Canberra (Head Office)

Level 10
60 Marcus Clarke St
Canberra ACT 2601

GPO Box 2201
Canberra ACT 2601

p: +61 2 6247 0960
e: appea@appea.com.au
w: www.appea.com.au

29 January 2020

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

Email: prebudgetsubs@treasury.gov.au

RE: 2020-21 FEDERAL PRE-BUDGET SUBMISSION – AUSTRALIAN PETROLEUM PRODUCTION EXPLORATION ASSOCIATION

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body representing upstream oil and gas explorers and producers active in Australia. APPEA's member companies account for more than 90 per cent of Australia's petroleum production. Further information about APPEA can be found on our website, at www.appea.com.au.

APPEA seeks to work with Australian governments to help promote the development of the nation's oil and gas resources in a manner that seeks to maximise the benefits of the industry to the Australian industry and community.

The oil and gas industry is an integral part of the Australian economy, including through:

- the supply of reliable and competitively priced energy;
- the investment of hundreds of billions of dollars of capital;
- the direct payment of billions of dollars in taxes and resource charges to governments;
- the direct employment of tens of thousands of Australians; and
- the generation of significant export earnings.

International Outlook

The global liquefied natural gas (LNG) market is undergoing a transformation due to surging growth in global gas trade. In mature natural gas markets, like the United States and Europe, coal-to-gas switching is a compelling near-term option for reducing emissions, given existing infrastructure and spare capacity. Natural Gas can also contribute to security of electricity supply by balancing variable renewables and meeting peaks in demand.

In the developing nations, natural gas plays a more pronounced role helping to replace more emissions intensive fuels out of the energy system, in both power and industrial sectors.

The International Energy Agency (IEA) in its *World Energy Outlook 2019* (WEO) estimates that there are 862 million people without electricity and another 2.7 billion do not have access to clean cooking facilities.[1] As the standards of living for these people improve and they move out of poverty, they will consume more energy for household and industrial purposes. The WEO estimates lack of access to clean cooking facilities is the cause of more than 2.5 million deaths globally per year.[2]

The Australian oil and gas industry has invested over $350 billion in natural gas production, transport, liquefaction and export facilities over the last decade. This investment will deliver returns for Australia with exports revenue increasing to more than $50 billion in 2018-19, more than double compared to $22.3 billion in 2016-17.[3] This growth means LNG is one of Australia's greatest export earners.

If Australia is to capture further investment in LNG production, it is vital to get the policy settings right by maintaining a stable and competitive tax regime and reducing regulatory costs. Key policies include:

- allowing transparent, open and secure access to resources for exploration and development;
- supporting investment and industry productivity through a stable taxation regime that recognises the costs of doing business; and
- facilitating access to domestic and international markets on globally competitive terms.

The Fraser Institute's *Global Petroleum Survey 2018* released in November 2018 ranked 80 jurisdictions on 'barriers to investment' to oil and gas exploration and production. The survey results indicate that New South Wales (73rd), Victoria (77th) and Tasmania (78th) are amongst the worst 10 in the world. Jurisdictions within this group include Venezuela (80th), Yemen (79th), Libya (76th) and Iraq (75th).[4] These are also the 3 jurisdictions in Australia that have banned or restricted onshore gas development. The three states have been poor performers for years, but their investment rankings continue to fall.

Domestic Gas Supply

The Australian domestic gas market is at a critical juncture of its development. A continuing failure to unlock new gas supplies will place homes and businesses under increasing and unnecessary price and supply pressure. The key to downward pressure on prices is increased investment and supplies. Government actions are needed to address supply tightness and climbing energy costs.

Over the previous two years, the industry has committed to developing and ensuring there is no shortfall in domestic gas supply and has been successful in making natural gas available to the domestic customers at prices lower than the peak of 2017. The release of the Australian Competition and Consumer Commission's (ACCC) latest *Gas Market Inquiry 2017-2025* report confirms that east coast gas prices remain below 2017 peaks, due largely to new supply entering the market.[5]

As the ACCC reports have repeatedly stated, customers in New South Wales and Victoria are paying more than necessary for their gas. This is at least in part as a result of state government restrictions on developing local gas resources. Importing gas from Queensland adds $2-$4/GJ to retail prices in the southern states, which can be up to a quarter of the price. As the ACCC noted in releasing the July 2019 report:

[1] International Energy Agency, *World Energy Outlook 2019*, November 2019, p. 83, Paris.
[2] International Energy Agency, *World Energy Outlook 2019*, November 2019, p. 83, Paris.
[3] Department of Industry, Innovation and Science, *Resources and Energy Quarterly* publication series.
[4] Fraser Institute, Global Petroleum Survey 2018, November 2018. The 2019 survey is yet to be released.
[5] ACCC, *Gas inquiry report 2017-2020 Interim report July 2019*, 22 August 2019.

… a key way to improve pricing outcomes for all C&I users—particularly the majority which are located in the southern states—is with the production of additional, lower cost supply in the southern states by a diversity of suppliers.[6]

APPEA continues to urge state governments to adopt policies that consider and manage the risks of individual gas development projects, rather than implementing blanket moratoria and regulatory restrictions. Governments wanting lower gas prices, more investment and more diversity of supply have the solution to hand – follow the Northern Territory's recent example and support the safe, responsible development of the resources within their jurisdiction.

While there has been no gas shortfall in the east coast gas domestic market, the industry has responded to government and market concerns, investing in and delivering more gas supply into the domestic market, notwithstanding development restrictions in the southern states.

In the past two and a half years, there have been gas supply agreement (GSA) announcements from companies including Arrow Energy, Australia Pacific LNG, Beach Energy, BHP, Cooper Energy, Esso Australia, GLNG, Origin Energy, Santos, Senex, Shell Australia, Strike Energy and Westside Corporation to provide new supply in various parts of eastern Australia gas market.

In addition to that, the Queensland government has has issued tenements with domestic supply conditions to six gas producers: Senex Energy, Chi Oil and Gas, Armour Energy, Central Petroleum, a joint venture between Santos and Shell, and a joint venture between APLNG and Armour Energy. Gas produced from each of these tenements must be sold domestically, and gas from the APLNG/Armour Energy tenement has an additional requirement that it must be sold to a manufacturer.

Since 2012, almost 80 GSAs have been publicly announced in Australia, including more than 40 GSAs with manufacturers. The entire industry has met and will continue to meet its commitment to the Australian people and businesses to ensure there is adequate supply of natural gas to the domestic market.

Petroleum Exploration in Australia

Australia's success as a supplier of oil and gas has been made possible by a long-term commitment to exploration. Without exploration, future production will decline, compromising Australia's energy security and prosperity.

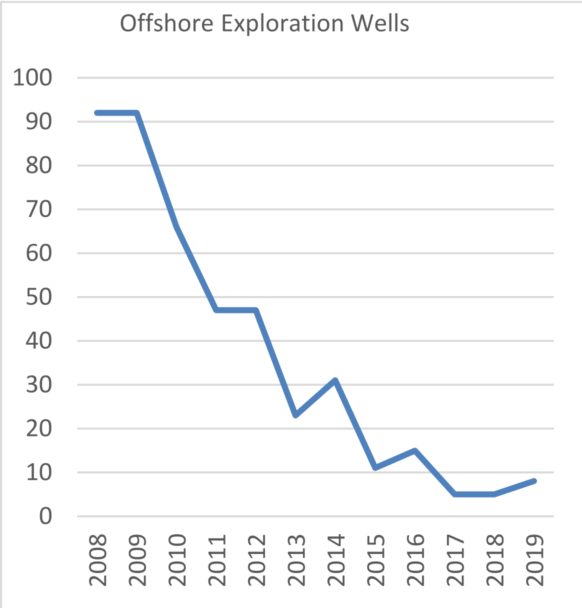
Exploration activity (measured by wells drilled) has been suppressed levels (both onshore and offshore) for a number of years. Looking ahead, the most recently disclosed exploration work programs show a very modest recovery may be underway in 2020. The causes of the fall in exploration are complex. Commodity prices is just one of the factors responsible for declining exploration; others include regulatory creep, a lack of prospective new acreage, data gaps, diminished access to capital and impediments that are placed on access by governments.

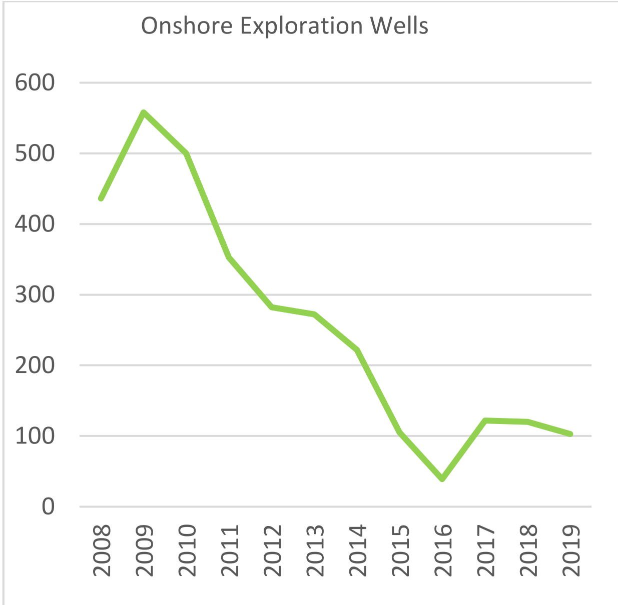
Australia needs to maintain a stable, attractive policy environment to reverse the decline in petroleum exploration investment. Policymakers should not lose sight of the fact that global investment capital is scarce and will always go to the best commercial prospects.

---

[6] ACCC, *Gas inquiry report 2017-2020 Interim report July 2019*, 22 August 2019, p. 108.

Chart 1: Petroleum exploration wells drilled (offshore and onshore)





Source: APPEA (2019)

Australia's success in terms of identifying and unlocking new petroleum resources has been underpinned by a long-standing and successful acreage release frameworks based on competitive work program bidding systems. The new tenure nomination and release process was announced in 2019 with a record 64 separate acreage release areas on offer. APPEA supports the ongoing release of areas for competitive bidding.

APPEA welcomes the Government's continued commitment to providing high-quality, pre-competitive geoscience information. Australia's pre-competitive offshore geoscience work, undertaken at a national level by Geoscience Australia, is highly regarded and provides an essential information base for explorers and governments. A review of Geoscience Australia undertaken by the Department of Finance and Administration in 2011 confirmed that there are strong 'public good' reasons for ongoing public investment in geoscience research. Such investment delivers positive returns to the community.

The announcement of the Australian Government's "Gas Acceleration Program" that seeks to support new supplies of gas into the east coast gas market by fast tracking new developments was supported by industry.[7] These are modest but targeted measures that seek to build confidence and utilise the experience of companies on the ground.

While there are no easy solutions that will deliver a quick recovery of Australia's exploration activity, regulators must understand that a 'business as usual' attitude will not deliver the new reserves needed to sustain and grow one of Australia's most important industries.

[7] Media Release, Senator the Hon Matthew Canavan, Gas Acceleration Program Grant Guidelines Released, 20 December 2017.

Fiscal (Tax and Commercial) Settings

A strong and growing oil and gas industry creates enduring wealth and prosperity for all Australians. The oil and gas industry has been operating successfully in Australia since the 1960s and during that time it is estimated that the industry has paid more than $250 billion – in today's dollars – to governments through resources charges and corporate income tax.

The more recent successes of Australia's oil and gas industry is making Australia a world leader in energy supply. This is a significant contribution when considered in the context of the oil and gas industry being truly global, and where projects must compete against each other on a global scale for a limited pool of funds available for both exploration and resource development.

These recent successes however, should not be taken for granted as more jurisdictions being accessible place stress on Australia's competitive advantages. To ensure that Australia can capture the next wave of investment, APPEA believes that a competitive taxation regime couple with a platform of stable political, economic, and taxation policies will be central to Australia attracting further investment.

The industry continues to be confronted with challenging operating conditions. Australia's oil and gas industry operates in a relatively high cost environment when compared with other jurisdictions. The development of an oil and gas resource into a project requires significant work and calculated risk-taking. This is because oil and gas projects have some of the longest time horizons for companies that require substantial upfront capital investment and a long-term commitment to developing the resource.

In early 2019, the Organisation for Economic Cooperation and Development (OECD) *Corporate Tax Statistic* released a study comparing more than 100 countries shows Australia is being left behind as other countries improve the competitiveness of their respective tax systems. For example, the report shows that Australia has the third highest effective corporate tax rate in the world. The Treasurer in the press release[8] on the report noted:

> *The OECD report highlights that tax is a factor that drives cross-jurisdiction competitiveness for investment.*

The petroleum resource rent tax (PRRT) has been operating successfully since the 1980s. It remains a global benchmark for profits-based resources taxation and has provided a stable framework that has underpinned investment in the industry over many years. This was highlighted when the Callaghan review of the PRRT was released where it was confirmed that the PRRT is an effective profits tax which delivers, over the life of projects, a higher return than royalties once a project has recovered costs.

As was evident throughout the Callaghan review, the PRRT has been instrumental in promoting a long-term and robust exploration effort in Australia. It remains a perfect fit for oil and gas operations in Australia. Any changes to this regime have the potential to undermine the next wave of investment in the industry over the next decade and should not proceed unless they have been carefully thought through to ensure that they do not disturb existing investments, or put at risk future investment.

This includes the PRRT gas transfer pricing review currently being run by Treasury. Whilst APPEA and its members are working constructively with Treasury, any changes to the regime need to be carefully

[8] Media Release, Treasurer the Hon Josh Frydenberg, *OECD report highlights low taxes are key to competitiveness*, 15 January 2019.

considered to ensure that it does not create an impediment to Australia's ability to extract oil and gas resources or fundamentally disturb the investment decisions of the past.

From a corporate tax perspective, an area where the industry recommends reform relates to the taxation treatment of petroleum asset swaps and realignments. Prior to 2013, where certain conditions were met, the cost of acquiring an interest in a petroleum permit from another taxpayer was immediately deductible, which generally made a petroleum title swap both efficient and tax neutral.

Following the May 2013 Federal Budget, immediate deductibility was replaced with deductibility over 15 years or a project's effective life. The impact of the change was to potentially make it costlier for investors to swap assets to aid resource development decisions. Some realignments that were executed prior to the law change may not have proceeded under the present law, given the large upfront cash that would have been required to meet both parties' tax obligations.

Post the 2013 announcement, the petroleum industry demonstrated the need for rollover relief for commercial transactions involving interest realignment permit swaps on the basis that these transactions were not the threat to revenue that the original law change was intended to address. The Government agreed to implement rollover relief for interest realignments within projects, however this did not extend to permit swaps across projects.

There is now a focus around the need to develop discovered gas resources and ensure the economic life of existing infrastructure is maximised. Challenges nevertheless remain in aligning the operational and commercial interests of the participants in different projects, including some that have significant taxation impacts. For example, where companies wish to swap their interests in a permit in exchange for an interest in a separate permit or infrastructure, parties are subject to potentially significant tax liabilities despite no immediate economic gain being generated.

To address the above concern, the industry recommends that the Government seeks to implement reforms to ensure that transactions involving swaps of permits and existing infrastructure in Australia, to the extent value has been merely exchanged, are tax neutral. Industry recognises that any cash component of a transaction (such as where differences in the values of permits or infrastructure exchanged are not the same) should still be subject to tax upfront as per the current law.

Such a "like for like asset" exchange rollover could achieve this outcome, similar to enacted laws applicable in the US and the UK. Rollover relief in these situations should not pose significant revenue concerns as there are no upfront deductions being claimed to reduce the other tax profits of the purchaser and there is no forgone tax revenue as the transaction may not have likely otherwise proceeded. The tax liability on the transaction itself is only deferred, not removed. Importantly, the broader picture here is that a new revenue stream for Government will potentially be unlocked.

Given Australia's vast size, remote terrain and distance from markets (both domestic and export), many permit areas which contain discovered resources cannot individually underpin the infrastructure required to undertake high cost exploration and/or development activities.

This presents challenges for both industry and governments. Government policy decisions need to consider facilitating access to multi-user infrastructure to better connect resource to markets. Industry needs to identify options where existing infrastructure can be jointly utilised to reduce costs and open up new opportunities.

Conclusion

Australia's upstream oil and gas industry remains committed to ongoing policy reforms that overcome the nation's high cost challenges and lead to more investment being secured to develop our abundant natural resources. To discuss any aspect of APPEA's submission, please contact Mr Damian Dwyer, Deputy Chief Executive, at ddwyer@appea.com.au.

Yours sincerely

Andrew McConville
Chief Executive

ATTACHMENT 1

THE ECONOMIC CONTRIBUTION OF AUSTRALIA'S OIL AND GAS INDUSTRY

Since the middle of the nineteenth century, the Australian oil and gas industry has contributed significantly to the Australian economy. The industry has supplied energy to Australia and through exports to our major trading partners, particularly in Asia.

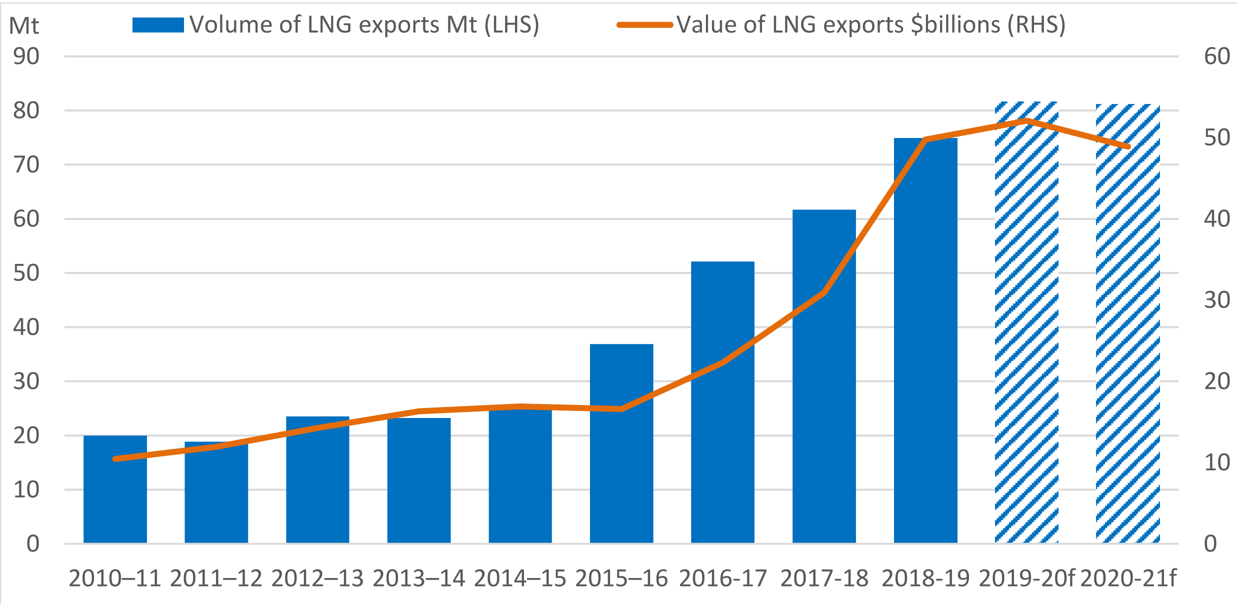
The industry enters 2020 towards the end of an unprecedented capital investment into Australia with approximately $350 billion invested into the development of oil and gas projects and related infrastructure over the last decade. This is significant when considered in the context of the oil and gas industry being truly global, and where projects must compete against each other on a global scale when there is only a limited pool of funds for both exploration and production. This investment will benefit Australia through export revenue, employment and taxes and royalties for decades to come.

National Economic Benefits

The oil and gas industry supports 80,000 jobs directly and indirectly in Australia and hundreds of thousands more in the manufacturing industry. At end of November 2019, industry employment has increased by 39 per cent year on year and is more than double the employment from a decade ago.[9]

According to the Department of Industry, Innovation and Science liquefied natural gas (LNG) is now Australia's second largest export commodity after iron ore, with export revenue of $50 billion in 2018-19, and has more than doubled over the last two years (from $22.3 billion in 2016-17).[10] LNG exports are forecast to increase to $52 billion in 2019-20 as plants commissioned in the last 12 months start producing.[11]

Chart 2: Volume and value of Australia's LNG exports



Source: Department of Industry, Innovation and Science, Resources and Energy Quarterly publication series

[9] Australian Bureau of Statistics, catalogue number 6291.0.55.003 - *Labour Force, Australia, Detailed, Quarterly*, Nov 2019, table 06, released on 23 December 2019.
[10] Department of Industry, Innovation and Science, *Resources and Energy Quarterly September 2019*, p. 50.
[11] Department of Industry, Innovation and Science, *Resources and Energy Quarterly, September 2019*, p. 50.

Contribution to domestic energy consumption

The Australian oil and gas industry plays a critical role in supplying energy in Australia, to residential and commercial customers, directly and through electricity generation. Gas powered electricity generation provides security, reliability, affordability to the electricity grid, and has half the emissions compared to coal.

In Australia, oil and gas are the largest and third largest fuel sources of energy consumption, together accounting for more than 64 per cent of energy consumption in 2017-18 (oil – 39 per cent, gas – 25 per cent).[12]

Oil is used mainly in the transport sector (51 per cent), manufacturing (36 per cent), mining (7 per cent, agriculture (3.3 per cent) and in commercial, services, electricity generation, residential and construction sectors.

Natural gas accounted for a quarter of all energy consumption in Australia in 2017-18, up from 19 per cent in 2000-01. Natural gas is used in electricity generation (37 per cent), manufacturing (26 per cent), mining (22 per cent), residential use (12 per cent), in commercial services, transport and the construction sectors.[13]

Natural gas is both a source of energy and an essential raw material for the manufacturing of everyday products like glass, ceramics, bricks, cement, plastic packaging for food and beverages, fertilisers, antifreeze, metals like aluminium, copper, zinc, tin and in processes of food preparation, fermentation and brewing. In most cases, there is no substitute for gas.

Natural gas is also a critical fuel for electricity generation in Australia. Gas currently accounts for around 12 per cent of National Electricity Market (NEM) generation and 21 per cent of Australian electricity generation. However, it is widely acknowledged that the path to lower emissions needs will require a significant level of gas-fired power generation.

Intermittent renewable energy requires "on call' electricity generation to manage falls in renewable output or spikes in demand. Gas-fired generation is a key technology capable of delivering flexible response (since it can ramp up and down quickly). On-call gas-fired electricity generation will continue to back up intermittent renewable generation into the foreseeable future. Renewable projects will also have a new incentive to create firm dispatchable power. This will provide new opportunities for natural gas and renewables to partner in providing affordable, reliable and low-emissions energy to Australian consumers and industry.

As an example, modelling conducted for the Climate Change Authority shows that if Australia is to achieve its 2030 Paris agreement emissions targets in a cost-effective manner and ensure supply stability, by 2030, gas-fired generation would need to increase significantly.[14]

Globally, the Australian oil and gas industry is playing its part in reducing global greenhouse gas emissions. According to recent government estimates, Australian LNG exports are reducing emissions

[12] Department of the Environment and Energy, *Australian Energy Update 2019*, September 2019, Table C.
[13] Department of the Environment and Energy, *Australian Energy Update 2019*, September 2019, Table F.
[14] Climate Change Authority, *Policy Options for Australia's electricity supply sector*, August 2016, p. 89.

by at least 159 million tonnes in our customer nations – equivalent to around 30 per cent of Australia's annual emissions. [15] Australian LNG is doing its bit in addressing the global problem of climate change.

Global gas demand – the economic opportunity

According to the IEA, global gas demand is forecast to increase by 37 per cent to 2040 at an annual rate of 1.4 per cent.[16] Gas share of global energy demand will increase to a quarter, overtaking coal to be the second largest fuel source after oil. By 2040, industrial use of gas is forecast to increase by 62 per cent.[17]

The IEA forecasts inter-regional gas trade is expected to increase by 62 per cent, totaling 1,278 bcm by 2040. By 2040, 57 per cent of international gas trade is expected to be in the form of LNG, with LNG trade accounting for 77 per cent of the growth to 2040. The Australian oil and gas industry is well placed to capitalize on the opportunity ahead with a significant investment in production capacity over the last decade which will in turn deliver significant benefits to the Australian economy and community.

INDUSTRY CHALLENGES

The outlook for the Australian oil and gas sector is one with significant opportunities as well as significant challenges. Looking forward to 2020 and beyond, Australia faces intense competition from established and emerging low-cost producers in the global market, particularly the United States, which is expected to grow its LNG capacity by 2020 to total 70 million tonnes.

Commodity Prices

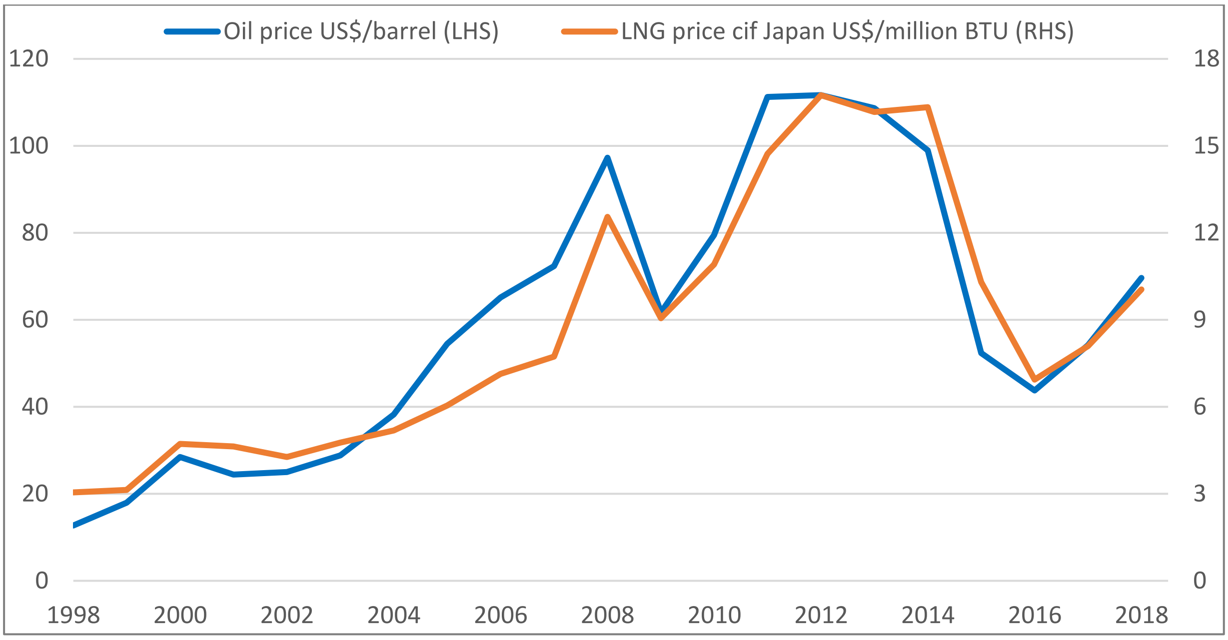
Global prices for oil and gas fell significantly in 2016, but have staged a recovery over the past few years. The declining prices resulted in very challenging conditions for the sector. The industry responded to the steep decline in prices by acting to lower costs across the board, introduce more innovative work practices and re-examine existing business models.

Exploration expenditure has rebounded significantly in response to a better price outlook. According to ABS data, total petroleum exploration expenditure (offshore and onshore) in 2018-19 totaled $1.3 billion, up 23 per cent as compared with 2017-18 ($1 billion).[18]

---

[15] Hon. Angus Taylor, Minister for Energy and Emissions Reduction, *Australia's National Greenhouse Gas Inventory June 2019 quarterly update released*, media release, 29 November 2019.
[16] International Energy Agency, *World Energy Outlook 2019*, November 2019, p. 674, Paris.
[17] International Energy Agency, *World Energy Outlook 2019*, November 2019, p. 674, Paris.
[18] ABS, *Mineral and Petroleum Exploration*, Catalogue No. 8412.0, released 2 December 2019, Table 6a.

Chart 3: Global oil and LNG price



Source: BP Statistical Review of World Energy, IndexMundi, World Bank

Industry Financial Performance

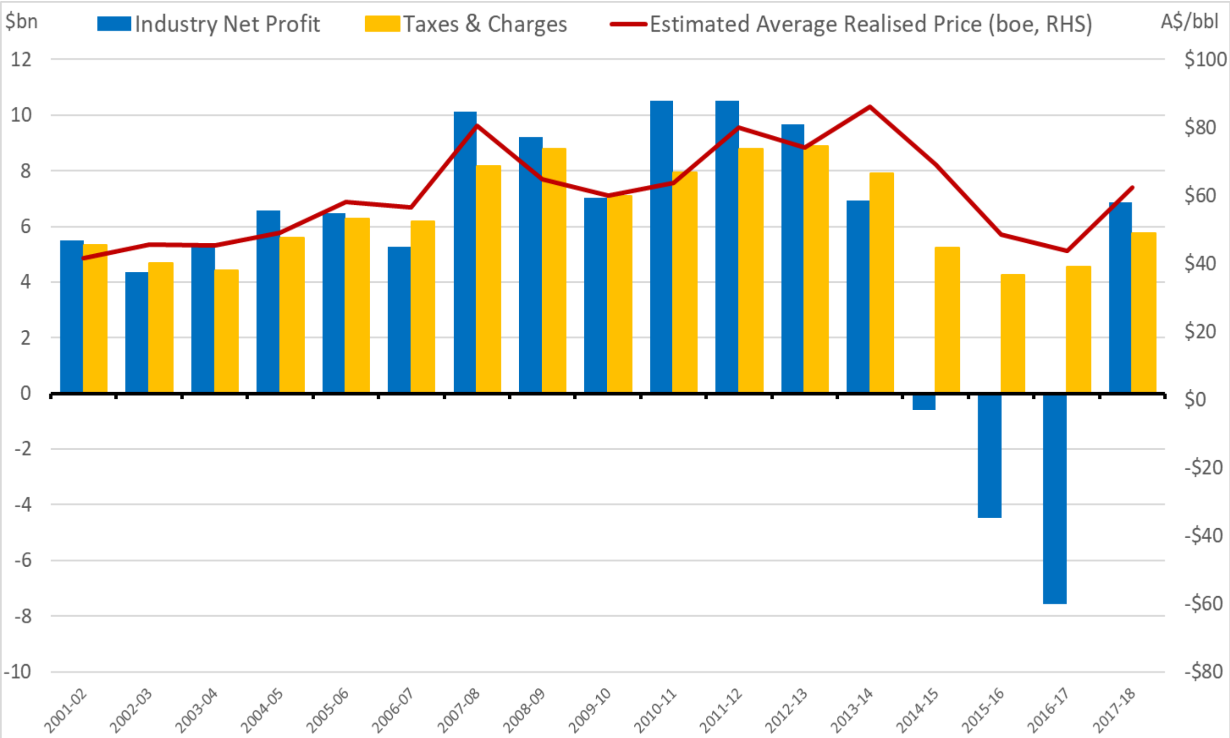
The Australian oil and gas industry is confronted with a variety of taxes, charges and fees in relation to petroleum activities. These include resource taxes (including the petroleum resource rent tax, petroleum royalties and production excise), company income tax and numerous other taxes, fees and charges ranging from import duties to state based licencing fees and duties.

APPEA's 2017-18 Financial Survey – the 31st instalment of the survey outlining the financial performance of the sector – showed the Australian oil and gas industry's major tax, rents and royalty contributions of around $5.8 billion, up significantly from $4.6 billion in 2016-17.

Rebounding from a record operating loss of $7.6 billion in 2016-17, the 2017-18 survey showed the industry recorded an overall profit of $6.9 billion. The average price received for the sale of oil and gas increased significantly from $A44 in 2016-17 to $A63 on a barrel of oil equivalent basis in 2017-18.[19]

[19] *APPEA Financial Survey 2017-18*, released 13 December 2019.

Chart 4: Oil and Gas Industry: Profitability, Taxes Paid and Average Realised Prices



Source: APPEA Financial Survey (2019)