulator and even staff members of the ACCC or Australian Public Service to issue further legislative instruments.<sup>64</sup>
- There is nothing in Part IVBB that requires the Mandatory Code to preserve the terms of gas supply agreements once they have been entered into and there is nothing in Part IVBB that ensures the Mandatory Code will not have retrospective effect.
- In passing the Act, the Federal Government has signalled a willingness for substantial intervention in functioning markets, without genuine consultation, setting a concerning precedent.
- Accordingly, Part IVBB entrenches instability into the framework within which gas investment decisions are made.
- Investment risk of this magnitude will result in less new gas supply, which is profoundly concerning when set against a backdrop of forecast supply reduction from aging sources in the medium term.
- Lower supply will drive further intervention, potentially resulting in breaking international contracts to divert supplies to the domestic market, energy rationing in Australian homes and industry, and intervention in other parts of the economy that impact gas demand.

5.2. **Description of the Issue**

The Act introduces “Part IVBB – Gas Market” into the CCA and sets out an extremely broad range of matters that are either required or permitted to be prescribed by gas market emergency price orders or included in a gas market code<sup>65</sup> (**Code Provisions**).

The Code Provisions empower the Minister and the ACCC to dictate to Senex, via a gas market code, who it must (and must not) offer or sell gas to, when Senex offers, sells and does not sell gas, and the terms on which it offers or sells such gas (including price, volume, location and flexibility).<sup>66</sup> Section 3 of Schedule 1, Part 1 of the Act expressly provides that, for the purpose of new Part IVBB, it does not matter whether an agreement was entered into before, on or after the commencement of the Act.<sup>67</sup> Senex is concerned that the combined effect of the foregoing is that binding contracts, freely entered into, can be overridden by force of a code.<sup>68</sup>

The Competition and Consumer (Gas Market Emergency Price) Order 2022 (the **Order**) was made by the Minister on 22 December 2022. That order and/or any subsequent order will terminate on 23 December 2023, unless repealed earlier.

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<sup>64</sup> See Sections 53P and 53ZI of Part IVBB.

<sup>65</sup> See Sections 53M and 53L of Part IVBB.

<sup>66</sup> Subdivision B of Part IVBB (Matters that gas market codes may deal with) Sections 53P-53W; Subdivision C of Part IVBB (Matters that gas market emergency price orders may deal with) Sections 53X-53Y; and Subdivision D of part IVBB (Incidental and other matters that gas market codes and gas market emergency price orders may deal with) Sections 53Z-53ZI.

<sup>67</sup> Section 3 of Schedule 1, Part 1 of the Act.

<sup>68</sup> Sections 53S and 53T of Part IVBB.



The intervention material released on 9 December 2022 contained principles intended to be included in a Mandatory Code to be issued under Part IVBB of the CCA. At the time of writing, no draft Mandatory Code has been released, but we understand it is imminent and will have no time limit to its application.

### 5.3. Impacts and consequences

#### 5.3.1. Wide-ranging interference in the wholesale gas market.

Presently the scope and remit of the proposed Mandatory Code is unknown. However, whatever its terms, Part IVBB contains potential for future wide-ranging interference in the wholesale gas market. A gas market code may include rules regulating “gas market conduct” which is an extremely broad concept; it incorporates anything to do with the supply or purchase of gas.

Senex is concerned that Part IVBB effectively allows for almost unlimited regulation of anything to do with the supply and purchase of wholesale gas. This enables an extraordinary and unprecedented level of Federal Government intervention into, and effective control of, a functioning market segment.

Senex cannot take any comfort that the provisions of the Order or Mandatory Code issued pursuant to Part IVBB may have a more narrow or defined application, because the Orders and Mandatory Code can be modified at any time; Part IVBB refers to “codes” in the plural. Further, Part IVBB contains potential for future wide-ranging interference in the wholesale gas market.<sup>69</sup> It allows for the proposed Mandatory Code to be drafted in such a way that it gives powers to any Federal Minister, the Regulator and even staff members of the ACCC or Australian Public Service to issue further legislative instruments.<sup>70</sup> The potential for amendments or further “rules” to be made in addition to a Mandatory Code undermines any stability and predictability that the proposed Mandatory Code may offer, even with the parliamentary registration and disallowance process providing a degree of oversight.

Part IVBB does not prevent the introduction of a Mandatory Code that could:

- re-open already executed contracts agreed between willing and sophisticated counterparties, including contracts that were already on foot prior to commencement of the Act.<sup>71</sup> If a customer contract may have its key terms and conditions replaced by a third party based on as yet unknown rules then the entire basis of contracting (i.e., to provide certainty) falls away. In such circumstances, gas producers have no incentive to negotiate contracts;
- unilaterally force gas producers into a lengthy mediation or arbitration process, and ultimately force them to supply gas, regardless of whether they have gas to sell, at a price determined by a third party.

The Consultation Paper indicates the objective of a code is to guide the behaviour of domestic gas producers during the negotiation of wholesale gas supply contracts (that is, pre-contract).<sup>72</sup> Part IVBB goes well beyond that by not prohibiting a Mandatory Code that applies to executed contracts.

While broad enabling legislation may not be unusual, the passing of the Act, and the manner in which it occurred, has above all else signalled an inclination by the Federal Government to intervene in otherwise functioning markets in a wide-ranging and permanent way and Senex has no confidence that the broad provisions of Part IVBB will be sensibly and consistently applied.

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<sup>69</sup> Up until 23 December 2023 in the case of orders, but ongoing in the case of codes.

<sup>70</sup> See Sections 53P and 53ZI of Part IVBB.

<sup>71</sup> Sections 53S and 53T of Part IVBB, and Section 3 of Schedule 1, Part 1 of the Act.

<sup>72</sup> Consultation Paper, p. 9

### **5.3.2. Substantially increased investment risk.**

In making a decision to invest in new gas supply to eastern Australia's domestic market, a company like Senex carefully balances the expected reward against the myriad of risks taken. Prior to this intervention, gas producers faced escalating risks to new supply compared to previous years. This included increasingly burdensome and lengthy approvals processes, land use competition, the potential for legal challenge, and a policy environment designed to shorten the useful lives of fossil fuel projects (which typically run for decades following extremely large upfront investment).

Shrinking availability of finance from debt and equity markets and decreasing appetite from insurers – in each case driven by changing attitudes toward investment in fossil fuel projects – has further increased the difficulty of successfully executing new gas supply projects.

Senex is well-versed in making investment decisions in environments that are uncertain, but in which the rules of the game are consistent. This allows the investor to take a view on a market, confident that the framework within which such views are being taken is (relatively) stable, and that low return periods will be offset by high return periods throughout more than two decades of the asset's life.

However, Part IVBB entrenches instability into the framework within which gas investment decisions are made. The speed, manner and extent of intervention legislated by the Federal Government means, from an investor perspective, that any assurances from the Federal Government as to further regulatory interference must be viewed with scepticism.

Senex and its shareholders, who are being asked to put their capital at risk, will be required to take a view on investment while bearing substantially elevated regulatory risk.

### **5.3.3. Reduced new supply of gas.**

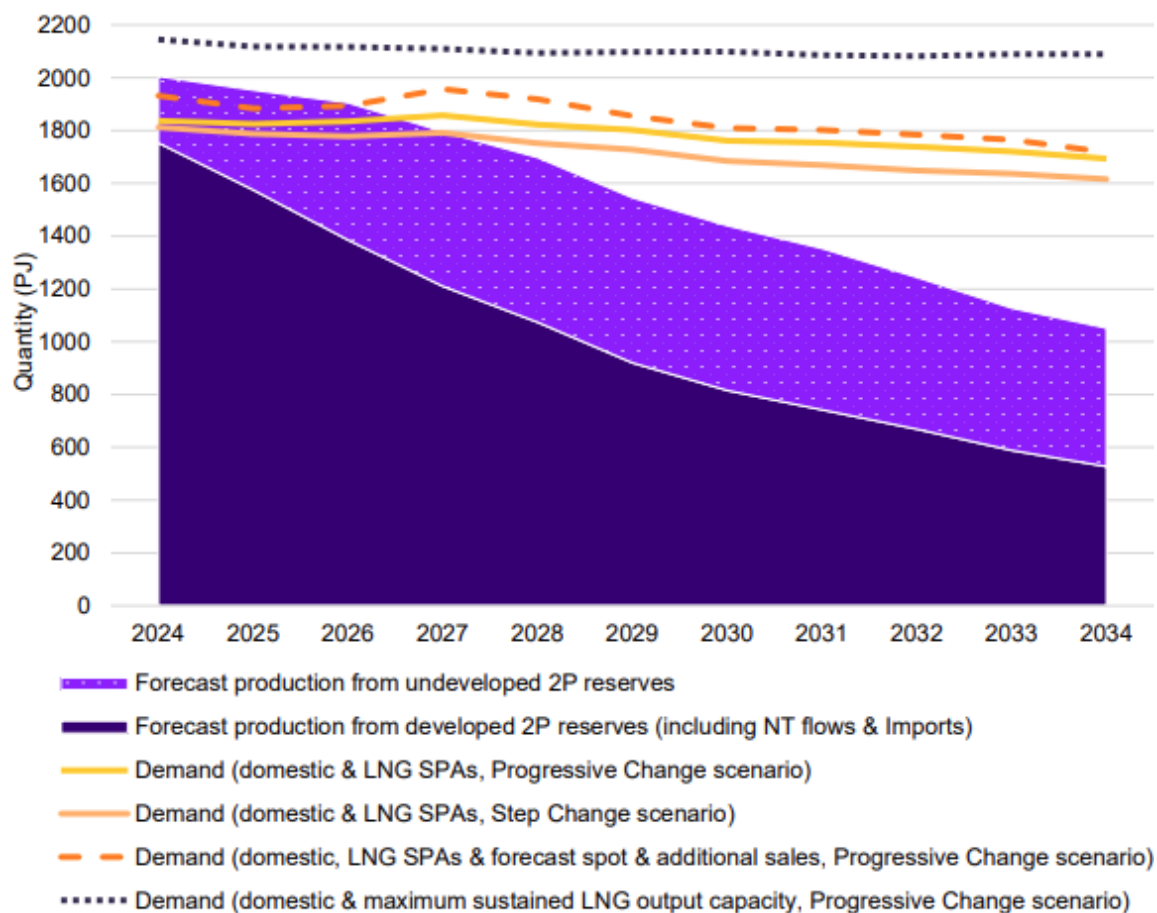
The natural consequence of increased investment risk of the magnitude introduced by Part IVBB is reduced new supply of gas. Eastern Australia has been forecast for years to be approaching a supply shortage in the medium term as traditional sources of gas in southern States decline. The eastern Australian gas market is facing a "projected 30 PJ shortfall in supply in 2023"<sup>73</sup> and structural shortfalls from next year without new investment.

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<sup>73</sup> ACCC, January 2023 Interim Report, p.8

Figure 3: Copy of Chart O.4 of ACCC January 2023 Interim Report<sup>74</sup>

**Chart O.4: Forecast supply from 2P reserves and demand in the east coast, 2024–34**



Source: ACCC analysis of data obtained from gas producers as at August 2022 and domestic demand from AEMO's March 2022 GSOO.

Despite the various pro-renewable energy policies in place, demand for gas in eastern Australia is widely recognised to persist for decades, both as a fast start form of electricity generation to firm intermittent renewables, and as an essential feedstock to the industrial and mining sectors.<sup>75</sup> Given the lead times for development of new supply, disincentivising investment is fraught with risk.

#### 5.3.4. Intervention leads to more intervention.

As the ineffectiveness of Part IVBB and the proposed Mandatory Code in meeting their stated objectives becomes clearer, and as gas shortages emerge in eastern Australia over time, the Federal Government will be left with few alternatives to rectify the situation. More intervention is likely, resulting in export volumes being diverted into the domestic market (since domestic supply has been discouraged), potentially breaking international contracts. This may be complemented

<sup>74</sup> ACCC, January 2023 Interim Report, p.18

<sup>75</sup> AEMO, 2022 Integrated System Plan, p. 52; AEMO, 2022 Gas Statement of Opportunities, March 2022, pp. 6,7

by more “emergency price orders”, rationing and intervention in other parts of the economy that influence gas demand such as electricity generators, coal miners and manufacturers.

#### **5.3.5. Buyer behaviour is reinforced, eroding the proper functioning of the market.**

The propensity that the Federal Government has shown to not only intervene in a functioning market, but to do so without responsible consultation, has reinforced gas buyer expectations that the Federal Government will intervene whenever terms and conditions of supply are unsatisfactory to them. This expectation drives buyer behaviour that further erodes the proper functioning of the eastern Australian gas market through:

- Buyers withdrawing from active negotiations with suppliers. Senex has seen its EOI process for the sale of gas volumes from 2024 derailed as potential buyers have withdrawn. This EOI process was being conducted in strict accordance with the existing Voluntary Code and was demonstrably on track for the sale of substantial long-term volumes at prices acceptable to both buyers and seller.<sup>76</sup>
- Undermining of EOI processes through submission of bids well below market price based on public signalling through the media of what the Federal Government may or may not introduce through intervention.<sup>77</sup>
- Declining to participate in EOI campaigns in expectation of Federal Government intervention.

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<sup>76</sup> Senex would be willing to disclose the relevant supporting evidence for this statement to the ACCC under suitable confidentiality undertakings should it be necessary.

<sup>77</sup> 30 October 2022: Former ACCC chairman Rod Sims calls for east coast prices to be limited to less than \$10/GJ. Source: [AFR](#)  
28 October 2022: “A \$10/GJ price cap would be pretty fair and reasonable,” Andrew Richards, CEO of the Energy Users Association of Australia. Source: [The Guardian](#)

**6. Price regulation of a competitive market is an inappropriate and disproportionate regulatory measure that will result in a distortion of the market price signals needed to bring on new supply, while providing limited likelihood that policy objectives will be met.**

**6.1. Summary of the issue**

- The choice of a regulatory response to an identified issue should seek, as precisely as possible, to address the cause of such identified issue. The ACCC and Federal Government have failed to correctly target the cause of high prices, and so seek to apply an inappropriate regulatory solution to ALL gas producers.
- There are a range of alternative ways that higher prices could be dealt with – but over-regulation through price regulation will distort the very market signals necessary to deliver investment and supply.
- An uncertain price setting regime will act as an inaccurate price cap, exposing suppliers to only downside risk, disincentivising investment and new supply.
- Applying price regulation normally reserved to monopoly infrastructure to a competitive market ignores the diverse nature of services and products provided under gas contracts.
- The proposed price setting mechanism will be excessively difficult to apply in practice and will not in any case arrive at the theoretically pure pricing that the ACCC believes it should.
- During times when, but for the regulated price, the “market price”<sup>78</sup> would have been higher than an estimated regulated price and the producer and customer do not agree on price, arbitration will become the primary means by which wholesale gas prices are set, rather than being a fallback mechanism.<sup>79</sup> This will drive a range of behaviours and outcomes, including threatened arbitrations, that will be contrary to the stated aims of the intervention.<sup>80</sup>

**6.2. Description of the issue**

As proposed, the Mandatory Code will have the capacity to impose price setting regulation on all domestic gas contracts related to first sale of gas.

The Consultation Paper and ACCC Advice identify that regulated price setting under the Mandatory Code will be intended to reflect the “efficient long run marginal costs of domestic supply”<sup>81</sup>, and will be determined with reference to the cost of the “most likely new domestic gas production to meet forecast domestic demand”.<sup>82</sup> The Mandatory Code, including the price setting elements, would apply only to “first sale of gas”.<sup>83</sup>

Gas contract prices could be set via arbitration in the event of a pre-contractual dispute between a gas buyer and seller.<sup>84</sup> It is presently unclear what requirements the buyer or seller will need to satisfy before seeking arbitration, or what may constitute a ‘dispute’ within the meaning of that described in the Consultation Paper. In addition, the Consultation Paper provides that the regulated price will be assessed

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<sup>78</sup> See footnote 31

<sup>79</sup> Page 9 of the Consultation Paper proposes a Code without setting limits on when a buyer can unilaterally initiate arbitration, and on what terms and conditions can be the subject of such arbitration

<sup>80</sup> In circumstances where a producer faces the prospect of multiple expensive and time consuming arbitration proceedings, and there is no differentiation between customers (other than credit quality) because there can be no price differentiation under the Mandatory Code, a producer would rationally limit the number of Gas Sales Agreements it makes

<sup>81</sup> ACCC Advice, p. 3

<sup>82</sup> Consultation Paper, p. 10

<sup>83</sup> Ibid, p. 10

<sup>84</sup> Ibid, p. 10

using what appears to be a 'building block model', that takes into account the operating expenditure, depreciation, return on capital, and tax allowance (and royalties).<sup>85</sup>

### 6.3. Impacts and consequences

#### 6.3.1. The regulated price will act as a uniform floating price cap, exposing producers to only downside risk

Based on the wording in the Consultation Paper, the proposed operation of the regulated pricing provisions of the Mandatory Code will mean that arbitration could be initiated unilaterally by either the buyer or seller, and a price set for the cost of the gas commodity under the contract.

This regulated pricing mechanism appears to have been proposed by the ACCC, and will be set by the ACCC, on the basis of what the ACCC believes is an adequate return ("a reasonable return on capital") to the gas producer over the life of the relevant production project.<sup>86</sup>

The ACCC is not a gas producer, nor is it ordinarily a pricing regulator.<sup>87</sup> There is no suggestion that there will be a process by which the pricing it sets may be challenged or subject to review. In that respect what is proposed is not akin to the current methodology and framework of Part IIIA of the CCA.

Leaving aside the range of reasons why the regulated pricing approach does not, and cannot, accurately reflect an adequate return for a gas producer taking into account assumed risks (see sections 6.3.5 and 6.3.6 below), the implicit assumption is that an appropriate regulated price is received for all product over the life of the relevant project.

However, based on the information provided in the Consultation Paper the practical outcome of the proposed price regulation in the Mandatory Code is that the seller will not receive the regulated price for all production and so, on average, will not achieve the "reasonable return on capital" anticipated by the ACCC. This is because:

- the price the producer receives will be recalculated each time the producer wishes to enter into a new contract with a customer (or, potentially, amends an existing contract with an existing customer);
- The customer will (rationally) seek to obtain gas at the lowest possible price:
  - a) When, but for the regulated price, the "market price"<sup>88</sup> would have exceeded the regulated price, they will obtain the regulated price, which may be guaranteed through arbitration with the producer. The same result may be obtained simply by threatening arbitration thereby avoiding the costs of engaging with producers via that means.
  - b) When the customer expects the "market price" to be less than the regulated price, they will seek to obtain gas at that market price either through negotiation with the producer or the spot market (instead of engaging with gas producers).
- Under scenario (b), if the gas producer wishes to engage with the market, it is exposed to pricing outcomes below the regulated price and/or a production profile different to that assumed in the calculation of the regulated price (given the producer's choice is to either sell at the lower market price or curtail production).
- Should the regulated price be updated annually, Senex expects many customers may gamble on there being a "better price next year" and seek only short-term contracts. Short-term contracts do not support, nor act as an incentive to, long term investment as returns are not guaranteed over the long term.

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<sup>85</sup> Ibid, p. 10

<sup>86</sup> Ibid, p 4

<sup>87</sup> Compare the role of IPART, a specialist independent pricing Tribunal, for example, with that of the ACCC.

<sup>88</sup> See footnote 31

Given the above, the regulated price, even if only intended to be a “reference” price or pricing guide, will act as a floating cap on the contract prices available to producers. This will expose the producer to only downside risk, but without the compensatory upside risk associated with inherently high-risk exploration and resource production sector investment. This will mean, on average, the regulated price will not reflect the producer’s long run marginal cost.

Senex also expects the regulations will be applied inconsistently between customers and gas producers thus inhibiting a gas producer’s ability to achieve the regulated gas price where it may be greater than the prevailing market price.

This asymmetrical risk profile underscores that this form of regulation fundamentally misunderstands the investment environment for upstream gas production, as investors take a view on long-term pricing based on long-run marginal cost of production, but expect actual pricing to fluctuate above and below marginal costs due to market forces. The intervention targets the long-run marginal cost of production becoming the regulated price, but, as described above, investors can expect periods of pricing below the regulated price, but none above it, decreasing prospective rewards.

Given that the regulated price appears to change over time (potentially each time an arbitration process is conducted), investors will have no ability to accurately forecast the prices at which parties will contract. This is in addition to the risks posed by Part IVBB discussed in Section 5. As noted, the scale of the additional risk resulting from the intervention will result in lack of investment in new gas supply and market shortages. This is inconsistent with the objectives for the reasonable pricing provision set out in the Consultation Paper.<sup>89</sup>

Senex notes that, given the broad scope of the Mandatory Code permitted under Part IVBB, and the uncertainty in the Consultation Paper as to how the ‘reasonable pricing provision’ will apply, it is also possible that the ‘reasonable pricing provision’ could be imposed as a published ex-ante price cap similar to what has already been introduced under the Order. The application of regulated pricing in this form would significantly distort the market; in particular it would remove the market signals that allow for the efficient allocation of resources, as customer responses to producer offers would not be above the ex-ante price cap, and in any event, the producer could not form agreement with those customers who did offer above the cap.

### **6.3.2. An arbitrator will have no capacity to balance the interests of the customer and producer (as is the case in other, more nuanced, regulatory regimes).**

The Consultation Paper provides that:

- return on capital will reflect “the industry’s risk profile”;<sup>90</sup>
- ‘reasonable prices’ would be assessed, “with reference to the cost of the most likely new domestic gas production to meet forecast domestic demand...”;<sup>91</sup> and
- “depreciation and return on capital would reflect the capital costs of identifying and bringing new developments to market...”<sup>92</sup>

This wording in the Consultation Paper omits any reference to the arbitration having regard to the particular circumstances of the producer, suggesting that where prices are “determined via arbitration in the event of dispute”<sup>93</sup> it will be based on some form of hypothetical new market entrant and new development. In effect, this would impose a single floating price cap that will serve to set prices at arbitration between relevant parties in the event of dispute. It appears there will be no opportunity for an arbitrator to attempt to identify the particular costs of any producer

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<sup>89</sup> ‘Maintain incentives for investment in new sources of supply’

<sup>90</sup> Consultation Paper, p. 10

<sup>91</sup> Ibid, p. 10

<sup>92</sup> Ibid, p. 10

<sup>93</sup> Ibid, p. 13



based on their particular circumstances, or adjust the price based on the other terms of the contract.

In addition, the arbitration and price regulation process outlined in the Consultation Paper appears to provide no way for the contract price to reflect the specific circumstances or risk positions of the respective parties, or other value-add components of contracts. This underscores that the price regulation applying in other non-competitive market segments for homogenous services (see Section 6.3.3 below) is ill-suited to a competitive market which offers a range of products and services and on a range of terms.

For example, a producer like Senex may offer flexibility desired by the customer, which in turn comes with risk for Senex and is therefore valued in a negotiation. A uniform price set in the manner proposed removes any incentive for a producer like Senex to offer terms demanded by the customer and will see reversion to contract terms that are basic and risk-free for the producer. The proposed price regulation will drive a market product that does not cater to the demands of its customers.

Senex notes that the ACCC guidelines applicable to the Price Order<sup>94</sup> contains wording and examples that infer that any attempt to cease offering supply terms that were historically paid for by a customer (such as firm supply and load factor) will be taken into account in assessing attempted avoidance of the Order by the producer, with accompanying penalties. If a similar approach is adopted with regard to the Mandatory Code, it will ensure that producers will not entertain new customer requests for tailored terms and conditions, reducing flexibility and market efficiency.

This lack of nuance in the proposed price setting approach mischaracterises or ignores the complexity of contractual negotiations that underpin gas sales in many circumstances, and the fact that parties will often trade off concessions associated with risk and price.

Under the proposed interventions, customers will be forced to buy only gas (at the regulated price), and negotiations over other aspects of a transaction will be curtailed (e.g. transport, storage, part-year deals and/or shape (e.g. winter only), and flexibility for the buyer). Unless those other aspects of a transaction are able to affect the gas price, gas supply will need to become fully interruptible as gas producers will no longer be permitted to price and effectively manage gas market price risk associated with firming supply (these are usually covered under “permitted interruptions” and “force majeure” clauses).

Importantly, given arbitration is likely to become the default mechanism for price setting for substantial periods of time, and the process will be complicated, expensive and time consuming, producers will be incentivised to minimise the number of separate arbitrations they are exposed to, driving a bias to contract with fewer and larger customers. This will reduce competitive market activity and efficiency.

### **6.3.3. The proposed price setting approach for the Mandatory Code has historically been reserved for monopoly infrastructure, where there are no competitive pressures to generate efficient outcomes**

Neither the Federal Government nor the ACCC has provided evidence that the upstream eastern Australian gas market displays the type of monopoly characteristics that should be subject to the sort of price regulation proposed in the Mandatory Code. In addition, no evidence has been provided of the principles (economic or otherwise) upon which the decision to impose price regulation on gas producers is based.

Price regulation in an otherwise competitive market is at odds with modern Australian economic regulatory policy. The price regulation proposed in the Consultation Paper and ACCC Advice has

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<sup>94</sup> ACCC, Interim compliance and enforcement guidelines on Part IVBB and Competition and Consumer (Gas Market Emergency Price) Order 2022, p. 13 (section 3.6)

historically been applied to businesses operating monopoly infrastructure unlikely to face direct competition and at risk of abusing market power. Existing examples of application of the proposed building block methodology include gas pipelines, electricity transmission and distribution networks, and some rail and port infrastructure.<sup>95</sup> Price regulation in such market segments is necessary to simulate competitive market outcomes in an attempt to obtain economic efficiencies.<sup>96</sup>

Decisions to adopt price regulation for a particular market segment or assets within that segment has historically been made on the basis of thorough review,<sup>97</sup> and/or based on principles contained in legislation, with recommendations on regulation made by independent entities. For example, the National Competition Council (NCC) can only recommend that the Minister declare a service subject to the third-party access regime under Part IIIA of the CCA (and therefore bring it under potential price regulation) where it considers all declaration criteria have been satisfied.<sup>98</sup> Similarly, before making a recommendation that price regulation should apply to a particular gas pipeline, the NCC must be satisfied that certain pipeline coverage criteria are met.<sup>99</sup>

#### **6.3.4. There is no modern analogous example of price regulation in competitive markets that the Federal Government can point to in support of such price regulation**

The only recent Australian example of price regulation in a competitive market is the default market offer (DMO) introduced in the retail electricity market in 2019.<sup>100</sup> However, DMO arrangements are distinguished from the proposed price regulation of upstream gas markets because:

- The DMO is intended to support unsophisticated retail electricity customers, and to apply merely as a 'safety net' for customers that are unwilling to access alternative market offers.<sup>101</sup> As noted in Section 6.1 of this Submission, the regulated gas price will not act as a fallback, but will become the primary means by which sophisticated market customers seek to set prices for all contracts when, but for the regulated price, 'market prices'<sup>102</sup> would have been higher than the regulated price.
- Calculated electricity retail default market offers are intended to "result in a price that is higher than the lowest priced offers in the market, but is much lower than current standing offer prices."<sup>103</sup> This acknowledges that centralised price setting should not attempt to replicate price discovery that occurs in competitive markets. This is in contrast to the intended gas price regulation, which has the objective of ensuring that prices "...reflect the cost of production."<sup>104</sup> As noted in Section 6.3.5 of this submission, the regulated gas price cannot reflect gas production costs across the market.
- In addition, the DMO is set for homogenous services on a differentiated basis for relevant distribution regions in the National Electricity Market.<sup>105</sup> As currently proposed, it appears the regulated gas price will be set on a uniform basis for the entire market which has far more differentiated costs and services than retail electricity.

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<sup>95</sup> See National Electricity Rules, Ch 6, 6A; National Gas Rules, Pt 8, 9; ACCC, Arbitration Report, Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; ACCC, Final Decision, ARTC Access Undertaking for the Interstate Rail Network, July 2008

<sup>96</sup> Commonwealth of Australia, *National Competition Policy*, 1993 (Himler Report), p 270; Industry Commission, Report No.11 (Energy Generation and Distribution), May 1991, p 16

<sup>97</sup> For example, in respect of Australian energy markets, see Industry Commission, Report No.11 (Energy Generation and Distribution), May 1991

<sup>98</sup> Competition and Consumer Act 2010 (Cth), s 44G

<sup>99</sup> NGL, s 97(2)(a)

<sup>100</sup> Competition and Consumer (Industry Code—Electricity Retail) Regulations 2019

<sup>101</sup> ACCC, Retail Electricity Pricing Inquiry - Final Report, June 2018, p 240

<sup>102</sup> See footnote 31

<sup>103</sup> AER, Position Paper, Default Market Offer Price, November 2018, p. 5

<sup>104</sup> Consultation Paper, p. 10

<sup>105</sup> AER, Default Market Offer Prices, Options Paper, 25 October 2021, pp. 12, 13

Further, any comparison with price control measures taken by the European Union (EU) or the United Kingdom (UK) Government is inappropriate:

- In the case of the EU, the 'market correction mechanism' provides a price cap for gas futures transaction based on a dynamic limit set by reference to international LNG hubs, plus a margin (35€/MWh). It is only triggered where gas futures on the EU reference trading hub (the Title Transfer Facility (TTF)) exceed a cumulative static price (180€/MWh, equivalent to approximately A\$80/GJ) and an internationally pegged dynamic limit. The cap only applies for a particular period once triggered (20 working days) and deactivates automatically under certain conditions.<sup>106</sup> The EU arrangement is not unlike existing price caps that already function in the Victorian Declared Wholesale Gas Market (DWGM) and Short-Term Trading Market (STTM).
- In the case of the UK, the 'energy price guarantee' provides an energy cost subsidy to households via Government funding.<sup>107</sup>

**6.3.5. It will not be possible to identify a regulated 'reasonable' price that is applicable to the parties in arbitration, or to replicate price that the parties would agree upon, were gas supply sufficient to meet demand**

As discussed in section 6.3.2 the wording in the Consultation Paper suggest that prices set via arbitration will be based on application of a building block model to a hypothetical market entrant and project. It is unclear how this would be calculated and applied in practice.

However if such an approach is adopted, even where it might cater for some permutations, this will not result in a 'reasonable price' that reflects what participants would agree were gas supply sufficient to meet demand. This is because a regulated price based on the hypothetical new market project/entrant will not account for the large differences in real producers' financing, risk and ownership structures, nor the differences in real project characteristics compared to a hypothetical 'new development'.

In particular, the benchmark return on capital generally adopted in the building block model will not reflect the realities of producers and projects in the market. This is because:

- It will be necessary to make significant general assumptions on the total capital required (including for exploration, development, and production) for the hypothetical new project to produce, and allocate the use of those assets to the particular quantity of gas being supplied under the relevant contract (as opposed to other products).
- The weighted average cost of capital (WACC), which generally determines the rate of return, will require consideration of equity return expectations for different project stages – with these differing significantly based on the project.<sup>108</sup>
- The capital structures of actual producers within the market will differ significantly as compared to any hypothetical new entrant.
- The equity beta will also differ significantly between producers.<sup>109</sup>
- The tax allowance will not be representative of the various ownership structures of all producers in the market.<sup>110</sup>

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<sup>106</sup> Council Regulation 2022/0393 (NLE)

<sup>107</sup> UK, Department for Business, Energy & Industrial Strategy, Policy Paper, Energy Price Guarantee, November 2022; Chancellor of the Exchequer, Autumn Statement 2022, November 2022

<sup>108</sup> See RBA, Exploration in the Listed Resource Sector, Bulletin September 2012, p. 41

<sup>109</sup> See, for example, variance of beta for Australian firms in the energy sector contained in AER, Staff Industry Equity Beta Analysis, April 2018, pp. 26 - 30

<sup>110</sup> Even within regulated network businesses, the rate of tax paid varies significantly between companies depending on ownership structure, see AER, Final Report, Review of regulatory tax approach, p 19

Relatedly, the characteristics of any hypothetical 'new' project will not reflect existing developments because project characteristics vary widely. Senex notes that some fundamental differences between projects are:

- *The costs (including differences in exploration, appraisal, development Capex, ongoing Capex and Opex)* – this includes whether the 'new project' involves a new field, wells, processing facilities, pipelines, or a refurbishment of an existing resource.
- *Production profile and uncertainty*, optimal processing and pipeline sizing, and Capex spend rates dramatically change between projects, changing when the gas (and revenue) is delivered. Developments are subject to significantly different production uncertainty, for both peak/plateau well rates and ultimate recoverable resource.
- *Location* – especially relative to the delivery point in the contract in arbitration. For example, the next 'new' development might be in the Northern Territory, which is not directly comparable to a contract with delivery into Melbourne.

These characteristics have obvious implications for the risk profile of development, and the level and sources of funding required.

**6.3.6. The non-homogenous nature of producers and projects, coupled with market distortions, means that there is no certainty the regulated price would always be above the costs of all producers in the market.**

It appears that the methodology described in the Consultation Paper has assumed that the costs of the 'most likely' hypothetical new entrant and project would be sufficient to cover the costs of existing developments under all conditions.

If this is the case, it is noted that such an assumption would typically only be valid in a market segment that is free of distortion, leading to a reasonable assumption that the highest returning projects are developed first. The eastern Australian gas production segment is not free of distortion, so future developments won't necessarily always sit at a progressively higher position on the cost curve. Existing distortions include the system of allocation of development acreage, historic locations of supporting infrastructure such as pipelines, and onshore development prohibitions in New South Wales and Victoria.

**6.3.7. Alternatively, if the intention is to allow the arbitration process to take account of the actual commercial interests of buyer and seller, this will be a time and resource intensive process.**

If, contrary to the wording in the Consultation Paper, the price regulation methodology to be applied during arbitration is intended to allow the arbitrator to undertake meaningful consideration of the commercial interests of the parties, this will require significant time and resources: based on previous industry experience (e.g. arbitration under Part IIIA of the CCA), arbitration outcomes may take over a year.<sup>111</sup> While this time requirement may be acceptable for long lived infrastructure access, it is completely inappropriate for competitive gas markets where participants may wish to quickly secure short and medium term agreements. Drawn out arbitration disputes will create significant uncertainty for producers as to what gas they can actually sell pending arbitration outcomes, and will ultimately disincentivise efficient contracting between participants, further reducing market efficiency.

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<sup>111</sup> See Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd, 18 September 2018 (<https://www.accc.gov.au/public-registers/access-to-services-registers/determination-of-the-access-dispute-between-port-of-newcastle-operations-and-glencore-coal-assets-australia>)

Senex cannot see how arbitration will practically work in the context of an EOI process where there may be multiple customers contending to buy within a timeframe mandated by a Mandatory Code where some or all customers may seek an arbitrated price.

**6.3.8. The arbitration process will not be a fall back to genuine negotiations, but the primary means by which commodity prices are set in the upstream gas market when market prices are high.**

The interventions proposed under the Mandatory Code will do nothing to address the supply issues which are the key cause of higher prices in the market. Given this market dynamic, it is foreseeable that buyers will not engage in genuine contract negotiations in relation to gas commodity prices, but rather will, in all cases where the regulated price is below the 'market price'<sup>112</sup>, seek to raise a dispute under the Mandatory Code and contract at the price set by arbitration. This is inconsistent with the objectives for the RPP set out by the Federal Government in the Consultation Paper.<sup>113</sup>

Not only will this frequency of price setting create significant administrative costs for all market participants, and poorer economic outcomes, but it will inform investor expectations that prices will be set by regulation, rather than the market. This will also lead producers to seek larger, longer-term deals with a small number of counterparts to minimise regulatory risk – leading to lower market activity and poorer economic outcomes.

The rules to be contained in the Mandatory Code around arbitration must ensure that:

- Pre-contractual arbitration may only be initiated by parties that are involved in good faith, genuine negotiations over gas supply that has advanced at least to a defined point. A potential customer should not be allowed to threaten or drag a producer into an arbitration simply because they have indicated interest in acquiring gas from a producer. To allow arbitration too early in the gas marketing process will result in non-sensical outcomes where producers are forced to come to terms with a customer they may never have intended to sell to, for volumes they may have never intended to sell, or don't have.
- The scope of any arbitration must be limited to points of actual disagreement between the parties. The Mandatory Code must not allow gaming of the arbitration process by customers who "bait and switch" terms and conditions. Good faith negotiating must be the objective.

Senex remains concerned that the arbitration process could force the producer to contract on terms that are counter to the basis of its investment decision in new productive capacity.

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<sup>112</sup> Refer footnote 31

<sup>113</sup> 'Allow for competition on price and price variation reflecting differences in suppliers' costs'

## **7. Recommendations**

Refer to Section 1.6.