Denison Gas Limited
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23 July 2020

Committee Secretary
Economics and Governance Committee
Parliament House
George Street
Brisbane QLD 4000

By Email: ***egc@parliament.qld.gov.au***

Re: Submission to the Economics and Governance Committee in regards to the Royalty Legislation Amendment Bill 2020

Thank you for the opportunity to provide a submission addressing aspects of the Bill and the proposed changes the Queensland Petroleum Royalty System.

Denison Gas provided a submission to Office of State Revenue consultation process on 1 July and is pleased to note that a number of the suggestions made in that submission were addressed in the draft legislation. There are, however, a number of areas which have not been included which, Denison Gas believes, would minimise negative impacts of the proposed changes to the petroleum industry, especially the smaller producers focussed on new developments targeting supply into the domestic markets.

Denison Gas supports a simpler Royalty system but believes that benefits of achieving such a system should not come at the expense of the effectiveness and equity of the system and should not hinder the future development of Queensland's natural resources and risk the associated jobs and government revenue. There are three aspects of the proposed system which threaten to do that but which, through minimal changes and negligible incremental complexity, can be avoided.

1. Transportation Costs

- **The Issue:**

  Gas can be sold at multiple locations including ex-plant, at a local trading hub, at a remote trading hub or delivered to a customer. The sales price of the same commodity may vary considerably depending on the location of the point of sale and transportation costs, for example, have recently exceeded 40% of the final sales price. Royalty levied on a delivered gas value, without adequate allowance for the transportation costs involved effectively includes Royalty on the cost of pipeline infrastructure and operations. This appears to be inconsistent with the key rationale of the Royalty and diverges, unnecessarily, from the principle of applying Royalty to an approximation of the wellhead value. In the absence of a change in this regard, market distortions will tend to occur where sales transactions are negotiated to be closer to the source of production, to minimize payment of Royalty on transportation costs.

  The same principle applies to oil sales. Oil is often trucked long distances to refineries or collection points. The cost of this transportation can be a significant part of the cost of doing business and the use of unadjusted price at the point of sale means that Royalty is effectively levied on the incremental transportation cost.

LNG can also be sold at various locations including Free on Board ("FOB") or Delivered Ex-Ship ("DES"). In the case of DES LNG sales, Royalty would be payable on the international shipping cost component of the sale which would place Queensland producers at a significant disadvantage relative to other Australian and international sellers and unable to compete on an equitable basis where buyers require DES sales

- **A Potential Solution:**

  Third party transportation costs are well known to producers, they are supportable by a small number of monthly invoices and can easily be verified and audited if required. When calculating total petroleum revenue (gas, condensate and oil) an adjustment for third party (non-associated party) transportation costs to the point of sale could be allowed where such costs are truly arm's length.

2. Measurement of Fuel, Flare and Vented Gas

- **The Issue:**

  The new Royalty system is intended to be based on produced volumes of hydrocarbons. Through the process of production and processing, quantities of hydrocarbons are used or lost. Although wellhead metering of gas is possible, it is not reliable or accurate enough for Royalty purposes and is generally used only for resource and production management. The produced volume of hydrocarbons can be calculated by mass balance by adding the quantity of fuel, flare and vented gas to the quantity of gas sold. Fuel, flare and vented gas is metered or can be estimated by producers, but generally this cannot practically be done to "custody transfer" standards. In the case of non-LNG producers, however, gas sold represents more than about 90% of the gas produced and is very accurately measured so the relative size of any inherent inaccuracy in the calculation of fuel, flare and vented gas has minimal effect on the total quantity of gas upon which Royalty is applied.

- **A Potential Solution:**

  It is proposed that producers measure, calculate or estimate the quantity of gas burnt as fuel, lost in the flare or vented between wellhead and point of sale and include these in each return. Producers will ensure that the estimates will be as accurate and verifiable as is reasonably practicable. In the absence of a defendable estimate, an assumed "benchmark" factor could be applied as in a similar way to which the benchmark pricing structure is applied in the draft Bill.

3. Cost of New Developments

- **The Issue:**

  Historically, calculation of Royalty has allowed deduction for certain development costs which have tended to ensure that projects are profitable, or at least well advanced, before Royalty is levied. The proposed system levies Royalty on new projects from day one, provides an added hurdle to reach break-even and is therefore an economic disincentive to new developments or major expansion.

- **A Potential Solution:**

  It would be possible to include a category of development or expansion project similar to the Federal Government's Major Project Status where new projects of significant benefit to the State of Queensland are authorised to deduct a portion of their development costs for the initial production period.

The three items above represent the key items that Denison Gas would like to have considered by the Parliamentary Committee.

We would be happy to provide additional information regarding the issues and potential solutions above or about Denison Gas's development plans and the impact that potential changes in the Royalty system may have on our business. Please note that, due to COVID-19 travel restrictions, it may not be possible for a Denison Gas representative to attend the planned public hearing in person. I would, however, be pleased to attend via video link if available. Please feel free to contact me by return email ([redacted]) or via phone on [redacted].

Yours sincerely,

Robert Gard
Chief Executive Officer
Denison Gas Limited

This submission has been reviewed and approved by an Executive Director of Denison Gas and is consistent with the views of the Board of Directors of the company.

About Denison Gas:

Denison Gas Limited (Denison or Company) was formed in 2017 with the specific intention of acquiring from Santos Limited (Santos) and Australia Pacific LNG Pty Limited (APLNG) a suite of complementary assets in the northern and southern areas of the Denison Trough, Queensland. The Company's founders identified the existing conventional fields (which they assessed were underperforming relative to their potential), together with sizeable coal seam gas (CSG) fields which overlay the conventional fields, and a very large, deep, tight gas play underneath the main spine of the sub-basin.

In late 2017, the Company executed a sale and purchase agreement for the acquisition of Santos's 50% non-operated interest in the northern and southern assets. In April 2018, the Company executed an agreement for the acquisition of the remaining 50% interest in the northern assets which was owned by APLNG, and for APNG's 50% beneficial interest in the southern assets. These assets are now known by the Company as the Denison North project and the Denison South project.

In April 2019, Denison Gas assumed operatorship of both the Denison North project and the Denison South project, employing former field staff who had key operational experience of the assets. Since that time, Denison Gas has invested more than $6 million in maintaining the Denison South assets, improving their efficiency and reliability and $31 million to upgrade and restart the Denison North assets which had been "mothballed" in 2011.

Having achieved stable, reliable production, the Company has commenced a field development program to bring additional reserves into production to maximise the capacity of the existing infrastructure, and to meet its firm contract commitments in 2021 and beyond. The Company will also commence a pilot well testing program focused on a portion of its contingent CSG resources to position itself to become a significant independent producer into the east coast gas market.

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31 July 2020

Committee Secretary
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Parliament House
George Street
Brisbane QLD 4000

By Email: ***egc@parliament.qld.gov.au***

Re: Follow-up Letter - Royalty Legislation Amendment Bill 2020

A number of issues were discussed in the public hearings held on 28 July 2020 to which Denison Gas seeks to briefly comment.

1. Simplicity of new system and cost savings to Industry

Denison Gas acknowledges that the revised system will be simpler for producers to administer and there will likely be lower compliance costs but re-iterate the comments of Ms. Snelling in that, where systems are already set up, the burden of compliance is minimal since collection of cost, revenue and allowable deduction data are automated via general ledger systems. Reductions in the cost of compliance will likely be orders of magnitude smaller than potential changes in the royalty payments themselves.

Notwithstanding the savings, it is our belief that there should be a balance between simplicity and effectiveness. Deductions have been excluded with the intention of simplifying the system but, in doing so, have sacrificed the effectiveness and equitability of the system.

In particular, the exclusion of deductions for new capital employed and for the transportation of hydrocarbons to the point of sale mean that new developments and/or those that are remote from points of sale will be discouraged under the modified system. This means that expansion of remote projects and new developments will be disproportionately discouraged effectively eroding the future revenue base compared to a system where such deductions are allowed. The ultimate end result will be to directionally reduce future industry activity and reduce both direct and indirect jobs in regional Queensland.

2. Cost of Transportation

A number of presenters to the panel commented on the impact of including the costs of transportation in the royalty calculation. They generally focused on the potential market distortion which would likely result from this mechanism, a point with which we concur. It is clear that the distortion would likely occur when intermediate traders would be incentivised to buy hydrocarbons close to the wellhead and on-sell to downstream buyers effectively circumventing the royalty calculation mechanism.

Very little was made of disincentive it would place on remote and regional development activity. Given the option to invest in exploration and development of hydrocarbons close to a point of sale versus activities further away, the change to royalty will tend to discourage regional and remote activity with a flow on effect to economic activity and jobs.

3. Recovery of development costs before royalty commences

This issue was most concisely dealt with by Professor Andrew Garnett in his discussion with the panel. As he outlined, the proposed new system will result in royalty being paid from day one of the commencement of production before a producer has been able to recover the cost of exploration and development. This is an extremely critical time in a project's life and most often coincides with the point of maximum cash impairment. Reducing revenue at this stage can severely impact the viability of an operation and will increase the risk of insolvency in this period.

Denison Gas is cognisant that providing critical comments of the proposed system without suggesting solutions is not helpful to the review process. We therefore suggest that the negative impact of the items listed above can be alleviated by minor changes to the proposed legislation without significantly impacting the near-term royalty payable by existing projects. Two amendments we propose are firstly to allow deductions for third party transportation costs and secondly for a portion of the capital spent on pre-approved projects. These have both been raised in our previous submissions but are included below for completeness.

A. Deductions for Transportation

Third party transportation costs are well known to producers, they are supportable by a small number of monthly invoices and can easily be verified and audited if required. When calculating total petroleum revenue (gas, condensate and oil) an adjustment for third party (non-associated party) transportation costs to the point of sale could be allowed where such costs are truly arm's length. It is clearly necessary that a producer demonstrate the independence of the transporter before the deductions will be allowed. There is already a process in the legislation to identify members on LNG projects so a process to identify that transporters are not associated with the production projects would not significantly extend the scope of the legislation

B. Deductions for pre-approved projects

Where a producer identifies a development or expansion project which satisfies certain guidelines, it is proposed that an application be made to allow the producer to deduct a portion of a capital cost "bank" for the project from the assessed revenue as part of the royalty calculation. This would allow a portion of the capital costs to be recovered before royalty payments commence and disconnect the timing of royalty commencement and maximum cash impairment.

Denison Gas supports a simpler Royalty system but believes that benefits of achieving such a system should not come at the expense of the effectiveness and equity of the system and should not hinder the future development of Queensland's natural resources and risk the associated jobs and future government revenue. The minor changes proposed above would significantly reduce the negative effects on regional development and jobs, add negligible incremental complexity to the system and result in minimal short-term changes to the revenue collected.

We would be happy to provide additional information regarding the issues and potential solutions above or about Denison Gas's development plans and the impact that potential changes in the Royalty system may have on our business. Please feel free to contact me by return email ([redacted]) or via phone on [redacted]

Yours sincerely,

Robert Gard
Chief Executive Officer
Denison Gas Limited