Committee Secretary
Senate Economics References Committee
Department of the Senate
PO Box 1600
Parliament House
Canberra ACT 2600
Email: economics.sen@aph.gov.au

31 March 2017

Dear Committee Secretary,

Re: Senate Economic References Committee Inquiry re Australia's Offshore Oil and Gas Industry

ConocoPhillips Australia ('COP') submission relates to the recently announced expanded terms of reference of the inquiry regarding royalties, Petroleum Resource Rent Tax (PRRT), deductions; and other taxes, referred to collectively as 'petroleum taxation'.

Overview

ConocoPhillips welcomes the Committee's inquiry into Australia's petroleum taxation regime, which has been demonstrably successful in attracting massive capital commitments to local projects within a competitive global environment.

Our company is operator of the Barossa Project, which is unique as the next and one of the only Australian LNG project on the horizon. Its success is integral to the continued operation of Darwin LNG, which supports over 1,300 direct jobs (and thousands more indirectly), and requires a new gas source in ~2022.

The Barossa Project would keep DLNG operating for another ~20 years, employ a significant construction workforce, pay more than A$5B in Company Tax at current commodity prices and significant additional PRRT and Company Tax payments if commodity prices recover.

The US shale revolution has driven major changes in global petroleum industry, as evidenced by the dramatic fall in commodity prices over the last several years. One of many consequences is increased competition for new investment funding. In this environment, a stable fiscal regime will be critical to the viability of Barossa, which requires an investment of up to A$10B.

Barossa is on track to seek approval for Front End Engineering Design (FEED) in Q1 2018 (an investment of several hundred million dollars) and a Final Investment Decision (FID) 12-18 months later; however, its base economic case for these investment decisions is built on the existing taxation regime.

Changes to the offshore tax regime being considered by the current Treasury review could add billions of dollars in costs and render Barossa uneconomic as a Darwin LNG Backfill option.

If the Barossa base case economics no longer competes for global capital, then as well as the A$10B investment, thousands of jobs and A$5B in taxation revenue that would be lost, as an industry this would cast doubt on the viability of any future Australian LNG backfill projects

In examining the existing regime, the inquiry should therefore be clear-eyed about the very real, immediate and far reaching consequences of proposed changes.

Background

COP is the world's largest independent exploration and production company based on proved reserves and production of liquids and natural gas. Headquartered in Houston, Texas, and listed on the New York Stock Exchange, the company has a market capitalisation of around US$58 billion. As of Dec. 31, 2016, the company had operations and activities in 17 countries and employed approximately 13,000 employees worldwide.

In Australia, COP's key activities comprise of the following:

(a) COP is the largest joint venture owner and operator of the Bayu-Undan gas condensate field and world-class Darwin Liquefied Natural Gas ("Darwin LNG") project, directly supporting more than 1300 jobs across WA, the NT and Timor-Leste and many more indirectly.

(b) In 2008, COP entered into a joint venture with Origin Energy Limited (**"Origin"**) to develop the Australia Pacific coal seam gas ("**CSG**")-to-LNG project which comprises approximately 8.1 million acres of coal bed methane resource spanning across the Surat and Bowen Basins in Queensland. The joint venture vehicle for this project is Australia Pacific LNG Pty Ltd ("**APLNG**"), which is now held by COP, Origin and Sinopec. APLNG directly employs more than 1,400 staff excluding a significant contractor workforce.

(c) COP also has interests in other exploration and development projects located offshore Northern Territory and Western Australia, including the Greater Sunrise, Athena, Greater Poseidon and Caldita and Barossa discoveries

(d) Darwin LNG will require a new gas field to be developed to backfill the Bayu-Undan gas as it declines, to remain operating post-2021. The lead candidate is Barossa, an ~A$10B project currently one of the only potential LNG investments on the horizon, and in pre-FEED. A decision to proceed to FEED on Barossa will be made in Q1 2018.

Overall comment on Petroleum Resource Taxation

COP supports and endorses the principles raised in APPEA's submission to both the Treasury Review and the Senate Inquiry. Australia's longstanding, bi-partisan approach to petroleum resource taxation has maximised returns to the Australian people from their resources by not discouraging investment in more marginal projects in what is a high-cost jurisdiction to do business.

In a fiercely competitive global market, Australian LNG projects provide lower economic returns than other competing regimes[1] and a stable and efficient fiscal system has been a key driver in securing investment in gas projects.

---

[1] *Australia upstream: 5 things to look for in 2017*, WoodMackenzie January 2017

An Australian Success Story

The oil and gas industry has contributed, and continues to contribute, significantly to the economy and prosperity of Australia and the well-being of its people directly and indirectly through tax revenue, jobs creation and enhanced productivity gains. The strength of the oil and gas industry has in recent times driven Australian growth, investing more than $200B in just the last decade, creating thousands of high-skilled jobs, with multiplier effects right across the economy in a subdued global investment environment.

The massive expansion in investment, jobs, government revenue and infrastructure has in large part been focused in regional areas, and had been central to progress on development of Australia's north. In WA and the NT, the North West Shelf and Darwin LNG projects have paved the way for further mega-developments, while northern Queensland has seen a giant economic impact from Coal Seam Gas to LNG.

Catching The Next Wave

Lasting decades, these legacy LNG projects can position Australia for future growth. As highlighted in the 2016 Wood Mackenzie report 'The Death of Australian LNG', the infrastructure established provides Australia with a comparative cost advantage going forward, to be harnessed by backfill and brownfield expansion projects – the 'second wave' of investment.

In an international capital market featuring competitors such as the US 'shale gale', leveraging established infrastructure to catch this wave is vital for Australia to continue to reap the benefits brought by development of its resources.

Challenging Times

However deep deterioration in market conditions has challenged new Australian investments of any kind. Sustained low prices, high costs and increased competition has resulted in large write-downs, very low returns for existing investments and a myriad of greenfield projects shelved; even backfill projects are now marginal.

Changes to petroleum taxation that increase the tax burden for such projects will kill the next wave of investment, cancel out Australia's competitive advantage and future revenue growth, bringing the community no benefit from its resources. COP supports the need to bring an equitable return to the community from Australia's scarce resources, but evidence suggests that raising taxes will have the opposite effect.

Independent research supports the fact that government's share of profits in Australian resource projects is already high by international standards[2] Adverse changes to the PRRT would signal to international investors, with shrinking capital budgets, that a market renowned for its high-cost but stable fiscal environment just got costlier and less stable.

Any fiscal changes that add costs to the base case for new investments will exacerbate the problem of declining revenues, creating a 'death spiral' reducing government revenue and killing jobs and investment; both existing and planned.

---

[2] *Independent Report on the PRRT Review in Australia*, Wood Mackenzie, January 2017

To avoid the serious ramifications of this to Australia's economy, any reviews of petroleum taxation must take an economy-wide and indeed global view of the appropriateness of Australia's fiscal regime looking at all stages of the project and commodity price cycle.

PRRT: Capturing Investment Throughout the Cycle

The value of the PRRT to Australia in securing investment in marginal projects cannot be understated.

When prices recover, these marginal off-cycle projects, which captured cost deflation in leaner times, then stand placed to deliver higher government revenues through the PRRT system.

Case Study: Darwin LNG and Bayu-Undan

The Bayu-Undan and Darwin LNG projects illustrate the benefits of profit-based taxation. Commissioned during very low prices, they were marginal investments that only just managed to secure the required investment and initially forecast to yield a combined $US4.4B in taxes over their lifespan. Subsequent price movements have seen over $US20B in taxes paid to governments, with production likely to run until 2021.

As well as government revenue, they have supported thousands of jobs and hundreds of service-providing businesses, while establishing infrastructure to leverage further resource development.

Tax changes which negatively impact base case economics and stop marginal projects like these being developed benefit no one; killing jobs, investment, corporate tax revenues and future PRRT revenues.

Impacts of Petroleum Taxation Changes: Darwin LNG and Barossa

COP's Darwin LNG and Barossa projects starkly illustrate how tax regime changes may have an immediate impact on major investments.

Supporting more than 1,300 direct jobs, Darwin LNG requires more gas from 2022, its operation hinging on the development of the Barossa field, a marginal project 270km from Darwin in Commonwealth waters.

In challenging times, COP has continued to pursue a backfill project for Darwin, investing over US$1.4B on exploration as our global capital budgets dropped from US$17B to US$5B per annum.

Barossa is Australia's next potential LNG investment – perhaps the only one for several years, but it is by no means assured. Its economics remain marginal, and COP continue to work on reducing costs to be able to secure the required capital in a global portfolio featuring increasingly attractive US shale projects.

Any potential changes to petroleum resource taxation being considered by the current Treasury review have a significant impact on the base case of Barossa, adding several billion dollars in costs. This will most likely render the project uneconomic, in turn spelling the end of Darwin LNG and all the associated benefits of this iconic project.

Conclusion

COP considers that the petroleum taxation regime is operating as intended, and strikes the right balance between achieving an adequate return to the community from finite resources and incentivising industry to take the risks required to develop these resources.

The scale of investment in Australia under the regime underlines this view; lower payments in recent years reflect the massive investments followed immediately by a depressed economic environment, not a design flaw. Government must continue to be mindful of the fact that industry has signed up to a certain set of rules that provide the required confidence to invest and trust in a stable taxation regime. Looking to potential future investments, the strength of a profit based tax regimes is securing investment at the bottom of the cycle to bring great benefits as conditions improve.

However, currently the economics of potential projects are very finely balanced and therefore heavily dependent on fiscal certainty. In a high-cost, extended low price environment even backfill projects are marginal.

In the case of Barossa, the next potential major LNG project, changes to the existing taxation regime would erode its base case several billion dollars making the project uneconomic and leading to the likely closure of Darwin LNG.

As the Bayu-Undan /Darwin LNG case study demonstrates, profit-based taxation attracts investment in tough times, to reap extra benefits during the good. Taxation changes that erode base case economics of marginal projects work against the interests of the Australian community, stopping employment, reducing corporate tax take and future revenues.

Yours sincerely

[redacted]

Kayleen Ewin
Vice President – Sustainable Development, Communication and External Affairs