Conservation Council of WA

Submission to the Senate Economics References Committee inquiry into Australia’s oil and gas reserves

1 November 2019

The Conservation Council of WA welcomes the opportunity to make a submission to the Senate’s inquiry into how to maximise the benefits to the public of Australia’s national oil and gas resources.

In 2018, Western Australia and the waters surrounding the State produced 69% of Australia’s production of petroleum liquids and 61% of the nation’s gas[1]. Gas from WA supplies the North West Shelf, Pluto, Gorgon, Wheatstone, Ichthys and Prelude LNG projects that accounted for 69% of LNG exports in 2018.

This submission focuses on the LNG projects supplied with gas from fields off the WA coast, but the points made do apply to the Australian oil and gas industry more broadly.

We submit that that the best starting point for this inquiry is a realistic assessment of the net effect of developing Australia’s oil and gas reserves from the perspective of Australia’s public interest. Many discussions of the industry exaggerate its benefits to Australia and minimise or ignore the costs and long-term liabilities that will be left behind.

We believe the following key points need to be understood to assess the net benefit or cost that the Australian community derives from its oil and gas industry.

1. We are giving most of our offshore gas away for free
2. The LNG industry has not delivered its promises – and Australia pays for it
3. The LNG industry exaggerates its contribution to Australia
4. The LNG industry is doing very well out of this deal
5. Government is doing nothing to get Australians a better deal
6. There will be massive decommissioning costs in the future
7. The very high carbon pollution from LNG will cost Australia dearly
8. Policies that put Australia first are called “Sovereign risk” by the industry
9. The vast majority of LNG profits flow overseas.

These points are detailed in the submission that follows.

1. WE ARE GIVING MOST OF OUR OFFSHORE GAS AWAY FOR FREE

When LNG projects trumpet the vast amounts of government revenue they claim they will generate two very different payments are grouped together – regular taxes that all companies pay and the Petroleum Resources Rent Tax that that is intended to pay the Australian people for extracting and profiting from the nation's gas.

The Ichthys LNG Project is estimated to generate a total of $73 billion in government revenue to 2050 according to an assessment by ACIL Allen[2] that project operator Inpex released in 2017. What the report did not mention was that ACIL Allen had calculated that Ichthys would pay no PRRT, ever, even with a high oil price assumption[3], so Ichthys will extract all its oil and gas for free and forever.

Company tax payments from Ichthys were estimated by ACIL Allen to total $39 billion by 2050. Companies are taxed at 30% and this means that Ichthys is predicted to have a total taxable income of $130 billion. The owners of Ichthys, all foreign companies, will reap a $91 billion after-tax profit.

Some may say fair enough – Inpex and its partners have made a significant investment and deserve a return. But that return is based on the Australian people giving away a valuable non-renewable resource for free for decades.

No one would consider giving property developers billions of dollars of land for free and then applaud them after they build huge apartment blocks with little local content years late and hugely overbudget. Yet that is precisely how Australia's oil and gas industry demands to be seen.

Ichthys is not an isolated example. Analysis of the Gorgon Project performed for oil and gas lobby group APPEA in 2017[4] predicted Chevron's Gorgon would pay some PRRT at an oil price of $US80 a barrel[5] but the results indicated no PRRT would be paid at an oil price of $60 a barrel. On 28 October the price of Brent crude was $60.43 a barrel[6].

Chevron released an updated assessment of the economic impact of the LNG projects it has an interest in - Gorgon, Wheatstone and the North West Shelf – in 2018[7]. Hidden away in the fine print was that "the taxation estimates …excludes Petroleum Resource Rent Tax (PRRT), which was not modelled." Why would Chevron pay for a report that excluded PRRT unless the predicted payments to Australia were minimal to non-existent?

Note that Australia's first LNG project, the North West Shelf, is an exception to the current rule that LNG projects get free gas. It paid $1.9 billion for its gas over just 18 months in 2014 and 2015[8]. Why is the NWS different? Because it is subject to a royalty, not the PRRT.

2. THE LNG INDUSTRY HAS NOT DELIVERED ITS PROMISES – AND AUSTRALIA PAYS FOR IT

The industry reasonably points out that no PRRT payments should be expected in the early years of a project as PRRT is profit-based and profits take time. But how can it be that projects like Gorgon and Ichthys may never pay PRRT when their owners think their investments are doing very well (see point 4)?

The answer is the disproportionate effect that cost overruns and delays have on PRRT payments. PRRT is paid once the owners have recouped deductions for what they have spent, but these deductions automatically increase each year by an "uplift" rate.

If an ordinary business makes a loss, then a dollar of expenses it cannot offset against tax that year can be carried forward and help reduce tax the next year. LNG producers have a much better deal. For example, $1 spent designing Gorgon in 2005 would be worth $7.12 of deductions by 2017 and will keep rising[9].

So, if a project goes over budget there are more deductions, and if the project is late these deductions have more time to grow. And the Australian LNG industry has been very good at being over budget and late.

When Chevron approved Gorgon it was going to cost $US37 billion and start production in 2016[10]. It eventually cost $US54 billion[11] and shipped its first cargo in 2018[12]. That meant $US17 billion ($25.5 billion) more in the deduction pool and two more years for it to be uplifted before revenue starts coming in. The deduction pool keeps growing and if revenue never catches up no PRRT is ever paid.

Ichthys tells a similar story. Inpex thought it would cost $US34 billion and start producing by late 2016[13] Costs blew out to $45 billion and the first cargo was almost two years late[14].

Why should the Australian public be out of pocket because these companies are lousy project managers? When Chevron and Inpex received production licenses there was an implicit deal from the Australian Government: you can have our gas reserves, and in exchange you apply your capital and expertise and repay us in PRRT. The expertise did not arrive and nor will the PRRT.

3. THE LNG INDUSTRY EXAGGERATES ITS CONTRIBUTION TO AUSTRALIA

The oil and gas industry happily promotes the massive $200 billion investment in Australian LNG in recent years, but this should not be confused with the benefit Australia gets.

Much of the money is spent overseas. The two giant offshore facilities for Ichthys were entirely built in Korea as was the Prelude floating LNG facility. The onshore LNG plants are largely brought from overseas as modules that are just assembled on site.

Even before the projects were approved Australia missed out. Dr Mike Nahan, a former Liberal opposition leader in WA recently told the State Parliament "very little of the design activity on those facilities, particularly the upfront engineering of the facilities, was done here."[15]

And when profits flow from the Australian offshore LNG industry only about 12% will stay in Australia as the installed capacity is about 88% foreign-owned (see supporting material).

The Reserve Bank has spotted that enormous revenue to the LNG players does not mean a massive benefit to Australians[16]. It concluded that LNG gives a big bump to domestic output but "the effect on Australian living standards will be less noticeable than this given the low employment intensity of LNG production, the high level of foreign ownership of the LNG industry and, in the near term, the use of deductions on taxation payments."

4. THE LNG INDUSTRY IS DOING VERY WELL

While Australia waits, perhaps forever, to be paid for its gas the foreign investors tell their shareholders? back home what a good deal they have.

Chevron chief executive Mike Wirth told Wall Street analysts in early 2018 that Gorgon and Wheatstone were "becoming strong cash generators with cash margins of more than $US30 per barrel at a $US50 Brent price.[17]"

He was right. Chevron Australia made a pre-tax profit of $US5.9 billion ($8.6 billion) in 2018 and returned $US7.1 billion to its US parent in just past 16 months[18].

Inpex is expected to earn $US612 million from its share of Ichthys in just 9 months this year[19], indicating the entire project will make about $1.8 billion this year.

5. GOVERNMENT IS DOING NOTHING TO GET AUSTRALIANS A BETTER DEAL

After it was revealed that Ichthys would pay no PRRT in 2017 Finance Minister Mathias Cormann commented[20]: "PRRT arrangements remain the preferred way for the Australian Government to achieve a fair return to the community from LNG production and exports without discouraging investment."

The Callaghan review of the PRRT was called in 2016 to look at providing "an appropriate return to the community on Australia's finite oil and gas resources while supporting the development of those resources.[21]" After almost 18 months the report was released.[22] It summarised the issues in 3294 words, but only 144 of those words addressed the question that formed half its scope: did the Australian community get an equitable return? Nor did it reach a conclusion on that issue.

One aspect of the PRRT, the gas transfer price, that Callaghan found likely undervalued the gas and hence reduced PRRT payments, is under review to ensure "the community receives a fair return for its oil and gas resources, while not discouraging investment in the industry.[23]" The Department of Industry, Innovation and Science made a submission[24] that noted the role of Government was to support development and ensure Australians receive a fair share, but then totally ignored whether we were getting that fair return.

What do these three examples have in common? A minister, a review and a department – paid by the Australian taxpayer – were all asked to balance Australia getting a fair share and the LNG companies having a good deal. Every time they ignored or minimised the interests of the resource owner: Australians.

6. THERE WILL BE MASSIVE DECOMMISSIONING COSTS IN THE FUTURE

Eventually the huge LNG projects, and other oil and gas infrastructure, will need to be made safe and dismantled at an estimated cost of more than $US21 billion ($31 billion)[25] and taxpayers will bear up to 58% of this cost.[26] So not only will some projects pay very little PRRT but they will get much of it refunded to cover decommissioning costs.

And if companies owning old assets with declining production strike financial trouble - like the Northern Endeavour in the Timor Sea has recently with a $144 million decommissioning liability[27] - the taxpayer could be left with the entire bill.

7. THE VERY HICH CARBON POLLUTION FROM LNG WILL COST AUSTRALIA DEARLY

Australia has committed to reducing its carbon emissions by 26 to 28% of 2005 levels by 2030. The Paris Agreement is a zero-sum game for Australia. If any sector adds a tonne of CO_2 to its emissions between 2005 and 2030 someone, or some company, needs to cut or offset their emissions by an extra tonne.

The LNG sector is Western Australia's largest polluter by a very wide margin. LNG projects' processing of gas extracted off the coast of WA are currently permitted under the federal safeguard mechanism to emit 32.1 million tonnes a year of greenhouse gases, or 321 million tonnes in the decade leading up to 2030.

Permitted carbon emissions from WA's LNG industry (millions of tonnes CO2 a year)[28]

North West Shelf	7.57
Pluto	2.39
Gorgon	8.35
Wheatstone	4.09
Ichthys	6.95
Prelude	2.72
Total	**32.1**

Using a carbon price of $US75 ($109) a tonne, that the International Monetary Fund estimated Australia needs to meet its Paris commitments[29], six LNG projects will generate a carbon liability of almost $35 billion by 2030.

Whatever the final cost of reducing emissions is, the burden to the nation from LNG emissions will be enormous. And there are more oil and gas production emissions from onshore production, new LNG projects and the Bass Strait.

The LNG industry loves to talk about the relatively small amount of direct long-term jobs it generates, but how many jobs will be lost elsewhere when other sectors- that employ more people, pay more tax but have lower profits – have to bear the cost of the carbon burden LNG has created.

8. POLICIES THAT PUT AUSTRALIA FIRST ARE CALLED "SOVEREIGN RISK" BY THE INDUSTRY

In April 2017 this Senate committee heard the oil and gas industry's argument against so-called sovereign risk from then managing director of Chevron Australia Nigel Hearne:

"Our FID was made under certain circumstances that were assumed to prevail through the life of this project," he said, referring to the Gorgon and Wheatstone projects.

"We thought some of those assumptions were very stable—like the fiscal regime; like, we thought, our own costs to develop, and our own schedule,"

When asked about possible changes to the PRRT Mr Hearne said "If anything were to be done retrospectively, you would have to consider the sovereign risk.[30]"

So, Mr Hearne wants no changes to the fiscal terms through the projects' lives, that he said could be for 30 to 50 years, because Chevron "assumed" they would not change.

This argument has many flaws:

- The Australian Government has never guaranteed fiscal stability over decades to an oil and gas project. If a large multinational makes an incorrect assumption that is their problem.
- Even if assumptions made when a project goes ahead did matter, then they should all count. Chevron may have assumed that the fiscal regime would be constant, but the Australian taxpayer assumed Chevron had

the competence to deliver the projects on time and on budget. The LNG industry has not kept its side of this assumed bargain but expects the Australian Government to naively not respond to new circumstances.

- No Australian citizen gets decades of fiscal certainty when they make important life decisions like choosing a career, buying a home or starting a business. Why should large foreign companies be treated more favourably than individual Australians?

9. THE VAST MAJORITY OF LNG PROFITS FLOW OVERSEAS

The following table summarises the ownership of Western Australia's LNG industry, showing that the majority of companies are entirely foreign-owned and overall the industry is approximately 12% Australian ownership.

		NWS	Pluto	Gorgon	Wheat-stone	Ichthys	Prelude	Total
Capacity (millions of tonnes per year)		16.3	4.9	15.6	8.9	8.9	3.6	58.2
	Australian ownership	Project Ownership						
BHP[31]	25%	16.7%						
BP	0%	16.7%						
Chevron	0%	16.7%		47.3%	64.1%			
ExxonMobil	0%			25.0%				
Inpex	0%					66.2%	17.5%	
Kufpec	0%				13.4%			
Shell	0%	16.7%		25.0%			67.5%	
Total	0%					26.0%		
Woodside[32]	75%	16.7%	90.0%		13.0%			
LNG Buyers	0%	16.7%	10.0%	2.7%	9.5%	7.8%	15.0%	
Australian-owned LNG capacity	mtpa	2.7	3.3	0.0	0.9	0.0	0.0	6.9
	%	0.0	0.0	0.0	0.0	0.0	0.0	**12%**

END NOTES

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