Senate Economics Committee
Inquiry into the

Excise Tariff Amendment (Condensate) Bill 2008
Excise Legislation Amendment (Condensate) Bill 2008

Submission by the North West Shelf Venture Participants:

BHP Billiton Petroleum (North West Shelf) Pty Ltd
BP Developments Australia Ltd
CNOOC NWS Private Limited
Chevron Australia Pty Ltd
Japan Australia LNG (MIMI) Pty Ltd
Shell Development (Australia) Proprietary Limited
Woodside Energy Ltd

7 July 2008

1. Executive Summary

The North West Shelf Venture is surprised and concerned at the Government's decision to remove the excise exemption on condensate in the recent budget measures contained in the ***Excise Legislation Amendment (Condensate) Bill 2008*** and the ***Excise Tariff Amendment (Condensate) Bill 2008*** **(Bills).** The removal of the exemption will have significant consequences for the North West Shelf Project (**Project**) and the broader upstream petroleum industry. The North West Shelf Venturers are particularly disappointed that they were not consulted about the Bills prior to them being announced and submit that the impact of the Bills has not been adequately nor appropriately considered.

This submission raises a number of concerns with the provisions of the Bills and the decision making processes which led to them. The details of these are set out further below. The principal concerns about this announcement are as follows:

- Substantial investment in the Project continues to be required in order to underpin continued safe and reliable operations and to maximise Project life through new developments.

- Australian fiscal arrangements need to be sufficiently stable to attract such investment. Where changes are proposed to be made to this structure, a rigorous and consultative assessment of the need for change must first occur.

- The surprising way that this change was announced has unnecessarily detracted from Australia's reputation as an attractive and stable investment destination by introducing a new element of sovereign risk not previously seen in this industry in Australia.

The Government has an opportunity to restore the reputation for stability that has characterised Australian fiscal arrangements under successive Governments for thirty years.

In this respect, the North West Shelf Venture participants welcome the Henry Review of Taxation process and the specific inclusion of gas taxation in the scope of the review. In order to maintain the integrity of that review and restore some fiscal stability, it is important that assurances be given that:

- in the interim period, the Government will not implement any further changes;

- Project participants will be invited to provide input on oil and gas taxation in the Henry Review (particularly given the important interaction this will have with the introduction of an Emissions Trading Scheme) and that an Issues Paper be published on future oil and gas taxation as part of that Review; and

- any further changes to the fiscal regime will only occur as a consequence of the Henry Review and then only after broad consultation with industry.

2. Overview of the North West Shelf Gas Project

The Project is Australia's largest resources and infrastructure project with capital expenditure over almost three decades totaling $25 billion and with currently more than $10 billion in further capital investment committed and/or under consideration

In 2007, the Project accounted for 48 per cent of Australia's petroleum production (54 per cent of natural gas production and 39 per cent of oil, condensate and LPG production) and total indicative sales of approximately 11 billion dollars (AUD).

Over the next decade, the Project is expected to consider a series of smaller offshore gas/condensate field developments to replace declining production from the large fields that have underpinned the Project to date.

The Project will continue to generate significant economic benefits to the nation and support Australia's energy security and targets on greenhouse gas emissions for decades to come.

3. Decision made without consultation

The decision to remove the condensate exemption was announced without consultation with the impacted companies or the wider industry, limited assessment of the rationale for change and without provision of detailed reasons.

The lack of consultation is a matter of particular concern to the participants in the North West Shelf Venture. This concern arises against a background where:

- in 1977, the North West Shelf Venture participants and the Federal Government entered into a partnership of assurances that the fiscal regime for the North West Shelf Project would remain stable;

- pursuant to these assurances, the fiscal regime relating to condensate had in fact remained stable for a period of over 30 years; and

- as further significant funds were committed by the North West Shelf Venture participants through this 30 year period, further assurances were given by Governments that changes would not be made to the fiscal arrangements without consultation.

3.1 The decision has created a new environment of Sovereign Risk

Low Sovereign Risk is currently one of Australia's main competitive advantages. The decision to change a longstanding fiscal regime without consultation and without a rigorous assessment of the key factors creates a new element of Sovereign Risk not previously seen in this industry in Australia.

Gas projects, which differ from oil projects, are especially sensitive to Sovereign Risk because:

- they are long term commitments;
- it takes five or more years to plan and construct a multi-train greenfields LNG project;
- upfront and ongoing capital investments in the tens of billions of dollars are required - usually from offshore sources; and
- it can take a decade or more to earn a positive return on this capital investment, with positive life of project returns requiring even longer periods.

In this respect, fiscal certainty and the availability of competitive fiscal terms are still among the most important factors which enable continuing investment in the gas industry, particularly in a global business environment with rising development costs.

For these reasons, throughout the life of the Project, the North West Shelf Venture participants have repeatedly sought and obtained assurances from Government, so as to create and maintain a stable fiscal regime. For example, in 1998, before being prepared to commit to the Train 4 and 5 LNG expansions, the North West Shelf Venture participants required clarification of government policy in several key areas. In response, the Government assured the participants that it recognised the importance of providing continuing stability in taxes applying to production, and that they would be consulted in the event that any changes were being considered. Policy settings in other areas (including greenhouse gas emissions, Australian industry participation and import duties) were also clarified through the LNG Action Agenda released by the Government in October 2000.

The recent announcement casts doubt nationally and internationally to businesses and investors on the value of these assurances and any future assurances on fiscal stability and that major tax changes will not be introduced after capital has been committed and long term sales contracts executed.

3.2 Tax neutrality

It is not immediately obvious that the Project has enjoyed a taxation advantage over other Australian LNG projects. Royalties have been paid every year since the project commenced production in 1984. Whilst records are not readily available royalties to the Commonwealth and WA Governments are estimated to have totaled $6.5 billion during the 12 years from 1995/96 to 2006/07.

The suggestion that the tax paid by the Venture participants needs to be increased to achieve tax neutrality with projects being developed under other tax regimes requires further detailed review.

3.3 Developing industry assistance

We are aware of suggestions that the excise free status on condensate was an incentive for the initial development of the Project which is now no longer justified and that to exempt condensate from excise creates a competitive advantage for the North West Shelf project compared to other Australian LNG projects. These suggestions do not accord with the facts.

The exemption was part of a broader fiscal regime introduced in 1977 that was intended to last the economic life of the Project. It has remained in place on that basis for over 30 years.

If the exemption was truly viewed as being a form of developing industry assistance, the Government would have abolished it after 1992 once the originally envisaged domestic gas and three train LNG phases of the Project had all become fully operational. Instead in 1987, when introducing the 30 million barrel excise exemption for crude oil, the Government re-affirmed the 1977 commitment on condensate and LPG excise. Later, all condensate production effectively became excise-exempt when in 1995 the Government extended the exemption to include condensate which is produced separately from crude oil.

3.4 No proper consideration given to other key issues

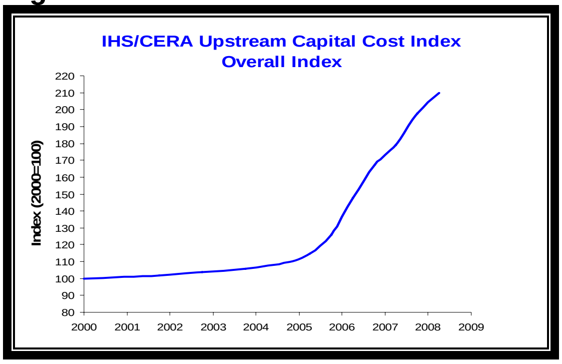
- ***Higher oil prices are substantially offset***

Higher tax payments, higher costs and long term contracting mean that the headline oil price does not flow on to companies on a proportionate basis.

Higher oil prices are already delivering greater tax returns to Governments without the need for a new tax on condensate. (The Project's excise and royalty payments have increased by more than $700 million (85 per cent) over the past three years from $826 million in 2003/04 to $1,527 million in 2006/07.)

It is important to recognise that as indicated in Figure 1 below, upstream oil and gas project development costs have doubled over the past five years.

Figure 1



These costs will continue to escalate, both as a product of broader economic pressures affecting the oil and gas industry, but even more so as the North West Shelf Venture participants pursue the exploration and development of more remote and challenging gas reserves. In this respect, the Project's Operator has estimated that the effective costs of developing offshore gas fields, for use in the West Australian market, has more than trebled because of increasing construction costs and the fact that fields are further from shore and contain less liquids and more impurities.

Secondly, much of Australia's gas production is sold locally or if it is exported, is sold under long term contracts with prices not totally linked (if at all) to global oil or gas prices. In this respect, there is a significant lag between the prices realised by the North West Shelf Venture participants and current global oil or gas prices.

Thirdly, the rise in the Australian dollar has offset a material part of the rise in US dollar denominated oil and export gas prices. The combined effect of an appreciating Australian dollar and low-priced gas contracts is that the average realised price per barrel-of-oil-equivalent (boe) of oil and gas production in Australia increased by just 36 per cent over the five years to 2006/07 compared with a near trebling of world oil prices (from $US21.59 per bbl in 2001/02 to $US59.45 per bbl in 2006/07 in trade weighted terms)[1].

- ***Consistency with other key policy objectives***

The North West Shelf Venture participants believe the decision to remove the excise exemption on condensate will adversely affect future investment decisions for the development of new fields.

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[1] Source: Australian Mineral Statistics, September Quarter 2003 and March Quarter 2008, ABARE

In this respect, Australian and State Governments have repeatedly expressed a desire to address the delays being experienced in the development of many of the large offshore gas fields in Australia's North West.

To provide genuine impetus to these policy objectives, important fiscal decisions must be made in a proper context, with full consultation and by reference to the overriding need to ensure that there is an internationally competitive and stable fiscal framework for gas projects.

4. Recommendations

It is vital that immediate steps be taken to restore transparency and confidence in the fiscal arrangements affecting the North West Shelf Project. To this end, the North West Shelf Venture participants requests that the Committee:

1. calls on the Government to restore the reputation for stability that has characterised Australian fiscal arrangements under successive Governments for thirty years, specifically by assuring the industry that in the interim it will not implement any further changes prior to completion of the Henry Review of Taxation and after broad consultation (including the publication of an Issues Paper).
2. calls for the Government, in consultation with industry, to consider the merits and means of introducing a formal bipartisan system of fiscal stability agreements to provide fiscal certainty to long-life gas projects.
3. calls for further Senate consideration of the Excise Tariff Amendment (Condensate) Bill 2008 and for the Excise Legislation Amendment (Condensate) Bill 2008 to be deferred to allow a proper period of consultation on the proposal with the North West Shelf Venture participants and industry generally. So as to remove any fiscal uncertainty during this period, and so as to replicate what should have transpired, the 'effective date' for any decision to proceed with the removal of the condensate exemption be the date of the new decision (if any).
4. calls for the Government to acknowledge, as part of any review of the fiscal arrangements applying to the North West Shelf Project, including greenhouse and energy security measures, that consideration be given to promoting the development of Australia's vast gas resources through measures such as company tax depreciation write-off periods, for the upstream production, transmission and processing of gas, being reduced to five years.