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Attention: Mr Joshua Runciman,

Australian Competition and Consumer Commission

LNGnetbackreview@acc.gov.au

RE: ACCC review of the LNG netback price series – Draft Decision

Dear Mr Runciman,

Senex Energy Ltd (Senex) welcomes the opportunity to provide comment on *the LNG netback review - Draft decision paper* (the draft decision paper).

As noted in its initial submission to the ACCC *LNG netback price series review* (dated 12 April 2021) Senex supports the Federal Government's view that natural gas has a major role to play in meeting Australia's energy needs for the foreseeable future and its economic recovery from Covid-19 and is ready to work with all branches of Government, including the ACCC, to help deliver this objective for the benefit of all stakeholders.

The review of the ACCC LNG netback price series is acknowledged as being an important part of the broader range of measures announced by the Government to achieve the policy objectives of increased, reliable, and secure gas supply at competitive prices, and to support jobs.

Senex has reviewed the draft decision paper and participated in the LNG netback price series review roundtable held on 20 July 2021.

Senex commends the ACCC for the rigorous review it has undertaken (with the support of Wood Mackenzie), and for the objective conclusions it has drawn.

As a general comment, Senex supports the recommendations of the draft decision and considers that the continued publication of the ACCC LNG netback price series, calculated using the methodology outlined in the draft decision, will materially help provide increased transparency in domestic market as to the price 'point of indifference' for the LNG exporters and help address the perceived information asymmetry in the market.

In addition, Senex wishes to take this opportunity to make specific comments on aspects of the draft decision and related topics that have the potential to impact us, similar Australia-focused natural gas producers, and the domestic natural gas industry as a whole:

1. Term contracts dominant the market and are fundamentally different to short-term or spot sales

The ACCC LNG netback price effectively represents the price at which LNG exporters would be indifferent to selling a spot cargo into the international LNG market or directing such spot cargo into the domestic market.

This point of indifference, however, has little relevance to the majority of gas sales in the east coast gas market (ECGM), in which >80% of the volumes are sold on a term basis. The price point of indifference, or LNG netback price reflects the spot or short-term market for LNG in Asia. It can be highly volatile, reflecting the short-term supply/demand fundamentals of the market, with the price varying as a function of short-term factors such as weather, supply outages, etc.

Pricing in term contracts in the ECGM is a function of the supply / demand fundamentals within the east coast over the term of the contract, transportation requirements, and the nature of any embedded options or flexibility sought by the gas buyer over the term. Such embedded options include flexibility around daily volumes, curtailment rights, extension rights, banking etc, all of which expose the seller to additional cost and/or risk which needs to be priced, and none of which have relevance in a spot or short-term sale. The LNG netback price series has little bearing on the prices negotiated for such transactions.

The base gas price of such term contracts fluctuates over time as the prevailing view of long-term supply/demand fundamentals fluctuate, however, the range within which the base gas price moves is relatively narrow as compared to the volatility which is seen and routinely reported for LNG netback price series.

Senex announced on 22 July 2021, that it had entered into a 7-year agreement with construction materials and industrial mineral manufacturing company Adbri, commencing in 2023 for up to 11PJ of gas¹. This agreement was concluded between 2 parties seeking to work constructively to find a mutually beneficial outcome, but more importantly it was concluded without any consideration of the LNG netback price, or what it could be over the term of the agreement.

The agreement between Senex and Adbri is a clear demonstration, with the right approach, gas producers and manufacturers can work together to find solutions that benefit the Australian economy for the long-term. The market is functioning as it should.

2. Continued investment and new development are underpinned by term contracts

In addition to the above point, that the debate as to the appropriateness of ACCC LNG netback price series as a marker in the domestic market fails to recognise the limited role that spot sales play in the domestic market, the debate also seems to fail to recognise that there is not an unlimited supply of developed gas which can be produced into the market on a short-run marginal basis.

For the domestic gas market to be sustainable it needs a constant flow of new gas developments to provide new supply. These developments will only occur when the financial returns from such development adequately cover the investment made and the risk taken by the developer.

Senex has already invested in excess of \$500 million on developing gas into the ECGM and has plans in place to invest in excess of \$500 million more on further developments. However, Senex will only make a positive investment decision on a new gas development once:

- an appropriate quantity of foundation gas sales have been contracted in the term market; and
- confidence has been achieved for an appropriate quantity of further gas sales post-FID; at prices which will generate sufficient returns to cover the investment and risk.

As noted above, the pricing of such term contracts will be a function of expectations on the long-term supply/demand fundamentals and any specific factors affecting each transaction, but to underpin an investment decision we must have confidence that gas pricing through the cycle will deliver the necessary returns to justify the investment.

In taking FID without having fully contracted all sales, Senex acknowledges that it is accepting a certain level of market risk. However, such risk is only taken after a careful assessment of the market. To the extent, that the risk is assessed as being higher either because of competing supply or the threat of Government intervention, clearly a higher percentage of the volumes will need to be contracted to underpin the investment ahead of FID.

Actions by Government to effectively cap prices in the domestic market, or failure by the manufacturing sector to work with gas producers to support economically viable new gas developments, will have the result that new investment will constrict or evaporate, supply will

¹ <https://www.senexenergy.com.au/investor-centre/files/senex-and-adbri-sign-new-long-term-gas-sales-agreement-to-support-manufacturing-operations/>

further tighten, and even higher prices will result from LNG imports (because of international pricing), all as a prerequisite to re-initiating domestic investment.

3. Gas industry subsidisation of the manufacturing sector is short-sighted and unsustainable

The statement was made in submissions to the *LNG netback price series review* by gas buyers, and during the 20 July roundtable, that east coast domestic gas, as an input into certain manufacturing processes, is higher priced than in certain countries with whom the manufacturing sector competes, and as such, Australia's competitiveness is put at risk. The position was further put that domestic gas prices within the east coast should be capped to preserve Australia's manufacturing competitiveness against such competitors.

Whilst Senex acknowledges that it has a commercial interest in helping to ensure a sustainable and viable manufacturing sector, gas input prices are just one of many cost-structure differences between Australia and those of Australia's manufacturing competitors.

The onus needs to be on the manufacturing sector to interrogate all costs, their cost structures and how they can be legitimately reduced in order to maintain competitiveness. There is no rational commercial basis to suggest that the gas sector should sell gas at sub-commercial prices in order to subsidise another sector of the economy, any more than there is to suggest that Australian workers should accept reduced pay and work conditions on the basis that they are superior to the pay and work conditions of Australia's manufacturing competitors.

4. There is a single East Coast domestic market. All sellers into the market should be treated equally

It has been noted by the manufacturing sector that there are certain gas production licenses in Australia (e.g. the Australian Market Supply Conditions (AMSC) licenses in Qld), where there is no scope for the gas produced to be sold into the LNG market. As such it has been suggested that the price of such gas should be set at a lower level than for those volumes being sold into the domestic market for which the ACCC LNG netback price represents the point of indifference between a domestic and an export sale.

Senex strongly challenges this assertion. There is a single east coast gas market, the supply for which comes from various sources; marginal production from LNG exporters, production from domestic producers who have the capacity to directly or indirectly to sell into the export market, and production from 'domestic only' licenses. In a market-based economy any producer of gas into the market should have the right to freely sell into such market at the market price.

It is correct to say that the AMSC conditions define that production can only be sold into the ECGM. This condition was understood by all participants in the respective bid rounds for such licenses. There was, however, no condition seeking to cap or constrain the price that could be attained for such production in any way on its sale into the market.

As with any goods or services produced in Australia which we also trade in the international market, the price of such good or services within Australia will be influenced for all producers by the international market. This will be case, irrespective of whether any producer has the capacity to trade internationally. Price fluctuations in the Australian market as a function of circumstances in international markets are commonly reported in sectors such as meat, seafood, and fruit & vegetables. As it is with the producers of these products, the producers of gas should in no way be restricted in being able to access the market price for their product simply because they do not have access to export market.

5. Competitive pricing results from new supply and new suppliers

That the ECGM is influenced by the Asian LNG market, reflects that the LNG exporters, those who have the capacity to sell into either the domestic market or the export market are the marginal suppliers into the ECGM.

Increasingly actions are being taken by various state Governments which will only increase the degree to which LNG exporters are the marginal suppliers into the ECGM.

Senex's experience is that maintaining reliable and secure gas supply at competitive prices in the market is most effectively accomplished by encouraging new gas supply and market participants and by maintaining a stable regulatory and fiscal regime.

Increasing gas supply relies on sound investment settings, regulatory stability and reasonable and sustainable prices that realise the necessary returns to the developer; returns that recognise the capital investment committed, and the risk taken.

6. In many instances negotiation asymmetry is in favour of gas users

It was noted both in the draft decision and during the roundtable, that one of the objectives of the ACCC LNG netback price series is to help address the information asymmetry in the market.

Senex wishes to reiterate a point it made in its original submission, a point which is relevant for this discussion, and other related discussions such as those the ongoing discussions on the Code of Conduct.

Senex acknowledges that there can be asymmetry in the market as a function of the level of sophistication and size of the negotiating parties. However, Senex does not believe the asymmetry is systematically to the benefit of the gas producers. In fact, in many instances where there is asymmetry, it is in favour of the gas users. Many of the gas buyers are large, multinational, commercially sophisticated parties. Relative to small-to-medium domestic gas producers, they have much more exposure to the market as part of the numerous negotiations they are party to and are, therefore, likely to receive significantly more information on gas pricing.

Senex considers that the hypothesis that there is a systematic imbalance in the market in respect to information is incorrect.

Summary

Senex supports an open market, and we support initiatives that will improve the efficiency, transparency and liquidity of an open domestic gas market. Such initiatives enhance reliability and certainty both for producers and customers, which in turn, encourage investment in gas supply and use, including from existing and new gas assets.

Senex has reviewed the draft decision paper and participated in the LNG netback price series review roundtable held on 20 July 2021.

Senex supports the recommendations of the draft decision and considers that the continued publication of the ACCC LNG netback price series, calculated using the methodology outlined in the draft decision, will materially assist to provide increased transparency in the domestic market as to the price 'point of indifference' for the LNG exporters, and help address the perceived information asymmetry in the market.

Pricing of term contracts in the ECGM is a function of the supply / demand fundamentals within the east coast over the term of the contract, transportation requirements, and the nature of any embedded options or flexibility sought by the gas buyer over the term.

For the domestic gas market to be sustainable it needs a constant flow of new gas developments to provide new supply. These developments will only occur when the financial returns from such development adequately cover the investment made and the risk taken by the developer.

Actions by Government to effectively cap prices in the domestic market, or failure by the manufacturing sector to work with gas producers to support economically viable new gas developments, will have the result that new investment will constrict or evaporate, supply will further tighten, and even higher prices will result from LNG imports (because of international pricing), all as a prerequisite to re-initiating domestic investment.

We look forward to further constructive engagement with the ACCC as the review proceeds to deliver a fair, balanced, and sustainable outcomes for all parties.

Please contact the undersigned on [REDACTED] or at [REDACTED] if you have any queries.

Yours faithfully

[REDACTED]

Neil Sutherland,
Executive General Manager – Corporate Affairs and Sustainability
Senex Energy Limited