



6 February 2014

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Attention: Mr Stephen Hally-Burton
Email: prebudgetsubs@treasury.gov.au

2014-15 Pre-Budget Submission

Please find attached a submission from the Australian Petroleum Production & Exploration Association (APPEA) in relation to the 2014-15 Federal Budget.

APPEA would like to highlight five areas where we believe the Federal Government can make a genuine difference to the legislative and regulatory arrangements facing the industry and play a role in ensuring Australia remains a competitive destination for oil and gas industry investment:

1. The importance of fiscal stability
2. The need for market-based energy policy
3. Maintaining industry access to resources
4. Regulatory reform: red tape and green tape reduction including streamlining Australia's greenhouse policies and programs
5. Developing viable labour markets that encourage mobility, flexibility and productivity.

APPEA would be pleased to further expand on any of the issues raised in the submission. Contact in APPEA is Damian Dwyer, telephone 02 6267 0902 or email at ddwyer@appea.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read "David Byers".

David Byers
Chief Executive

SUBMISSION TO THE
FEDERAL GOVERNMENT

2014-15 Federal Budget

February 2014

The economic significance of the Australian oil and gas industry

Reliable, secure and competitively priced energy is crucial to our everyday lives in Australia. Within this framework, oil and gas play a key role in meeting many of our energy needs. It is important to place our views in the context of the current and potential future contribution of the upstream oil and gas industry to the Australian economy and to the welfare of all Australians.

Our abundant natural gas resources, in particular, place Australia in an enviable position to maintain long-term, cleaner energy security domestically and internationally. Natural gas makes it possible for Australia to meet the world's growing energy needs over the coming decades while incorporating a strategy to curb greenhouse gas emissions.

Just as importantly, the industry creates significant wealth for the country, including through the employment of many Australians, underpinning the revenue collections of governments and generating valuable export revenue for the Australian economy.

Almost \$200 billion is currently being invested in oil and gas projects, including seven major liquefied natural gas (LNG) export projects¹. According to economic modelling commissioned by APPEA and conducted by Deloitte Access Economics², this will increase Australian GDP by up to 2.2 per cent a year and over the investment phase will create about 103,000 (full-time equivalent) jobs across the Australian economy. Companies all over Australia are supplying goods and services to the oil and gas industry. This together with sourcing our workforce from many different regions is spreading the benefits of the industry across Australia.

By 2020, the sector's economic contribution to the national economy will more than double to \$65 billion and taxation paid will rise from \$8.8 billion (an estimated \$4.9 billion in corporate taxes and \$3.8 billion in production taxes) to reach almost \$13 billion.

While the Australian economy has benefited and will continue to benefit significantly from LNG investments committed in the past, there are even more projects under consideration, representing a potential additional investment exceeding \$180 billion. Realising these would benefit the entire nation. Analysis by McKinsey & Co³ shows GDP would increase by 1.5 per cent, about 150,000 jobs would be created across the Australian economy, and tax revenues created equivalent to nearly half the total federal debt. The benefits of improving productivity would also flow to other sectors.

This means that the stakes are high in realising the industry's potential benefits.

The major challenge to the industry's continued growth is maintaining Australia's international competitiveness in the face of growing global competition. A high-cost local environment and the emergence of new LNG competitors in East Africa, North America and other locations has increased the level of competition Australia faces as it seeks to win market share and attract investment. The industry and governments must do everything possible to ensure the \$200 billion in projects under construction commence production in a timely manner and that Australia secures future oil and gas investment opportunities.

¹ See Bureau of Resources and Energy Economics (2013), *Resources and Energy Major Projects*, for a listing of upstream oil and gas projects (available at www.bree.gov.au/publications/rempp.html).

² See Deloitte Access Economics (2012), *Advancing Australia: Harnessing our comparative energy advantage*, 25 June (available at www.appea.com.au/wp-content/uploads/2013/04/120625_DAEreportAPPEAfinal.pdf).

³ McKinsey & Co (2013), *Extending the LNG boom: Improving Australian LNG productivity and competitiveness*, 28 May (available at www.mckinsey.com/locations/australia/knowledge/pdf/extending_lng_boom.pdf).

Some factors affecting current and future investment, such as the high Australian dollar, are beyond the ability of industry to influence. However, other key challenges must be addressed. In particular, the industry and its suppliers need to work harder at constraining cost growth and to meeting skilled labour requirements. Industry is investing in technology and undertaking various business initiatives to reduce costs.

There are also critical policy areas that require genuine reform. Five major state and federal policy priorities are clear:

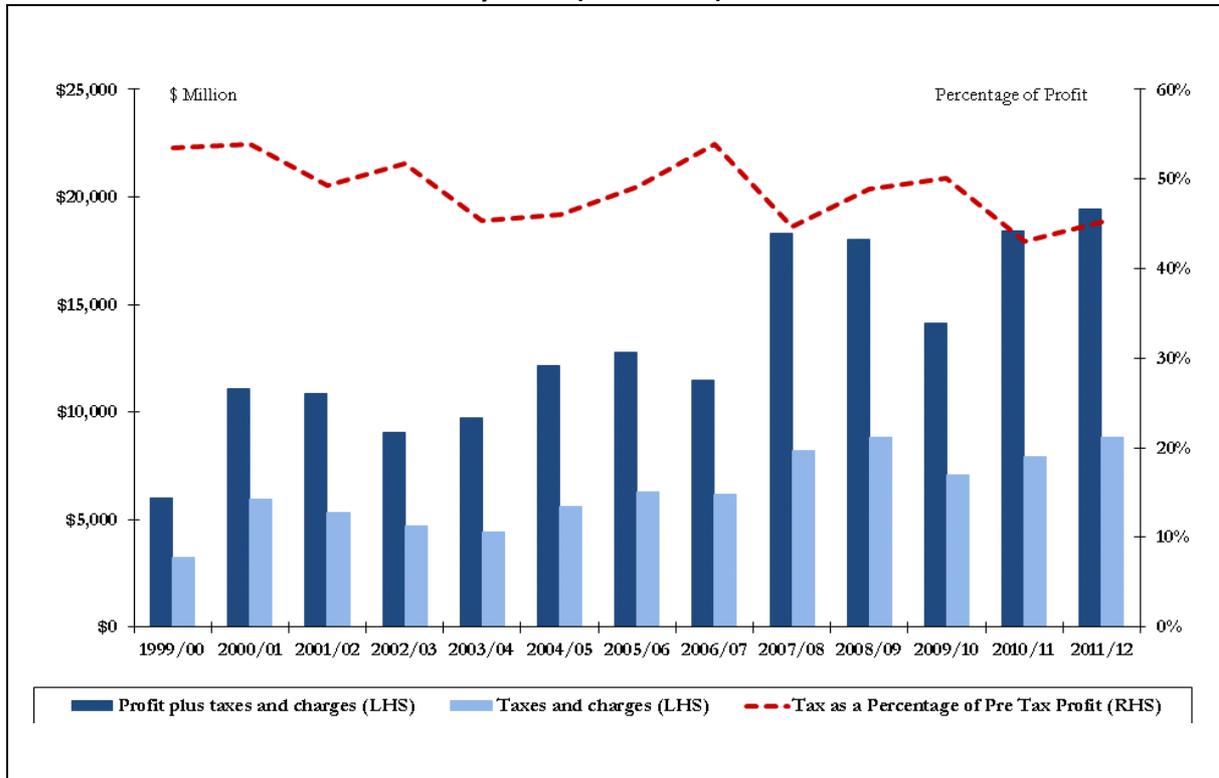
1. The importance of fiscal stability
2. Regulatory reform: red tape and green tape reduction including streamlining Australia's greenhouse policies and programs
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5. Developing viable labour markets that encourage mobility, flexibility and productivity.

Issues and Recommendations

The importance of fiscal stability

The oil and gas industry in Australia is confronted with a vast array of taxes, charges and fees in relation to petroleum activities. Fiscal imposts include resource taxes (including the petroleum resource rent tax, petroleum royalties and production excise), company income tax and a wide variety of other taxes, fees and charges. Annual industry financial survey data compiled by APPEA indicates that on average, taxes account for just under half of the industry's overall level of pre-tax profit.

Chart 1: Estimated Petroleum Industry Profit (Before Tax) and Taxation Contributions



Source: APPEA Financial Survey

In terms of the segmentation of the two primary forms of taxation paid by the industry (company tax and resource taxes), total payments have averaged around \$8 billion per year over the last five years, with company taxes estimated to account for slightly more than half of the total amount.

From a resource taxation perspective, modified fiscal terms now apply to petroleum production sourced from areas not previously subject to the petroleum resource rent tax (PRRT). This covers all onshore areas in Australia and the North West Shelf project. In addition to the then existing royalty and production excise regimes (which still remain in place), the PRRT was extended to cover production not then subject to PRRT, with effect from 1 July 2012. A number of transitional, interpretative and administrative details remain the subject of discussion between the industry, the Australian Taxation Office and policy agencies. It is clear that the new arrangements are imposing a significant additional layer of administrative complexity and uncertainty on companies, as well as potentially complicating future investment decisions.

In the context of the 2014-15 Federal Budget APPEA believes that a number of resource and corporate tax issues need to be addressed.

Petroleum Resource Rent Tax

While APPEA is broadly supportive of the high level principles that support the operation of the PRRT regime, there are a number of companies in the industry that are concerned about the potentially significant impact of the tax on onshore operations. Some companies do not believe the tax is able to be efficiently applied to certain onshore projects. Furthermore, the Government's decision to abolish the minerals resource rent tax effectively means that additional burdens (both from payment and compliance perspectives) are now placed on gas producers relative to coal producers in Australia, despite the fact that in some cases, they are operating within the same domestic energy market.

Introduction of 'Barrel of Oil Equivalent' Exemption

The decision of the previous government to extend the coverage of the PRRT has significantly increased the number (and size) of companies that are impacted by the tax, as well as the complexity of the operations covered by the legislation. For example, a range of unconventional oil and gas operations are undertaken in onshore areas that are generally not encountered in offshore projects. The decision has been complicated by the continued application of the existing royalty (federal, state and territory) and production excise (federal) systems.

A number of relatively small actual and potential oil and gas projects in 'onshore' areas are likely to incur PRRT liabilities earlier than would have been the case had different transitional provisions been implemented. Companies with onshore operations only became aware of possible changes to the then taxation framework in the middle of 2010 at the time of the announcement of the resource super profits tax, and as such, were unable to anticipate and plan for the new arrangements. In the context of the challenging fund raising climate for small companies, an additional tax on those few entities that are able to achieve success onshore is a regressive and damaging outcome.

APPEA considers that the negative impact on these smaller projects needs to be addressed through the introduction of a modest "barrel of oil equivalent" production exemption for new onshore petroleum projects. Such an exemption would have a relatively small impact on the overall level of PRRT collections. It could be quarantined to 'onshore projects' and would assist the project economics of relatively small developments but importantly, would not impact on the overall integrity of the regime. While the details of any such provision would need to be considered as part of more detailed consultations, it is important that the issue be addressed with an in-principle commitment to ensure that the regime does not operate in a way that disadvantages small scale projects which provide the basis and reward for innovative and entrepreneurial activity.

Recommendation: The Government introduces a tax free threshold on a barrel of oil equivalent basis for new onshore petroleum projects and consults on the practical application of such a measure.

PRRT Administration and Compliance

The PRRT, which is based on the relatively simple premise of revenue less costs, is highly complex and time consuming from a compliance perspective. Prior to 1 July 2012, the scope of the tax was limited to offshore projects, and therefore a relatively small pool of companies would directly be impacted. The extension of the regime has seen many more companies (a large proportion of which are small or mid-sized entities) needing to comply with the provisions, irrespective of whether a tax liability exists (which will generally not be the case). These companies are effectively operating under a dual resource taxation framework and therefore need to place a greater proportion of their limited resources on tax compliance. A reduction in the compliance burden on small and mid-sized companies should be a priority for government and industry alike.

The decision to extend the tax continues to be a complex process. The industry has worked with government officials to attempt to address the numerous technical issues that have arisen from the introduction and application of the tax. Considerable work still needs to be done on a range of outstanding matters to ensure that the regime operates effectively and anomalous outcomes are addressed. This includes compliance obligations on all companies that have onshore interests.

Furthermore, APPEA notes that in a joint media release from the Treasurer, Minister for Industry and the Minister for Finance on 24 October 2013, it was indicated that *“In relation to the Petroleum Resource Rent Tax, the Government is considering the issue of the onshore administration of this tax, in the context of its deregulation agenda and the removal of red tape.”*

Recommendation: The Government commits to work directly with industry to identify and implement measures to simplify the administration of the PRRT regime, and in particular, eases the burden on small and mid-sized entities.

Definitional Improvements

The focus of petroleum activities in Australia and the way that operations are undertaken have changed significantly since the PRRT was first introduced in the mid 1980's. Gas operations are becoming more common than oil developments, projects are becoming more complex and companies often need to bring in new partners and create new operating structures within projects to ensure that discoveries can be commercialised in an increasingly competitive environment. During this period of change, the key concepts contained in the PRRT legislation have remained broadly unchanged. As a result, a range of interpretative and definitional issues are now creating considerable uncertainty. Of particular concern to industry is the scope and definition of what constitutes 'exploration' (a core area in the legislation). The notion of exploration for the purposes of the operation of the legislation, is becoming increasingly complex and uncertain due to the revisiting of key concepts by tax administrators. A detailed example of the background and issues associated with a narrow definition of 'exploration' being adopted by the ATO is at Box 1.

On 21 August 2013, the ATO released a draft taxation ruling addressing the definition and scope of exploration for PRRT. The release of the draft ruling was accompanied by a discussion paper that raised a number of matters connected with the date of effect of the ruling. From an industry perspective, the ruling effectively narrows the definition and scope of exploration for PRRT purposes. While the ruling has a prospective application date (as it is proposed to apply to expenditures incurred following the release of ruling), it is silent on the treatment of past costs. The treatment of past costs was in part addressed in an accompanying discussion paper. APPEA responded to the

draft ruling objecting to the definition proposed and raised concerns about changes in the interpretation previously advised and administered by the ATO. Below is a summary of a number of the issues that have been raised by APPEA.

Box 1: The Scope and Deductibility of 'Exploration' for PRRT Purposes

In the draft ruling, the Commissioner forms the view that there is nothing in the statutory context necessarily to support other than a core meaning of 'exploration' being the ordinary meaning. He considers that ordinary meaning refers to those searching, investigative and limited appraisal activities that are directed towards discovering resources including determining whether it is technically feasible to extract it.

APPEA considers this view to be incorrect as it would create a significant black-hole not identified and unintended by Parliament. This would mean expenditure incurred for the purpose of making a decision to mine that is not preparatory to the carrying on of mining operations, facilities and other things comprising a petroleum project is not exploration. It seeks to define the ordinary meaning of exploration in a narrow sense unrelated to its context in the PRRT legislation and in a manner that does not promote the intent and purpose of the framework of the Act.

In APPEA's view, the ruling is taking too narrow a view of the meaning of exploration and doesn't take account of:

- The need to interpret the words in their context.
- The need for the ATO to have regard to the intention of the Act in respect of its operation within the petroleum industry.
- The fact that the concept of exploration had a generally understood meaning both in the industry and in taxation laws at the time the legislation was introduced and in that sense may be argued to have had a technical legal meaning which differs from the ordinary meaning.

Even in its ordinary and common usage, the concept of exploration is broader than the concept of prospecting which encompasses the search or exploration of a region, or working of a claim experimentally in order to test its value. As the word exploration suggests, the ordinary meaning also covers activities which are exploratory in nature including investigation, scrutiny and examination.

In addition, exploration is not undertaken in a vacuum to merely identify the presence of a resource, but is undertaken with a particular objective in mind, namely to identify, locate and understand a resource which is capable of economic exploitation and in the context of the Act, capable of development into a project. The context suggests that the investigation, scrutiny and the examination is not merely one directed towards finding a resource and whether it is technically feasible to extract it, but is directed towards the investigation, scrutiny and examination necessary to find and understand a resource which is capable of development into a petroleum project that will produce a marketable petroleum commodity.

There is also nothing to suggest that the meaning of exploration for the purposes of the Act should not be based on a phased approach to defining exploration. That is, activities in relation to the discovery and determination of a commercially recoverable accumulation of petroleum which support a decision to mine are exploration and activities in relation to the development and recovery of petroleum involve general project expenditure. Exploration is a means by which a taxpayer achieves its objective. The relevant objective goes beyond prospecting and includes investigating, evaluating and scrutinizing information that is relevant to the decision to mine. This decision making process is part of a continuum that is recognized by the phase approach. To ignore the phase approach is to ignore the context in which the Act was drafted and intended to operate, thereby frustrating the intent and purpose of the Act.

Furthermore, APPEA considers that there is the very real possibility of the creation of categories of 'black-holed' expenditure through the adoption of the approach proposed in the draft ruling. This could arise both in terms of non-transferable expenditure where a production licence never comes into force in relation to an exploration permit or retention lease, and through the possibility of expenditures falling outside the scope of the relevant sections. These outcomes would clearly be inconsistent with Parliament's intentions to encourage exploration.

Regulatory Uncertainty

APPEA also notes that the Government has raised regulatory uncertainty as a key area of policy priority. As part of their policy framework, it has identified concerns about the impacts on parties arising from the inconsistent and changed positions adopted by decision makers, including parties finding themselves subject to legal proceedings or penalties for actions where they have acted in good faith. To address this concern, the Government has indicated that they will “*avoid retrospective or administrative rulings (i.e., rulings contrary to prior administrative practice), except in extreme circumstances where there is a compelling and reasoned justification consistent with wider community benefits or national interests*”.

Recommendation: In addressing the existing technical and policy uncertainties associated with the operation of the PRRT legislation, an approach is adopted that recognises industry practice and that avoids narrow and/or technical constructs that do not reflect operational and commercial operations in the industry.

Abolition of ‘Onshore’ Crude Oil and Condensate Production Excise

The resource taxation framework that applies to oil and gas production in Australia is multi-layered and in many cases involves both Federal and State/Territory taxing powers. In summary, the regime is broadly as follows:

- Prior to 1 July 2012, all ‘offshore’ projects, with the exception of those production licences derived from Exploration Permits WA-1-P and WA-28-P (the North West Shelf project) were subject to the provisions of the *Petroleum Resource Rent Tax Assessment Act 1987*. From 1 July 2012 and onwards, the application of the PRRT regime was extended to cover all activities in both ‘offshore’ and ‘onshore’ areas.
- In addition to PRRT, production sourced from the North West Shelf (NWS) project is subject to Commonwealth crude oil and condensate excise and Commonwealth petroleum royalty.
- Onshore production and that sourced from projects located in submerged lands under state jurisdiction are subject to Commonwealth crude oil and condensate production excise and royalty under the relevant State/Territory jurisdiction (plus PRRT).

The crude oil excise regime has been in place since the mid-1970s. As outlined above, it applies in conjunction with the Commonwealth royalty or state/territory royalties (depending on the location of a project). With the exception of the NWS Project, no other offshore projects are subject to production excise or royalties. It was originally introduced as a levy on each barrel of oil production sold from eligible areas, and was then substantially modified in 1983 such that it then applied at varying rates depending on the discovery and development date of the relevant producing field or project. In April 1984, the ‘new oil’ excise scale was introduced, while the ‘intermediate scale’ was introduced at the end of 1984 to encourage the development of satellite fields that had become uneconomic under the ‘old oil’ scale. In July 1987, a 30 million barrel excise exemption for each field was introduced to further stimulate the development of oil discoveries. In the 1977/78 Federal Budget, a number of announcements were made covering the operation of the excise regime. In relation to condensate, the following was announced:

The levy will not apply to condensate marketed separately from a crude oil stream; such condensate may now be sold at commercially negotiated prices. Nor will the levy apply to liquefied petroleum gas fields yet in production. This will assist the marketing

of LPG and condensate from fields already discovered but not yet developed in the North West Shelf and Cooper Basin. Condensate sold commingled in a crude oil stream will continue to be treated as crude oil for pricing and levy purposes.

Condensate and gas production remained subject to petroleum royalties. A further adjustment was introduced in 1995 which allowed for condensate that was either produced or marketed separately from crude oil to be excise exempt. This ensured that condensate was not regarded as crude oil for the purposes of the excise regime merely because of the fact that it was commingled with crude oil post the point of production. Overall, the arrangement provided an important stimulus for companies to explore for and make subsequent investment decisions to produce condensate that occurs in association with natural gas. The production of condensate can underpin the economics of gas projects.

On 13 May 2008, the Federal Government announced an intention to remove the exemption of condensate from the crude oil excise regime. The Treasurer stated that the “... *measure will increase the return to the Australian community from allowing private interests to extract non-renewable energy resources located in the North West Shelf project area and onshore*”.

Information currently available to APPEA in relation to onshore production indicates that very few petroleum fields have or will ever exceed the 30 million barrel excise free allowance threshold. Even in the very limited cases where this threshold may be passed, the annual levels of production that will apply to the relevant taxable areas will most likely be insufficient to incur an actual excise liability. In effect, there is not expected to be any duty incurred for onshore crude oil and/or condensate production in Australia. Despite this, all onshore producers are required to meet the on-going verification, administrative and compliance obligations imposed by the excise regime.

In addition to the compliance obligation on companies, the imposition of a potential excise liability on onshore crude oil and condensate production (in the event of a future discovery) has the real potential to discourage future exploration decisions. In particular, this may have implications for exploration in frontier onshore areas where the risk/reward balance can be different to more traditionally explored regions. High risk frontier exploration requires a fiscal framework that provides an incentive for risk capital to be directed towards these areas – the imposition of a potential excise liability on future discoveries clearly sends a negative fiscal signal. The imposition of this form of taxation will be even more complex in the event that liquids production is generated from unconventional sources. For example, the definition of a ‘field’ that currently exists will largely be unworkable in the context of the different geological factors associated with unconventional resources.

The Government has also effectively recognised that PRRT is now its primary mechanism for the taxation of crude oil and condensate and therefore the continued application of excise for areas that are unlikely to incur a liability is inconsistent with established benchmarks.

Recommendation: In recognition that:

- Production excise duty is unlikely to be payable on current onshore discoveries;
 - there are ongoing reporting and compliance burdens being placed on many onshore producers;
 - the Commonwealth now applies PRRT to all onshore petroleum production; and
 - the potentially negative impact that production excise can have on onshore exploration decisions;
- the Government should remove the operation of the crude oil and condensate production excise regime from all onshore areas.

Immediate Deduction of Mining Rights and Information First Used in Exploration

The future of Australia's oil and gas industry is dependent on the level of exploration. Oil and gas cannot be produced without first locating commercially viable resources and these cannot be discovered without undertaking exploration. By its very nature, petroleum exploration is high risk. This riskiness of exploration can be demonstrated by comparing the number of exploration wells drilled with discoveries and the percentage of discoveries that are subsequently converted to production. Based on Geoscience Australia (GA) data, in the period 1955 to 2011, a total of 4,248 conventional exploration wells were drilled in onshore and offshore areas. Of the wells drilled, 1,200 were considered as being 'discoveries' (a discovery well is defined as a well that recovers petroleum or encounters a producible log pay zone). This represented a 28 per cent success rate as a percentage of the number of exploration wells drilled. Of the 1,200 discovery wells, 585 led to production. This represented a 14 per cent success rate as a percentage of total wells drilled.

Exploration is often unsuccessful, more often than not it does not lead to the generation of petroleum reserves, and many decades can pass before a company is aware as to whether a discovery can ultimately be made commercial and be converted into production. Information collated by GA in relation to exploration wells drilled and discoveries provides an understanding of the inherent uncertainties associated with converting a discovery into production and the lengthy time lags that can exist between those points in time. There were 210 separate petroleum discoveries made in Australia prior to 2000 that have still to be developed.

In the 2013-14 Budget, the then Government indicated that it would re-target the immediate deduction for the cost of assets first used for exploration, by excluding mining rights and information. Under the measure, mining rights and information first used for exploration will be depreciated over 15 years, or their effective lives, whichever is shorter. The effective life of a mining right and associated exploration information will be the life of the mine or field that it leads to. If the exploration is unsuccessful, the remaining amount will be written off when this is established. It was indicated that the following will continue to be immediately deductible (that is, the measure will not apply to):

- The costs of mining rights from a relevant government issuing authority.
- The costs of mining information from a relevant government authority.
- The costs incurred by a taxpayer itself in generating new information or improving existing information.
- The mining rights acquired by a farmee under a recognised 'farm-in, farm-out' arrangement – which are often used by small explorers and do not represent a base erosion concern.

The measure was reconfirmed in late 2013 by the new Government.

The measure has application from the night of the 2013-14 Budget, however the Government indicated that it would consult closely with industry on the design and implementation of the measure. While APPEA has raised some general policy concerns with the announcement (including the incorrect suggestion that the immediate deductibility of exploration costs is a concession), a number of specific concerns were also raised. APPEA has discussed key aspects of the implementation of the measure with Government officials, and a number of issues either need to be addressed or revisited.

It is important that the policy reflects that significant sums of money are paid for exploration rights which are not about to enter production, which require substantial additional exploration expenditure to establish the existence and extent of a commercially recoverable discovery and involve significant risk. In reality, the transfer of exploration rights between parties can take place over a continuum of the exploration cycle, ranging from a point where virtually no activity has taken place, to a point where a key focus may be on delineating or seeking to convert the discovery of hydrocarbons to commercial reserves.

The purchaser of such exploration rights in the vast majority of situations is committing to the purchase price in a particularly risk activity and should receive a tax outcome that encourages further exploration effort. In comments provided to Treasury in APPEA's submission of 12 July 2013, there seems to be minimal empirical or technical justification for the imposition of a single 15 year write-off period as a default uniform safe-harbour rate, particularly as the vast majority of exploration does not lead to production. The fact that more often than not there is not a single decision point or time that reflects when exploration is 'unsuccessful' points to the need for a pragmatic outcome that balances a range of determining factors. APPEA has proposed a three year rule as being an objective measure as to whether an immediate write-off should be available.

Furthermore, it is important that reconstruction/rollover relief exists where parties within a joint venture or with interests in permits realign or reconfigure their interests in order to more efficiently develop resources (either through single or multiple projects). The use of these mechanisms (for both offshore and onshore areas) is relatively common in the petroleum industry and can be crucial to the timely development of resources. There is little risk to tax revenue providing appropriate integrity measures are implemented.

In relation to the proposal announced as part of the original decision to 'codify' the tax treatments for farm-in/farm-out arrangements that currently exist in relation to rulings MT 2012/1 and 2012/2, it is essential that this be done at the same time as any changes are made to the income tax treatment of mining rights acquired through farm-in transactions. The complexity of the rulings (and therefore the reliance of many companies to commit considerable internal and external resources to both understand and comply with the terms of the rulings) would best be resolved through the adoption of an exclusive provision in the legislation. Furthermore, APPEA considers that the existing rulings present considerable uncertainty to parties to such dealings and potentially treat commercial arrangements that have the same 'economic' outcome in a different manner for tax purposes.

Overall, the industry is seeking an outcome that ensures that exploration is recognised as a high risk undertaking, and that the details of the provisions reflect normal commercial practice in the petroleum industry.

Recommendation: The Government commits to work closely with industry in determining the details of the 'first-use' measure to ensure that the final provisions reflect the risks that are associated with the exploration phase of petroleum activities.

Introduction of Cash Bidding for Nominated 'Offshore' Acreage

APPEA remains a strong supporter of retaining the work program bidding system for the release of all exploration acreage. The work program bidding system has served Australia well and has positioned the nation to be a leader in the supply of gas to both domestic and global markets. The industry is estimated to have paid nearly \$200 billion in resource taxation since the early 1970's. It is important that potentially significant future taxation streams are not threatened by short term revenue objectives. However, APPEA recognises that legislation to enact key elements of the measure for offshore areas was passed by Federal Parliament in late 2013.

APPEA notes that the Government is currently developing guidelines that are intended to provide information and assistance in terms of the operation of the regime. They have the potential to amount to a significant additional regulatory burden on the overall acreage release framework. Key elements of the guidelines that APPEA considers need to be revisited in a policy context are:

- Prequalification – the proposed provisions are inflexible, excessively complicated and will arguably make it difficult for some companies to prequalify to bid for acreage.
- Reserve Price – there are considered to be a number of impracticalities associated with both establishing a reserve price and the decision as to whether the reserve price should be disclosed.
- Forfeiture of Deposits – there are a number of circumstances where bidders may lose a 10 per cent deposit where such an outcome would appear to be inequitable.
- Companies will be exposed to significant expenses through a rigid cost-recovery framework.
- The ability of smaller companies to participate in the offshore acreage release bidding process may be threatened if appropriate settings are not established.

Recommendation: That the Government revisits a number of key elements of the legislative package that implements the offshore cash bidding regime to ensure that it does not represent a significant increase in regulatory burden and works in a manner that doesn't diminish investor confidence in the integrity of the overall acreage release framework.

Exploration Development Incentive

The Government has announced that it will introduce an 'Exploration Development Incentive' that will allow investors to deduct the expense of mining exploration against their taxable income. Under the scheme, the ATO will determine a proportion of expenses that can be claimed as tax credits by investors. The scheme will target small exploration companies by limiting eligibility to companies with no taxable income. It will start for investments made from 1 July 2014 and will be capped at \$100 million over the forward estimates period (four years).

Under the proposed program, a tax credit will be provided to Australian resident shareholders for eligible 'green fields' exploration expenditure incurred in Australia. A 'no taxable income' test will ensure that the program is only available to junior minerals explorers. APPEA understands that the scope of the regime will be limited to mining companies. That is, it will not extend to oil and gas activities. It is unclear as to the policy basis for such a quarantining of the scope of the regime to one sector of the resources industry.

Recommendation: That the Government revisits the decision to exclude oil and gas operations from the scope of the 'Exploration Development Incentive'.

A comprehensive streamlining of Australia's greenhouse policies and programs

APPEA supports a national climate change policy that delivers abatement at least cost. This means that with a national greenhouse policy approach in place, any additional measures targeted at reducing greenhouse gas emissions should only apply to sectors of the economy that are not covered by single national approach. There is an urgent need to comprehensively streamline Australia's greenhouse policies and programs.

APPEA is working co-operatively with the Australian Government as it develops its Direct Action Plan and provided a submission⁴ to the recent consultation on the Emissions Reduction Fund (ERF) Terms of Reference and is similarly preparing a response to the ERF Green Paper⁵. As part of that approach, APPEA has urged federal and state governments to expedite the removal of the plethora of other policies and programs regulating greenhouse gas emissions in Australia. The growth of separate greenhouse initiatives and their lack of consistency increases costs and uncertainty for Australian industry, including the upstream oil and gas industry.

Recommendation: With the planned commencement of the Emissions Reduction Fund from 1 July 2014, a comprehensive rationalisation of greenhouse measures across all Australian jurisdictions should be undertaken.

Key amongst the policy approaches requiring rigorous assessment and streamlining are:

- The Energy Efficiency Opportunities measure.
- The Renewable Energy Target.

Energy Efficiency Opportunities

In relation to the Energy Efficiency Opportunities (EEO) measure, APPEA member companies have in place long-standing and pervasive energy management policies, systems and measurement indicators that form a core part of their operational performance⁶. The industry has also been a participant in numerous voluntary and mandatory energy efficiency and energy efficiency related programs since such programs commenced in Australia.

One of the features of these experiences has been a relative misunderstanding and under-appreciation by many of the existing and powerful drivers for energy efficiency that pervade the operations of the upstream oil and gas industry in Australia and the industry's history of reducing the energy intensity of its operations and increasing its energy production efficiency.

A clear example of these existing drivers can be found in the operations of Australia's existing and proposed export LNG plants. The process of liquefying natural gas is energy-intensive. The fuel used to power the various processes at the facility is often derived from the natural gas itself. Any gas used to serve as an energy source for the process is gas that cannot be liquefied and sold to export customers. This means that the use of natural gas as an energy source at the LNG facility has a very

⁴ See www.appea.com.au/wp-content/uploads/2013/11/APPEA-Emissions-Reduction-Fund-18-Nov-13.pdf for a copy of APPEA's submission.

⁵ See www.environment.gov.au/topics/cleaner-environment/clean-air/emissions-reduction-fund for further information.

⁶ An outline of these policies, processes and management systems were provided in a number of APPEA member company submissions to the Prime Minister's Task Group on Energy Efficiency, which reported in 2010. See ee.ret.gov.au/energy-efficiency/strategies-and-initiatives/prime-ministers-task-group-energy-efficiency for further information.

direct opportunity cost associated with it – every unit of gas that can be saved through reducing energy use is a unit of gas that can be sold.

This driver, that pervades the initial design and ongoing operation of these facilities exists independent of any energy efficiency policy or program and drives energy efficiency actions throughout the facility. Similar drivers exist for other upstream oil and gas facilities, producing crude oil and condensate, or gas for domestic use.

As noted above, with the proposed introduction of an Emissions Reduction Fund (ERF), where energy efficiency opportunities can bid into the Fund for potential funding, the reason for most existing energy efficiency programs is obviated. This includes programs such as EEO (including, most importantly, the recent EEO extension to greenfields and major expansions), which has been designed to encourage:

... large energy-using businesses to improve their energy efficiency. It does this by requiring businesses to identify, evaluate and report publicly on cost effective energy savings opportunities⁷

. The ERF will provide an incentive (over and above existing drivers considered above) to identify, evaluate and, where cost effective, act on any energy efficiency opportunities. For energy producing companies, particularly those operating in the upstream oil and gas industry, EEO is additional, and not complementary, to a mechanism like the ERF.

EEO imposes a range of administrative and compliance costs on participants and these costs can, for each participant, approach \$500,000. In addition, the Department of Industry incurs administration costs for the EEO program that total around \$8 million.

The *Mid-Year Economic and Fiscal Outlook* announced, at page 145, that the Government would be terminating funding for the Energy Efficiency Opportunities programme from 1 July 2014. APPEA has welcomed this announcement. While the announcement unfortunately leaves obligations in place for the compliance period ending 30 June 2014, it does provide a clear signal as to the future of the scheme and underlines the Government's desire to reduce the level of unnecessary regulatory burden on Australia industry.

Recommendation: With the commencement of the ERF and the end of funding for the current phased of the scheme, the Energy Efficiency Opportunities Assessment programme should be permanently discontinued and the *Energy Efficiency Opportunities Act 2006* should be repealed.

Renewable Energy Target

The role of the Renewable Energy Target (RET) which forces a fixed quantum of renewable energy into the electricity supply mix, displacing lower cost non-renewable, but relatively low-emission alternatives (most notably natural gas), should now be the subject of rigorous assessment.

The ERF is the primary policy initiative through which the Federal Government will achieve its greenhouse gas emissions reduction target (5 per cent reduction in 2000 emissions levels by 2020). Paradoxically, the RET will not result in any extra greenhouse gas emissions abatement, but will

⁷ See www.energyefficiencyopportunities.gov.au for further information.

certainly result in extra costs as it locks in coal fired power generation while driving the deployment of higher cost renewable technologies.

The RET is an economically inefficient policy that should be discontinued. Based on economic modelling conducted by BAEconomics, the cost of continuing with the RET scheme when a national climate policy is in place⁸ will reduce Australia's economic output (GDP) by \$6.5 billion more than would the standalone approach.⁹

Recommendation: The RET should be discontinued. At least in the medium-term, it is a policy that results in a higher cost to achieve the same level of overall constraint on greenhouse gas emissions than would have been achieved in the absence of the RET.

But if the RET is retained, its negative impact should be reduced:

- The fixed gigawatt hour target should be revised down to reflect the level that achieves the 20 per cent by 2020 commitment.
- The partial exemption certificates (PEC) provided to trade exposed industries, including LNG, to offset costs of the RET should be increased to 100 per cent.
- Amendments to the operation of the self-generation provisions contained in the current legislation are needed.

Streamlining of Environmental Approvals

The Australian oil and gas industry supports a strong and robust environmental regulatory framework that is:

- Underpinned by sound science and evidence
- Has clear objectives and transparent oversight
- Objective-based and does not place unnecessarily prescriptive conditions on operators
- Appropriate to the nature and scale of the project
- Supported by extensive guidance on expectations
- Considered in the context of all legislation (federal, state and local council to ensure that conflicting objectives are identified and minimised)

Red and green tape is consistently raised by companies as one of the top issues impacting the ongoing competitiveness of Australia's oil and gas industry. We welcome the Government's ongoing commitment to reducing red and green tape, but believe it remains imperative that all levels of government continue to work with industry to streamline regulatory approvals and processes.

The Federal Government's move to establish the framework for a 'one-stop-shop' for Commonwealth and State / Territory Government environmental approvals under the *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act) is a step forward in streamlining regulatory approvals. Further, considerable progress has been made towards the objective of streamlining the environmental assessment of petroleum activities in Commonwealth waters under both the EPBC Act and the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (OPGGs Act).

⁸ In the case of the BA Economics modelling, an economy-wide carbon price.

⁹ Available at www.appea.com.au/wp-content/uploads/2013/06/APPEA-submission-on-RET-BAE-report.pdf.

While much needs to be done to successfully implement the reforms underway, we believe the strategic assessment process being undertaken under the EPBC Act for offshore approvals by National Offshore Petroleum Safety and Environmental Management Authority (NOPSEMA) may present a model that could be utilised to further streamline onshore industry approvals. This process ensures environmental processes achieve the objectives of the EPBC Act rather than duplicating the EPBC Act approval processes.

The 2014-15 budget should consider further mechanisms that introduce greater efficiency into approvals processes while maintaining standards of environmental regulation. We put forward two specific suggestions for the Government's consideration.

1. Safety and environmental approvals for petroleum activities in state waters ("inshore matters")

A number of offshore petroleum activities cross the boundaries between state and federal jurisdictions and as a result require both state and commonwealth government approvals. For example, an operator of a pipeline crossing federal and state waters needs to submit a safety case and environmental plan to NOPSEMA for the pipeline section in commonwealth waters as well as submitting separate approvals to state authorities for the pipeline section in coastal waters. Similar dual-track approvals processes are required for activities such as seismic surveys and when undertaking incident contingency planning. Significant differences and inconsistencies often exist in legislative requirements between the jurisdictions resulting in an increased regulatory burden for industry and increased administrative burden for regulators. There is clear scope for significant improvement.

Under the *Offshore Constitutional Settlement Agreement (1979)* dealing with commonwealth and state jurisdiction in the waters to the edge of the territorial sea, the States agreed to align their respective legislation and regulations with that of the Commonwealth. Among other things, it was recognised that this would provide consistency to operators. The Commonwealth's OPGGS Act contains mechanisms for the States or Northern Territory to confer environmental functions (as well as Occupational Health and Safety and structural integrity matters) in designated coastal waters (generally the first three miles seaward of the territorial sea base line) to NOPSEMA. However, these have not been fully utilised by the States or the Northern Territory. In most cases, no conferrals have occurred; or in cases where they have been conferred (OH&S), most have since lapsed.

APPEA believe the conferral of the responsibility for environmental approvals (as well as OH&S and integrity) of petroleum activities within three mile state and territorial water limits to NOPSEMA would represent a vital next step in the regulatory reform process for the oil and gas industry.

2. Repeal of the 'water trigger' for CSG activities under the EPBC Act

The June 2013 amendments to the EPBC Act by the previous government introduced impact on water resources as a matter of National Environmental Significance (NES) in relation to coal seam gas and large coal mining activities (the water trigger).

APPEA continues to contend there was no clear policy failure warranting the introduction of the water trigger and endorses statements made by the Coalition during debate on the amendment that the legislation was "*driven completely by the politics of the (then) government and not science.*" Indeed, the water trigger was never even subjected to the most rudimentary regulatory impact

assessment process. The amendments have created an additional unnecessary layer of approval, imposing a preventable regulatory burden on industry and the resources of the federal government.

As the Government has acknowledged, the Australian natural gas industry works within a robust regulatory framework for environmental approvals and water management. Existing assessment processes require detailed scientific, social and economic analysis of both surface and groundwater at both a local and regional scale to ensure potential impacts are understood, mitigated and managed. As an example of the comprehensive nature of the existing regime, it took three years and three months and a 13,500 page Environmental Impact Statement (EIS) for Commonwealth and State approval to be granted for the Santos GLNG Project. These approvals included 1,200 strict conditions over the project's operations and requirements for further, extensive scientific work to be undertaken as the project proceeded. In relation to water, the EIS process included numerous studies and reviews by companies, regulators and independent scientific authorities to understand the potential impacts of the project

The Productivity Commission's (PC) recent report into *Major Project Development Assessment Processes* (2013) examined inefficiencies in the regulatory processes that currently apply to major projects in Australia. It made a specific recommendation (Recommendation 6.3) that the Government should repeal the water trigger amendment should a regulatory impact assessment indicate that the trigger does not provide meaningful benefits to the community.

The water trigger remains a key concern for the oil and gas industry. It adds to the cost and time-frames of approvals, and the risks that industry must consider when investing in Australia. It also prevents full implementation of negotiated bilateral agreements. While the state may be accredited with the responsibility for assessing and granting most EPBC Act environmental approvals, water trigger related actions are unable to be approved by the States and Territories under an approvals bilateral agreement. This is due to the specific preventative provisions that were inserted in the EPBC Act during the passage through the House of Representatives.

Recommendation: Further action to streamline safety and environmental approvals should be taken through discussions with the states aimed at conferring regulatory oversight in state waters to NOPSEMA. Action should be taken to repeal the CSG development –related water trigger under the EPBC Act as a matter of priority.

In summary, APPEA believes that ongoing reforms are needed to address poorly developed and administered regulation at all levels of government. APPEA therefore recommends that the Government continue to resource and promote efforts to encourage clear and efficient regulation.

We believe that addressing the areas outlined below are would further the Government's objective of achieving regulatory efficiency and strong environmental standards and complement the work done to date on delivering a "one-stop shop":

Developing viable labour markets that encourage mobility, flexibility and productivity

Promoting Local Industry Participation – *The Australian Jobs Act 2013*

The *Australian Jobs Act 2013* (the Act) was introduced by the previous Government as part of a broader local industry participation policy and seeks to influence procurement decisions connected with large investment projects in Australia. Rather than achieving its stated objective, the Act imposes unnecessary cost burdens on companies while distorting the efforts and outcomes of existing company systems and processes. Existing systems already provide full, fair and reasonable opportunity for local suppliers to participate in the delivery and operation of major projects.

The upstream oil and gas sector recognises that local suppliers can provide significant advantages to projects through faster turnaround of services, localised employment, improved timings and improved communication. A 2012 report by Australian Venture Consultants¹⁰ considered 59 Australian construction contracts and found that 48 had an average value of \$256 million for services ranging from engineering, fabrication, occupational health and safety, medical, aviation, marine and FIFO accommodation services. Thus a substantial contribution is already being made. The industry also continues to invest heavily both in financial terms and in the development of collaborative relationships to address capability, capacity, skills and training gaps.

When coupled with the potential for injunctions and other penalties, the Act introduces a system of onerous and complex administrative requirements to deliver the same results that companies have been achieving for some time. For example, the introduction of a ‘trigger date’ for the provision of an Australian Industry Participation (AIP) Plan without any clear need or definition has created significant ambiguity. As a result, the Act increases uncertainty and escalates compliance costs (particularly for smaller projects and/or those with limited exposure to the existing Enhanced Project By-Law Scheme (EPBS) structure) without a demonstrated commensurate additional benefit to Australian suppliers. Overall, the system has introduced a ‘form over substance’ regulatory regime that is inconsistent with the Government’s committed to reduce red and green tape.

Experience has indicated that key issues preventing the majority of local suppliers from successfully winning work include:

- Having appropriate management systems to address legislative requirements for health, safety and environment.
- Developing the management systems and processes required to prequalify.
- Knowing how to tender and submit compliant tenders.
- Remaining internationally competitive with a high Australian dollar.
- Complying with globally accepted technical standards for asset integrity and safety.

APPEA believes that the key focus of any reforms should be on increasing supplier competitiveness and capacity, not introducing additional red tape and increased bureaucracy.

¹⁰ Australian Venture Consultants (2012), *The Wider Contribution of the Oil and Gas Industry to the Australian Economy: A selection of case studies*, (available at www.appea.com.au/images/stories/Reports/the%20wider%20contribution%20to%20australia%20of%20the%20oil%20and%20gas%20industry%20-%20a%20selection%20of%20case%20studies.pdf).

This is the key pre-requisite step in order to address the productivity constraints that are limiting the ability of local suppliers to participate on a global basis.

Recommendation: The duplicative and additional regulations created by *The Australian Jobs Act 2013* distort similar processes established as a result of EPBS requirements. As such, the Government should commit to abolish the additional regulatory obligations placed on project developers that were introduced as part of the legislation.

Labour Market Testing in the Standard Temporary Work (Skilled) (subclass 457) visa program

Streamlined and efficient access to skilled overseas workers is essential if the oil and gas industry is to optimise its value to the economy and create ongoing, permanent jobs during the operational phase of resource projects. In the oil and gas sector there are two key drivers for using 457 visas:

- To access workers when the necessary skills and or experience, usually in highly specialised areas, are not available domestically.
- To develop the skills, experience and careers of employees within a company who are located internationally (intra-company transfers).

Most operational jobs in the industry are recruited, trained and developed locally. The assumption that it is cheaper for companies to hire overseas workers than local ones is simply not true. Bringing in workers from overseas on 457 visas is a high-cost option.

Research suggests that up-front relocation costs around \$65,000.¹¹ In addition, oil and gas industry experience is to allow a multiplier of between 2.0-2.5 times base salary to employ overseas workers. For example, if a salary was say the equivalent of \$100,000 for an Australian worker, the cost to employ an overseas worker would be up to \$250,000 per annum over the life of the assignment. These business costs generally include visa processing costs, flights, car, accommodation, medical checks, shipping costs for transporting personal effects, insurances, expatriate allowances and so on. They can be significantly higher if, as in many cases, spouse and children are also involved.

The oil and gas industry operates globally and is underpinned by a mobile, highly skilled international workforce. Australian workers benefit significantly from temporary skilled workers who have significant experience on projects around the world and share their knowledge and expertise with less experienced local workers. In addition, a number of Australian employees will, at some stage in their careers, be able to participate in project placements or secondments in other parts of the world as part of a company's global talent development strategy. These 'professional development' opportunities ensure that employees are at the cutting edge of a high technology and innovative industry, and that companies are retaining talent and optimising their global workforces.

Recommendation: That legislation requiring labour market testing for 457 visas be repealed.

Engineering is central to our industry. The requirement for all engineering roles to be market-tested is an unreasonable burden and adds to project timeframes, costs and administration.

¹¹ Bahn, G. Yap, L. Barratt-Pugh (2012), *457 visa workers in the Western Australian resources industry: the benefits and costs for business, migrant families, and the community*, Edith Cowan University (available at www.ecu.edu.au/data/assets/pdf_file/0003/406353/FINAL-34028-ECU_Research_Report-Web.pdf).

Engineering occupations and qualifications should be removed from the ‘protected experience’ and ‘protected qualification’ category. It is important that the oil and gas industry can assure international investors that Australia can secure the skills and talent necessary to ensure our keystone projects are on time, on budget, safe and productive.

Labour Relations legislation and provisions under the *Fair Work Act 2009 (FWA)*

There are a range of institutional barriers under the FWA that impact major project development costs and raise project execution risk:

- The requirement to negotiate greenfields agreements exclusively with employee organisations, which has exposed major projects to unreasonable union demands;
- The expansion of the subject matter that can be bargained by relevant employee organisations for inclusion in Agreements under the Fair Work Act 2009 (FWA) hampering efforts to improve productivity (e.g., restrictions on use of contractors) and running counter to the productivity objective referred to in the Object of the Act (at section 3(a)); and
- Right of entry provisions that allow unions right of entry to a site, regardless of whether they have members on that site. ²

Negotiations for greenfields agreements have become particularly problematic. Wage levels under a greenfields agreement applying to one major project have become the starting point on which negotiations for a greenfields agreement for another project begin. With the requirement to negotiate exclusively with employee organisations and tight schedule and cost considerations, increases in wages and conditions that have applied to some projects have become unsustainable, risking future investment.

Recent actions by unions engaged in EBA ‘negotiations’ provide evidence of the difficulty in bargaining with militant unions under the existing FWA, and demonstrate the critical need for workplace relations reform.

The Maritime Union of Australia’s (MUA) approach to the 2013-14 Vessel Operator Enterprise Bargaining Agreement (EBA) is likely to see the union take FWA sanctioned protected industrial action in pursuit of wage increases and other claims. It is seeking, among other things, a 24 per cent pay rise over four years that is not linked in any way to productivity gains along with the insertion of “job security” clauses in the EBA following a prolonged union campaign. The effect of these clauses is to restrict the use of contractors and influence the employment terms and conditions adopted by those contractors when operating on the client’s site. These provisions provide MUA members with primacy of employment over all other workers including foreign, contracted and non-union personnel, and perpetuate a ‘closed shop’ on particular sites.

Disputes such as the current MUA campaign stand to have a substantial impact on productivity, international competitiveness and the attractiveness of Australia for further investment in the oil and gas sector.

Urgent reform of the FWA is required in the following areas:

- Remove maritime unions as the sole and default bargaining representative body for employees in the maritime sector.
- Reduce access to legally protected industrial action; this should be an option of last resort used only when all other options are exhausted and only after genuine attempts to reach a satisfactory resolution.
- Reduce the scope of matters that can be included in enterprise agreements and over which industrial action can be taken. Ensure allowable matters relate to the direct relationship between employers and employees, not to third parties. This includes clauses that restrict hiring practices, entrench a union closed shop and undermine managerial decision-making.

Recommendation: APPEA recommends legislative amendments be made to the *Fair Work Act 2009* in the areas of greenfields agreements, union rights of entry, protected industrial action and allowable matters under EBA agreements.

Conclusion

The oil and gas industry plays a key role in meeting Australia's energy needs. It also makes a major contribution to the economy of Australia and welfare of all Australians.

APPEA believes government can facilitate the ongoing contribution of the oil and gas industry and recommends a number of legislative and policy changes.

These recommendations include:

1. The Government introduces a tax free threshold on a barrel of oil equivalent basis for new onshore petroleum projects and consults on the practical application of such a measure.
2. The Government works directly with industry to identify and implement measures to simplify the administration of the PRRT regime, and in particular, eases the burden on small and mid-sized entities.
3. In addressing the existing technical and policy uncertainties associated with the operation of the PRRT legislation, recognise industry practice and avoid narrow and/or technical constructs that do not reflect industry operational and commercial operations..
4. The Government removes the operation of the crude oil and condensate production excise regime from all onshore areas.
5. The Government to work closely with industry in determining the details of the 'first-use' measure to ensure that the final provisions reflect the risks that are associated with the exploration phase of petroleum activities.
6. That the Government revisits a number of key elements of the legislative package that implements the offshore cash bidding regime to ensure that it does not represent a significant increase in regulatory burden and works in a manner that doesn't diminish investor confidence in the integrity of the overall acreage release framework.
7. That the Government revisits the decision to exclude oil and gas operations from the scope of the 'Exploration Development Incentive'.
8. With the planned commencement of the Emissions Reduction Fund from 1 July 2014, a comprehensive rationalisation of greenhouse measures across all Australian jurisdictions should be undertaken.
9. The RET should be discontinued. At least in the medium-term, it is a policy that results in a higher cost to achieve the same level of overall constraint on greenhouse gas emissions than would have been achieved in the absence of the RET.
10. Further action to streamline safety and environmental approvals should be taken through discussions with the states aimed at conferring regulatory oversight in state waters to NOPSEMA. Action should be taken to repeal the CSG development –related water trigger under the EPBC Act as a matter of priority. .
11. The Government commits to abolish the additional regulatory obligations placed on project developers that were introduced as part of *The Australian Jobs Act 2013*.
12. Legislative amendments be made to the *Fair Work Act 2009* in the areas of greenfields agreements, union rights of entry, protected industrial action and allowable matters under EBA agreements.